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and Social Structure:  
Elements of Economic  
Sociology**

*MILAN ZAFIROVSKI*

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# Exchange, Action, and Social Structure

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# Exchange, Action, and Social Structure

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*Elements of Economic Sociology*

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MILAN ZAFIROVSKI

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## *Introduction*

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This work focuses on the effects of social action and social structure on economic exchange. It is a theoretical-empirical analysis of exchange processes, which situates and constitutes them within their social (including institutional, political, and cultural) framework. As such, it represents a contribution to a neo-Weberian economic sociology as an exploration into what Max Weber called the sociological categories of economic action in light of the presence and salience of social influences in the economy. The work particularly contributes to building a neo-Weberian sociology of the market, combining Weber's classical insights with recent theoretical developments and empirical findings in the new economic sociology.

Thereby, the present work performs an essential revision and inversion ("creative destruction") of current social exchange theory in sociology, and secondarily of pure exchange theory in economics. Modern exchange theory in sociology tends to conceptualize social action as (an extension of) economic exchange by reducing all social relations and processes to market-style transactions. In contrast, a neo-Weberian approach conceptualizes market-economic exchange as a particular form of social action. The same can be said of other concrete forms of economic behavior, since these too are types of social action. Rather than reducing social relations to exchange transactions, a neo-Weberian approach identifies and analyzes the social factors of these transactions. The social constitution and construction of exchange transactions constitutes the realm of the sociology of the market (Weber 1968:81).

The neo-Weberian approach originates from the framework of a theoretical-empirical economic sociology, the subject matter of which is the social constitution of economic action generally and of exchange particu-

larly. Such a neo-Weberian approach thereby leads to the reversal of current exchange theory in rational choice sociology as well as pure exchange theory in orthodox economics. Whereas social exchange theory construes social actions as market-economic transactions, using this approach we treat the latter as an ideal type of the former. Such a treatment is consistent with Weber's classical conception of social action and with the major tenets of the new economic sociology, and to that extent *neo-Weberian*.

The scope of this work in the field of economic sociology is well defined and limited in relation to current social exchange theory, with its attendant ambition to explain all social action, economic as well as non-economic, in terms of exchange. This work analyzes solely the social structuration or construction of market-economic exchange, not the latter in itself, let alone all human action ("social exchange"). This gives to this analysis a distinctive characteristic in relation to social exchange theory in rational choice sociology and to pure exchange theory in conventional economics alike. First, the analysis, by focusing *exclusively* on sociological variables in market-economic exchange, differentiates itself from social exchange theory, insofar as the latter reduces social action to such exchange. Second, by emphasizing the social setting of economic exchange, this analysis differs from pure market theory, which examines exchange transactions and related processes as if they emerge and exist within a social vacuum (i.e., a Robinson Crusoe-style economy). Such an emphasis is justified by the fact that exchange, and generally the economy, is placed within a social milieu, including relationships between individuals as well as between collectivities, expressed as values, symbols, norms, and culturally conditioned patterns of economic conduct.

Developments in economics are therefore of secondary interest here relative to those in economic sociology. The intention is not to reformulate the conventional economic theory of exchange processes but to carry out a different, sociological analysis of these processes. Although this work is intended to be an interdisciplinary endeavor in a theoretical-empirical analysis of exchange phenomena, primary emphasis is placed on a sociological treatment of the matter under consideration rather than on a purely economic approach to these phenomena. This would be a distinctive characteristic of this work relative to analyses of the same phenomena in orthodox economics. On the other hand, by not neglecting major developments in this regard within non-orthodox economics, this work would be distinctive in relation to those sociological analyses of economic exchange that overlook or downplay these developments. Thereby both theoretical-methodological economism and sociologism are avoided, by virtue of their conjunction in a synthesis, in which, nevertheless, sociological ingredients are primary relative to economic ones.

The main purpose and contribution of the work is to postulate and demonstrate the social constitution, construction, and structuration of market-

economic exchange and related phenomena (i.e., the operation of the principle of *sociologics* in the economy). From a neo-Weberian sociological perspective on the economy, it seems more sensible for modern sociology to engage in identifying and analyzing social-cultural variables in economic action than in conceiving all human action as a market-like exchange of objects and rewards. This is especially so given the neglect of these variables in modern exchange theory in sociology, just as in pure economics. Some exponents of rational choice models of exchange have conceded this neglect. Multiple and complex institutional arrangements create the setting within which exchange and other transactions occur, with such structural conditions placing limits on these transactions (Blau 1994). Nevertheless, in rational choice models of (social) exchange, just as in neoclassical economics, the impact of the social and institutional structure within which markets emerge and function is admittedly unexamined (Coleman 1986). It is the task of this work to reexamine the impact of social-institutional structure on market-economic exchange by applying the framework of a neo-Weberian economic sociology.

More precisely, we analyze economic exchange at three levels: the level of human agency or social action, the level of society, culture, or institutional-social structure, and the comparative-historical level. On the first analytical level, we analyze the impact of individual human agency and social action on economic exchange. A key premise of the analysis on the agency level derives from Weber's insight that economic activities generally, and exchange particularly, are situated in and affected by the autonomous character of social action. At the second level, we analyze the effects of society and culture as wholes or institutional-social structure on market-economic exchange. Such an analysis of an institutional-structural level is also predicated on the neo-Weberian assumption that the economy or economic organization as a whole exists within and is influenced by society or social organization. On the third level, we undertake a comparative-historical analysis of these phenomena. In doing so, we aim at linking human agency levels of analysis with institutional-structural analytical level by examining the influence of both social actions and society on market-economic exchange in comparative-historical perspective.



## *Chapter 1*

# *An Overview of Economic Sociology*

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### ANOTHER LOOK AT ECONOMIC SOCIOLOGY

Economic sociology represents an interdisciplinary field at the interstice between sociology and economics. In this sense, economic sociology is often considered a no-man's and every-man's land (Schumpeter 1956:134; cf. also Simon 1957), almost a kind of virgin territory (Coleman 1994), placed between economic science and sociology. Economic sociology, especially its neo-Weberian formulation, can be defined as a sociological theory of economic action (Weber 1968:68). As the sociology of economic action (Weber 1968:68), the hallmark of economic sociology is applying a sociological perspective on the economy (Smelser and Swedberg 1994). In doing so, economic sociology conceptualizes economic variables in terms of their sociological categories (Weber 1968:63).

Notably, neo-Weberian economic sociology<sup>1</sup> treats economic exchange as a particular form of social action and the market as a set of social relations and rules (i.e., as a social institution or structure [Weber 1968: 635–36]). In this connection, it stipulates that those social-cultural phenomena (viz., institutions, power, rules, values and preferences, rationality, etc.) that economics usually takes as given, constant, or exogenous to the economy are endogenous and feature structural variation from a sociological standpoint (Weber 1968:341). Thus, from a sociological perspective on the economy, economic rationality (viz., maximization of utility, wealth, or profit) is not a parameter, as it is within conventional economics, but a variable subject to variation over historical time and across societies (Granovetter and Swedberg 1992; Martineli and Smelser 1990). In contrast, in neoclassical economics, exogenous phenomena such as tastes (preferences),



technology, governments, institutions, norms, or culture are taken as givens, data, or parameters, and thus are virtually rejected as irrelevant, ignored, or relegated in a residual category (Fararo 1993). Yet, specific cultural conventions and institutions (e.g., money, credit, accounting, contract, decision-making entities, etc.) admittedly underscore economic agents, including firms' production functions (Samuelson 1983:7, 117). In consequence, firms become institutional, including governance, structures rather than production functions or technological constructions (Williamson 1998), as assumed in standard economics.

The preceding indicates that neo-Weberian economic sociology reconstitutes (i.e., situates and embeds) economic actors, behaviors, and variables within what Weber (1949:65–66) termed the “totality” of social-cultural life. In this connection, recent reformulations of Weber's economic sociology stress the salience of sociocultural factors for the constitution and functioning of the economy and propose a culture-inclusive theory of economic processes as having definite advantages over standard economics (Holton 1992). These factors are often exemplified in what Weber (1976:43–44) called economic cultures (viz., economic traditions and conventions), work and market ethics, the capitalist ethos and spirit, religious valuation and penetration of the economy (viz., religious economies), and the like.

The previous also suggests that neo-Weberian (and any) economic sociology represents a multidimensional explanation of or approach to the relationship between the economy and society (i.e., between economic and social action/organization) (Parsons 1947). More precisely, economic sociology identifies and examines the effects of social phenomena on economic actors and behaviors (Weber 1949:45). Hence, economic sociology centers on the presence and salience of sociological relations in the economy (Weber 1968:63; Wieser 1967:151–53), including the operation of exchange and competition (the sociology of the market). Particularly emphasized is the societal “heteronomy” or determination of economic aims (Weber 1975a:84) (i.e., the social construction of motives and goals (including utility, wealth, or profit) in economic behavior), as well as of economic institutions such as markets and firms (Granovetter 1992a).

The central themes of economic sociology therefore involve social institutions, relationships (networks), and embeddedness and their importance in shaping economic behaviors and processes (Carruthers 1997a). In this regard, the core of economic sociology is often considered the analysis of institutions (Schumpeter 1954a:9–22; Stinchcombe 1997) and their impact on individual economic behavior versus mechanisms (e.g., markets *per se*) dealt with by pure economics (but for recent advocacy of social mechanisms in social theory, cf. Hedstrom and Swedberg 1998). In this connection, economic sociology postulates institutionalized individualism/motivation in economic behavior rather than innate propensities (e.g., the propensity for exchange, maximization, and calculation), as does orthodox economics, the

leading principle of which is that “every agent is actuated only by self-interest” (Edgeworth 1967:16).

Generally, economic sociology observes market-economic variables as social phenomena by virtue of being outcomes of social action/interaction within the setting of larger societal structures, including institutional arrangements, cultural patterns, and historical conditions. Such a multidimensional approach (Holton 1992)—also called Schumpeter’s, and, for that matter, Weber-Durkheim’s recipe (Kovalainen 1995)—involves a broadly conceived analysis of economic phenomena combining economic sociology with some insights from conventional economics as well as history (Granovetter and Swedberg 1992). To some degree, this can lead to complementary relations or cross-fertilization between the two (Ritzer 1989), above all in a Weberian framework. However, the new economic sociology is often seen as a competitor or substitute rather than as a supplement (as was in part its old version) of mainstream economics (Caruthers 1997b).

This is exemplified by the comparative treatment of markets within economic sociology and pure economics. Since in contemporary (and classical) economic sociology, markets are primarily understood as social structures (Burt 1992; Swedberg 1994; White 1981) rather than automatic mechanisms, as viewed in orthodox economics, economic sociologists reject the latter’s non- or anti-social assumption. Instead, they, starting from Weber and Durkheim to the new economic sociologists, substitute for these admittedly unrealistic assumptions (Arrow 1998) the notion of economic behavior as a special case of social action embedded in and influenced by a complex set of relations, networks, and institutions (Granovetter 1985). In addition, economic sociology, old and new alike, is sometimes characterized as a critical discourse on economic liberalism and (classical) political economy (Holton 1992) as well as on Benthamite utilitarianism and individualism (Etzioni 1988; Schumpeter 1954a), which incidentally contrasts with sociological rational choice theory’s (including social exchange theory’s) mostly positive attitude toward these intellectual traditions.

Thus, though economic sociology as an interdisciplinary area has sometimes stronger ties to economics than sociology, and its results are important to core economic theory (Steiner 1997; see also Jevons 1965:20–21; Schumpeter 1954a:9–22), it has traditionally sought to offer a critical and realistic alternative to this latter<sup>2</sup> (Mutti 1992). Thus, the old economic sociology, including its formulation in Weber, involved a substantive and methodological critique seeking to transcend or at least to supplement economic theory, including neoclassical mathematical economics as well as the German historical school (Steiner 1998: here reference is made to Simiand’s and indirectly to Durkheim’s economic sociology, especially the conception of price formation or economic values, as based on social representations). This suggests the existence of some important differences

between economic sociology (old and new) and mainstream economics. According to some new economic sociologists, the two differ in the following dimensions: the concept of the economic actor, the arena of economic action, modes of economic action, the result of economic actions, the view of the analyst, the notion of time, and general methodology (Smelser and Swedberg 1994).

In general, economic sociology seeks to explain the economy, culture, polity, and institutions not as separate realms but as intertwined phenomena making for a complex social world. In particular, economic sociology analyzes the impact of changing institutional arrangements, cultural patterns, and social relations on the economy. While standard economics relies on methodological individualism, economic sociology conceives economic agents as being guided and limited by social groups and institutions (i.e., as socially constructed). In contrast to the monism and purism of pure economics, economic sociology combines theoretical pluralism with methodological eclecticism. Economic sociology treats economic rationality as a variable to be accounted for by social-cultural and historical settings rather than as an assumption or a parameter, as seen in economics. Notably, economic sociology regards exchange transactions as embedded in or governed by institutions, cultural values, and social relations rather than as self-regulating mechanisms (Pressman and Montecinos 1996).

In retrospect, classical or old economic sociology has passed through several stages, beginning with its early formulation or adumbration by sociologists such as Comte and followed by (neo)classical economists such as J. S. Mill and even Jevons (who probably coined the term) between the 1840s and the 1880s. The “golden era” of classical economic sociology was probably the 1890–1920 period, marked by the contributions of Weber as well as Durkheim, Simmel, Simiand, Veblen, Pareto, and others (Gislain and Steiner 1995). According to some contemporary economic sociologists (Mingione 1999), it was Weber (especially in *The Protestant Ethic*) who provided the best description of economic behavior under an exchange economy, not only as rational and individualistic, as depicted in economics, but also as being grounded in a social-cultural context, as in modern capitalist society and culture. In comparison to the previous, the 1930–1960 period was reportedly less productive and important (Steiner 1997), albeit the mid-twentieth century witnessed the reemergence of economic sociology as an autonomous discipline with Keynes’ heterodox social economics and especially Parsons’ works (Mingione 1999) attempting to integrate economic and sociological arguments in analyzing exchange phenomena.

The connections of Parsons’ economic sociology to Weber’s warrant some additional comments in this respect. Namely, Parsons’ formulation of economic sociology was to a large measure inspired and influenced by Weber (in conjunction with Durkheim, Pareto, and some neoclassical econ-

omists, e.g., Marshall). Overall, Parsonian economic sociology is predicated on the economy and society approach by treating the first as a part or subsystem with a certain function (adaptation) within the second as a whole or system (Parsons and Smelser 1956). Akin to Weber and Pareto (but unlike Durkheim), Parsons' original approach consisted in starting with mainstream—incidentally preferred over heterodox institutionalist—economics and then trying to supplement and in part transcend it by (economic) sociology. In this approach, economic sociology differs (from standard economics) in centering on a more fundamental property of action (social) systems (viz., integration) than that (resource allocation) dealt with by economics. While often using concepts from economics, Parsons seeks to situate the economy and thus ground economic analysis in society, thus setting the foundation for economic sociology which conceives the market-economic system not as self-contained and free-floating (as does pure economics) but as a differentiated subsystem of the total social system. In doing so, Parsons adopted and further elaborated on the early systems approach and terminology of Durkheim and especially of Pareto. Thus seeking to transcend or redefine economic theory, Parsons considers it, like Weber (and Durkheim), a special case of the general theory of social actions and systems, contending that the parameters of microeconomics/macroeconomics can be analyzed as variables within a social action/systems theory (Gould 1991).

Yet, as critical commentators note, Parsons' itinerary toward economic sociology was sometimes ambiguous, as shown by an "excessive tendency toward analogical isomorphisms" (Chazel 1989) or formal equivalencies (viz., between money and power) (as well as solidarity and influence) as the generalized media of exchange. Also, others (Velthuis 1999) reconsider Parsons' specification of the relationship between economic sociology and institutional economics (viz., his critique of the old institutional economics) on the grounds that, as embodiments of cultural values, social institutions are the subject of sociology rather than economics. New economic sociology rejects Parsons' division of labor by seeking substitutes rather than mere complements to economics, thus countering economic imperialism. Significant similarities thus exist between new economic sociology and old institutional economics as well as the new institutionalism in economic theory<sup>3</sup> (Velthuis 1999). On the balance, as critiques object, Parsons' economic sociology was particularly unsuccessful in its use of macroeconomic theory as the presumed foundation of macrosociology (e.g., the AGIL scheme) and its failure to reconstruct the utilitarian logic of neoclassical economics in sociological terms (Gould 1991). However, further positive assessments are implied in efforts (Holton 1992) to create a "new synthesis" in economic sociology through an elaboration of what is called Parsons' multidimensional theory of economy and society: for instance, in these efforts, the economy is defined *à la* Parsons (viz., in terms of the

performance of a set of social functions designed to solve certain types of problems in society) in a process of economy's differentiation from and then reintegration into society.

Parenthetically, in contrast to the explicit and systematic economic sociology of Parsons, that of some of his influences, such as the neoclassical economist Marshall (included in the "major" theorists of social action in *The Structure*), is implicit, unsystematic, and even unintentional. Still, analysts suggest the presence of elements of Marshall's economic sociology or sociological economics as a broad perspective on the economy by a multidimensional economist and in part social theorist (Parsons 1937). Such elements include the (social) generation of preferences (the role of traditions), the theory of economic and social action and welfare, and the introduction of organization or entrepreneurship as a (fourth) factor of production (Aspers 1999). And Marshall's economic sociology/theory is sometimes seen as evincing some important resemblances to Weber's as well as Veblen's (Aspers 1999).

Next, regarding the commonalities between classical and contemporary economic sociology, the second is sometimes characterized as the new synthesis of economics and sociology by analogy to the first as the old synthesis (Krier 1999). However, according to some interpretations (Steiner 1997), current ideas of economic sociology do not have much in common with the economic sociology or social economy of the nineteenth century, although the new economic sociology is seen as a descendant of classical sociological studies, especially from the 1890–1920 period. In these views, a major difference between the two resides in that, in contrast to its old versions, the new economic sociology (Smelser and Swedberg 1994; Swedberg 1993) moves beyond the critique of the unrealistic utilitarian concept of actor in economics to center on the latter's failure to incorporate social structures (viz., networks of interpersonal relations as well as impersonal institutions) into analysis (Granovetter 1990). In this connection, however, some economic sociologists (Piore 1996) object that it is too early to herald the coming of the new economic sociology to replace the old. Further, other economic sociologists (Stinchcombe 1997) praise the virtues of the old economic sociology (more precisely, the old sociological institutionalism in organizational analysis) versus its new formulations (i.e., the new institutionalism often premised on rational choice theory).

In any event, the new economic sociology rejects the atomized conception of actor in favor of the concept of embeddedness, stressing the social construction of economic behavior (Granovetter and Swedberg 1992) or the social organization of the economy (Carruthers and Uzzi 2000). In response to economic theory's inability to analyze economic institutions, the new economic sociology involves the use of social structures to study the economy as one of the major developments in contemporary social science (Swedberg 1997a). Some accomplishments of new economic sociology, es-

pecially as developed since the mid-1980s, include highlighting the theoretical dimension of economics' failure to incorporate social structure into analyses, advancing the concept of embeddedness to express the social construction of the economy, and providing a vehicle to fill the void in the analysis of economic institutions (Swedberg 1997b). Particularly, the notion of social embeddedness occupies a central place in current economic sociology, including that in Europe (Mingione 1999), though some (Laville 1997a) differentiate its Anglo-Saxon formulations that focus on the social embeddedness of the exchange economy from its French versions, stressing the political embeddedness of a plural or mixed economy. Overall, many sociologists and economists agree that recent years have witnessed the renewal<sup>4</sup> or renaissance of economic sociology as being firmly rooted within the sociological tradition (Lallement 1996) through a consistent use of the sociological approach to economic phenomena (Laville 1997a).

## THE SOCIAL CONSTITUTION OF THE ECONOMY

As suggested earlier, a key assumption of both the old and new economic sociology (Granovetter and Swedberg 1992) is the social nature and embeddedness (i.e., social constitution) of economic phenomena in general (Granovetter 1985) and of exchange transactions in particular (Podolny and Baron 1997). More precisely, the social character (Podolny 1994) and embeddedness of economic exchange is in the focus of the sociology of markets (Lie 1997). In economic sociology, new and old alike, economic exchange then constitutes social action (Weber 1968) or interaction (Simmel 1990) and thus a social fact<sup>5</sup> (Durkheim 1964). Hence, the economy represents an integral and embedded (rather than isolated and disembodied) instantiation of society (Fararo 1993), with the total social system being more comprehensive and complex than the economy (Pareto 1963). Thus, economic sociology's analytical integration of the economy, as an interactive social system of (heterogeneous) actors<sup>6</sup> (Gallegati and Kirman 1999) in society, contrasts sharply with the assumption of "perfect disintegration and unsympathetic isolation" within pure economics (Edgeworth 1967:12).

In retrospect, in its initial formulation (Polanyi as the "father," according to Barber 1995) the concept of social embeddedness addresses economists' lack of attention to the impact of institutional arrangements and social system supports on economic exchange, despite some ideas to that effect in economics (Callon 1998). As some unorthodox economists lament, most of their orthodox colleagues are prone to abstract exchange and all economic activity from other social processes, thus ignoring the social embeddedness or construction of the economy as an irrelevant sociological detail (Bowles 1998:77). In such an abstraction, any prolonged impact of extra-economic social conditions and institutions on exchange transactions is

ruled out or minimized, as these transactions are assumed to proceed in a smooth, almost automatic way, without any external disturbances.

While some dissident economists or economic anthropologists (e.g., Polanyi) applied the concept of social embeddedness mostly to non-market forms of economic exchange (viz., reciprocity and redistribution), the concept of embeddedness in the new economic sociology is reformulated to have applicability to all economic systems, including those based on the market<sup>7</sup> (Barber 1995). Thus, empirical economic sociology suggests situating and embedding market modes of economic exchange within society (Lie 1992), since markets can be socially embedded and influenced just as reciprocal and redistributive modes.<sup>8</sup> For example, studies report that the rise of the exchange economy in England and elsewhere was a historically specific process involving individual and institutional networks (Lie 1991).

Generally, the concept of embeddedness is an expression of the process of social determination or structuration of the economy (i.e., social determinants in or the impact of social structures on economic agents and their actions). A case in point is the important role that complex networks of interpersonal ties or “social capital” (for critical overviews of the concept cf. Baron and Hannan 1994; DiMaggio 1979; Portes 1998) can and do play in exchange transactions between firms (Baker, Faulkner, and Fisher 1998; Uzzi 1999), as well as between them and consumers (DiMaggio and Louch 1998) and other economic activities, including those within economic organizations (Burt 1995; Eccles and White 1988; Podolny and Baron 1997) and among immigrants (Portes 1995; Portes and Sensenbrenner 1993).

For illustration, some new economic sociologists (Burt 1995) explore the role of social capital/networks with “structural holes” in making the world of entrepreneurs or managers what is called the “interpersonal politics of competition.” Reportedly, those rich in social capital (defined as the information and control benefits provided by contact networks rich in structural holes) receive higher returns (to human capital). Social capital matters for managerial promotions, these being precluded or delayed when it is concentrated: too few contacts (small network size), contacts too strongly interconnected (high network density), or too strongly connected to a single other contact (network hierarchy). Social capital is more important at the higher layers of the organization and to those people in unique rather than the same jobs (cf. also Podolny and Baron 1997). In turn, other economic sociologists (Baron, Hannan, and Burton 1999) stress the role of path dependence in the evolution of economic organizations (i.e., the importance of organizational history [viz., founders’ “logics of organizing”] in the subsequent structure and functioning of enterprises).

Notably, economic action generally and exchange particularly are characterized by double or even multiple social embeddedness. One facet is the micro-social embeddedness of economic action in networks of interpersonal

relationships<sup>9</sup>—sometimes not very accurately termed “social structures”—and another its macro-social embeddedness in institutions and other large-scale societal structures (Carruthers and Uzzi 2000). In reality, the micro-relational and macro-institutional embeddedness of the economy cannot be separated, as they are intertwined and operate in interaction (Carruthers and Uzzi 2000).

Applying the principle of social construction to the economy (Granovetter and Swedberg 1992), the new economic sociology treats economic institutions, including markets and firms, as social constructions (Granovetter 1992a). In doing so, the new economic sociology displays essential differences in relation to the new institutional economics as the application of orthodox economic principles to analyzing economic and other social institutions. Since the new institutional economics is largely based on admittedly narrow neoclassical assumptions (*viz.*, self-interest, efficiency, maximization, etc.), for most new economic sociologists such an approach falls short of a persuasive account of economic institutions. It is to be noted, however, that recently leading advocates of the neo-institutional economics suggest using economic sociology’s principle of social embeddedness as a background condition in studying exchange transactions. By pertaining to societal features such as norms, customs, mores, and religion that vary across groups/societies and function as societal supports (e.g., reputation-effect mechanisms) for credible contracting, this condition is admittedly critical for conducting economic exchange (Williamson 1998).

At any rate, the new economic sociology is deemed to offer a broader alternative grounded in classical sociological arguments about the embeddedness of economic goals and activities in socially oriented goals and structures, stressing the coordination of economic activities by social institutions or groups, not by independent individuals. Some new economic sociologists present such cases of the social construction of economic institutions as firms in developing countries, business groups, and the origins of the electrical utility industry in the United States (Granovetter 1992a). Others adduce for this purpose the social-cultural construction of money as an economic institution to the effect that the meaning or value of money is socially and culturally constructed (Zelizer 1996), as is that of monetary accounting in the historical development of the exchange economy (Carruthers and Espeland 1991).

Overall, for the new economic sociologists, the very meaning and significance of exchange itself is subject to a process of sociocultural construction under definite historical conditions (on the relations of markets, meanings, and social structure, cf. Carruthers and Babb 2000). Further, in a modern economy, money, and thus exchange, based on the use of such a medium is found to operate most efficiently when its social-cultural construction is implicit or hidden and its value is taken for granted. Alternatively, sudden potentials for radical political and social change are expected to emerge



when money ceases to be taken for granted and thus becomes problematic or contested as an exchange medium, as during the American Civil War (Carruthers and Babb 1996).

In the new economic sociology, the principle of social embeddedness and construction is sometimes associated or combined with the notion of uncertainty in economic processes under an exchange economy. Arguably, the new (and old) economic sociology is unified in its critique of the maximization assumption of economics (*viz.*, actors can accurately determine the probable outcomes or expected utility of their actions). Since the utility maximization assumption is considered largely invalid in the conditions under uncertainty as the prevalent feature of the real world, economic sociology analyzes the decisions of rational actors under precisely such conditions. A focus on uncertainty in the exchange economy allows the incorporation of the concepts of culture, power, institutions, social structure, and cognitive processing in economic decision making (Beckert 1996). In turn, research (Podolny 1994) reports that organizations as well as individuals resort to some ways of overcoming exchange uncertainty. Reportedly, exchange uncertainty increases the extent to which organizations and other economic agents resort to social structural positions, as grounds for evaluation of transactors and transaction opportunities, by reliance on information acquired in prior transactions (*i.e.*, using previous exchange partners) and, if in the absence of such experience, by considering the status of potential exchange partners. However, these (first- and second-best) approaches to resolving exchange uncertainty both are embedded in networks of social relations between actors insofar as their status rests on such networks. In particular, social status has shown to have multiple salience in markets, which thereby develop into some kinds of status orders, as phenomena that are socially constructed by the protagonists in exchange transactions (Podolny 1993). Thus, for actors trying to evaluate exchange partners, social status is an economizing factor, and for those evaluated, an asset enhancing their attractiveness as exchange partners. As a result, status is both an attribute facilitating and economizing on exchange transactions and a constraint partitioning the market in the face of uncertainty (Podolny 1994).

Research in empirical economic sociology (Lie 1992) has identified various forms and expressions of the social embeddedness of economic exchange. One of these is the effect of social-institutional forces on the continuity (*viz.*, establishment, nature, and duration of interorganizational exchange relationships) (Baker et al. 1998). Thus, continuous or long-run interorganizational transactions such as relational contracting (Dore 1992) are reportedly embedded in and sustained by certain social relations between organizational actors, including personal contacts and friendships between their chief executives and other employees (Baker et al. 1998; Uzzi 1999). Another form of embeddedness is the economic impact of social ties

on economic performance, as the existence and sustaining of such ties between business organizations is found to be instrumental in organizational performance by generating network effects (Uzzi 1996). Social ties and networks also have been shown to have important financial consequences for organizations, with those firms embedding their transactions with lenders in social attachments receiving lower interest rates on loans (Uzzi 1999). Still another form of social embeddedness has to do with the influence of networks of interpersonal connections on individual success, especially promotion or mobility within organizations (Burt 1995; Podolny and Baron 1997).

Another form of embeddedness concerns the role of weak (Granovetter 1992b) or/and strong (Bian 1997) social ties in labor markets, especially in finding and exploiting employment opportunities. Other forms are then found in socially organized consumer markets, as these are reportedly embedded in networks of social relations between sellers and buyers (DiMaggio and Louch 1998). This tends to lead to thin-network exchange as a pattern of generalized reciprocity in which there is a bias toward in-group exchange<sup>10</sup> (Bearman 1997). To that extent, consumer transactions are characterized by a higher degree of social organization and embeddedness than usually assumed by standard economic theory. So are reportedly intraorganizational and interorganizational productive and other transactions (Eccles and White 1988) and thus production markets as structures of socially defined roles (White 1981).

A related embeddedness form consists of the process of the social construction of value or prices in consumer markets (Blinder et al. 1998; Okun 1981) as well as in other (e.g., auction) markets (Smith 1989). Prices thus constitute social phenomena (Caldwell 1997:1863) as a variety of social variables, including personal and durable connections among economic actors, have essential importance in the explanation of these and other exchange phenomena (Bowles 1998:77). Also, the impact of informal social constraints on market-economic behavior is a particular form or manifestation of its embeddedness. Reportedly, in exchange economies informal constraints stemming from and operating in social networks affect economic behaviors and outcomes (e.g., productivity), as evidenced by the role of the informal norm of satisficing in opposition to the formal rules within organizations. In transition economies, social networks based on personal ties are used to organize exchange behavior in accordance with informal norms that express the private, rational expectations of entrepreneurs and other agents (Nee 1998).

The embeddedness principle has a further form or ramification in the impact of firm-worker relations on wage setting. In labor markets, the character of the relations (*viz.*, relative positional and thus bargaining power) (Perrone 1984) of employers and workers can be instrumental in creating wage settings that are admittedly different from the competitive one (Blan-

chard and Katz 1997). This thus reflects the historical influence of owner-worker conflicts on the institutions shaping wages and incomes in exchange economies (Western 1998). In addition, as shown by the experience of Western European labor markets in the 1980s and 1990s, sociological factors can increase reservation wages for unemployed workers, insofar as long periods of unemployment tend to change society's attitudes toward them, so that it is socially more acceptable to be unemployed and to receive welfare benefits (Blanchard and Katz 1997).

Hence, the social embeddedness conception suggests that markets, by virtue of being embedded in a broader context of society, are social structures (Swedberg 1994), with production markets defined as induced role structures (White 1981). Specifically, on the basis of the specific form of their embeddedness, markets are characterized as status orders, political phenomena, institutional arrangements, cultural patterns, and networks of social ties with effects on economic actors and activities (*viz.*, intercorporate relations, consumer transactions, and job search).

In this connection, exchange competition is assumed to be shaped by a social structure, including a variety of networks of interpersonal relations, featuring structural holes or network bridges (Burt 1992). In addition to production, labor, and consumption markets, this reportedly applies even to supposedly pure stock, futures, bond, and other financial markets (Abolafia 1996; Carruthers 1997b). Namely, many of these markets are permeated by and constitute social structures (*viz.*, complex networks of interpersonal connections, rather than purely impersonal or anonymous exchange mechanisms contrary to their depiction in standard economics). For instance, the United States national securities market is characterized by a certain pattern of social relations among the participants (Baker 1984), thus exemplifying the social structure of markets and competition (Burt 1992).

In these and many other markets, transactions are far from being only exchanges of goods (securities). They also are trans-economic events by virtue of being influenced by such social factors as exchange agents' social attitudes and relations, with an anonymous market being an extreme (or a denial) of a social network (Arrow 1998). Another case in point is the social structure of exchange liquidity. As reported, the commodity homogenization (standardization) instrumental in markets' liquidity as a social and cognitive process (e.g., in the United States, secondary stock exchange liquidity) is the function of public knowledge of economic assets (Carruthers and Stinchcombe 1999). To that extent, liquidity and the overall operation of financial and other markets hinge upon solid institutional and other social foundations (Carruthers 1996). These examples thus epitomize the societal constitution (*i.e.*, the social nature and embeddedness) of economic exchange as the key assumption of economic sociology, including its neo-Weberian version.

Finally, some dissident and mainstream economists alike in part adopt the social, especially the institutional, embeddedness conception to various areas and aspects of the exchange economy. These areas include, for example, the formation of exchange values, preference formation and revelation, the nature and operation of economic agents (firms), the functioning of labor and other markets, and so on. Thus, leading representatives (Williamson 1998) of the neo-institutional economics explicitly propose incorporating, as a “background condition,” the societal embeddedness conception from the new economic sociology into their discipline. Justification for such incorporation is found in social embeddedness and implies elements such as rules and values, (e.g., customs, conventions, and religions), which while varying across societies and groups provide reputation-effect mechanisms and other societal supports for credible exchange transactions, and which are in time prior to organized governments. It remains to be seen whether this adoption will bring the new economic sociology and neo-institutional economics closer to each other.

Summarizing, contemporary economic sociologists and some heterodox economists have centered on the societal embeddedness of exchange and economic action generally—especially its embeddedness in networks of interpersonal ties and relations—within modern societies. In recent decades, such an emphasis has been instrumental in the emergence of the “new” economic sociology, including the sociology of markets, premised largely on the social embeddedness conception. Within the new economic sociology, rather than as mere exchange mechanisms, markets are generally conceived of as social systems/structures, including production, labor, and consumption markets. In this regard, they are assumed to be underscored by networks of interpersonal ties and relations, including sets of informal norms, which influence both producers’ or entrepreneurs’ and consumers’ behaviors and outcomes. Similarly, markets are also redefined as (phenomena of) politics as well as status orders and cultural, especially institutionalized, arrangements.

## CHARACTERISTICS OF NEO-WEBERIAN ECONOMIC SOCIOLOGY

### Research and Theory in Neo-Weberian Economic Sociology

As suggested earlier, the social constitution of economic exchange has been the subject of various theoretical analyses and empirical studies, despite some lamentations about the paucity of such endeavors. Of these endeavors, particularly pertinent to this work is Weber’s theoretical and historical-empirical analyses of exchange processes in their social settings. The crucial insight of these analyses is the characterization of economic exchange as a special case of social action. Such a characterization is

grounded in rich historical and empirical observations, as found in Weber's *General Economic History* and *The Protestant Ethic and the Spirit of Capitalism*. This characterization also is elaborated by theoretical insights presented in the *Methodology of the Social Sciences*, and especially in *Economy and Society*, by a remarkable synthesis of an empirical and a theoretical economic sociology. Regarding the social-cultural setting and historical contingency of economic exchange, especially its capitalist variations, of particular importance is Weber's dichotomy between primitive or traditional exchange, as exemplified in politically oriented or robber capitalism, and contemporary economic exchange, as epitomized by sober, rational, bourgeois capitalism. This implies a dichotomy between pseudo- or non-market and market exchange in the contemporary sense.

Such an implication was carried further in substantive economic theory's/ anthropology's (Polanyi 1968) conception influenced by Weber's and, for that matter, Durkheim's ideas of economic exchange. This conception distinguishes quasi- or non-market modes of economic exchange (reciprocal and distributive) from market exchange. In Weber's words, the first two modes would be characteristic of economic traditionalism and the third of modern capitalism. Durkheim's (1964) corresponding social-historical settings associated with these exchange types are societies with mechanical solidarity and organic solidarity, respectively. In this connection, Tönnies' *Gemeinschaft* and *Gesellschaft* also could be used as functional equivalents or approximations of Weber's economic traditionalism-modernism and Durkheim's mechanical-organic solidarity dichotomies. The same could be said of some other societal evolutionary dichotomies and taxonomies found in classical sociology. These include, for example, Comte's theological, metaphysical, and industrial (positive) social stages, Spencer's militant and industrial society, Sorokin's ideational, idealistic, and sensate sociocultural systems, and the like.

A major element of the neo-Weberian sociological theory of exchange phenomena (economic sociology or sociological economics) is a conception of the social constitution and construction ("embeddedness") of these and related economic phenomena. As originally advanced or adumbrated by Weber and others (e.g., Durkheim and Simmel), classical sociological arguments about the embeddedness of economic preferences and actions in social values and structures (Granovetter 1992a) have been embraced and reformulated by contemporary economic sociologists and anthropologists as well as by some economists. Notably, some dissident economists theorists turned economic sociologists/anthropologists (Polanyi 1944) under the influence of Weber and Durkheim have rehabilitated and reinvented the concept of social embeddedness (for historical reviews of the concept, cf. Barber 1995; Portes and Sensenbrenner 1993) and have applied it to modes of economic exchange (viz., reciprocal and redistributive early, pre-market societies).

Contemporary economic anthropologists also focus on the social embeddedness of economic exchange in current traditional or primitive societies. Then the established dichotomy between formal and substantive economic theory/anthropology (Geertz 1992; Polanyi 1968) reflects Weber's (1968: 85–86) distinction between formal and substantive rationality as well as the Durkheimian problem of substantive rationality (Fararo 1989:223).

Some other studies of the sociocultural construction of exchange within or with pertinence for neo-Weberian economic sociology are mentioned as follows. Thus, economists (Keynes 1972) and sociologists (Zelizer 1996) have explored the invention of money and its applications, including accounting (Carruthers and Espeland 1991). Contemporary economic sociologists stress the social structuring of historical and modern markets elaborating on Weber's treatment of economic exchange as a social relationship as well as on Durkheim's convergent views of exchange values and related variables as forms of collective representations.<sup>11</sup>

Other sociologists (Merton 1968; also Becker 1984) also have studied, inspired largely by Weber's analysis of the bearing of the Protestant religion on the emergence of modern capitalism, the historical relationships between an emergent exchange economy and the society in seventeenth-century England. Tocqueville's concern with the interrelations between political democracy and the exchange economy, especially commercial exchange in nineteenth-century America, also can be seen as an early example of a comparative-historical economic/political sociology. Weber's analysis of the emergence of the modern exchange economy, particularly the elective affinity (i.e., convergence or interconnection) between a particular religious (Protestant) ethic and capitalist enterprise, has established itself as a classic in the field, a necessary point of departure for any systematic effort in this direction (Collins 1997; Chirot 1985; Mingione 1999). Generally, Weber (1968:341) suggests that the degree of elective affinity between "concrete structures of social action" and "concrete forms of economic organization" can be subject to analysis and generalization. In this regard, Weber shared with Marx the view that modern capitalism was a unique phenomenon characterized by a certain conventional style of work, though Weber looked for the underlying source of this style, first and foremost, in the Protestant religion, and Marx in structural factors (i.e., changes in society's economic structure). Moreover, not only Weber but also Marx, to some degree, realized the existence of historical connections between the emergence of modern capitalism and Protestantism.

Modern world-system theorists, more or less influenced by predecessors such as Marx and others, also have offered explanations for the emergence and development of modern capitalism as a world exchange system. Specific analyses of economic processes at the emerging stage of modern capitalism as a world system emphasize the strong historical influence of institutions and policy choices on exchange. One example is Great Britain,

from the Industrial Revolution through World War I (Crafts 1996). Such institutional-political influences reportedly permeated many aspects of Britain's market-economic process during the period commencing in 1780, the first phase of the industrialization, and ending in 1913, the eve of World War I (Crafts 1998).

In this connection, analysts (Findlay 1996) note the sociohistorical specificity rather than the universality of exchange processes as well as industrial revolutions and technological developments, for all of these were limited to the social space of Western Europe at a definite historical time (sixteenth to eighteenth centuries). This finding supports Weber's original thesis of the uniqueness of modern capitalism—its original emergence in the Occident, not just in a thought experiment (as used by Weber) but also in reality. In this regard, Weber would not consider modern capitalism, at least in its initial stage, a world system in the sense of Marx and the world systems (and dependency) theories. However, here the term *system* or *structure* is irrelevant in relation to the word "world," for it is the latter that conveys the idea of universality versus specificity. Besides, as a comparative-historical analyst, Weber probably would not be comfortable with systemic or structural notions as well as causal or functionalist concepts<sup>12</sup> (Bendix 1977:64–65). But this is of secondary import here. The issue is not if modern capitalism is a system (i.e., a coherent structure, or something random), but rather if it is a cultural universal (i.e., human nature, or a specific historical phenomenon). Marx and Weber seem to agree in regard to the historical specificity of capitalism, with Marx as a structuralist attributing a higher degree of system or structure to such a phenomenon.

At this juncture, the findings of recent research appear favorable to the hypothesis of the social-cultural construction of capitalism. This research reports that in most existing traditional communities and in some modern societies (Japan), money-based exchange, that is, market pricing (Fiske 1991) or price contracting (Dore 1992), represents just one of the many historical types of social relationships. The other types include, for example, authority ranking, community sharing, and equality matching. These are reportedly not convertible into the first type; rather, all four are subject to variability in the cultural specification (Fiske 1991:392).

Next, researchers emphasize the historical precedence of power and politics over profit and markets (Myrdal 1953; Polanyi 1944) and of the non-rational generally over the rational in exchange processes. Such an emphasis follows Weber's (1968:939–41) insights into the primacy or autonomy of political power (i.e., domination by virtue of authority, relative to economic power, or domination by virtue of a constellation of interests, for example, monopoly). Weber's historical observations are particularly pertinent in this regard. For illustration, Weber (1927:24–26) casts doubt on the notion of original *homo economicus*, warning that no definite statement can be made about primitive man's economic life given that this,

including the early accumulation and division of labor, is conditioned by economic as well as extra-economic (*viz.*, military, political, moral, traditional, religious, and magical) factors.

Alongside economists and economic historians, Weber and other classical sociologists such as Durkheim and Marx were concerned with the social conditions of recurrent changes in exchange (business cycles or economic crises). For example, Weber (1927) made various historical observations on these phenomena, including the Tulip craze in early capitalist Holland, as probably the first example of a business or trade cycle, offering theoretical explanations of their causes and effects. Durkheim (1966) also studied the social factors and consequences of exchange conjunctures (the French term for trade cycles), noting the effects of economic depression and prosperity, as two phases of these conjunctures, on suicide rates. Along similar lines, contemporary sociologists (Blau 1993; Davis 1992) observe the various effects of trade cycles and related economic crises on the patterns of social behavior, including the frequency, openness, and coolness in interpersonal relations.

More generally, many classical and contemporary sociologists and economists alike pay attention to the historical and empirical significance of non-utilitarian and non-hedonistic factors in exchange and related economic processes, including conspicuous consumption. Such factors include altruism, other moral commitments and related non-economic values, then traditions, habits, and conventions, and institutions, as well as emotions and sentiments. In this connection, economic sociology compares and contrasts the relative pertinence of money and related utilitarian-economic variables versus social considerations, including power and morality, in exchange processes (Etzioni 1988).

Against this background in the current literature, the following analysis will be carried out along the lines of an economic sociology of exchange processes, especially the sociology of markets. Such an analysis focuses on multiple social variables in exchange and thus differs from a pure economic theory that views it as a strictly economic phenomenon driven by an internal logic and isolated from other social phenomena. As such, this analysis is grounded in a neo-Weberian framework of the sociology of economic action (Weber 1968:68), including exchange.

### **Weber as an Economic Sociologist**

The aforesaid implies in no way that Weber was simply or only a pure sociologist. No doubt, Weber also was an economic theorist—despite the opposite assertions of some Austrian economists—as well as an economic historian, theorist of law, and so on, with “broadly ranging interests” (Swedberg 1998:173). However, by training, Weber was not mainly an economist. For instance, he received his license to teach at a university



(Habilitation) for the realm of commercial law. Moreover, his main work, *Economy and Society* (first published in 1922), was a treatise in sociological theory, namely, an “outline of interpretative sociology,” not to mention *The Protestant Ethic*, for which he is probably best known among many economists.

It is true that Weber was friendly to marginalist economics, especially its Austrian version, and was considerably influenced by Menger and Böhm-Bawerk. This influence is shown in that following these two and other neoclassical (marginalist) economists, Weber (1949:64–65) regarded the scarcity of means in relation to human ends or wants as the fundamental economic phenomenon. Weber (1968:92) also adopted—but without making extensive use of—some specifically Austrian marginalist concepts, such as marginal consumers, marginal pairs of sellers and buyers (Böhm-Bawerk 1959:224–25), alongside the general notion of marginal utility (and by implication, marginal productivity). However, this adoption notwithstanding, the conception of marginal utility has been largely impertinent in Weber’s economic sociology, including that presented in *Economy and Society* (Swedberg 1998:25, 215). Incidentally, in a famous essay (Stigler 1965: 117), Weber (1975b) analyzed the relations of marginal utility theory and psychological principles (the Ernst Weber-Fechner law of psycho-physics) by dissociating the former from the latter. At this juncture, Weber might have appeared as the champion of the Austrian school (Swedberg 1998: 186) and generally neoclassical economics.

On the other hand, Weber often was skeptical and critical of certain assumptions and laws of pure economics, though he was comparatively less so than other classical sociologists such as Durkheim as well as some disident economists such as Veblen. For instance, though starting from the premise of rationality by applying what he calls rationalistic method to the economy and society, Weber considered economically rational action (viz., the economic principle of wealth acquisition) an ideal type rather than a natural law with empirical salience. For Weber (1949:86–87), the notion of orthodox economists that social, including economic, action is induced solely by unrestrained self-interest or the acquisitive impulse is just a “fantastic claim,” because this commits the fallacy of deficient “psychological isolation” of one “psychic motive” to posit the “dominance of pure economic interests.” Weber’s skeptical attitude toward economic laws was exemplified by his reinterpretation of the so-called Gresham law (“bad money drives out the good money”) as, for orthodox economists, a putative example of iron economic law. Specifically, Weber (1968:10) maintains that Gresham’s law or generalization is just a “rationally evident anticipation” of social action given certain conditions and ideal-typical assumptions of purely rational behavior, so the extent to which actual conduct conforms with such assumptions can solely be ascertained by experience. Then, as shown earlier, Weber (1968:202–3) viewed economic (and social) action

as being induced not only by material self-interest, as the “first principle” of pure economics (Edgeworth 1967:160), but also by ideal considerations, including ultimate or transcendental values (e.g., the ethic of absolute ends). This Weberian view implies the duality of extrinsic and intrinsic motivation, or rather the plurality and infinity of motives in economic and other social behavior.

In general, Weber considered the perfectly rational economic actor, as embodied in *homo economicus*, an ideal-typical concept or model rather than an actual agent driven by the law of maximization. As such, this model of economic agents represents not human beings but rather puppets or “homunculi,” created by the analyst for analytical purposes only (Schutz 1967:339). In this connection, Weber (1927:24) argued that “In reality, nothing definite can be said in general terms about the economic life of primitive man,” thus denying to the depiction of the latter as *homo economicus* driven by some natural impulses for profitable exchange, maximization, and cost-benefit calculus.

Not surprisingly, some orthodox economists were quick to vehemently reject Weber’s argument concerning the rational economic agent. For example, certain members of the Austrian school (Mises 1960:180) claimed that *homo economicus* was not an ideal type in Weber’s sense but some kind of actual and universal agent not only in the production, distribution, exchange, and consumption of wealth but also in virtually all social life. Such claims were made on the grounds that human behavior is “necessarily rational” (Mises 1966:19), thus reducing Weber’s modes of social action to a single, instrumental (*zweckrational*) one. Incidentally, some Austrian economists (e.g., Mises and Hayek) often dismissed Weber’s knowledge of economic theory as limited, though his writings and teaching in economics (e.g., the essay on the relations between marginal utility theory and psychological laws, the analysis of historical economics, etc.) would suggest the opposite (cf. appendix “The Evolution of Weber’s Thought on Economics” in Swedberg 1998:172–206).

Reportedly, Weber was largely neutral during the *Methodenstreit* (battle of methods) between the marginalist (Austrian) and historical (German) economists, taking a middle-of-the-ground position between the two opposing camps and aiming to transcend or resolve the dispute by advancing economic sociology or more generally social economics as a solution. According to some recent accounts (Swedberg 1998:297), Weber intended to build a new type of economics by linking the marginalist (theoretical) and historical schools to an integrative discipline termed *Sozialökonomik* (social economics) which would analytically connect the economy to society (viz., state, law, technology, culture, art, etc.). Social economics thus included economic theory, economic history, and economic sociology. During the *Methodenstreit*, Weber’s sympathies were split between (Swedberg 1998: 190) the Austrian and Historical schools (e.g., between their leaders, Men-

ger and Schmoller). In some respects, Weber was reportedly closer to Menger than Schmoller (e.g., the use of “rationalistic method” and the view of social and economic institutions, namely, state, money, and so on as intentional and unplanned effects of individual motives and behaviors [Swedberg 1998:176]). Yet, in contrast to the economics of Menger and others, Weber’s methodological individualism was not atomistic but rather social (Swedberg 1998:164), especially institutional individualism (Parsons 1947).

Further, Weber sought to practically transcend, and to effectively end (Schumpeter 1991:220–25), the *Methodenstreit* by initiating and editing the huge and ambitious project of *Grundriss der Sozialökonomik* as an intended synthesis of (marginalist) theoretical and historical economics, which included certain members of both schools (e.g., Wieser, Schumpeter, and Hayek from the Austrian and Bucher from the Historical). Despite Weber’s (1975a) critical analysis of some “logical problems” of early historical economists (e.g., Knies and Roscher), and despite some neoclassical economists’ (Robbins 1998:244) approvingly calling it a “famous essay,” he saw himself as the member of the heterodox (Young) Historical School (alongside Sombart and Brentano, for example) rather than orthodox economics, and he adopted as valid many of the former’s objections against the latter. In this connection, some later Austrian economists (Lachmann 1992:43, n. 12) warn that to attach to Weber’s economic sociology any “intended relationship to the neoclassical orthodoxy of our own days would of course be grotesque.” Nevertheless, though some Austrians (Mises 1960; Schumpeter 1991) qualified him as an historical (or no) economist or an economic historian, that is, a member of the Youngest Historical School (with Sombart and Spietkoff, for example), Weber’s attitude toward neoclassical economics was more moderate and balanced than that of certain other members of the Historical school (e.g., Schmoller).

Notably, Weber to some degree influenced theoretically as well as methodologically the later formulations of the Austrian school, with some of its members even being fascinated (Swedberg 1998:204) in this regard. For instance, what was termed Weber’s *verstehende Soziologie* was reportedly a favorite topic of the Mises seminar (in Vienna during 1920–1934) that involved the second- and third-generation Austrian economists such as Hayek, Machlup, Haberler, Lowe, Morgenstern, and Rosenstein-Rodan, as well as Alfred Schutz (Swedberg 1998:302). Specifically, Weberian influences involve Wieser’s (1967) conception of social economy that sought to achieve integration between economics and sociology as part of Weber’s project. Both personally and conceptually, Weber was thus greatly instrumental in Wieser’s curious trajectory from a relatively narrow and staunch exponent of marginalism to a more open-minded social economist or economic sociologist (Swedberg 1998:89). Moreover, due to such influences during the 1910s, Wieser showed an increasing interest not only in the

sociological facets of the economy (Swedberg 1991:44), thus economic sociology. Wieser also was interested in general social theory (Swedberg 1998:287), as incidentally indicated by what Schumpeter (1956:301) terms Wieser's "great sociological book" on power (*Das Gesetz der Macht*).

*A fortiori*, Weber's impact was particularly pronounced in Mises' (1966) praxeology as some kind of general sociology within Austrian economics. In this connection, some neo-Austrian economists (Lachmann 1990:327) concede that Mises' praxeology, as a putatively universal instrumental theory of human behavior, conceived of as invariably pragmatic or rational, has essential origins in Weber's conception of social action, especially in the concept of instrumental, goal-oriented, or aim-rational action. In this connection, Mises' theory of human action seems no more than an extensive application of Weber's (1975b:33) dictum that economic theory (e.g., the marginal utility conception of subjective value) is "pragmatically" grounded by using ends-means categories.

Included in such Weberian influences are Schumpeter's (1949) comparative economic sociology, including fiscal sociology, the sociology of imperialism, and the sociology of enterprise and development (Swedberg 1991). In regard to the latter, some analysts (Carlin 1956) note that Schumpeter's entrepreneur represents a constructed type in the Weberian sense of ideal types. In particular, Schumpeter's heroic and supernormal entrepreneur (MacDonald 1965) appears as a special case of Weber's ideal type of a charismatic leader (Swedberg 1991:35)—that is, "personal capitalism" as a particular form of Weberian charismatic authority (Langlois 1998). Given these and other Weberian influences on Schumpeter (Swedberg 1991), the latter often is deemed Weber's greatest successor in the field of economic sociology (Hughes 1977).

Finally, some important Weberian influences also can be discerned in Hayek's later (institutionalist) economics, especially his implicit economic sociology and social philosophy. Thus, what some analysts (Parri 1999) call Hayek's involuntary economic sociology—perhaps given his hostility to sociology as a general social science—evinces many traces of or at least connections to Weber (as well as to Pareto and even Durkheim). On the one hand, the contributions of such a staunch orthodox economist to the field of economic sociology were probably unintentional (Parri 1999) in contrast to Weber (as well as to Durkheim, Pareto, Parsons, Simmel, and others) who, also originally an economist, made a conscious choice to enter the field. On the other hand, Hayek adopted or shared some key assumptions of Weber's economic sociology. First, while embracing methodological individualism, Weber and Hayek criticize and modify central neoclassical assumptions in light of the acknowledged fact of a socially embedded economy, and thus the social rather than the atomistic character of individual economic behavior. Second, both Weber and Hayek seem to abandon the abstract concept of *homo economicus* acting in a narrow

exchange realm in favor of the notion of a complex social actor having both material and non-material values and acting in a broader social context. Third, they both conceptualize the market not as a strictly economic mechanism but as a social institution underscored by entrepreneurial activities as particular forms of social action (here Schumpeter also can be mentioned), including what Weber (1977:98–99) termed “rule-governed behavior,” as later did Hayek (1991:368). Also, they both place in proper conceptual frameworks the influence of social institutions and forces, including the interventions of states and interest groups, on the economy, thus anticipating a major theme of contemporary economic sociology (Parri 1999). In addition, Weber probably to some degree influenced, perhaps via *verstehende Soziologie*, Hayek’s subjectivist epistemology. The latter particularly includes Hayek’s epistemological pessimism (Caldwell 1997:1871) regarding the possibility of discovering the existence of what Weber (1968:7) termed “non-understandable uniformities” or social laws and so on.

The preceding suggests that the later generation of Austrian economists, including Schumpeter and those participating in the Mises seminar, was extremely interested (Swedberg 1998:205) not only in Weber’s methodological ideas (e.g., *Verstehen* and ideal types) but also in his economic sociology and/or social, including political, economics (Lowe 1965). Moreover, an early Austrian economist like Wieser participated in Weber’s project *Grundriss der Sozialökonomik* (starting in the early 1910s) with a work entitled *A Theory of Social Economy* (translated as *Social Economics*), as did Schumpeter (with *Economic Doctrine and Method*), and later (in the 1920s), Hayek (with a work on monetary theory). Hence, Weber’s legacy in Austrian economics (Lachmann 1971) is much broader and substantive than just *Verstehen*, ideal types and other elements of his methodology.

Further, in substantive Weberian (1968:24–25, 85–86) terms, the principle of economic rationality (wealth accumulation) can sometimes be insufficient as an explanation of aim-rational (*zweckrational*) action itself, let alone its value-rational (*wertrational*), traditional, and emotional counterparts. This is because in a Weberian framework, instrumental, goal-oriented, purposeful, or rational behavior as such is a broader concept than economic action/rationality. In other words (Weber 1968:24–27), instrumental or formal calculative rationality (*Zweckrationalität*) is not exhausted by wealth-maximizing behavior, and neither is a *fortiori* value or substantive rationality (*Wertrationalität*). Since aim-rational or purposive behavior can be economic as well as non-economic, this suggests that one should not regard every instrumental or rational action as economic (Weber 1968:339). This implies a broad teleology of social action (i.e., a multiplicity of human purposes or engines of economic as well as social or non-economic character), which propels that action. And all of these can only by a reductionist logic be subsumed under a single economic motive, in-

cluding an all-purpose utility function, of which profit or wealth is usually seen as the main ingredient.

The fact that economic action/rationality is one of the forms of purposive behavior/rationality casts doubts on the frequent analytical mutation—in much of purist modern economics (Samuelson 1983:90–92) and rational choice sociology (Coleman 1990:13–19)—of the latter into the former (viz., the law of utility-profit maximization). Weber (1968:70) recognizes a major reason for the insufficiency of this law, in that the “development of rational economic action has been to a large extent determined by non-economic events and actions.” Such determination is indicated, for instance, by the salience of traditions in economic behavior. Thus, while economic activities can be matters of traditions and instrumental rationality alike, even in the second case the role of traditional orientation is “considerable” (Weber 1968:69). Hence, Weber would not be surprised that within much of neo-classical political economy, a social explanation of rational economic behavior often is more sensible or imperative than a purely economic account of all social action, including its economic mode. Alternatively, Weber (1949:44–51; 1976:183) would recommend that both the “one-sided materialistic conception of history” or orthodox Marxism and the “one-sidedness of the economic approach” or rational choice model be “emphatically rejected” on account of their economic determinism.

The preceding suggests that Weber’s theory of exchange can be invoked as a prototypical instance of the sociological theory of economic action (i.e., economic sociology, in particular, the economic sociology of the market). Generally, the distinctive mark of Weberian sociological analysis is its focus on the relationships between economy and society and thus its permeation by the idea of economic sociology as a study of these relations. Exploring the sociological relationships in the realm of economic exchange represents the key ingredient of Weber’s economic sociology or sociological economics (Knight 1958:17).

Particularly, two original elements separate the Weberian model of economic action, including exchange, from social exchange theory in contemporary rational choice sociology and pure exchange theory or catallaxy in orthodox economics. First, in the Weberian model, market-economic exchange is defined as an ideal type of social action in contrast to social exchange theory that construes the latter in terms of the former. Second, by regarding (market) exchange as a social-cultural rather than a universal and natural phenomenon, the Weberian approach rejects the naturalist, psychological, or pseudo-biological (under the euphemism of evolutionary psychology) treatment of exchange within neoclassical economics. This is made more apparent by briefly condensing Weber’s sociological theory of economic exchange or sociology of the market.

Weber specifies and implements the idea of economic sociology by analyzing the co-variation of the economy and society, including the polity and

culture, specifically multiple paths and forms of non-economic influences on the economy (Weber 1949:45). A paramount characteristic of Weber's (1968:63) economic sociology is treating economic phenomena as sociological categories, a treatment justified by the importance of social relations in the economic sphere. As such, economic sociology represents simply the sociology of economic action (Weber 1968:68), focusing on the overall economic importance of social structure (including the political order), culture, and historical conditions (Weber 1968:193). By virtue of this focus, Weberian economic sociology involves a comparative-historical, social-cultural analysis of the nature, structure and operation of the economy, including exchange processes.

## NOTES

1. Also there are interpretations of Weber as a rational choice theorist (i.e., of his views on the role of rationality in economy and society); qualifying or opposite interpretations also are found (Turner 2000).

2. In this connection, Mutti (1992) proposes an integration of economic theory and economic sociology (e.g., positivistic and sociological arguments in new Keynesian macroeconomics), centering on social issues such as uncertainty, inter-organizational negotiations, asymmetrical information, power, trust, and social expectations. In such an integration, economic sociology would have to, it is urged, operate within the "system of instrumental actions, with well-informed, optimizing actors," and interact with economic theory at substantive-institutional, historical, and concrete levels.

3. Relatedly, Dubois (1996) analyzes the relations between economic or constructivist sociology and institutionalist economics in France and finds a consensus about the basic assumptions (with some remaining differences)—for example, a plurality of action ends and values. However, economic sociology is suggested to pay more attention to the nature of power and sources of social hierarchies.

4. In the view of Ritzer (1989), economic change or the permanently new economy in recent years provides a strong need for the revival of economic sociology focusing on the relationship between the economy and other social institutions.

5. In general, Durkheim considers economic phenomena, including exchange, subclasses of social facts based on the assumed association between the first and social representations, institutions, and values. Thus, for Durkheim, economic behaviors and activities are social facts once they have acquired a moral character and are institutionalized. Notably, Durkheim views economic exchange as being grounded in socially determined values and ultimately resulting in economic justice, in opposition to traditional economic theory (Steiner 1992).

6. The nature of the economy as an interactive system suggests the need for what is termed *social interaction economics* (Gallegati and Kirman 1999) as an alternative to pure economics.

7. However, whereas some economic sociologists (Lie 1991) maintain that Polanyi excludes social relations from his concept of market exchange, others (Laville 1997a) argue that Polanyi is far from negating the embeddedness of market transactions themselves in networks of interpersonal relationships.

8. Using different terminology, some economic sociologists (Laville 1997b) propose embedding economic poles (*viz.*, market, nonmarket, and nonmonetary) as functional equivalents to the modes of economic exchange in social associations. The latter's role and involvement in economic exchange is deemed to confirm the relevance of its embeddedness in social associations for the discipline of economic sociology (Laville 1997b).

9. Some rational choice theorists (Montgomery 1998) propose what is called a role-theoretic conception of embeddedness based on a repeated-game model with the players being, instead of individuals, roles (e.g., profit-maximizing businesspersons and nonstrategic friends). For instance, profit-maximizing roles involve strategic acts in light of metarules governing "intrapersonal role switching." By assumption, rational choice theory construes social relationships as repeated strategic games (Montgomery 1998) between profit-maximizing players, thus ruling out the possibility that relationships also can be established and maintained for non-instrumental purposes, even within economy organizations and the economy overall (Granovetter and Swedberg 1992; Podolny and Baron 1997).

10. In the context of economic exchange, a social network has sometimes been described as a "nonhierarchical contracting relation in which reputation effects are quickly and accurately communicated" (Williamson 1991:291).

11. Granovetter and Swedberg (1992) and earlier Parsons (1937) note this path of convergence between Weber and Durkheim.

12. As Bendix (1977:64) states, Weber's essay on Protestantism and capitalism "does not deal with the problem of causal imputation, except incidentally." Bendix also expressed serious misgivings about the functionalist interpretations of Weber, as found in Parsons (1937) and others.





## *Chapter 2*

# *Applying a Sociological Approach to Economic Exchange*

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### GROUNDING ECONOMIC EXCHANGE ON SOCIAL ACTION/STRUCTURE

In the following section we outline a distinctive approach to exchange transactions, which is premised upon a sociological theory of economic behavior (Weber 1968:68). For that purpose, first we undertake the analytical reconstruction of market-economic exchange on social factors (i.e., social action and human agency in society) and contrast this with reducing all social action to economic transactions pursued in (rational choice versions of) social exchange theory.

A peculiar characteristic of social exchange and other rational choice theorists is that they “do not always theorize exchange rather than explaining markets and exchange, they employ markets or exchange to explain social and economic life [neglecting that] market theories are not the same as theories of markets” (Lie 1997:343). If these theorists propose grounding social exchange or human action on market principles, a neo-Weberian approach attempts the opposite. This is the conceptual founding market-economic exchange on sociological principles as a distinctive feature of a theoretical-empirical economic sociology (Weber 1968:78–79), especially the economic sociology of the market (Boulding 1970:153). Weber’s analysis of the sociological categories of economic action or sociological relationships in the economic sphere is a classical attempt to analytically build market-economic exchange on social principles. His analysis involves no efforts to ground social action on exchange principles or economic factors, as shown by Weber’s rejection of the economic approach to social action and the materialistic conception of history being one-sided.

In general, the neo-Weberian approach proposed engages in an inquiry into the social character and organization of market-economic transactions rather than their intrinsic nature and operation. Such an approach thus distinguishes itself from the purely economic theory of exchange or catalactics with its exclusive focus on this inner logic. It also differs from social exchange/rational choice theory that extends catalaxy to non-economic spheres by using the concept of exchange to depict and explain other social phenomena as exchange. Thereby the procedure of sociological grounding to the phenomenon of market-economic exchange transcends both the view of these as extra-social phenomena and the dissolution of all social action into such exchange. Such a procedure transcends standard economic theory by treating this phenomenon as being socially situated and structured. Thus, in contrast to “unsympathetic isolation abstractly assumed in Economics” (Edgeworth 1967:12) and the resulting view of the economy as an “isolated instantiation” of society (Fararo 1993), the procedure is premised on the conception of the social construction and structuration (embeddedness) of economic behavior in general and exchange in particular, including both interorganizational and consumer transactions.

Thus, such grounding treats exchange transactions as total social phenomena<sup>1</sup> insofar as the circumstance that actors resort to these transactions is far from being a simple economic fact (Simmel 1990:54). Hence, grounding exchange on sociological principles transcends rational choice theory, including its social exchange version, by attributing to the non-economic types of social action an autonomous structure (Weber 1968:341). The rationale for this autonomy is that these types of social action are subject to their own laws (Weber 1968:341) in relation to economic action/rationality, including exchange.

The conceptualization of exchange processes, as proposed by the neo-Weberian economic sociology of markets, is an interdisciplinary endeavor (i.e., no-man’s land, and every-man’s land) (Schumpeter 1954a:139; Simon 1982:391), though not a kind of virgin island, as sometimes implied (Coleman 1994). It integrates theoretical insights and empirical findings from both sociology and economics. It is thus historically and empirically grounded in that it conveys a knowledge of concrete reality, of the general cultural significance of the socioeconomic structure of modern and traditional society (Weber 1949:69, 72). Such a conception contrasts with the unrealism and abstraction in the economic theory of exchange (and rational choice models of social exchange), namely, that exchange emerges and operates smoothly without any prolonged effects of extra-economic conditions (Hirschman 1982:1473). This conception seeks to do justice to a complex economic reality (ontology) in which social phenomena affect economic actors and activities (Weber 1949:45). It thereby adequately expresses the pertinence of the social framework of the economy (Schumpeter

1949:60), especially of those institutions and related societal forces shaping individual economic behavior<sup>2</sup> (Schumpeter 1956:134).

On the other hand, this inquiry into the social constitution of the exchange economy highlights the sociological problems in the economic theory of exchange (Wieser 1967:153) as well as of the rational choice (e.g., expected-utility maximization) model of extra-economic exchange (Macy 1995). The rationale for grounding exchange transactions on sociological principles is given by the fact that these, just as all economic phenomena, are constantly influenced by social, including political and cultural, forces (Schumpeter 1951:113). Exchange transactions, including exchange rates or prices, are evidently social phenomena (Schumpeter 1951:19) by being results of social relations (Wieser 1967:153–54), namely, power constellations (Weber 1968:108–9) and various extra-economic regulations.<sup>3</sup> At this juncture, exchange value appears as social value (Durkheim 1964:382) in the sense of being the outcome of social relations rather than a mere reflection of scarcity and utility independent of such relations, as assumed by economic theory.<sup>4</sup>

In general, the guiding idea is, as Pareto (1963:1406–8) put it, that in sociological analyses of economic phenomena such as exchange, one shall consider not only these phenomena but the whole social setting of which these are only elements or phases. In such analyses, then, the economic problem would be subordinate to its sociological counterpart (Pareto 1963:1406). This necessitates and justifies treating economic exchange as a particular form of social action (Weber 1968:66–67) and interaction (Simmel 1955:61–62) versus the rational choice status of the latter as extensions of the former (i.e., as social exchange). Particularly indicative in this respect is Weber's (1968:66) definition of economic behavior as a form of social action that, in its subjective meaning, is oriented toward the satisfaction of desires for goods or utilities (Weber 1968:66). Notably, economic exchange, including competition, can be redefined as a peculiar form of social interaction (Simmel 1955:61) rather than construing the latter as exchange and competition.

A neo-Weberian economic sociology of the market, by exploring social variables in exchange transactions, is based on the fact that these implicate and are implicated in the total society<sup>5</sup> (Boulding 1970:153–55). In this connection, a sociological analysis of exchange variables (e.g., supply, demand, price) can constitute a basis, rather than being a nuisance, to a purely economic theory (Myrdal 1953:187–88). This is justified by the salience of the social (and psychological) configuration of these variables (Sombart 1932:65) and other extra-economic factors in exchange. Hence, the latter is better treated as a particular form of human social action, not natural behavior driven by innate propensities, as seen in pure economics (and behaviorist sociology). Such a treatment also contrasts with regarding social action as an extension of economic-style exchange and thus of society as a

universal marketplace, which highlights the one-sidedness of the strident economic approach to human behavior (Weber 1949:75), including rational-choice models of non-economic relations.

From a sociological viewpoint, the market is not just an exchange mechanism but also a complex social structure, that is, a set of consociations among social actors, based on domination by virtue of constellations and conflicts of interests (Weber 1968:939–40). Hence, exchange is in essence a special case of social action, with not only formal or calculative rationality but substantive or extra-economic rationality (Weber 1968:638–39). The basis for such characterization lies in that any act of exchange that involves the use of money represents social action, since money obtains its meaning or value from its relations to the actual or potential actions of other actors (Weber 1968:636). Thus, the field of economic sociology includes the sociological factors and consequences of the use of money in exchange (Weber 1968:78–79). Relatedly, the laws of exchange, such as the law of supply and demand, the law of equilibrium price, the iron law of wages, and so on, can more plausibly be characterized as socially constructed and sanctioned maxims for action, not as natural laws (Durkheim 1966:26). This implies that the market is a definite social structure with certain functions, for example, a permanent distributive apparatus of society allowing a regular series of frequent exchanges (Spencer 1969).

In epistemological terms, such laws of exchange represent ideal types (i.e., synthetic constructs, abstractions, or typifications of concrete historical-empirical phenomena). Weber demonstrated this for the Gresham's law, implying that economic rationality is an empirical generalization of action or an ideal type rather than a law in the sense of physical science. In response, some neoclassical economists (Mises 1960:192) disputed this view by arguing exactly the opposite, namely, that the rational economic actor (*homo economicus*) is an actual social universal expressing human nature.

Overall, the exchange economy constitutes an element of the social system that is broader and more complicated (Pareto 1963:1442). In consequence, non-economic interactions (social contracts) are more complex in relation to economic exchange or deals by being permeating by a rationality with a higher complexity (Blau 1993:35, 61). As a subsystem of society, the economy is differentiated on the basis of its function, namely, adaptation of the social system (Parsons and Smelser 1956:15; see also Munch 1990). The economy as the realm of exchange is then necessarily implicated in the socio-sphere as the most complex domain (Boulding 1970:155) and thus in society as the only or largest self-sufficient (Barber 1993) and self-referential social system (Luhmann 1995). Since the exchange realm is involved in and involves society, purely economic models have limited value (Boulding 1970:153). This holds true especially in relation to a neo-Weberian sociological approach, which emphasizes the social character,

structure, and operation—or simply sociologics—of economic exchange. Such contrasts between purely economic models of exchange and a sociological approach are illustrated next.

## **ECONOMIC ANOMALIES OR NORMAL SOCIOLOGICAL PHENOMENA?**

The distinctive nature of the social-cultural grounding of exchange transactions is revealed by its treatment as empirical generalizations or normal phenomena of what economics and rational choice theory call exchange anomalies or paradoxes. These represent inversions or exceptions of the putatively universal economic laws of exchange, especially the law of supply and demand. Such paradoxes include the Giffen paradox, the Veblen paradox, and the paradox of labor supply.

For example, the so-called Giffen paradox involves a positive correlation between price and demand—the higher the price, the higher the consumption, especially for those goods (necessities such as bread, salt, cereals, etc.) consumed by lower classes (Jevons 1965; Marshall 1961). Thus, as reported by Marshall<sup>6</sup> (1961:109–10), investigating historical consumption patterns in England, Sir Giffen (a nineteenth-century British aristocrat) first observed that in some situations the rise of the price of goods of first necessity, such as cereals, bread, or salt, did not cause the demand for them to fall but rather to increase, which implies a positively sloping demand curve. (In passing, Giffen made these observations in his memorandum on the “Real Agricultural Development of the Last 20 Years.”)

From the stance of the law of supply and demand, this tendency implying a positively sloping demand curve is clearly paradoxical or anomalous, as the law postulates exactly the opposite. As suggested by Giffen, the explanation for this tendency lies in the fact that the rising prices of goods of the first necessity drained the material resources of the lowest social classes so that they were unable to convert their consumption pattern from these to goods of the higher order, such as meat and dairy products (Marshall 1961:109). Moreover, the consumption of the existent substitutes for goods of the first order was reportedly reduced as the result of the increased price of bread. Such price increases exhausted these classes’ resources, thus increasing the marginal utility of money for them, forcing them to reduce the consumption of goods of the higher order, which might have otherwise been substitutes for lower-order goods (Marshall 1961:110). Presumably, since the paradox pertains to inferior goods (Hicks 1961:35–36), it would be of relatively limited occurrence in an exchange economy. However, if there is a generalized inferiority of goods, one can have a generalized Giffen paradox (Samuelson 1983:163). To that extent, what has been a paradox, a rare exception, or an anomaly becomes an empirical generalization, rule, or normal phenomenon. In any event, the ghost (Prest 1948:60) of the

Giffen paradox reverses the negative relationship between price and demand implied in the law of supply and demand.<sup>7</sup>

The same reversal between price and consumption is found in the Veblen paradox or effect, though this pertains to the ostensive expenditure (Hicks 1961:56) of goods with snob appeal (Samuelson 1983:117). The Veblen paradox essentially consists in the relationship of conspicuous or ostentatious consumption to the price of the goods consumed. Whereas the Giffen paradox pertains to inferior goods, the Veblen paradox refers to superior goods or goods of the higher order. Specifically, the Veblen paradox involves a positive correlation between conspicuous consumption or luxury demand and the prices of such goods, with the first increasing as the second rises, and vice versa. Alongside conspicuous consumption, Veblen (1934) used some other terms to characterize this phenomenon, such as differentiated consumption or differentiation in consumption, honorific consumption, punctilious consumption, wasteful consumption, ostensible consumption, invidious comparison in opulence or invidious consumption, emulation in consumption, consumption of expensive goods, canon of reputability in consumption, and so on. In contrast to the association of the Giffen paradox with lower social classes, the Veblen paradox is mostly associated with their higher counterparts, namely, the leisure class (and its mutants at the various levels of social stratification), defined by conspicuous consumption and manifest abstention from productive work.

Veblen's effects are generated when certain luxurious goods are objects of conspicuous consumption because of the social construction of their scarcity and high value (the margin of expensiveness) rather than their superior quality for want satisfaction, that is, functionality, instrumentality, or utility (Bagwell and Bernheim 1996). In Veblen's picture of the leisure class, its members tend to avoid consuming inexpensive goods, goods whose prices have fallen, or mass-produced goods in favor of their opposites, all according to the self-imposed rule that a cheap product makes a person "cheap." As such, the Veblen paradox or effect entails a radical inversion of the economic law of supply and demand, which posits that luxurious (or, for that matter, any) consumption/demand should decrease with rises in luxuries' prices, not increase, as in a Veblenian framework.

In addition, Veblen's (1919:73) framework suggests that most people are not lightening calculators, as portrayed by received economic theory, but rather human creatures, that is, flesh-and-blood *dramatis personae* acting in the state (or on the stage) of society, not emanations of an "one-dimensional, anemic homo economicus" (Bowles 1998:68). At best, even perfectly rational actors (hedonists) would admittedly stop calculating at the point at which the costs outweigh the benefits (Clark 1918:25; see also Knight 1964).

Another less known market-economic paradox involves an inversion of the law of supply to the effect that there is a negative (rather than a posi-

tive) correlation between price and supply, for instance, of the labor force. Thus, increases in wages can result in a lower, not a higher, supply of labor, because of the perceived higher marginal utility of leisure than that of extra income, especially during periods of already high wages (Wicksell 1934: 96–97). Hence, the paradox of leisure versus working time also can describe this situation.

En passant, to some degree, exchange speculation, defined by Keynes (1960:379), for example, as the “activity of forecasting” the psychology of the market, can be deemed a paradox in that it reverses the operation of both the law of supply and the law of demand. Such reversal occurs because of the presence of rational expectations (or sophisticated costly prediction strategies) as well as quasi- or non-rational (or naïve) expectations that present processes will continue in the future, though such beliefs can be updated in light of historical and present evidence, for example, evolutionary “fitness” measures such as past realized profits (Goeree and Hommes 2000). For instance, present increases in prices can increase rather than diminish demand, or decrease rather than increase supply. This is paradoxical from the viewpoint of the law of supply and demand, but is the effect of the expectation that such increases will continue in the future. Speculation is thus underscored by expectations concerning the present and prospective prices of goods and assets, which tend to be self-fulfilling (i.e., instrumental in generating exchange outcomes) (Conlisk 1996). In this sense, not only equilibrium, as assumed by economists (Marshall 1961; Mises 1966; Phels and Zoega 1997), but also disequilibrium (e.g., lack of aggregate demand) in exchange can be an outcome of self-fulfilling expectations, as witnessed by the Great Depression (Merton 1968). Despite the opposite assumption of the rational expectations theory, expectations are not necessarily rationally or accurately grounded on strong-form rationality (Gartner and Wellershoff 1999) but also pseudo-rationally or inaccurately based on weak-form rationality. This is so given their dependence on full knowledge of an economy (even the world at a time of globalization), something that is difficult or too costly to attain (Conlisk 1996).

In any event, while for most economists Giffen’s, Veblen’s, and other reversals of the law of economic exchange are anomalies or paradoxes,<sup>8</sup> this is not necessarily so from a sociological perspective. Far from being just unimportant exceptions to a universal law of supply and demand (Hicks 1961:35), these paradoxes, especially Veblen’s paradox (as well as the paradox of leisure), may be relevant economic and social phenomena. For example, if a sociological perspective observes social prestige as a major incentive of economic exchange in relation to which wealth and other materialistic ends (Mueller 1996:346) are just means (Robbins 1952:145), then the Veblen paradox may turn out to be the rule rather than the exception of an iron law of supply and demand. With regard to the latter, one can, moreover, argue that no real law of supply and demand can be



derived from the statistics of quantities and prices but only a law of ideal phenomena (Pareto 1932:1595–96), and thus an ideal type in Weber's sense or empirical generalization.

Thus, no Veblen paradox violating all-ruling exchange laws exists, because to assume that seeking what Weber called social honor through exchange transactions is paradoxical or anomalous would be counterfactual from a sociological standpoint that observes the "quest for status" as a major facet of human, including economic, behavior (Frank 1985). Apart from the classical Veblenian-Weberian demonstration of such a *non-paradox*, this is suggested by recent findings reporting the dominance of social status versus materialistic considerations in economic behavior (Bakshi and Chen 1996; Bagwell and Bernheim 1996) as well as in non-economic life (Aschaffenburg and Maas 1997).

No doubt, Veblen effects appear as pathologies or paradoxes, as they are completely irrational, abnormal, or not amenable to rationalization within the framework of standard economic theory. In the frame of reference of neo-Weberian economic sociology, however, they seem rational in the sense that they tend to be "naturally rationalized" (Bagwell and Bernheim 1996) in terms of concerns for social prestige or approval as the normal human desire (Frank 1996). Thus, the Veblen's paradox may turn out to be no paradox at all, insofar as it merely does justice to the fact that economic agents are simply human, something that is admittedly often forgotten, lost, or neglected in mainstream economics (Thaler 1991:3), which qualifies any observed behaviors deviating from their axioms as anomalies or paradoxes. Alternatively, abandoning the preconception that assumptions (*viz.*, those implied in the Veblen paradox), that deviate from the premises of *homo economicus*, rationality, or self-interest are methodologically illicit can free economists to estimate the validity of these heterodox assumptions with the identical standards that they use to evaluate their cherished premises (Rabin 1998:41).

The same can be said of the so-called labor-supply or leisure paradox. The latter may not necessarily be a paradox but rather a normal or rational behavior if economic actors at some points (of their labor-supply curve) prefer leisure and consumption to work and earning extra income. In other words, they can have stronger habits in leisure and consumption than in work and wealth acquisition (saving) as a result of which their labor input (and consumption) is counterfactually smooth in time and even counter-cyclical (*e.g.*, decreasing during the good times of high wages and increasing in the opposite case) (Lettau and Uhlig 2000). In comparative-historical terms, this is indicated by the long-term or secular (Fogel 1999) trend toward a decrease in working time and a corresponding increase in residual or leisure time in advanced societies.

Data indicate some tendencies in working time among selected developed countries relative to the United States as a benchmark over a three-decade

period, from 1960 to 1989 (Dougherty and Jorgenson 1996). For example, in 1989, only Japanese worked longer than Americans, just as in 1960 only Canadians (and Italians) worked less than Americans. Today's hard-working Americans would be perhaps surprised to find that four decades ago they worked less hard than most developed nations. This points to some major shifts in the working time level in the United States, a change that is, however, comparatively and historically opposite to the general tendency in this regard. Reportedly, there has been a consistent tendency among major industrial societies, except in the United States, toward decreases in labor hours (per capita) and thus toward increases in non-working hours. For illustration, in 1960, German workers had almost one-third more labor hours per capita than American workers, but in 1989, the former's hours were less than the latter's. The same overall tendency toward an increase of leisure can be observed in France, the United Kingdom, Italy, and probably most other European (especially welfare-state) societies.

Next, there exist evidence and estimates for secular trends in time use (the average hourly division of the day) pertaining to industrial society as a whole from 1880 to 2040 (Fogel 1999). Thus, the share of work in the average hourly division of the day has fallen dramatically in the industrial world between 1880 (8.5 hours) and 1995 (4.7 hours) and is expected to be lower in 2040 (3.8 hours). On the other hand, the corresponding share of the residual for leisure activities has increased substantially during the 1880–1995 period (from 1.8 to 5.8 hours) and is estimated to be greater in 2040 (7.2 hours). Notably, in recent years (1995), work has a smaller share (4.7 hours) in the average hourly division of the day than does leisure (5.8 hours), and such a condition is predicted to further intensify in the future: in 2040, for example, work's share in the day would be about half (3.8 hours) of that of leisure (7.2 hours). This is reflected in the secular trend toward changes in the lifetime distribution of time (i.e., toward a reduction in lifetime earn-work hours and an increase in lifetime voluntary or non-working, including leisure, hours).

Reportedly (Fogel 1999), lifetime earn-work hours have considerably diminished (from 182,100 to 122,400), and lifetime voluntary hours increased fourfold (from 43,800 to 176,100) within the lifetime distribution of time during the 1880–1995 period. As a result, while lifetime earn-work hours were more than four times higher than lifetime voluntary hours in 1880, they were significantly lower (about 54,000) one century later. Such trends are predicted to continue in the future to the effect of lifetime earn-work hours falling to less than one-third (75,900) of lifetime voluntary hours (246,000) in 2040.

Comparative data (Organization for Economic Cooperation and Development, or OECD, employment outlook) for annual hours per worker in developed countries in 1996 complement the picture. If the United States

is taken as a benchmark, these data indicate that annual hours per worker in most developed countries in 1996 were less than U.S. hours, and thus tended to fall over time in most of these countries because their hours were closer to U.S. levels in previous periods. The same can be said of total labor supply obtained by combining measures of active population and working hours. More precisely, total labor supply is calculated by multiplying the ratio of the employed to the total population and total hours worked as a percentage of the maximum number of hours (2040) per year. Comparatively, as one might expect, only Japan features a higher level of total labor supply than the United States, due to the former's higher employment/population ratio and the higher percentage of hours worked relative to the latter.

Generally, the higher the employment/population ratio, the higher the total labor supply, and vice versa. On the other hand, the lower the percentage of hours worked of the maximum annual hours, the lower the total labor supply, and vice versa. This explains the relatively low figures for the total labor supply of some European countries with high employment/population ratios and the low numbers of hours worked. For example, Sweden has the second highest employment/population ratio, yet its total labor supply is among the lowest due to its low percentage of hours worked of the maximum yearly hours. The almost identical pattern of relations between their employment/population ratios, their percentages of hours worked, and their total labor supply can be observed for Switzerland, Germany, Norway, and Austria.

In this connection, comparing the maximum possible annual hours per worker to the actual hours worked gives the total amount of leisure time, including a rough measure of the length and number of holidays, in various countries. Such differentials indicate that the American population has, on average, shorter leisure time (or fewer holidays, official and unofficial) than any other country (besides Japan and Portugal). Thus, the U.S. differential (of 100 hours) is the lowest among OECD countries (with these two exceptions). Comparing across countries, the difference in annual working hours between, for example, the United States and Norway (510 hours) suggests an equivalent difference in leisure in favor of the latter country. Such differences also can be observed by comparing in these terms most European countries. The differences in annual working hours are salient not only between different types of capitalism (European and American) but between instances of the presumably same type (North American) of capitalism. For example, at comparable levels of economic development and standard of living, Canada's annual working hours in 1996 were less than those of the United States. On the other hand, among the European countries, only Portugal and Spain were outliers in regard to annual working hours. Since these two countries are not at comparable (high) levels of development and living standards as other European countries (within the

European Union, or EU), their being outliers conforms with the hypothesis that the average working time decreases and leisure increases with economic development, especially technological progress. Hence, one can predict that as these two countries, just as others such as Greece and the East European countries, approach the level of economic development and living standards of the West Europeans, they will exhibit convergence in terms of working/leisure time with the latter.

The question may recur as to why the United States does not display this kind of convergence with other developed countries. Some authors suggest the general answer in what they call American exceptionalism as a double-edged sword (Lipset 1996) in economic as well as political and social terms. Particularly, due to a conjuncture of factors operating especially since the early 1980s, such as the declining real income by 13 percent and sharply increasing distributional inequality (Gottschalk 1997), Americans now work harder than most developed nations, albeit they worked less so than the latter several decades ago. This would suggest that in the 1980s and 1990s, American workers (the middle class) invested more labor to achieve a lower standard of living, or at best to retain the previous level, than before. In retrospect, such a reversal in the working/leisure time ratio and its relationship to real income is probably unprecedented in recent economic and social history, with distant and indirect parallels in the surging ahead and falling behind of the first industrial nation, Great Britain (Crafts 1998:193). Generally, the trend for the majority of developed countries is toward an increase in the total leisure/working time ratio in relation to the United States and thus in historical terms, given their prior convergence with the latter.

Hence, apart from American exceptionalism this general tendency toward working less and having more leisure time can express the increasing incremental valuation (or marginal utility) of leisure on the part of social actors in relation to the valuation of extra work and additional income. In Weber's terms, actors attribute definite and divergent subjective meanings to extra leisure and extra income, respectively. If so, then no paradox of labor supply exists. It is normal or rational for people to offer less services (work less hard) in response to increased labor prices during times of high wages if they impute lower subjective valuations to extra income than additional leisure.

Moreover, given the physical, psychological, social, and other limits to profit optimization and thus the self-defeating tendency of an "irrationally rational passion for impassionate calculation [rationality]" (Clark 1918: 24), by working hard the opposite behavior of invariably preferring work or income to leisure would be a paradox. Even when able to overcome these limits, and thus to transform Simon's bounded rationality (satisficing) of human actors into the absolute rationality (maximization) of *homo economicus*, those behaving in this manner would resemble rational fools (Sen

1977) or foolish rationalists (DiMaggio 1990). This is because such rationality ultimately mutates into its opposite, hyper-rationality qua irrationality (Elster 1989b:9; Schumpeter 1951:173–78). This is *a fortiori* true of leisure when conjoined with status as well as power and related pursuits on which it is spent, which indicates linkages between the labor-supply paradox and the Veblen paradox. Such links are exemplified by the prestige-driven behavior of Veblen's leisure class and Weber's status (by assumption, leisured) groups, with their various modern equivalents and proxies.

## THE CONCEPT OF SOCIAL EXCHANGE REVISED

In the ensuing discussion we elaborate more on the reasons the concept of social exchange should be treated as a metaphor in an empirical economic sociology (Lie 1992), including a realistic political economy (Krugman 1997). As mentioned earlier, in this work we specifically understand the concept of exchange in the sense of economic transactions. This is because the notion of social or non-economic exchange is ill defined, imprecise, and even tautological. For one thing, exchange processes involve definite exchange objects (or media) and exchange rates (prices), as in exchange transactions. But these components are either absent or difficult to accurately determine in non-economic relations or social exchange. For example, while economic exchange involves well-specified exchange rates or prices as determined by the supply and demand of a given exchange object (commodity or input), this is not the case in the social exchange of a non-economic character. In this latter case, there is no equivalent mechanism, namely, a market in the proper sense, to determine exchange values, as research reports (Fiske 1991:374).

This casts doubts on attempts at determining exchange value in social exchange, based on metaphors or questionable analogies with values or prices in economic exchange. For example, some advocates (Emerson 1987) of the economic analysis of non-economic phenomena made ambitious endeavors to advance a theory of value in social exchange. This and similar endeavors are based on various analogies with the economic theory of exchange values or prices, by importing (Macy 1995) and then applying its basic notions to non-economic exchanges (*viz.*, marginal utility, marginal productivity, total utility maximization, commodity and factor substitution or complementarity, the marginal rates of substitution or transformation, demand/supply elasticity, price flexibility, etc.) (Hicks 1961; Samuelson 1983). For example, just as in economic theory, the ratio of the exchange value of a social good, an exchange, or an actor to another—and thus the ratio of their marginal utilities—is defined as the inverse of the marginal rate of substitution between the two goods. Various sequels of such efforts (Yamaguchi 1997) associate exchange value in social

exchanges with, say, the substitutability/complementarity of an actor's multiple exchange relations.

Now, to the extent that exchange values and objects are fictitious or metaphoric in non-economic interaction, social exchange can be treated as a non-entity from the perspective of an empirical and a comparative-historical economic sociology. For these reasons, the term *social exchange* should at best be used as a metaphor or an analogy, and in most cases is of low usage for theory construction and empirical research (Knoke 1988). The terms *non-economic relations* or *social interaction*—which may or may not involve exchange transactions—seem more appropriate in this regard. Moreover, the use of social exchange may give the misleading impression that social life is just an exchange of objects and rewards, an economic reductionism to which a plausible theory cannot subscribe. The same can be said *ceteris paribus* of non-economic extensions of originally economic concepts, such as social capital or income, psychic income or profit, political, religious, and marriage markets, the price of spouses and children, and the like. For instance, as regarding the extensions of the concept of exchange to non-economic fields, observers point out that such extensions are wrong in at least two respects: the metaphorical market is a defective metaphor committing the fallacy of *argumentum ad populum*, and even the actual business market has never been the arbiter of excellence in literature, art, music, science, scholarship, and truth and beauty (Yeager 1997:161). Apparently, such non-economic markets are metaphors and analogies rather than substantive concepts to guide theory building and be operationalized in empirical analysis.

Exchange in the sense of a set of economic transactions tends to be characterized by some calculation (including accounting), albeit the rules are typically socially, and even politically, defined (Carruthers 1996; Carruthers and Espeland 1991; Fligstein 1996a). However, social exchange does not have such calculative properties. In their ideal-typical forms, economic exchange is an instance of Weber's instrumental, calculative action and formal rationality. In contrast, social non-economic exchange often is a form of value-rational action and value or substantive rationality, including symbolic action (Burns 1990) and interaction (Singelman 1972).

At this juncture, social exchange theory in sociology appears even more inadequate than the neoclassical theory of exchange or catallactics, of which it purports to be an extension to non-economic relations construed as exchange transactions. This is because of the failure of social exchange and generally rational choice theory to precisely define the criterion of quantitative ends (Sciulli 1992), for example, utility, profit, or gains in exchange, borrowed from neoclassical catallactics. Unlike the latter's demonstration for exchange, the former is unable to show, beyond simple analogies, that calculation or quantification is feasible in social exchange. Thus, economic variables such as cost-benefit, profit, income, money, capital,

price, and the like, which are easily ascertained in exchange transactions, are so poorly specified in social exchange that they are no more than metaphors and are often meaningless.

For example, the predominant economic origin and nature of the phenomenon of capital are indicated by the relatively recent historical fact that in medieval Italy and the rest of Europe the capital concept evolved out of the property of the firm (*corpo della compagnia*) (Weber 1927:228). To be more accurate, in its original meaning, the word capital (*capitale, de caput*) designated the principal of a loan in money (*capitalis, pars debitis*) as different from the return accruing to that loan, thus being synonymous with a sum of money yielding interest (Böhm-Bawerk 1929:31–32). At this juncture, one can distinguish private and social capital in that the first is a lucrative capital and the second a set of goods serving as a means to obtain other commodities or as productive implements in a subsequent production, thus composed of intermediate products (Böhm-Bawerk 1929:71–75). In other words, private capital represents a sum of economic valuables invested (rather than consumed) for the sake of individual profits (capital-value) and social capital, a stock of material assets used in future production, not consumption (capital-goods). Like classical political economy, Marx (1967:156–66) defines capital as a stock of the means of production (industrial capital) or a sum of monetary values (financial capital) used for further production or for surplus value (including profits, interest, and rent), and to that extent as a strictly economic category. Marx's distinction between individual and social capital applies this generic definition, the first being profit-seeking capital and the second the aggregate of individual capitals. Moreover, Marx (1933:27–28) treats capital as being embedded in and constituted by social factors by also defining it as a social relation of production (more precisely, a “relation of production of bourgeois society”) rather than as solely an economic variable, given that it is not merely a sum of material goods. In retrospect, since this treatment of capital and other economic variables is a major proposition of economic sociology or sociological economics, on this account Marx can be deemed an economic sociologist or a sociological economist like Weber.

The discussion so far suggests that if one uses the term *capital* in a non-economic or non-financial sense, such as social capital as a (non-monetary) sum of social ties and networks, it is to resort to metaphors or analogies. Such usage is characteristic of rational choice theorists (especially Coleman et al.) as well as other sociologists (e.g., Bourdieu), with the difference that the first argue that such social capital is really capital by being employed for economic purposes, while the latter view it mostly as a useful metaphor or a convenient/fashionable term. Thus, the initial (cf. Portes 1998) metaphorical usage often has misled economists and rational choice theorists to treat social capital as more than a metaphor, but like economic capital a means of making (financial) profits. In general, one can object (DiMaggio

1979:1468, in reference to Bourdieu) that the various concepts of extra-economic capital (political, cultural, social, symbolic, etc.) have become weak figures of speech rather than potent and precise tools of analysis. In particular, this seems to apply to the usage of the concept of (social) capital in rational choice theory, with its admittedly puzzling tendency to refer to virtually all social features as forms of “capital,” thus seeking to expand “capital” types (Baron and Hannan 1994:1124). Such tendencies involve misapplying in social domains beyond the economy the orthodox economic premise that all capital is used to yield net income, profit, or interest (Böhm-Bawerk 1929:95).

In another example, the concept of social profits is no more than a metaphor pertaining to symbolic goods such as title, honors, and (generally) social esteem<sup>9</sup> (Wilson and Musick 1997:696–97), rather than the material gains resulting from the differential between total benefits and total costs. The same can be said of implicit markets, such as marriage, political, religious, or intellectual markets, since these are not markets in the strict sense. As leading economists (Arrow 1997:761) admonish, many of those (marriage, political, religious, and other) markets conceptualized by the advocates of the economic approach to human behavior are not literal markets but analogies or metaphors. This is because the (economic) market is one phenomenon, society, including polity, another to which the concepts of the former, including exchange and cost-benefit ratios, cannot be so easily applied. In fact, such applications can offend intuition, reason, and evidence<sup>10</sup> (Arrow 1997:765). Political and related social processes are largely non-economic in character and cannot be subsumed under the heading of market-like exchange.<sup>11</sup> Overall, the hallmark of non-economic interaction or social exchange is reportedly (as reported for reciprocal exchange or gifts and related social relations in some developing societies by Kranton 1996) its basis in influence, prestige, social networks, and related non-economic categories rather than in exchange transactions driven by profit.

Economic exchange and social interaction differ essentially in terms of both comprehensiveness and character. As some classical sociologists (Simmel 1990:82–90) demonstrated, social interaction is a more comprehensive notion and economic exchange is a narrower notion. This precludes any reduction of the former to the latter as done by current exchange theory. Instead, it suggests that economic exchange as well as non-economic exchange is a special case of a process of social interaction controlling it (Boudon 1981:91). At this juncture, economic exchange can be conceived of as a form of social interaction with definite social actors operating under institutional parameters, such as exchange rules that become institutionalized, as well as property rights, state regulations, governance structures, and conceptions of control (Burns 1990). Thus, rules of economic exchange, as shared collective understandings of exchange transactions and



transactors, are those (institutional) parameters that constitute markets as social institutions, including political entities (Fligstein 1996a:658). For instance, such rules stipulate the exercise of exit (and entry) options in a certain industry (Hirschman 1970). Generally, all markets are governed by institutional rules defining the behavior of agents and their exchange transactions (Baker et al. 1998:173).

Cognate propositions also are implied in Weber's (1968:65–71) status of exchange as a particular mode of social action, a generic concept that includes both economic and non-economic behavior (or economic and social exchange). Those in character accompany these differences between economic exchange and social interaction in comprehensiveness. While the exchange of economic values tends to entail the concept of sacrifice (sacrifice of a useful good) and cost-benefit calculations, most social interaction or non-economic exchange seems to be devoid of such sacrifices and calculations—for example, when people exchange, as Simmel (1990:82), put it, “love for love,” they sacrifice no material goods. Hence, economic exchange involves an objective appraisal and social interaction a subjective impulse (Simmel 1990:291). As a result, defining an exchange rate or price in this latter is impossible if not meaningless. The fact that in all cases of non-economic interaction increases in subjective value do not involve a balancing of gains and losses (Simmel 1990:90) makes the notion of objective exchange value or price in social exchange fluid or metaphoric. For instance, though many economists and rational choice theorists talk seriously about the prices of spouses and children as consumption goods that are formed in marriage (and other implicit) markets, it is clear that such prices and markets are admittedly no more than metaphors and analogies. Nonetheless, social scientists continue to be, as put by some heterodox economists (Stanfield 1999), inflicted by models of children and spouses as commodities and of the family or marriage as a case of bilateral exchange resting on comparative advantage. This exemplifies the general penchant of orthodox economists and rational choice theorists to treat non-economic relations as forms of exchange with (implicit or imputed) relative prices (Stanfield 1999).

Notably, the impossibility of determining an exchange rate as a quantifiable or measurable magnitude in the same way as a price in economic exchange makes it difficult if not impossible to precisely specify distributive justice in social exchange. Because of such an impossibility of calculation, social exchange does not comprise ways to accurately measure or estimate those variables that define distributive justice in general, namely, productive contribution, investments, or inputs in relation to rewards, returns, or outputs. It comes as no surprise that even some rational choice theorists (Coleman 1988) view distributive justice when applied to the realm of social exchange as merely an ad hoc principle.

Such a property of social exchange sharply contrasts with economic

exchange as the first instrument for reconciling (distributive) justice with property changes and rights (Simmel 1990:291–93). In economic exchange, justice in distribution can, though formal and relative, be precisely assessed by comparing material quantities, such as productivity and rewards (wages), inputs and outputs, or costs and revenues. Such assessment relies on what Weber (1968:108–9) calls capital accounting. This suggests that whereas economic (in)equality is subject to calculation and given by certain quantitative rules (e.g., the equation between marginal productivity and wages in neoclassical economics) (Pigou 1960:551), or, between the labor incurred and the product received in Marxism—non-economic inequality is not in the same degree. Hence, economic inequality is calculable—and because of that, limited in a sense that non-economic relations are not (Curtis 1986)—and given by certain quantitative rules (e.g., the equation between marginal productivity and wages in neoclassical economics, or the labor incurred and the product received in Marxism). But non-economic inequality or injustice is not or much less so (Pareto 1963). Economic calculation in cost-benefit terms, measuring quantitatively distributive justice, is virtually impossible or artificial for non-economic processes<sup>12</sup> (Mises 1966) or social exchange, though both economic and non-economic relations can be subject to exploitation and self-seeking with guile (Williamson 1983). Thus, while economic and non-economic relations alike are subject to opportunistic behavior, especially post-contractual opportunism (Williamson 1983) or “re-contracting” without mutual consent (Edgeworth 1967:17–18), this behavior still seems more frequent and salient in the former than in the latter.

The aforesaid suggests that non-economic relations are not mere additions of two economic processes of exchange (selling and buying) but a new third phenomenon (Simmel 1990:90). Thus, the term *social interaction* is more appropriate to denote such social exchange in that it avoids the connotation of economic reductionism or determinism, namely, that social action is an extension of economic exchange. As Weber demonstrated, not all social action can be reduced to these latter. The latter express or approximate a particular, instrumentally rational, mode of social action, in relation to which the others (e.g., value-rational, traditional, and emotional action) have their own rules of operation (Weber 1968:341).

The term *social exchange* also can have other dubious ramifications. This is shown by the tendency of current social exchange theory, just as pure economics, to neglect various sociological variables in exchange processes, including social institutions and structures. More particularly, economic models of exchange and their social exchange versions neglect variegated systems of social rules (Burns 1990). The underlying rationale for such neglect is the conviction that social life is an economic exchange (the marketplace), so extra-economic considerations assumedly do not matter. Using social exchange thus leads to a questionable theoretical assumption and

methodological misspecification in which non-economic variables are omitted or relegated to the residual.

Hence, a sensible and realistic approach to exchange processes should view with caution social exchange, non-economic markets, and related terms. Unless otherwise stated, this work refers to economic exchange, while what current exchange theory calls social exchange will be referred to as non-economic action and interaction. These conflation and inaccuracies indicate that social exchange theory in sociology resorts to market-economic metaphors and analogies borrowed from pure exchange theory (catallaxy) in economics and extends to the non-economic realm. To the extent that these metaphors are not realistic, substantive concepts and approaches, such a theory deals with exchange phenomena that are almost non-entities in empirical terms. For such phenomena (social interactions) are not exchange categories in a proper economic sense (i.e., exchange transactions, prices, costs and benefits, and so on). To call them social exchange is no more insightful than to call non-economic institutions, political, religious, marriage, and other social markets non-economic resources, social (or cultural) capital, non-economic satisfaction and rewards, psychic or social income/profit, and the like. Not surprisingly, some economists realize the futility of this indiscriminate extension of economic concepts and principles by admitting that the market is just a particular system relative to society, including the polity, and that using its metaphors, analogies, and language produces results that “offend our intuitions” (Arrow 1997:765).

With this in mind, the present work intends to be a corrective in this regard in that it avoids the notion of social exchange as being not very useful for analysis. Instead, it operates with the concept of market-economic exchange analyzed from a sociological perspective on the economy rather than from a strictly economic one. Since here we apply a neo-Weberian approach to exchange phenomena, it is perhaps appropriate to mention that Weber had almost no use for the notion of social exchange in his economic sociology.

What today’s exchange and rational choice theories label social exchange Weber simply called social action/interaction. Formally, Weber has hardly ever used the concept of social exchange in the sense of an extra-economic relationship being driven by economic incentives, as in his framework; exchange is by definition a market-economic one. More substantially, unlike social exchange theory, Weber’s “rational choice” sociology implied no idea that all human behavior was an exchange of rewards and thus no reduction of social action to economic-style transactions. Since Weber usually employs the concept of exchange in reference to economic, especially market, transactions, he does not advance some social exchange theory or the exchange approach in sociology in the sense of the “economic analysis of non-economic social situations” (Emerson 1976:336) by extending ele-

mentary microeconomic models (viz., expected-utility maximization) to “extraeconomic exchange” (Macy 1995:73).

In retrospect, the only major classical sociologist that used the term *exchange* in a non-economic sense was perhaps Simmel. However, Simmel highly qualified this usage. Thus, Simmel (1990:82) states that social interaction is the more comprehensive and exchange the narrower concept, thus avoiding the reduction of the former to the latter in modern social exchange theory. Furthermore, most often Simmel (1990:90) understood the concept of exchange in the sense of market-economic transactions rather than non-economic interactions, as he says, “exchange, i.e., the economy.” More importantly for a neo-Weberian economic sociology of exchange, Simmel (1990:54) argued that the fact that actors exchange their products in no sense represents a simple economic phenomenon, because in reality there exists no phenomenon that is completely conceived of in the image of economics. Positively stated, Weber (1968:636–37) would specify this statement by adding that such an exchange is a social phenomenon. Because we apply a neo-Weberian approach to economic exchange, we present Weber’s exchange theory in more detail in a separate chapter, contrasting it to rational choice theory, including its social exchange version, which we also examine separately. Next we summarize the differences of a neo-Weberian approach to economic exchange in relation to social exchange and pure exchange theory.

To summarize, a crucial difference of a neo-Weberian approach from social exchange/rational choice theory and pure exchange theory is that the former assumes social co-determination of economic exchange, the second posits economic determination of social action, and the third views the exchange realm as a social desert. The neo-Weberian approach used in this work neither expands on all human actions or social exchange, as in current exchange theory in sociology, nor confines itself to market-economic exchange per se, as in economics. Rather, this approach is concerned specifically with what Weber would call the “social co-determination of economic exchange,” in the stochastic or probabilistic sense different from determinism.

A neo-Weberian approach rejects the premise that social action is a simple extension of exchange and generally the economic factor, as implied in social exchange/rational choice theory (and orthodox historical materialism). Instead, this approach attributes an essentially autonomous structure (Weber 1968:341) to social action in relation to economic phenomena, including exchange transactions. In turn, a neo-Weberian approach does not observe economic exchange as a natural and an independent phenomenon devoid of social components and influences, as in the pure exchange theory of economics. Rather, such an approach posits that exchange transactions are socially embedded and constructed and are thus special cases of social action. This focus on the social co-determination of economic

exchange completely reverses rational choice versions of exchange theory, for whereas in the latter all social life is construed as a marketplace, a neo-Weberian approach treats exchange as a part of economy and society alike. Such a focus also is skeptical of the pure economic approach to exchange processes as phenomena insulated from society and driven by some assumed inner laws.

Therefore the domain of the neo-Weberian approach is well defined in relation to both rational choice models of social exchange and the pure economic theory of exchange. The former are plagued by scope-inflation, in that they claim that the economic approach is comprehensive and valid for all human behavior (Becker 1976:8). The latter is handicapped by scope-deflation, in that it neglects the social setup of economic exchange. The neo-Weberian approach remedies the former's scope-inflation, in that it confines itself to market-economic exchange and *only* to the latter in its social context of co-determination. At this juncture, the economic approach cannot be taken at face value, even in regard to exchange, let alone all social behavior. For exchange transactions often are affected not only by rational-economic factors but also by their opposites, ignored by rational choice models of exchange. In turn, a neo-Weberian approach redresses the latter's scope-deflation by taking into consideration the social-cultural conditions of economic exchange, otherwise neglected by pure economics. Negatively defined, the domain of the neo-Weberian approach advanced in this work does not encompass all social action as a pseudo-economic exchange, as in rational choice models of social exchange, nor exchange transactions in themselves, as in pure economics. In positive terms, its domain centers on market-economic exchange's social-cultural covariates or explanatory variables. In exploring such sociocultural co-variation or co-determination of the economy, including the market, the neo-Weberian approach to economic exchange represents an exemplar of economic sociology.

#### A NOTE ON CATALLECTICS

The argument that catallectics, as the purely economic conception of a "perfect market" (Edgeworth 1967:30), or chremastics as a "theory of market economics" (Schumpeter 1954b:12), is essentially different from a sociological perspective on these processes highlights the caution regarding extending the concept of exchange to all social action. The common trait of catallectic and sociological conceptions of exchange is that both are concerned with its economic forms alone (viz., with the "economical problem of exchange, the maze of many dealers contracting and competing with each other") (Edgeworth 1967:4). No idea of social exchange (i.e., of human social behavior as a market-style exchange) is implied. However, a crucial difference is that catallectics treats exchange processes as purely economic phenomena independent of other social phenomena; the socio-

logical conception places these processes within a broader social framework. In the first case, they are economic actions. In the second case, they are special cases of social action. In contrast to both, in rational choice or social exchange theories, all social action is regarded as economic activity in general, as an exchange of rewards in particular. The economic theory of exchange is outlined as follows.

Neoclassical catallactics associates exchange processes with the market. Catallactics defines the market as an exchange system (i.e., as a system of continual exchange relations between trade bodies) (Jevons 1965), of mutual exchange relations (Cournot 1960:127; Marshall 1961:270) of selling and buying. As such, the market represents an interconnected system of exchange transactions (Clark 1962:451), a system of regulation and coordination of exchange (Hicks 1961:99). Specifically, the market represents a realm where both products or commodities and productive services or the factors of production are exchanged (Walras 1926:44). The market is an area for linking together sellers and buyers for the purpose of exchange (Stigler 1952:55–56), a mechanism for bringing economic agents into mutual communication with the view of exchange transactions, a whole of permanent and interdependent exchange processes. According to the nature of exchangeable values (objects), markets have been divided into markets for individual values and markets for generic values, and on the basis of the external composition of exchangeable values into commodity markets, capital (or credit) markets, and labor markets. In short, exchange and institutions of exchange form a market (Boulding 1970:155).

In its pure form, the market constitutes a system of multiple exchange under perfect competition (Hicks 1961:83–84), and thus is underscored by the operation of the law of freedom of exchange or competition (Jevons 1965; Stackelberg 1952). In turn, the operation of this law of exchange tends toward the establishment of equilibrium in exchange processes. This equilibrium is generally attained by the equation between the supply and demand of exchange objects (commodities or the factors of production) at a given exchange rate (equilibrium price). Specifically, the following conditions define equilibrium in exchange (Pareto 1927:209–10): the equivalence of marginal utilities of all exchanged goods for all individual actors; the equivalence between total outlays and total revenues; the equivalence between quantities before exchange and quantities after exchange; the equivalence between the cost production and the sales price of exchanged goods, and the equivalence between quantities for transformation (production) and quantities transformed. In particular, exchange agents attain equilibrium at the point at which their indifference curves and their lines of exchange are tangent (Pareto 1927:210). For sellers (producers), this implies an equality of (marginal) revenues and costs, and for buyers (consumers), an equality of (marginal) utilities and prices.

In addition to free exchange relations between sellers and buyers of prod-

ucts and productive services (Walras 1926:149), including unrestricted mobility of labor and other production factors (Pareto 1927:209), perfect markets are characterized by a single uniform ratio of exchange or price (Jevons 1965). By assumption, exchange rates “naturally originate on the market under the influence of competition” (Walras 1926:149). Hence, the market represents the only method for objective determination of exchange values (Wicksell 1934:54), to the effect that prices are the only real exchange values. In contrast to this treatment of exchange processes and variables as simple and pure economic categories, a neo-Weberian sociological approach observes them as complex social phenomena.

## NOTES

1. The concept of total social phenomena is implied in various ways in Durkheim, in part in Weber, Simmel, Marx, and Pareto, and later reformulated by some European sociologists (e.g., Mauss, Gurvitch, Levi-Strauss).

2. These social forces also include various social definitions and perceptions, because such definitions can be not just subjectively constructed but also socially shared and represent constraints external to the actors (Singelman 1972:414).

3. As Smith (1939:50–52) observed, regulations of policy can keep market prices above or below natural price (in essence, a labor-cost value).

4. Durkheim (1964:382–83) remarks that each object of exchange has a determinate, a social value, and an exchange contract is agreed upon solely insofar as the goods or services exchanged possess equivalent social values.

5. A neoclassical economist like Marshall (1961:94) characterizes (following Weber’s colleague Wagner) market conjunctures or fluctuations being caused not only by economic factors but also by extra-economic ones, such as political, institutional, socio-psychological, or technological. This would partly justify Parsons’ dubious inclusion (in *The Structure of Social Action*) of Marshall in the major classical social theorists, alongside Weber, Durkheim, and Pareto, presumably all converging upon a voluntaristic theory of social action.

6. According to Stigler (1947:154), however, Marshall was “wrong in his conjecture that Giffen was the first to allege a positively sloping demand curve for wheat; Simon Gray had done this shortly after the Napoleonic Wars.” In retrospect, reportedly “for more than half a century economists have recognized the possibility of a positively sloping demand curve. They have desired a real example [and] almost invariably they have used Marshall’s Giffen paradox as this example” (Stigler 1947: 153).

7. A reinterpretation of the Giffen paradox, denying a positively sloping demand curve for necessities (wheat or bread), has been advanced by Stigler (1947: 155), who argues that the available data “do not reveal a positive relationship between quantity and price; in fact there is a small, statistically nonsignificant negative coefficient of rank correlation between [them].” Presumably, this is shown by the two (failed) tests of the Giffen paradox: “first, whether observed quantities and prices of wheat indicate a positively sloping demand curve; and second, whether the income elasticity of demand for wheat is negative, which is a necessary condi-

tion for a positively sloping demand curve” (Stigler 1947:154). Critics of these arguments object that the “ghost that Giffen raised may not be very substantial, but at least it has not been laid by [such] arguments” (Prest 1948:60). Further, reportedly some evidence “does exist about negative income elasticities of demand for bread, although, of course, it is not sufficient to prove that the demand curve of any section of the community is positively inclined” (Prest 1948:60). Nevertheless, Stigler (1947:153) admits what is not in dispute (*viz.*, that a positively sloping demand curve in general can exist).

8. Analogously, for rational choice theorists, individual voting is a paradox or an anomaly (*i.e.*, irrational behavior). Their premise is that rational (self-interested) individuals will not participate in large (latent) groups providing public goods but rather will engage in free-riding on the efforts of others.

9. Some sociologists (Wilson and Musick 1997:696) somewhat tautologically state that these social profits yield social esteem, since social profits *are* in fact social esteem. Rather, both economic capital (wealth) and social, cultural/symbolic capital can yield such social profits. Generally, profits do not yield something, but they a yield (income) of capital.

10. As Arrow (1977:761–65) elaborates, there is the “risk in applying market reasoning. The same argument holds for the application of benefit-cost analysis to [non-economic issues]. The pure theory tells us to look at all costs and benefits, including those not taken account of by the market. But it is easy to overlook the intangible and prefer to concentrate on the measurable.”

11. Despite the salience of material resources in political and other social action, the latter are far from being extensions of the economic. For instance, whereas wealth as such is a strong political tool, the political process is largely one of non-economic exchange (Curtis 1986).

12. Most *laissez-faire* theorists argue that economic calculation is impossible, even in economic exchange not performed in market prices or money, as in a socialist economy.





## *Chapter 3*

# *Economic Exchange and Socially Formed Motivations*

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### EXTRINSIC AND INTRINSIC MOTIVATION IN ECONOMIC EXCHANGE

The purpose of this section is to specify the relative significance of extrinsic or utilitarian and intrinsic or non-utilitarian motivations in economic exchange. Particular attention is paid to the salience of egoism and altruism in economic exchange. A key thesis is that exchange transactions are permeated not only by egoistic and other utilitarian elements but also by altruistic and related considerations. Hence, the relationship between egoism and altruism in economic exchange is far more complex than rational choice (utilitarian) conceptions suspect. A major problem in this regard is that both orthodox economics and the current rational choice model view the individual as a “ruthlessly selfish monad” (Frank 1996:117), at best as some kind of “Robinson Crusoe contracting with Friday” (Edgeworth 1967:28). Reportedly, neither egoistic nor altruistic considerations are exclusive in exchange but intermingled in various proportions, with many actors moving back and forth between altruism or generosity and selfishness (Palfrey and Prisbrey 1997:829).

In general, actors in economic exchange, as well as in other social relations, are guided both by extrinsic incentives and intrinsic motivation (Kreps 1997:359). The first is exemplified in utility/profit seeking by following the law of supply and demand and other economic laws, and the second, in altruism, warm glow, the sense of duty, and the like. For instance, some studies of individual behavior in NIMBY (not-in-my-backyard) situations report that civic-minded individuals “do not only further their own goals, but are prepared to bear some cost for the benefit

of the larger group [and] the support for noxious facility decreased when monetary compensation to host it was offered” (Frey and Oberholzer-Gee 1997:752–53). To the extent that intrinsic motivations express non-economic considerations, especially internalized values and rules, norms and economic incentives interact (Kreps 1997:359) in exchange as well as in other social action, including household behavior (Bergstrom 1996; Lindbeck 1997).

Hence, the importance of altruism often is greater than assumed by narrow rational choice theories based on egoism as a *deus ex machina*. For such theories, any behavior not guided by self-interest is irrational and thus paradoxical, anomalous, or pathological. However, the widespread incidence of such paradoxes, anomalies, or pathologies of dis-interested behavior in economic exchange and non-economic fields, including politics, makes such behavior far from being paradoxical or exceptional in empirical terms. For example, as its author remarks, the so-called Allais paradox, which generally contradicts the rational choice axiom of expected utility maximization, “is paradoxical in appearance only, and it merely corresponds to a very profound psychological reality, the preference for security in the neighborhood of certainty” (Allais 1997:6). In epistemological terms, such paradoxes and internal contradictions can be self-defeating, as with rational choice versions of social exchange theory. They can be a reason for a serious reexamination, since they “signal trouble for current economic models of selfish behavior” (Palfrey and Prisbrey 1997:829).

The generosity or extravagance of the *ancien régime* of France as well as other European societies can be adduced to illustrate this possibility: “When Prince Conti sent a diamond of 4,000–5,000 francs to a lady and it was returned to him, he ordered it to be crushed so that he might use it as writing sand for the letter he wrote her in reply” (Simmel 1990:247–51). This episode can be deemed a particular variation on the theme—as condensed by French philosopher Taine in the dictum: “The more one is a man of the world, the less one is a man of money” (*On est d’autant plus un homme du monde que l’on est moins un homme d’argent*)—that money and generally utilitarian considerations often can be directly incompatible with behavior in certain forms of exchange, including, for example, gifts (Carruthers and Espeland 1998; Solnick and Hemenway 1996).

Some dose of extravagance is not absent in the capitalist entrepreneur as depicted by Marx as well as by Senior (1951) and other classical economists stressing abstinence, asceticism, or saving. Even this supposed incarnation of *homo economicus* often is helpless vis-à-vis what Marx (1967:592–98) calls the original sin of extravagant consumption. This exchange actor is far from being a mere embodiment of capital, as the development of exchange involving progressive accumulation of wealth proceeds further from the primitive accumulation or emergence of the capitalist spirit to mature or secular capitalism. The explanation implied in Marx is that this

human creature is ambivalent and Janus-faceted, becoming more and more suspicious of asceticism as a prejudice of the old-fashioned miser and having a variety of physical and spiritual wants. The modern capitalist gradually begins to regard the accumulation of wealth as abstinence from pleasure in contrast to the classical type looking upon consumption as abstinence from accumulating and thus as a sin against this function. This ambivalence expresses economic actors' inner tension or dilemma of the kind Faust experienced: namely, in conjunction with capital accumulation, they develop simultaneously in their "breast, a Faustian conflict between the passion for accumulation, and the desire for enjoyment" (Marx 1967: 594). As the lyrics go, "*Two souls alas do dwell within [their] breast; The one is ever parting from the other*" (Marx 1967:598).

Hence, Marx's conception of the exchange actor is more complex than implied in the term *capitalist* as an assumed incarnation of *homo economicus*. Weber (1976:181–82) would to some degree concur with Marx's depiction of modern economic actors by the observation that these have succeeded to escape from the cage of religious asceticism, namely, the ethic of Protestantism (yet on the economic and educational impact of today's Protestant fundamentalism, see Darnell and Sherkat 1997), the support of which "victorious capitalism" does not need any longer. In Veblenian terms, formerly ascetic Protestants can forego their pristine asceticism by engaging in ostentation, invidious comparison, pecuniary emulation, and other acts of conspicuous consumption as a means of attaining good reputation. In Weber's (1976:176) depiction, such an actor is not just an isolated economic man centered on abstinence, calculation, and wealth accumulation but also a social creature trying to leave a mark in the "market-place of Vanity." Within a neo-Weberian economic sociology, characterizing the economy as a status system (Podolny 1993) in the sense of the consistent seeking of social honor is more appropriate than viewing society as a marketplace of optimizing profit and other economic maxims. Relatedly, the economy is better characterized as a set of what Weber called power constellations/conflicts. This exposes the weaknesses of construing all types of power as economic, that is, domination associated with interest constellations, as distinguished from political power as domination grounded on legitimacy or authority (Weber 1968:936).

The Veblen–Weber social status hypothesis has been supported by recent studies. For instance, one of these examines the implications of Weber's hypothesis for consumption, savings, and stock prices and concludes that exchange actors in actuality seek wealth for its social prestige rather than for its consumption utility (Bakshi and Chen 1996). In a similar vein, other studies find that economic agents often are driven in their economic transactions by the motivation to obtain social distinction via conspicuous consumption signaling wealth (Bagwell and Bernheim 1996).

Historically, while egoism, avarice, asceticism, and abstinence were the

ruling passions at the dawn of capitalism, a world of delights was created by its rapid development and has perpetually tempted its actors, capitalists and workers, and producers and consumers alike. As a result, the capitalist actor undertakes as a business and social necessity a conventional degree of prodigality as a public exhibition of wealth. Such prodigality represents a source not only of what Marx calls credit for further accumulation of economic capital through appropriation of surplus-value (profits), as Marxists, orthodox economists, and rational choice sociologists would think. Prodigality also is instrumental in increasing or retaining political, social, and symbolic capital (Bourdieu 1990:128–30), that is, power, prestige, and cultural differentiation. Such prodigality, exhibition, and luxury are treated as the element of the cost of commercial and social representation.

Hence, capitalist exchange has historically always generated in the actors a Faustian conflict between abstinence and pleasure, avarice and extravagance, saving and prodigality, egoism and altruism, and individual and social goals, between the function of accumulation and the desire for enjoyment. Moreover, people can engage in altruistic behavior, including generosity or prodigality, as an intrinsic motivation, that is, for its own sake (Weber 1968:626), regardless of instrumental considerations, as shown by presenting recent evidence on altruism in modern economies. In addition, like levels of living standards, generally prodigality or generosity can become a question of habits, customs, or conventions, and thus a form of traditional social action. Veblen's leisure classes and Weber's status groups largely conform to this pattern of prodigality or extravagant consumption as a conventional, economically non-rational rather than rational behavior.

The pertinence of various forms of altruistic behavior in an economy often is considerable, as indicated by the incidence of charity in the modern, including the American, economy. Research (Rose-Ackerman 1996) indicates that, overall, almost three-quarters (73.4%) of Americans make (based on a survey in 1993) voluntary contributions to different types of charity. (The average amount of such contributions is \$880 per contributing household and \$648 per household, regardless of whether contributing or not.) This suggests that private charity is important in the U.S. economy (Rose-Ackerman 1996:703), despite government welfare spending, with its tendency to crowd private donations and contradict the selfishness assumption of standard economic or rational choice theory. In general, with motivations ranging from warm glow and pure altruism to social prestige, these data indicate that nine out of ten Americans make some voluntary contributions.

These figures on charitable contributions in the United States suggest that altruism and cooperation—not just egoism and competition, as economic theories assume—can be teleological, rather than instrumental, categories (i.e., ends in themselves, not just means to other ends). Hence, such behaviors, including those associated with the location of obnoxious facilities

(for example, the NIMBY, or “not-in-my-backyard” problem), can be induced by intrinsic or non-economic motivation rather than by extrinsic or instrumental incentives. This demonstrates simply the limitations of money and other economic rewards<sup>1</sup> (Frey and Oberholzer-Gee 1997:753). Such findings suggest that people engage in charitable and other altruistic activities mostly because of the inner value of these activities for them—that is, they feel good about it (warm glow)—not just because of the expected material benefits. For instance, research on private charity reports that most donors are guided by generous impulses and thus experience intrinsic benefits from the act of giving itself rather than extrinsic (monetary) payoffs (Rose-Ackerman 1996:702–3). To that extent, they can be termed *non-economic*, including ideological entrepreneurs, rather than economic ones.

Overall, various motivations for giving, such as commitment, sympathy, prestige, pride, conformism, and moral values of reciprocity, tend to be intertwined. For example, prestige considerations in charity often are important in cases when donors behave driven by the desire to demonstrate their economic (and other) worth, thus signaling wealth by donations (Glazer and Konrad 1996; Harbaugh 1998). Similar patterns often have been observed in volunteer work and informal helping (Wilson and Musick 1997). However, when this is the case, such donors reportedly can obtain social prestige from making donations “only if others view one’s action as worthy [for] if the narrow private benefits of gift giving are too obvious and large, gift givers will not be praised for their self-sacrifice” (Rose-Ackerman 1996:725). In addition, reciprocal values such as altruism and fairness (Camerer 1997) are widely observed motives for donations within empirical as well as laboratory settings, as are voluntary contributions with conformism as a key social influence (Gallegati and Kirman 1999).

In light of these findings on charity and related altruistic acts in an exchange economy such as in the United States, the hypothesis of universal selfishness perhaps has to be reconsidered in its status of a sacred paradigm of both neoclassical economics and rational choice sociology. Not without irony, within rational choice sociology, this paradigm of pan-egoism has euphemistically been designated the charity principle (Elster 1979:116–17).

These findings also suggest that it is problematic to reduce altruistic behavior in the economy and all society, including the family, to a form, means, or result of egoism or individual rationality as done by rational choice theorists. Such an approach is predicated on the assumption that altruistic behaviors in an exchange economy are actually driven by non-altruistic extrinsic incentives rather than intrinsic motivation. Thus, altruistic behavior is seen as a mutant of rational egoism, for what economists and rational choice theorists say is that “altruism is not really altruistic but is profit motivated” (Davis 1992:24–27). It is a mere figure of speech to say that altruism is only the converse of spite or egoism, just as it is to term

egoism the inverse of lofty behavior or altruism (Elster 1989a:47). Following the rationalist tortuous logic (Knoke 1988) of universal though mutated egoism, then one might also say that egoism is no more than an inverted form of altruism toward *oneself*.

Notwithstanding, those engaging in such really egoistic behavior are called—in another use of euphemisms typical of mainstream economics—pure altruists. However, given the assumed character and impetus of their behavior, “it seems strange to label such people altruists. They look like free riders [for] such a donor obtains no warm glow from the act of giving and will free ride in the large numbers case” (Rose-Ackerman 1996:703). Admittedly, most economists “attribute rationality to everyone, as though all individuals act like highly trained economists” (Buchanan 1991a:62), that is, cost-benefit calculators and generally egoists just pretending to be altruists through impression management. This amounts to a depiction of the modern economy/society as a realm of spurious altruism in the form of universal egoism and hypocrisy. Human actors are thus depicted as emanations of the “rational economic man”—reflecting the “revenge of homo economicus” (Bowles and Gintis 1993) in modern economics and rational choice theory—and as bearers of the hypocritical Puritan illusion.

The problem with the implied assertion that only egoism can be an incentive for economic exchange often has been untenable on historical and empirical grounds. For altruism can *also* have such a role in the form of what even some economists recognize as warm glow and related intrinsic benefits. These latter are in turn imponderables, intangibles, or invaluable goods (Arrow 1997:761–64) not subject to cost-benefit computation in the same way as material goods. Alongside various charitable donations, this is evidenced by volunteering, informal help, and related disinterested actions within an exchange economy such as in the United States, which is supposedly driven only by material interest. However, many studies cast serious doubts on the wisdom of this conventional view of standard economics and its extensions in rational choice sociology. For instance, recent research reports that volunteer-recipient relationships in an exchange economy are ethical in character in the sense of being guided by altruistic and related value imperatives rather than naked self-interest (Wilson and Musick 1997). In Weber’s (1968:24–27) terms, intrinsic value-rationality rather than extrinsic instrumental-rationality often permeates such relations even within an exchange economy.

The conceptual or empirical reduction of altruism to egoism is unacceptable even within an exchange economy, because altruism is a distinct phenomenon in relation to its counterpart and often polar opposite. Despite all of the possible shades between the two on a continuum of egoism/altruism, each is a *sui generis* category, in the analogous way as a capitalist economy is a qualitatively different entity from a socialist one, in spite of a continuum of capitalism/socialism. Hence, altruism, trust, and solidarity

represent “genuine phenomena that cannot be dissolved into ultra-subtle forms of self-interest” (Elster 1989a:46). This demonstrated impossibility notwithstanding, the logical or evolutionary dilution of altruism into egoism “remains a characteristic of rational choice theory (Elster 1979:141–42). However, recent experimental and empirical research shows that there exist essential differences and conflicts between egoistic and altruistic motivations in economic and other social actions. Under laboratory as well as real-life conditions, altruism, warm glow, and related non-monetary elements of utility functions reportedly operate in the opposite direction of the monetary inducement to engage in free-riding and other egoistic behavior (Palfrey and Prisbrey 1997:830). Moreover, these findings show that frequently actors’ dominant strategy in their exchange transactions is not to free ride and otherwise behave egoistically as assumed by rational choice theory, but also to cooperate and generally be altruistic. Contrary to rational choice prediction, they also show that exchange actors do not become significantly more selfish with experience or with learning, so such endgame effects are weak.

## THE SOCIAL CONSTRUCTION OF THE ROLE OF MONEY IN ECONOMIC EXCHANGE

This section purports to examine the function of money in economic exchange. This is not an exercise in monetary theory but rather an analysis of the viewpoint of an empirical economic sociology of money that centers on its sociological underpinnings. The point of departure of this analysis is the assumption of the social-cultural construction of the role of money in economic exchange. This implies that the function of money in economic exchange has been sociohistorically contingent and often fused with or even secondary to non-monetary, social factors. In terms of motivational dynamics in economic exchange, this assumption posits limits to monetary compensation (Frey and Oberholzer-Gee 1997). Relatedly, money is assumed to be primarily a social-cultural creation, contingent on definite societal and historical conditions, and only secondarily a purely market-economic variable with an inner logic of its own reflecting some natural laws.

Like economic exchange, money is therefore a “sociological phenomenon, a form of human interaction” (Simmel 1990:172). From the perspective of a neo-Weberian economic sociology, money represents a form of human interaction, permeated by social actions and relations. As Weber (1968:636) points out, exchange transactions using money (e.g., sale and purchase) are particular forms of social action, because money obtains its value from its relation to the actual or potential actions of other actors.

First and foremost, the social constitution of money as an exchange medium as well as the measure of value, the means of payment or treasure



(Weber 1927:236–37), is indicated by the fact that money “is simply that which the State declares to be a good legal discharge of money contracts” (Keynes 1972:63). In addition to these political factors, money often is permeated by class and status considerations. Thus, according to Weber (1927:238), in some traditional societies the class nature of money manifests itself in the differentiation of “chieftain money” from that of the subjects as well as in differentiation based on gender. In consequence, money often has been not just a means of economic exchange but also an object of class possession and status distinction as well as power hierarchy. For instance, the Indian rajahs and Merovingian kings reportedly acquired and possessed money only or mainly because of prestige considerations, that is, for enhancing their “social self-esteem” (Weber 1927:237). Such monetary pertinence of political, class, and status variables implies that generally money represents an exogenous, extra-economic factor of exchange in the economy (Zelizer 1996), though certain monetary processes can become endogenized<sup>2</sup> (Andolfatto 1996).

Historically, economic components in money have not been entirely prevalent over or independent of the non-economic, including intellectual, normative, esthetical, traditional, and generally cultural ones. For instance, the artistic and cultural preeminence of Florence over the other wealthy Italian city-states often has been imputed to its orientation to banking since the thirteenth century, in contrast to Genoa and Venice, both enriched by commerce in the Middle Ages. This differential intellectual outcome of economic exchange of these equally wealthy cities could be explained by the character of banking that allowed more liberty for artistic-cultural development and demanding less specific work than trade (Simmel 1990:314–15).

In general, the utilitarian attraction of money can be compared to the psychological form of aesthetic attraction, since not just beauty but also money is defined to imply a promise for happiness (*une promesse de bonheur*). The importance of money in exchange is based on its power to enhance the individual’s independence vis-à-vis group interests or the collective. This divergence in interests epitomizes the difference between a barter economy and a money economy but can be found in the latter as well. This latter can be illustrated in the case of two economically prosperous Italian republics, Venice and Genoa. While the first built a great and prosperous state with only fairly wealthy private citizens dealing with trade, the latter’s state was impoverished as a result of its total orientation to financial dealings and the increase of individual wealth (Simmel 1990:342). This shows the effect of money on the relationship between the individual and the group, to the effect that individuals tend to acquire independent importance relative to society, viewing it as a power confronting this independence, insofar as money is the focus of action. Compare this to the relationship between the individual and a guild of watchmakers in the Mid-

dle Ages. This corporate entity lay claim on the whole individual, and so represents a living community with social, religious, political, and other non-economic interests, not just an association of individuals with mere economic interests in making watches or clothes (Simmel 1990:342–43).

This also holds true for the relationship between the individual and the group within a household economy (*oikos*) in Ancient Egypt and then in Greece and Rome. In such social-historical settings, trade and production for exchange were carried on as auxiliaries to a larger household, with no separation between the latter and industrial establishment. Such a type of economic organization has been called (Rodbertus 1971) *oikos*-economy (from the Greek word *oikos*), which served as the initial impetus of, for instance, the Egyptian system of grain banks as well as royal taxation in money in Ptolemaic Egypt (Weber 1927:58).

However, the creation of associations (e.g., trade chambers, business groups, or trade unions), based on the pursuit of monetary interests such as business enterprises, or on money contributions of individuals, presupposes an exchange economy. In this context, money performs a double function in exchange—one is the generalization of purchasing power to the exchange of goods, while another is symbolizing attitudes. While the first implies the utilitarian or wealth dimension of exchange, particularly of money or income, the social or prestige dimension is implied in the second. Of these two, the non-economic, the symbolic function of money, as well as of what Weber calls monetary, capital accounting<sup>3</sup> (Carruthers and Espeland 1991) and other material objects in exchange often is of primary significance, even in modern economies. A case in point is overspending, wasteful consumption, and related non-rational uses of money. The symbolic character of money has historically been displayed in that once people are accustomed to certain exchange objects due to social considerations, the monetary function is attributed to them as mere symbols with no intrinsic value, meaning, or relevance (Weber 1927:239), as historically shown by fur money in early Russia, since while performing such a monetary function, bits of fur have almost no use value in themselves.

In consequence, money and other commodities are subject to valuations based not just on their economic instrumentality or usefulness (utility) but also on their extra-economic relevance (i.e., their social construction). In Weber's (1927:240) words, the ground of such value scales is not solely economic quality but the goods' customary worth or their "traditionally imposed social significance." Generally, the conversion of any kind of economic capital, including money and goods, into symbolic capital is the "fundamental operation of social alchemy" (Bourdieu 1990:128–30). This is because the society's attitudes and policies about the supply and control of productive resources for attaining its ends are symbolized in money and operationalized through the monetary system and policy (Parsons and Smelser 1956:71–77).

The contrast between the symbolic and utilitarian functions of money in economic exchange as well as other social relations can be illustrated in the practice, in early England and in medieval Europe, of the atonement of murder by financial payment called *wergild* (Simmel 1990:355; Weber 1927:239) or head/blood money (Zelizer 1992:205). For example, in England, any killing, including the king, was accompanied by a *wergild* as a monetary form of punishment, the atonement of murder by money payment reaching a maximum amount for killing the king. In this reduction to a money yardstick as the worth of the person, *wergild* displays its utilitarian roots. In place of an impulsive revenge, the group (the family, kin, tribe, etc.) that lost one of its members preferred money compensation for the economic loss occurred by the death. However, the later development of this money compensation displays an increasing influence of social variables, such as custom, law, power, and status on its amount, and so relaxation from its individual economic origins. In consequence, head money, expiatory payments, and other considerations expressed in money gradually have become dissociated from economic values and instead linked to social valuation exclusively (Weber 1927:240). In particular, the prominence of such social valuation versus economic values in this regard was expressed in the primary role of traditional rules versus a market-based tariff. Thus, the head money and related monetary payments are dependant on dispensers' capacities to pay as defined by socially, namely, traditionally formed considerations for restitution rather than by a fixed tariff (Weber 1927:240–41).

The impact of these social valuations and factors also is shown in the practice of fixation of the amount of *wergild* at birth. The particular effect of social rank or position in this regard can be seen in that only or mostly members of special groups (e.g., freemen) were attached certain amounts of *wergild* or monetary values fixed from birth onward. Differing in accordance with social status, these values were determined by such "objective supra-individual" factors as customs and laws, suggesting *wergild* gradually had lost its private economic and utilitarian origins (Simmel 1990:355–60). As a historical curiosity, a *wergild* in the amount of 2,700 shillings was attached even to killing the king in early England. In another instance, the *wergild* of a free frank was 200 solidi and was fixed to establish definite numerical relationships with the head money for half-free or servile persons (Weber 1927:240). In another illustration, in medieval Florence, no *wergild* was attached to the lowest elements of the serf hierarchy (i.e., those totally dependent), while for others the degree of their bondage was reflected in the amount of *wergild*. This salience of the economic perspective and measurement was, however, far from being common even then. Further, it has been diminished with the development of the (Christian) conception of the value of life rejecting its quantitative, monetary measurement and compensation by another value since an absolute value

is attributed to humans. And, it is only at such higher cultural levels that the abstract conception of ends and means can emerge, and then develop into an “independent impulse,” namely, that punishments for crimes or damages are severed from their utilitarian roots (Simmel 1990:360–63).

Concomitant with, but opposite in character to, this cultural-religious mitigation of the practice and amount of *wergild* was the development of exchange, as the latter process tended to increase the *wergild* by adding lost profits to costs made. Historically, this happened in the early Middle Ages. Reportedly, as market-economic exchange expands, head money is not determined any longer in terms of claims for damage restitution, as it becomes usual that larger compensations are demanded (Weber 1927:240). Such a development had thus different effects on the *wergild* and related phenomena than the tendency toward an absolute valuation of human beings—which indicates that, contrary to conventional wisdom, individualism or the respect for the person and economic rationality or utilitarianism do not necessarily go hand in hand. This is especially the case insofar as exchange comes into conflict with those human values that collide with its impersonal, rational, and economizing effects (Zelizer 1992:286).

At a general theoretical level, the Simmelian theorem about the emergence of the abstract notion of ends and means only at higher cultural levels (Simmel 1990:360) suggests that rational action in the sense of such a notion is a relatively late development. In Weber’s (1968:24–25) frame of reference, aim-rational action—involving the realization of actors’ “rationally pursued and calculated” aims—implies such an abstract notion of ends and means. This would imply that this action type emerges or rather reaches its pinnacle in the higher stages of social development, such as this sober bourgeois capitalism founded on the rational organization of free labor (Weber 1976:24). A further implication of this is that value-rational as well as traditional and other economically non-rational action has historically antedated rational economic action. No wonder Weber rejected the opposite assumption characterizing one-sided historical materialism and the one-sidedness of the economic approach or rational choice theory. Such an implication can be detected in the temporal or sociocultural primacy often attributed by Weber to religious action, including magic, taboo, and the like, as well as to traditional and generally non-rational action relative to the rational type (albeit this may later be changed by the process of rationalization). Since religious behavior is an exemplar of value-rational action as an economically non-rational or non-economically rational action, this implies the original predominance of the latter over instrumental-economic action in the modern sense of continuous, rational, capitalistic enterprise (Weber 1976:17). This is evidenced by the fact that historically it is the ethics of Protestantism where one can find a religious-moral sanction for economic rationalism in general and the entrepreneur in particular (Weber 1968:436). Since this happened only in the wake of the Protestant

Reformation in the fifteenth century, it implies that economic rationalism is at least in its typical capitalist form a historical-cultural phenomenon, not a perennial or natural one.

Also, Durkheim posits the historical-cultural primacy of religious and other non-economic types of action underscored by mechanical solidarity over rational economic action. This especially applies to the early state of society, though like economic rationalization, the division of labor with its contractual organic solidarity can subsequently result in the increasing pertinence of exchange and other rational action. As Durkheim (1982:174) put it, in traditional societies, economic factors are rudimentary, and religious life is rich and pervasive. Overall, within a Durkheimian framework, only more complex sociocultural types would involve the notion of rational action, especially in the sense of capitalist exchange and production transactions. This is exemplified by modern industrial societies in which social order or harmony is the result of the division of social labor and where individuals consecrate to special roles or functions (Durkheim 1964:200).

Other functional equivalents, proxies, or analogues to Simmel's higher cultural levels at which the notion of rational action as a means-ends link is assumed to appear include the following. A first analogue is Tönnies' (1955:86–90) *Gesellschaft*, characterized by trade, industry, and science, in which the "loss of one is the profit of the other." A second analogue represents Spencer's (1969:3–20) industrial society, based on the regime of contract, class legal equality, and voluntary cooperation. Another analogue is exemplified by Veblen's (1934:53–60) higher barbarian culture, dominated by economic differentiation, especially the invidious distinction between the working and leisure classes. Sorokin's (1970:28) sensate sociocultural systems are still another instance in this regard, since these systems feature physical needs, preferences, and goals, of which the maximum satisfaction is aspired to.

## **MONEY AND NON-MONETARY MOTIVATION IN ECONOMIC EXCHANGE**

This section centers on the issue of the relative pertinence of money and non-monetary motivation, particularly the desire for social distinction, in economic exchange. We attempt to demonstrate that the role of non-monetary motivation such as social distinction or status honor in exchange transactions is often primary in relation to that of money and related materialist goals. As to the relationship between money and social distinction, income, wealth, entrepreneurship, and related economic resources are not per se status attributes or qualifications, while status can greatly affect and sometimes fully determine class position (Weber 1968:306) associated with such resources. This is indicated by the tendency of various groups, especially the upper classes, to seek out new realms of distinction (Aschanfen-

burg and Maas 1997:584), independently of money or economic capital, especially when this latter is overused (Rose-Ackerman 1996:725). In addition to economic capital, these new realms include symbolic or cultural capital, that is, competence in higher culture (Wilson and Musick 1997: 696) as well as political capital, that is, a dominating position within power hierarchies (Weber 1968:109).

In this regard, both economic and non-economic resources are used as means to obtain societal distinction or social capital overall as an underlying end. Such a relationship between economic and social capital reverts the standard rational choice assumption that the latter is simply instrumental in increasing the former (Coleman 1990:302–21). This assumption glosses over the possibility that people may seek money and other economic capital to achieve and retain social distinction, a possibility strongly confirmed by some recent studies (e.g., Bakshi and Chen 1996; Bagwell and Bernheim 1996), rather than just vice versa. The underlying rationale for such behaviors may be the human need for group approval (Frank 1996: 115), as well as for connections, relations, and trust in society (“social capital”), to which others, including economic capital, can often be subordinate. A related reason is the tendency for most people to construct social comparison functions (Markovsky, Smith, and Berger 1984)—that is, to engage in comparisons with others trying to “keep up with the Joneses” (Duesenberry 1949)—and thus to seek social distinction. In economic terms, this tendency implies that satisfaction depends not only on absolute income in intertemporal terms (i.e., having more or less now than before), it also depends on relative income (Frank 1996:119) in interpersonal or social terms (i.e., having more or less than *others*). On the assumption of the deep human desire for approval, happiness would thus be a comparative category and often a matter of Veblenian-like invidious comparisons and emulation. Since the desired outcome of such comparisons is distinction as social capital or profit<sup>4</sup> (Wilson and Musick 1997:696), higher distinction implies a higher level of happiness.

From this perspective, the happiness of Robinson Crusoe as a “catallactic atom” (Edgeworth 1967:28–31), while a frequent actor model in orthodox economics, would be an implausible concept in sociological terms. If the actor has no incentive to excel relative to others and thus to obtain social distinction, even his or her economic satisfaction and performance (i.e., the utility or profit level) would be suboptimal. Such an actor would be not only socially undistinguished but also economically inefficient and thus non-rational. For lacking incentives for social excellence, the actor is not induced, controlling for, for example, bequest considerations, to engage in economic efforts above the subsistence level of survival. In Engel’s terms, the long-term income elasticity of demand (i.e., the relation between relative changes in demand and those in income) would be constantly 1 or less than

1 and further falling, for example, 0.2 for food, 0.3 for clothing, and so on (Fogel 1999).

For this demand is limited to necessities and other material needs, with the exclusion of higher spiritual or cultural wants, including social distinction and approval. For illustration, data show a long-term tendency toward significant reductions in the relative share of consumer expenditure on food in the structure of consumption within industrial society in general (e.g., from 49% in 1875 to 5% in 1995) and in particular developed (and, in part, developing) countries (e.g., 23% in the United States, 27% in Switzerland, and 45% in Greece in 1955, 8% in the United States, 12% in the United Kingdom, and 21% in Ireland in 1992; cf. Johnston 1997). In contrast, the proportion of expenditures on leisure activities in the structure of consumption has increased dramatically in the developed world during a one-century period (e.g., from 18% in 1985 to 67% in 1995).

Alternatively, Engel's laws, as empirical generalizations linking relative changes in income and those in consumption, suggest that the long-term income elasticity of the demand for goods meeting higher or non-material wants is higher than 1 (e.g., 1.4 for leisure, 1.6 for education and health care; cf. Fogel 1999). This indicates that the desires of social actors for distinction and approval (i.e., ideal goods) tend to have increasing or constant additional value (marginal utility) and thus no strict threshold of satiation. (This would *ceteris paribus* apply to the desire for power and related ambitions, which can shed light on the tendency for many political actors to seek absolute domination, especially in the absence of countervailing powers.) Alternatively, it also implies that the material needs and goods of a primitive or modern or hypothetical or actual anti-social actor a la Robinson Crusoe have diminishing marginal value, thus subject to satiation. In addition, as a social isolate, Robinson Crusoe amounts to "an imaginary product of literary art" or a "mere conceptual construct" used by scholastic-like economists (Weber 1977:99). Admittedly, many (orthodox and contemporary) economists delight in analyzing the behavior of isolated, solitary couples as "catallactic atoms" by placing them in "lonely islands" (Edgeworth 1967:115).

In retrospect, the assumption of diminishing marginal utility of material goods, including money, wealth, or capital, is the building block of modern microeconomics. However, the alternative proposition of increasing or constant marginal utility of non-material goods, including social distinction and political power, as well as knowledge, aesthetic, ethical, and religious capital, and so on, has not yet been established in microeconomics and, for that matter, in rational choice sociology. But this omission seems ironic, since such a proposition is logically and empirically implied in Engel's (and related economic) laws pertaining to higher human needs and goods. For imputing these latter with an infinite elasticity of demand (i.e., a disproportionate increase of their consumption relative to income growth) means

attributing to them an increasing marginal utility. On the other hand, such an omission is not unexpected, given the emphasis of both conventional economics and its extensions in rational choice sociology on material interests, wants and goods at the expense of what Weber called ideal interests.

These considerations cast doubts on the rational choice premise that all human desires are merely servants of the master acquisitive impulse (Weber 1949:88–89), so gaining social capital is subservient to the accumulation of economic capital or money making. Instead, tendencies to seek out social distinction as an end by an ever-new means and realms support the Weber–Veblen status hypothesis (Bakshi and Chen 1996), in which prestige is a prime mover of economic behavior in relation to money or wealth.

This can apply not only to individuals (or families) as such but also to economic organizations, or to the former as members of such organizations. This was classically shown by Weber's depiction of early capitalist (Protestant) enterprises and their members. In essence, for these entrepreneurs, obtaining social distinction in a Shakespearean–Balzacian vanity market, as linked to or induced by the prospect of religious salvation, was a foremost incentive. Hence, such a pursuit of ideal interests, rather than just of money or material acquisition, was the underlying force of the spirit of capitalism, at least in its early Protestant, especially Calvinist, form. Moreover, its late forms also are permeated and often dominated by distinction and related non-economic considerations. For example, even actors in stock-exchange transactions are reportedly under the often-paramount strong impetus of these considerations, so a theory that considers motives for wealth-induced status “does a better job in explaining observed stock prices” (Bakshi and Chen 1996:135). Thus, exchange actors can treat money or wealth as just a means (Alexander 1982:72–74) of social status and related non-economic ends as more ultimate values (Weber 1968:109). At this juncture, it may be appropriate to associate Weber's concept of the spirit of capitalism with the Veblenian hypothesis of social prestige rather than with money making *per se*. Thus, some analysts (Bakshi and Chen 1996) redefine the spirit of capitalism in the sense of social status-driven economic behavior and distinguish it from money making or wealth accumulation for its own sake. This redefinition implies what is called Weber's status hypothesis. More accurately, the latter should perhaps be called the Veblen–Weber prestige or social distinction hypothesis of economic exchange.

In addition, prestige considerations can be salient for economic organizations or enterprises themselves, not just for their members. Even under a modern economy, from the viewpoint of many business organizations, the market appears as a status hierarchy or a set of social networks rather than as a purely exchange mechanism of price determination and resource allocation. As reported for both ordinary and luxury markets, including car markets, the reproduction of the firm's distinction or identity is a funda-



mental driving force of exchange behavior, so social status becomes an explanatory factor for understanding the “stable inequality of markets” (Podolny 1993:863). For instance, in luxury car markets, established (mostly European) companies try to maintain, at often large monetary costs, their high status or good will relative to that of their competitors (including Japanese or American newcomers in recent years). The same can be said of the behavior of many other companies in various markets (for instance, Coca Cola’s refusal to disclose its formula for almost any money, as a status-retaining device).

Hence, just for individuals and families, social distinction can have an intrinsic value even for economic organizations, and not just an instrumental one to increase profits. For distinguished and rich individuals or families, and even for prestigious businesses, it is probably more painful, even in very economic terms,<sup>5</sup> to lose their esteem than to lose money (short of bankruptcy) in the market. This suggests that business organizations can seek distinction not just to increase their profits, as usually assumed by economists and rational choice sociologists, but *also* to make profits to enhance their status in the economy and society generally.<sup>6</sup>

No doubt, money and status—and for that matter, power (Etzioni 1988: 217–36)—considerations are intertwined in the exchange behavior of most organizations. However, contrary to rational choice assertions, the latter often can be independent of and even primary over the former, especially in the long run, for many economic and other organizations have endured largely because of their distinguished reputation or good name rather than just because, or in conjunction with, their profitability or efficiency. Instances include not only the BBC or public television in the United States, postal, railroad, and other public companies in Europe and elsewhere, but also a variety of purely business corporations, ranging from car and consumer-electronic producers to retailers. In Weber’s (1968:341) frame of reference, like social action, as a whole the operation of social distinction in exchange transactions, evinces an essentially autonomous logic in relation to money and economic rationality generally.

Basically, in economic exchange, the relationship between social distinction and money revolves around the fact that a unique conjunction of senses of differences (Simmel 1990:390), at once grounded on and refusing invidious comparison, underlies the former. These differences between actors occupying differential social positions tend to be expressed in mostly non-monetary terms, regarding cultural or symbolic capital (Bourdieu 1990:192–97). Social distinction implies a certain ambivalence. This was shown in the case of the House of Lords, that in its early period, viewing even an authority relationship to persons-nonmembers as social devaluation did not accept the proposal recognizing it as the supreme judge of persons other than peers but established itself as the sole judge of its members. Sometimes the value of distinction evinces an inverse relationship to

the increasing role of money in exchange. Thus, the former tends to be less sought out or realized in social and physical objects, as these objects are more and more evaluated in terms of money, and vice versa. The latter was exemplified in ancient Egypt and India, whose aristocracies deemed such forms of exchange as maritime or foreign trade incongruent with the purity of the castes and thus avoided them. Another example is Venice, in which the ruling aristocracy was effectively prohibited from engaging in economic exchange until the end of the eighteenth century, for example, 1784 (Simmel 1990:390–93).

In turn, the freedom afforded by money often is experienced as merely potential, formal, and negative, since the sentiment of selling personal values can be felt if such positive contents of life are exchanged for money. This holds true not only for unalienable ideal values such as honor, beauty, love, truth, or friendship, but also for exchangeable material commodities. This is partly shown by the reluctance of many peasants in Southern Europe and of traditional people generally to sell any objects, because for them an unalienable individual mark of invention and an emotional connection are attached to almost any object received or produced, so the object, including the labor spent on it, has an exclusive personal usage and as such constitutes an element of their personality. Hence, to sell it or alienate it otherwise is experienced as losing a part of their body or soul. For instance, as reported regarding the Greek peasant women, it is difficult to purchase commodities from native people, since to them each object has an individual attribute of uniqueness and originality. Thus, the labor invested in producing and decorating the object as well as its exclusive personal use make it integral of the person, though ever since money was devised it seems that people have become “more inclined to sell than to buy” (Simmel 1990: 402–3). This phenomenon often persists in such communities, despite the fact that the penetration of money carries with it a stronger inclination for selling and thus saving than buying or spending. Thus, in an exchange economy, there exist, as Marx (1967:156) remarked, two antithetical processes (sale and purchase), of which the first is relatively more uncertain than the second.

The rising credit card American (and global) society may have reversed this inclination for selling and saving versus buying and spending. This is partly shown by decreasing saving rates, especially in the United States, where the aggregate rate has precipitously fallen (e.g., from 8.8% in 1981 to 4.2% in 1990) (Browning and Lusardi 1996:1817). Apparently, in the United States, there was a consistent tendency toward decreasing saving rates (as a percentage of GDP) during the period 1970–1990, especially since the early 1980s. As a result, in the late 1980s and early 1990s, the average saving rate in the United States was half of its level in the early 1970s. In light of these data, one may speculate that such a trend in saving

expresses or ushers in a mass consumption (Rostow 1991), more precisely, a credit card society.

However, the question remains whether this latter is an outcome of the increasing difficulty of selling in an open exchange system because of competitive forces, especially foreign competition (e.g., Japanese in car manufacturing and consumer electronics in the United States), or of other factors still unknown, and thus represented by the residual in model specification. In the first possibility, this would corroborate the views of Keynes and Weber, for such a society would reflect the increasing Keynesian marginal propensity to consume or effective demand, a concept invented by Adam Smith (effectual demand) and used by Weber as well—which refers both to consumption and investment (productive consumption) in relation to saving at the aggregate level. *En passant*, in the classical Keynesian (and, in part, Malthusian) framework, saving is the regular culprit, especially in the form of an excess of it over investment as well as hoarding, which causes economic malaise (*viz.*, recessions and depressions).

To summarize, conceptualizing the exchange economy as a vanity market, as well as power constellation, is in retrospect a fundamental assumption of neo-Weberian economic sociology or sociological economics. By contrast, conceiving of all society as a marketplace, as well as every power as market-economic or wealth, has been a feature of orthodox economics and modern rational choice theory, as well as Historical materialism, albeit here society is subordinated to the mode of production. Hence, this indicates some important inconsistencies of rational choice theory with neo-Weberian economic sociology as the conception of the social composition of economic processes, including exchange transactions. We elaborate on these inconsistencies between neo-Weberian economic sociology and rational choice theory in more detail later in this work.

## **INSTITUTIONAL MOTIVATIONS VERSUS PROPENSITIES FOR EXCHANGING**

The specific hypothesis of this section is that the role of socioculturally created motives in market-economic exchange has historically been primary in relation to innate propensities for exchanging. Hence, exchange and the motivations for it are contingent on definite social-historical conditions, rather than being natural, biological, or psychological phenomena. From a sociological perspective, exchange transactions can be considered instances of social action/association (Weber 1968:63, 40), with free competition being a key institutional feature of markets (Caldwell 1997:1883). In this respect, exchange microstructure is an institutional entity insofar as it is constituted of institutions of exchange (Spulber 1996:135). Hence, motivational forces in exchange transactions tend to express socially constructed, especially institutionalized, motivation rather than biological

impulses (viz., what Weber [1949:88–90] almost ironically referred to as the impulse for wealth acquisition).

Historically, the part of (market) exchange in social life had been largely secondary until modern capitalism. This implies that economic processes were not carried out along the principles of Market Pricing<sup>7</sup> (Fiske 1991: 13–6). In this context, the concept of the “species *Homo economicus*” (Friedman 1996:3) was predicated upon Smith’s “propensity to barter, truck, and exchange one thing for another,” as the presumed driving force of exchange and all economic action. However, the assumption of biological naturalness or cultural universality of market exchange is problematic insofar as they hinge on definite sociohistorical conditions. Market exchange occurs only under specific social conditions, such as private property and contract law, and thus is subject to historical contingency—as suggested by the various negations of property rights—rather than being the result of inherent human propensities (Willer, Markovsky, and Patton 1989).

For instance, sociopolitical structure has historically antedated the emergence of markets, as well as governed non-market exchange, such as reciprocity and redistribution (Barber 1993; Beatty 1992). This is indicated by the historical evidence that, prior to the emergence of markets, exchange transactions were governed by the “rules of those in power” (Myrdal 1953: 197). Specifically, the market in the modern sense of a set of money-mediated exchange transactions (Weber 1968:636), far from being a perennial phenomenon, was probably devised as late as the sixth or seventh century B.C., with the invention of money<sup>8</sup> (Keynes 1972:64). Regarding the latter, Weber (1927:241) reports that in the form of coinage, money first appeared in the seventh century B.C.: the oldest mines were set up in Lydia as the result of the collaboration between the Lydian king and the Greek colonists.

From the substantivist perspective of economic sociology/anthropology<sup>9</sup> (Geertz 1992), one may object that the idea of the propensity for exchanging involved a misreading of the past, which then has become prophetic of the future (Polanyi 1944:43–45). Historically, in the economic life until the Industrial Revolution, which was in turn geographically and historically specific (Findlay 1996), ingrained exchange propensities were secondary factors in relation to the social parameters of exchange transactions (Granovetter and Swedberg 1992; Hirschman 1977; Polanyi 1944). These transactions were characterized by the predominance of political and other social structures over economic ones (Collins 1997:846). In particular, the impact of traditional forces is pertinent, since traditionalism is reportedly at the origin of economic phenomena, as they rest on the perceived sanctity of tradition (viz., “exclusive reliance upon such trade and industry as have come down from the fathers”) (Weber 1927:354–55). Moreover, the salience of social conditions is far from negligible in the later development of

economic exchange, as indicated by the critical impact of institutions and policy choices on the early stages of capitalism in Great Britain (Crafts 1996:197).

Institutional and sociohistorical influences permeate individual behaviors in economic exchange generally. Such behaviors often are induced by institutionalized motivation rather than by biological or psychological propensities. In this sense, exchange transactions are not a product of psychological but rather institutional and other social processes (Willer et al. 1989:316). For one thing, social institutions as well as historical contingencies shape individuals' preferences and incentives. More generally, the outcome of such institutional influences is institutionalized individualism (Bouricauld 1981:14), as distinguished from ingrained individualistic orientation (natural-born individualists) toward exchange transactions. For a market exchange emerges, exists, and functions within a definite institutional and social structure and, generally, economic activities take place within a specific institutional framework (Caldwell 1997:1871).

Hence, Smith's biology/psychology of primitive (and modern) economic man as a natural-born trader appears, in its simplification, reminiscent of Rousseau's equally simplistic political psychology of the noble savage (Polanyi 1944:45). There are two classes of reasons for the inadequacy of the concept of the rational economic actor (*homo economicus*) as a cultural universal or human nature genetically rooted in what modern sociobiologists and economists call selfish genes. One class includes cognitive and other psychological limitations to perfect economic rationality, especially complete knowledge or full information, accurate calculation, and precise foresight. Given these limitations, admittedly the sensible or rational thing to do is often to be in fact irrational, especially when the deliberation, estimation, and information cost is higher than its worth or benefit. In reality, social actors are essentially unable or unwilling to do what *homo economicus* is assumed to do so readily: calculating, maximizing, planning for the future, and so on. (Blinder 1997:11). Actors therefore live and act in a "world of rational indifference (or ignorance) of a principled refusal to compute" (Galbraith 1997:96). Moreover, one may add that *homo economicus* might not act the way "responsible people do" (Blinder 1997:11), despite some more conventional assertions or prescriptions (Rodrik 1996: 35) for an invariably rational and forward-looking agent.

At this juncture, the idea of bounded or adaptive rationality based on satisficing (i.e., "of finding a course of action that is 'good enough' ") (Simon 1957:204–5) makes more sense than the orthodox rational choice model premised on maximizing. At best, these approaches might make some sense only if the world were actually populated by *homo economicus* (Blinder 1997:11). Real-life actors are not optimizing automatons (Rosen 1997:148), in that they do not completely conform to the rationality as-

sumption in its extreme form (viz., *homo economicus* with vengeance [Bowles and Gintis 1993] within mainstream economics since the 1970s).

Another class of reasons for the insufficiency of the notion of rational economic man involves extra-psychological (i.e., sociocultural and historical) ones. More important from a sociological viewpoint, there are, alongside psychological boundaries, institutional as well as historical, cultural, and other social constraints on rational specialists (Rosen 1997:146). Consequently, rational individual behavior in exchange is hardly biologically programmed by selfish genes or psychologically conditioned (via stimuli-responses) but is the result of certain institutional arrangements (Caldwell 1997:1885). Rational economic man would thus be an institutional and a generally sociocultural-historical creation, not a product of genetics or individual psychology, as suggested by sociobiologists, economists, and behavioral sociologists. In the framework of economic sociology, humans are not natural economic optimizers insofar as they do not, “by nature,” seek to maximize wealth or money but only to live as they are “accustomed to live” and earn accordingly (Weber 1976:60). In this sense, economic rationality is a property of social-institutional arrangements, such as a modern exchange economy versus what Weber (1976:36) calls economic traditionalism, rather than of individual actors and their psychological makeup (Martineli and Smelser 1990). Moreover, in a neo-Weberian approach, *homo economicus* is no more than an ideal-typical construct, abstraction, or utopia. Thus, Weber’s concept of economic man as an ideal type in epistemological terms and a sociocultural-historical construction in ontological terms is different from that found in sociobiology (or biosociology), rational choice theory, and orthodox economics.

Relatedly, individual exchange transactions are interdependent and embedded in social contexts rather than independent and emptied by any social content. This latter is implied in the tendency of pure economists and rational choice theorists to model Robinson Crusoe (Conlisk 1996:686). For instance, rational choice theorists (Lindenberg 1992) propose a core model of man based on some variation of *homo economicus*, termed RREEMM (Restricted, Resourceful, Expecting, Evaluating, Maximizing Man). They neglect those social actors who find meaning or satisfaction in “herding together” and display aversion to the “risk of standing alone” (Anderson and Holt 1997:859). For these reasons, a realistic analysis of exchange phenomena should treat economic rationality, as embodied in *homo economicus*, as a proposition subject to historical-empirical scrutiny, not as a sacred precinct (Schumpeter 1950:84) beyond doubts or falsification as in rational choice economics/sociology. This latter approach involves a methodological *pas faux*: “By starting with rational agents, standard analysis get things exactly backwards” (Caldwell 1997:1885). No wonder some economists (e.g., Hayek 1960:60–61) have ridiculed *homo economicus* as a key assumption of orthodox economics as well as much

of rational choice theory. The aforesaid *fortiori* applies to the non-market forms of economic exchange.

## SOCIAL MOTIVATION IN NON-MARKET MODES OF ECONOMIC EXCHANGE

In this section we summarize the sociocultural and historical components and conditions of motivation in the non-market or primitive types of economic exchange, with secondary references to their market types, which we analyze in more detail in a succeeding section. Historical and anthropological research finds that social-cultural relations govern economic exchange, especially its non-market modes. Such findings corroborate the conception of the embeddedness of exchange and all economic action, which posits that the economy is embedded in a set of social relations, rules, and institutions.

As studies report for today's simple (primitive) societies, the entirety of exchange transactions constitutes an overall subsystem or pattern that is part of the "reproduction of social and ideological systems" (Parry and Bloch 1989:1-2). In these societies most actors are reportedly preoccupied primarily with their social relations/standing and related goals rather than with naked economic interest. Material goods are sought mainly as means or intermediate objectives to attain such ultimate ends. In consequence, non-economic motivations or ideal interests, including the ethics of absolute values, are most frequently (though not exclusively) driving forces in economic exchange. However, these motivations are not constant but vary in different societal types (*viz.*, a small primitive hunting or fishing tribe, in a peasant community, and in a large despotic society). The conclusion emerging from these studies is that individual material interests are seldom primary, given the crucial importance of maintaining social ties, since human passions focus on non-material goals and the operation of a "sociological compass" (e.g., customs, laws, religion, and magic) as a limiting factor, as a result of which the economy is submerged in a social-institutional context, of which markets are accessory features (Polanyi 1944:60).

In traditional societies, the community meets all of the basic material needs of its members. As a result, individual self-interest tends to be subordinate to that of the community. The individuals would be isolated from the community to the point of becoming outcasts should they violate the accepted code of status honor (Weber 1968:262), especially of generosity ("noblesse oblige"). In addition, mutualism and related ethical principles regulate economic exchange and other social relations. Thus, the economy and the entire society rest upon moral norms of reciprocity (Parry and Bloch 1989:77), as opposed to self-seeking with guile or post-contractual opportunism (Williamson 1983). And the various community events, such

as redistribution of food from the common catch, give additional force to such an attitude and behavior in economic exchange. Moreover, it is in the best self-interest for the individual actors to observe the principles of reciprocity and generosity because of the social sanctions with corresponding economic repercussions in case of violations. Oftentimes, only altruistic behavior overcoming selfishness is rational in both economical and social terms, because of the high social premium put on altruism versus egoism. Social actors often act as quasirational altruists rather than superrational egoists, as typically depicted in economics and rational choice theory. Non-utilitarian, non-instrumental, or intrinsic motivations thus give direction and meaning to economic exchange embedded in the context of social life. Extrinsic economic motives and the social institutions based on them reportedly tend to be weak. This is shown by the weakness or absence of the impulse of acquisition, the “so-called economic principle” (Weber 1949: 88–89), that is, the motive of profit, wage-labor, the rule of economizing, and differentiated economic institutions (Polanyi 1944).

These findings suggest the rejection of the idea of natural propensities, as the explanation for economic exchange as well as social institutions, because both individuals and their wants and types of exchange are culturally defined, which suggests that economic actors cannot be separate from “culturally defined intentions” (Humphrey and Hugh-Jones 1992:13). This especially seems to be true of early and traditional societies characterized by agricultural organization (Weber 1927:3). In these societies, individuals’ economic existence is based on their membership in the clan, and the “credit of the individual is normally the credit of his clan” (Weber 1927:45). In Polanyi’s terms, the importance of the rational market principle in economic exchange is secondary in relation to those of reciprocity and redistribution (Barber 1993:226–27). Hence, the non-market modes of economic exchange, such as reciprocal relations and redistribution, dominate the market mode (i.e., money-mediated transactions guided by cost-benefit calculations). In turn, the institutional pattern of symmetry undergirds the principle of reciprocity in such an economic exchange. The institutional pattern of centrality is the underlying social basis of the redistribution (including collection and storage) of goods, as practiced in primitive and historical societies (e.g., city-states, despotism, and feudalism). In consequence of the primary relevance of reciprocal and redistributive exchange, economic or rational factors are largely secondary. For example, there is no shirking of personal effort insofar as social organization encompasses economic exchange as a function of it (Firth 1961:122). The propensity to barter, truck, and exchange is weak or socially deconstructed, as shown in the nonexistence (or institutional prohibition) of the idea of private profit, for the supreme virtue is giving freely or reciprocating.

In sum, the social components of motivation in exchange transactions and other economic activities in these societies are clearly primary in re-



lation to some innate motives or incentives for such transactions. This especially applies to the presence of institutional components in economic motivation, which thereby becomes a property or an outcome of institutional arrangements rather than of some presumed human nature predicated upon biological (selfish) genes or psychological (maximization) tendencies.

## NOTES

1. This study reports that monetary and other extrinsic incentives offered to host locally unwanted projects, in fact, tend to crowd out altruistic feelings, civic duty, and other intrinsic motivation (Frey and Oberholzer-Gee 1997:752–53; Frey 1997).

2. For example, Andolfatto (1996) argues that because monetary policy and deposit creation are endogenous to the economy, money is endogenous to economic exchange.

3. Carruthers and Espeland (1991) particularly emphasize the symbolic and other extra-economic or non-rational functions of monetary accounting relative to the economic or rational.

4. As suggested earlier, since social distinction *is* the very social profit expected from interpersonal or intergroup comparisons, it seems tautological to say that social profits such as honors, titles, club memberships, and other symbolic goods yield societal esteem (Wilson and Musick 1997:696).

5. For illustration, the accounting (monetary) value of Coca-Cola's goodwill is probably higher than that of its economic resources, and the same can be said of other highly distinguished modern (including high-tech or Internet-based) corporations.

6. Podolny's (1993) interpretation leaves much to be desired in this regard: it overemphasizes the instrumentality of market status for organizational profits at the expense of the opposite relationship (*viz.*, corporate, and individual, profits as an instrument of attaining social prestige, as well as power and other non-economic rewards).

7. Fiske (1991:16) defines Market Pricing in the following way: "In a Market Pricing relationship people value other people's actions, services, and products according to the rates at which they can be exchanged for other commodities."

8. The market in the primitive sense of barter (without the use of money) and in the broadest sense of any exchange mechanism or institution has probably been a "fairly common phenomenon since the later Stone Age" (Polanyi 1944:43–44).

9. For instance, in Geertz's (1992:225) view, the "extended debate between economic anthropologists designated 'formalists' and those designated 'substantivists' [is] rather stalled for all but the most persevering." This burial of the debate within economic anthropology is curious, given that the academic debate about the economy (Granovetter and Swedberg 1992:1) between a formalist-economic and a social-substantivist perspective is far from being over in economic sociology. Moreover, the same can be said of modern economics that is in the middle of a paradigmatic struggle (Etzioni 1988:ix) or *Methodenstreit* between entrenched pure economists and challenging socioeconomists (Etzioni 1991: 7).

## *Chapter 4*

# *The Political Structuration of Economic Exchange*

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### POLITICAL INSTITUTIONS AND ECONOMIC EXCHANGE

The influence of political factors on economic exchange goes beyond the formal monetary function of state institutions. Such influence is more substantial than the regulation of money or monetary policy and expresses what Weber (1968:193) calls the “non-monetary significance of political bodies for the economic order.” And monetary policy itself can be driven not only by economic considerations but also by political ones. Recently, this has been indicated by the proposed creation of the European Monetary Union (EMU), since the decision “will not depend on economic advantages [but] will reflect deeply held political views” (Feldstein 1997:23). Still, the EMU started on January 1, 1999, with the launching of the new currency Euro. No wonder some economists (Fox 1996:55) suggest that their colleagues “need to lose their self-absorption and get into the world of non-economists.”

In Weber’s framework, the economic significance of political institutions consists of various ways or channels by which the state and polity overall affect economic exchange. One of these ways is political institutions’ preference of their own economic subjects as sources of a supply for resources or utilities. Another way lies in their tendency to encourage, restrain, or regulate exchange transactions across its boundaries (i.e., trade policy). Still another way includes various types of formal and substantive regulation of economic activity by political institutions. A next instance consists of the important consequences on economic exchange of the differences in the structure of authority, of political power, and relatedly of administration and social classes, as well as of different attitudes toward earning and profit

making resulting from such differences. The competition among the directing authorities of political institutions to increase their power indicates one more example of the economic pertinence of these institutions. Finally, such pertinence is exemplified by the differences in the ways in which political institutions provide for their needs (Weber 1968:193–94).

This suggests that the main non-monetary significance of political structures for exchange transactions in a modern economy consists of setting up an institutional framework for regulating and otherwise influencing complex exchanges. In this connection, some authors (Wagner 1997) propose that such an institutional framework be created for the purpose of conducting complex exchanges within the government, for the latter, especially the fiscal system, is conceived of as a network of exchange transactions (e.g., between taxpayers and the government, providing public goods in the amount of taxes received). This is premised upon the neo-classical (Wicksell 1934) exchange theory of taxation, assuming a connection between tax price and public goods (i.e., between tax and expenditure choices) (Musgrave 1997:161). The problem with this view is that it dubiously equates government with a market, claiming that government, like the market, is a “network of polycentrally ordered relationships,” or economic exchanges (Wagner 1997:160).

At any rate, the preceding also would suggest that decision making within these political bodies regulating economic transactions is a human enterprise (Fox 1996:54). It is a social action to which policymakers and other political actors attach definite subjective meanings and in which they take account of other participants. Hence, it is far from being an automatic operation guided by an invisible hand, or a behavioral chain of stimuli (incentives) and responses (rent seeking), as assumed by rational public choice theory (i.e., the economics of politics).

A neo-Weberian conception of sociopolitical variables in economic exchange is exemplified by a model of the institutional conditions of dynamic capitalism (Collins 1997:844, 850). These conditions include political institutions such as a rational state, an efficient legal system, bureaucratic administration, legal-rational authority or/and democratic governance, and related arrangements (Weber 1927:276–77). Generally, a neo-Weberian conception assumes that social institutions have relevant effects on the operation of the economy (Piore 1996:752). Particularly, it stresses that the structure and functioning of political institutions do matter for economic outcomes (Chari, Jones, and Marimon 1997:957) in a modern exchange economy. *A fortiori*, a traditional economy or economic traditionalism (Weber 1976:36–37) is characterized by the predominance of political over economic structures (Collins 1997:846).

An instance of institutional effects in a modern exchange economy is the tendency of political (and other) social institutions to make micro-level incentives or private interests convergent with macro-level goals or public

interests (Kollman, Miller, and Page 1997:977). Political institutions tend to correct market failures as expressed in externalities (e.g., pollution, depletion, dilapidation, etc.) and other discrepancies between individual and social rationality. Such failures indicate that the invisible hand of exchange assumed to, via a magical conversion (Mueller 1993:405), automatically transform private vices into public virtues is far from being sufficient but is to be supplemented by political instituting (viz., laws and other social rules in the image of the ruling group's ideology) (Mill 1884:155–56). The assumption of the crucial economic significance of political institutions is supported by the fact that it is the world of politics in which the most relevant and difficult decisions are taken (Fox 1996:55).

The ensuing analysis elaborates on these insights by combining evidence and theory to support the argument that political institutions crucially affect exchange transactions. For instance, legal rules and institutions, including those protecting private property rights and governments, set up the rules of the game in an exchange economy (Rosen 1997:150). In this sense, exchange, including competition, represents to some degree a legal-social arrangement. In general, perfect competition in exchange, far from being a robust state of nature, is a “delicate flower,” blossoming and surviving solely in specific political and other social conditions and because of active legal and other institutional “nurturing” (Carruthers 1997b). Further, legal rules, just as moral and other social norms, inevitably frame individual preferences (Etzioni 1988) and their expression (revelation) and realization in exchange transactions. Finally, laws, including constitutions, can, in combination with politics and ideology, be instrumental in sustaining the belief in or myth of the invisible hand of exchange (Stiglitz 1991), as in the United States, especially since the 1980s.

## THE STATE AND ECONOMIC EXCHANGE

### Government Size and Economic Exchange

For our purposes, compulsory taxation or state revenue extraction from economic actors can be taken as an indicator or a proxy of government's relative size. Taxation exerts direct and significant political influence on exchange transactions. This influence is exemplified by the impact of changes in taxation rates on certain features of exchange processes, such as the competitiveness of exchange agents in different countries. For example, analysts (Alesina and Perotti 1997a:930) estimate that an increase of taxes on labor (payroll, social security, and income taxes) by 1 percent of the GDP, from the average of 25 percent of the GDP for OECD countries, results in a 2.5 percent decrease in competitiveness—as measured by the equivalent rise in unit-labor costs—of a country's agents relative to other countries. Specifically, this effect would hold for countries with in-

intermediate levels of centralization of their labor markets (such as most European countries), so the effect is assumed to be lower both for those with highly centralized (Scandinavia) and (the United States, Canada) highly decentralized labor markets.

Comparatively and historically, the level of government taxation and public expenditure has varied across countries and over time, with a long-run tendency toward its increase. This tendency has been especially pronounced since World War I and the Great Depression, though with some reversals in the 1980s and 1990s (especially in the United States and the United Kingdom). Comparative historical data confirm this trend in major industrial countries from 1913 to 1990 (Tanzi and Schuknecht 1997:165).

Reportedly, the average share of government taxation/spending in the GNP increased almost fourfold between 1913 (11.9%) and 1990 (44.9%). As to the United States, despite talk about excessive federal spending and high taxes, the respective figure (33.3%) is far below (11.6 percentage points) the total average (44.9%) for developed countries (only Japan has a lower figure). Historically, the U.S. public taxation/GNP ratio has been consistently lower than the average for the group of developed and democratic countries. In terms of this ratio, the U.S. government has tended to be the smallest among developed capitalist countries over the entire period from 1913 to 1990.

However, these data suggest some nuances in this regard. For illustration, judging from the taxation/GNP ratio, the growth of the U.S. government was particularly rapid from 1937 (19.7%) to 1960 (27%) but, contrary to the popular political misconceptions, slowed down considerably thereafter (33.3% in 1990). In comparative-historical terms, the evolution of the U.S. government was convergent with that of the other developed countries from 1937 to 1960, and then became divergent in this regard. Such convergence reached the highest point, for example, in 1960, when the U.S. public taxation/GNP ratio (27%) was almost equal to the average for the group (27.9%).

At this point, most developed countries, including even the United States, seemed to converge to some type of the welfare state. The ensuing divergence (i.e., American exceptionalism in the [welfare] state) was indicated by the significant differences between the corresponding individual and average figures of public spending/taxation in 1990 (33.3% and 44.9%). Such a trend would suggest that the crisis or reduction of the welfare state in the United States is to be traced to the 1960s, rather than its inception (the late 1930s) or expansion (the 1940s–1950s), as in popular misinterpretations. Data provide other interesting stories in this regard as well, which further qualifies the above-noted convergence/divergence of most developed countries and the United States. While the United States converged with these countries upon the birth of the welfare state between 1937 and 1960,

it diverged from them, including Canada, in its consolidation and expansion after 1960.

In light of these comparative-historical trends, one may speculate that the welfare state project was a transitory political expedience (induced by the Great Depression) that has never attained wide acceptance and legitimacy among the American political conservative (*laissez-faire*) establishment and the larger individualist society in contrast to most developed countries, including the United Kingdom and Canada. Generally, while data for taxation and public spending (Tanzi and Schuknecht 1997) suggest that the expansion of the Western welfare state system took place between 1960 and 1990, the ensuing period often was characterized as its crisis, as witnessed by the various reforms of the system, including lower taxation. Despite these recent tendencies, however, except perhaps in the United States since the early 1980s, in no Western country has the concept and practice of the welfare state been explicitly abandoned. This is particularly indicated by the fact that since the late 1990s, the vast majority of Western European countries (except Spain), including Great Britain and Germany, have been ruled by leftist or centrist parties (social-democratic, labor, socialist), predicated on some ideas of the welfare state. If these parties reflect the mood of the electorate, then most Europeans (and perhaps Canadians) do not seem ready yet to jettison the project of the welfare state (i.e., a certain high level of government spending/taxation for purposes of enhancing public well-being, including reductions in income inequality).

In operational terms, a welfare state could be defined by a public spending/GNP ratio that is equal to or higher than the average (44.9%) for the group. Using such a criterion, the following countries can be characterized as welfare states: Austria (48.6%), Canada (46%), France (49.6%), Germany (45.1%), Norway (54.9%), Sweden (59.1%), Belgium (54.8%), Italy (53.2%), and the Netherlands (54%). In particular, the designation of big governments (Tanzi and Schuknecht 1997:167) can be applied to those having a public spending/GNP ratio of 55 or higher. Those countries approaching the mean (44.9), namely, Ireland (41.2), New Zealand (41.3), the United Kingdom (40), and Spain (42), can be termed semi- or quasi-welfare states or medium governments. And those far below this mean (around the 35 threshold) can be named non- or anti-welfare states or small governments, for example, Japan (31.7), the United States (33.3), Switzerland (33.5), and Australia (34.7). These can be deemed operational indicators of the welfare state and generally types of government. No doubt, such operational or statistical definitions can capture parts of the real-life complexity of the modern welfare state and other types of government, and thus can be only proxies for a substantive (sociological) definition.

Next, data pertaining to the OECD countries (Alesina and Perotti 1997a) as a whole indicate tendencies in (labor) taxation and two major categories of public spending, such as social welfare expenditures and government

consumption in the strict sense, for the 1960–1990 period. Specifically, these data give the average shares (percentages) of social welfare expenditures, government consumption, and labor taxation in the GDP for different years, and then the growth rates of each over the respective period. For instance, the average OECD share of social-welfare expenditure in total government spending was less than 10 percent (8.3%) in 1960 and almost doubled (15.3%) by 1990. In contrast, the average OECD share of government consumption proper in the total only increased slightly (from 15.1% to 17.3%) over that period. On the other hand, the average rate of labor taxation, of taxes on labor incomes, increased significantly (from 13.2% in 1960 to 21.2% in 1990). The picture emerging from the preceding is that both social welfare expenditures and labor taxation in twenty-four OECD (developed) countries have increased more rapidly (by 85% and 65%, respectively) over the previous levels than government consumption in the narrow sense (by 14.9%). Such trends support the observation that the period after 1960 was one of the consolidation and expansion of the welfare state within the developed world, albeit with exceptions such as the United States and Japan.

At this juncture, a digression on the nature of taxation and its impact on economic exchange in the United States may be in order. Taxation in the United States is reportedly constituted by two components, such as tax progressivity, as measured by the difference between the effective tax rates of different groups and symbolic ones. The latter are indicated by the differences between the nominal and effective tax rates of high-income groups. It seems that often sociopolitical and ideological considerations, rather than purely economic ones, have major effects on taxation in the United States. American political elites tend to sacrifice fiscal prudence, economic efficiency, and the common good, usually invoked as the reasons for conducting certain economic policies to sectional interests for the sake of political expedience (holding power) and ideological correctness (cultural war). Recent cases in point include balanced budget or flat tax policies promulgated by U.S. conservatives as bona fide attempts at enforcing fiscal discipline, promoting economic efficacy, and even achieving social justice, though attaining social distributive justice, especially fair taxation, through flat (proportional) tax rates, as urged by fiscal conservatives, is virtually unknown in practice. However, as in other cases, these efforts can hardly be taken at face value, for they seem largely driven by political objectives (as formulated, for instance, in the Contract with America) or any other ideological manifesto of U.S. economic, political, and social conservatives (especially in Congress and state legislatures) in the 1990s. The U.S. political structures have a common tendency to provide symbolic appearances of prudence and fair share in taxation to ensure increasingly skeptical political subjects, especially the middle-class electorate, about half of which does not vote (as in the 1992, 1996, 1998, and 2000 elections).

Such tendencies for nominal fiscal purity but actual political-ideological opportunism have been especially pronounced since the early 1980s, with the revival of supply-side or trickle-down economics and its sequel in the 1994 Conservative revolution. As recent research reports, these tendencies corroborate the argument that U.S. political elites seek to meet the demands of special interest groups and are concerned not just with actual policy but with symbolic appearances by presenting symbolic reassurances to placate the general public (Allen and Campbell 1994). Beneath these symbolic appearances, other actual processes and policies in American society have been in operation. These include the diminishing tax rate for the upper class and the increasing rates for the middle and lower classes in the 1980s and 1990s. In comparative terms, this tendency in relative taxation has been a peculiar if not a unique phenomenon to the effect that the United States (and perhaps Norway) is the only country where federal tax rates decreased at the top and increased at the bottom of the income distribution (Gottschalk and Smeeding 1997:675). Now, despite—or perhaps because of—this tendency, the American upper class has intensified its demands for lower taxes, particularly since the 1994 Conservative revolution (and its “Contract with America”). As a result, the capital gain tax—a tax most strongly affecting this class—has been drastically lowered (almost halved in the last two decades: from around 40% to 22% in 1997). Overall, income tax progressivity has substantially declined (Frank 1996:123). And, as if this latter were not good enough for the upper classes, their burgeoning proposals for a flat tax—so that everyone would be taxed the same amount in relative terms—aimed at doing away with tax progressivity altogether. In addition, such proposals of a populist majority in Congress and most states come into conflict with the classical economic principle (since Smith et al.), that fair taxation should correspond to the ability to pay and thus be progressive.

Overall, the findings reporting the key role of symbolic and other non-economic factors in government taxation corroborate the Paretian non-rationality hypothesis. According to this hypothesis, political elites are driven more by residues, derivations, and related irrational forces reflecting sentiments, false reasoning, and ideological delusions about reality than by logico-rational factors either at the individual (material self-interest) or social (the public good) level. The aggregate economic outcome of this is an exchange economy as a realm of power hierarchies and domination (i.e., as a set of markets as political structures) (Fligstein 1996a).

Finally, that political elites are driven by their self-interest is assumed by fashionable public choice theory, the new political economy or the economic theory of politics, which thus revives Machiavelli’s insights on the behavior of political elites. On the other hand, the traditional theory of economic policy within both neoclassical and Keynesian economics assumes that policy makers (unlike individual economic actors) are induced



by social rationality or the common good (e.g., economic growth and stability), thus following to a degree the Aristotelian tradition. Although both assume rational behavior in either individual or social terms, public choice theory seems inconsistent with traditional macroeconomics (Mueller 1978) and non-Machiavellian political theory. This indicates the dangers of indiscriminate extension of the principle of individual economic rationality to politics and to all society.

### **Big Governments, Welfare States, and Democracy**

The data on the differential (higher) increase of social welfare expenditure relative to government consumption proper suggest that the after-1960s period was not one of growth of big government, as in popular perceptions in the United States, but of the welfare state in the well-defined sense. The question may arise as to how to differentiate the welfare state from big government, and vice versa. While earlier we preliminarily assumed their equivalence or affinity, now we are able to further specify the operational definition of the welfare state versus big government.

Based on earlier data and implicit suggestions (Alesina and Perotti 1997a), the welfare state can be distinguished from big government in that the former implies a high level or an increasing rate of increases in social expenditure, but not necessarily in government consumption proper. Those countries that, over the 1960–1990 period, experienced an increase in social expenditure, as a share in total government spending, by 85% or higher can be characterized as welfare states, regardless of the increase in their government consumption. For instance, this applies to those countries that increased by that amount their spending on social assistance grants, subsidies, and other transfers rather than on general government consumption, including the military, police, and other forms of social control. Countries such as Sweden, Norway, Holland, Belgium, and Austria exemplify this pattern of spending more on social welfare than social control, versus those such as the United States (and undemocratic societies) exhibiting the opposite pattern.

In the first case, public revenues (tax proceeds) have gone back to the society, and in the second, they maintain the government, especially the police and military. Applying Keynes' (1960:115–18) multiplier in interaction with the principle of acceleration (Samuelson 1997a), the first implies a process of income multiplication and increase in overall social well-being, but not the second. Even in economic terms, social welfare spending in aggregate seems preferable to social control expenditures that appear economically irrational (except in the case of a strong military complex à la the United States making profits on selling weapons). At this juncture, it is paradoxical to term welfare states such as Sweden and others, with minimal military and other spending on social control, big govern-

ments, as it is to call small governments non-welfare states, including the United States, spending lavishly on law enforcement, crime control, and punishment, including police numbers and strength, enforcing public conformity (viz., imposing morality by law and other forms of social control, or, for that matter, on the military) (e.g., a decade after the end of the Cold War,<sup>1</sup> the U.S. “defense” budget is \$288 billion for the 2000–2001 fiscal year, an increase of \$18 billion over the previous year). This remark adumbrates the operational definition of big government.

Using quantitative criteria, big government in the strict sense can be defined as one that has increased government consumption proper (viz., non-welfare or social-control expenditure) by 15 percent or more during the 1960–1990 period (Alesina and Perotti 1997a). Ironically, this suggests that it is the United States that conforms to this definition of big government, alongside other democracies such as France (because of its high military spending) and non-democratic states (outside of the OECD). Generally, these trends urge the utmost caution in defining big government, particularly that the lump sum of total government expenditure (i.e., social welfare plus government [social control] spending) is inadequate and imprecise as a defining criterion. And so is *a fortiori* social welfare expenditure (viz., subsidies and transfers) when used separately as an indicator of big government. Rather, it is only the second element, general government expenditure or public consumption, to be used for operationally defining big or small governments, with the exclusion of social welfare expenditures, for many of the reasons noted above.

Of these, the main reason is that social welfare expenditure, understood as a reinvestment of public revenues (taxes) in society’s well-being, thus generating social profits, cannot be deemed government spending proper and thus a hallmark of big government, insofar as (as mentioned before) such an expenditure additionally generates economic profits via the operation of the Keynesian income multiplier in conjunction with the acceleration principle. Otherwise, we are left with paradoxical definitions and situations that welfare and democratic states (such as Scandinavian and BENELUX countries) are qualified as big and therefore undemocratic governments, while their polar opposites (including partly the United States) are praised as small and democratic governments. Such paradoxes are predicated on the spurious equation of small government with democracy, and vice versa, especially by U.S. politicians and academics. *Prima facie*, there is no necessary positive association of small governments with democracy, and alternatively a negative one between big governments (welfare states) and its counterpart. On the contrary, the opposite may often be true.

Moreover, some estimates (Bollen 1990) indicate that most welfare states, or in American terminology, big governments, have the highest democracy scores, higher than democratic non-welfare states or small governments (examined later are the effects of welfare state measures on

economic exchanges). For example, countries with big governments, such as Austria (97), Sweden (100), Norway (100), Netherlands (100), Belgium (100), Canada (100), and Denmark (100), all evince higher democracy scores than those with small governments, such as the United States (92). Incidentally, the United States' democracy score was the lowest (after France and Germany) among eighteen Western countries during the 1970s and 1980s, using certain dimensions of democracy. These dimensions are grouped into two categories. The first includes political liberties (e.g., freedom of [broadcast and print] media, civil liberties, and group opposition). The second defines democratic rule by political rights, competitiveness in the nomination process, chief executive elected, and effectiveness of the elective legislative body (Bollen and Paxton 1998). Further elaboration of these issues belongs to the province of political sociology, and thus is outside the scope of this work. Since the present analysis proceeds along the lines of economic sociology, it is concerned not with political processes as such but with their impact on economic variables, including exchanges, that is, with issues of political economy.

### **Estimating the Effects of Government Size on Economic Exchange**

In a neo-Weberian economic sociology, the question arises about the impact of government power (i.e., public taxation and spending) on exchange and generally on economic efficiency. One possible answer can be based on the reported curvilinear association (represented by an inverted U curve) between government spending and economic efficiency in the sense of diminishing returns to increased spending (Hansson and Henrekson 1997; Tanzi and Schuknecht 1997). Medium-sized governments (in terms of spending) would be more efficient in both economic and social terms than either small- and big-sized governments. These effects of government expenditure/taxation on social-economic performance have been further specified as follows (Tanzi and Schuknecht 1997).

Thus, medium-sized governments, defined as those with public expenditures between 40 percent and 50 percent of the GDP, are predicted to achieve a faster rate of economic growth (2.6%) than both small-sized and big-sized governments (2% and 2.5%, respectively). However, medium-sized governments are expected to have a higher unemployment rate (11.9%) than either small (6.6%) or big-sized governments (8.5%). This seems an unexpected result, because if medium-sized governments grow faster than others, then one could expect that they also have lower unemployment rates than the latter. Expectedly, the public debt/GNP ratio would be the highest in big governments (79%), and the lowest in small governments (53.3%), with medium governments at intermediate levels (59.9%). Interestingly, the size of government is found to have almost no

impact on inflation, contrary to the conventional wisdom relating this to a certain type (big) of government. The inflation rate is expected to be almost identical (3.7% to 3.9%) in all types of government, and thus independent of public spending/taxation, including budget deficits typically associated with big governments. More consistent with theoretical expectations, the size of government reportedly has no impact on life expectancy, as this is the same (77%) in any type. Also consistent with expectations is the result that income inequality is lowest in societies with big governments. This is indicated by the finding that the income share of the poorest 40 percent of the population is higher in big governments (24.1%) or welfare states than in small (20.8%) and medium (21.6%) governments, or quasi- and non-welfare states. These findings relate to different distribution indices (subsidies and transfers): big governments' index (30.6%) is higher than those of small governments (14%) and of medium governments (21.5%). Overall, the results are inconclusive. For instance, medium-sized governments would have a higher unemployment rate (11.9%) as well as higher infant mortality (7.1%) than their counterparts. Some other findings are also curious, such as those on inflation, public debt, and so on. For example, one would expect inflation and public debt to be lower, not higher (3.9% and 7.9% respectively), in small-sized governments than in others.

Hence, if it is indisputable that state taxation/spending affects exchange and other economic processes, its concrete effect on economic efficiency or equality, despite the current politically and ideologically correct arguments against big government and for a *laissez-faire* market, is still unclear. It is far from empirically established that small-sized governments or traditional night-watchman states are socioeconomically more efficient than medium- or big-sized governments, as these arguments imply. Moreover, this conventional wisdom, reestablished in a post-Keynesian world that posits a negative impact of public taxation/spending on economic performance, may be on more fragile empirical grounds than usually thought. This applies to an unexpected case, the United States. Such an impact has been far from certain during the postwar period, contrary to the current views of a populist majority (Samuelson 1997b:156) in Congress, state legislatures, and the American political landscape generally, especially since the 1994 Conservative revolution. In fact, the effect seems to have been the opposite, specifically in the United States. Whereas its tax-GDP ratio is at the bottom among industrial societies, periods of vigorous economic performance have coincided with taxation exceeding post-1994 levels (Musgrave 1997:156).

At this juncture, particularly curious is the recent tendency that "even in the face of burgeoning income inequality, the United States has the least progressive tax structure of any industrial nation" (Frank 1996:122). Such a tax structure seems sustained and rationalized by the conventional economic wisdom positing a negative association between economic efficiency and social justice (*viz.*, between the Pareto principle of optimum welfare

and the notion of fairness (Kaplow and Shavell 1999). However, this presumed trade-off appears dubious in empirical terms. The experience of European welfare states, Japan, and partly the United States in the 1950s and 1960s shows that it is possible to build an economy that both operates efficiently and promotes the value of an equitable society (Musgrave 1997: 159). Moreover, the relationship between efficiency and equity (viz., between economic growth and income equality) may be, especially in the long run, opposite (i.e., positive) to that assumed by orthodox economic ideology in the United States and elsewhere. Simply, there is no necessary trade-off between efficiency and justice or fairness. Notably, income equality—though equity cannot be equated to equality—may in fact further economic performance, especially growth, and vice versa (Rodrik 1996; Sylwester 1999). At minimum, it does not always negatively affect this performance, despite many economists' contrary claims based on their unlimited (deistic) faith in the market's invisible hand (Worland 1993:59). For example, empirical studies report that in most countries initial income equality around 1960 is "robustly and positively correlated with growth over the next three decades" (Rodrik 1996:21).

In methodological terms, the direction (i.e., positive or negative sign) of the effect of public taxation, expenditure, and other political variables on the economy is secondary from a sociological perspective on economic exchange, though it is crucial for economics or economic policy. It is not a primary task of a sociological analysis of the impact of political (and other social) factors on economic exchange to ascertain if this effect is positive or negative in terms of efficiency. This would be the job of economists and policy makers. Rather, the proper task is only to identify and analyze the overall *substantive* salience of such effects. In Weber's terms, the analysis examines the significance of political bodies for exchange processes, regardless of whether this significance is favorable or unfavorable according to a standard of economic efficiency or equality/equity. The advantage of such an analysis lies in a reasonably value-free methodological position that avoids value judgments, so often found in orthodox economists' a priori pronouncements on the pernicious intrusions of the state, politics as well as morals, religion, and culture into the economy. In this sense, a neo-Weberian approach is simply neutral in terms of political, ideological, and other valuations. Such an approach does not lament over or praise such assumed or actual effects but only reveals and examines them, without engaging in the ideologically charged debate of *laissez-faire* or government failure versus state intervention or market failure.

## THE IMPACT OF OTHER POLITICAL FACTORS ON ECONOMIC EXCHANGE

Other political factors that have an effect on exchange transactions and other economic activities include short-term fiscal and other policies, wel-

fare state measures, and direct government regulation of the economy. Not only long-term strategies in terms of a definite tax structure and fiscal monetary system, but also short-term government fiscal policies and other regulations can significantly affect the functioning of the economy. One prominent example of such policies is the policy of budget deficits, surpluses, or balances. For instance, some empirical studies of the U.S. budgeting process (from 1961 to 1979) found that budget outcomes (deficits or surpluses) were not only stabilization measures of a Keynesian fiscal activism intended to mitigate business cycles, or were gimmicks aimed at creating and exploiting political business cycles in elections. These claims were implied in the conventional theory of economic policy, the first in macroeconomics and the second in its public choice extensions. However, such claims were mutually contradictory, a contradiction overlooked by most public choice theorists. For the first claim implied furthering the public interest through macroeconomic stabilization, the second, of government incumbents' private interests by electoral manipulation of the economy (Hicks 1984).

Ironically, this contradiction between macroeconomics and public choice theory suggests that the economic approach to all human behavior, including politics, can be the nemesis of economics as a science. For public choice theory denies the basic assumption of traditional macroeconomics, both neoclassical and Keynesian, that government officials attempt by appropriate economic policies to advance the stabilization and growth of the economy and thus the public interest, rather than seeking rents or private interest. Thus, the application of the fundamental microeconomic axiom (utility maximization) beyond its original realm to politics and other non-economic behavior in part conflicts with macroeconomics, especially the theory of economic policy.

So both conventional macroeconomics and public choice theory fail to envision that fiscal outcomes (deficits, for example) are not necessarily either macro-stabilization instruments promoting the common good or the election tricks of profit-seeking Machiavellian public officials. Instead, they are reportedly driven by class considerations, in that they favor one set of exchange actors (e.g., business) versus others (labor), as in American hard-line capitalism (Dore 1992: 174), or vice versa, as in some European welfare states (Germany, Sweden, the United Kingdom under labor rule before Thatcher, etc.). As such, fiscal policies and outcomes represent the means of the monopolization and control of exchange processes, especially conflicts in labor markets. Finally, fiscal policies can simply be the result of budgeting inertia. All of these facets and effects of fiscal policies on the economy are especially evidenced by the complex and multiple sources of U.S. past budget deficits (and current or future budget surpluses) and their effects on exchange processes (Hicks 1984).

Hence, in contrast to economic theory, including its public choice extensions, most sociological studies of budget policy indicate that the latter is

not just a rational procedure based on economic parameters but a political process with definite implications for exchange actors. Thus, some economic actors can be favored and others not, depending on such imponderables as political preferences and partisanship. For example, in research investigating U.S. economic policy from 1947 to 1977, fiscal policy is portrayed as a highly politicized instrument used within a political system with tenuous legitimacy and a fragile social order by the government to ensure private capital accumulation, to placate conflicting classes (and factions), and to redirect or reject demands for radical change (Devine 1985).

As mentioned before, other government strategies and policies with implications for exchange processes include welfare state fiscal and other measures. This is especially true to the extent that such measures amount to substantive changes in distribution patterns spontaneously arrived at in exchange transactions and networks in the market. On the other hand, the effect on welfare state policies of exchange processes is contingent upon the nature of the polity and society.

For example, different political systems, especially state institutions in Great Britain and the United States, have reportedly produced different welfare state policies that, via redistribution effects, have divergent implications for exchange processes. As historical studies report, Great Britain was the pioneer in establishing a contemporary welfare state prior to World War I by instituting labor compensation, old-age pensions, health insurance, and the compulsory system of unemployment insurance (first in the world). In contrast to Britain and other European countries (e.g., Germany, France, etc.), the United States failed to establish a system of pensions and social insurance for a long time, namely, until the late 1930s, under the impact of the Great Depression, and of course never (as of yet) instituted national health insurance. Historically, one factor in such failures was that while Great Britain and other European societies featured a strong civil service and pragmatically oriented political parties, the United States had no tradition of established civil bureaucracy and was entangled then, as it is today, in its characteristic patronage politics of special interests (Amenta and Carruthers 1988; Orloff and Skocpol 1984). This factor also can in part explain the lack of a system of national health insurance in the contemporary United States, virtually the only industrialized society without it (Fuchs 1996), thus manifesting its new (or perennial) exceptionalism in this regard.

In retrospect, such findings reporting state autonomy in relation to sectional interests and generally the economy support the premise of an autonomous character of social, including political, action relative to an economic one, a premise denied by historical materialism and rational choice sociology, which construe the state as an epiphenomenon or appendix of the material factor (Weber 1977:87). Such a premise can partly explain the trend toward increases in government spending on social wel-

fare and other programs in most industrial countries (except the United States), for this trend is not driven by exclusively economic factors but by political, ideological, moral, ethnic, religious, and other non-economic considerations. Unlike these findings stressing state autonomy vis-à-vis economic processes, others instead portray the welfare state as a mediator between divergent individual and group (class) interests. Some analysts argue this by invoking the enactment of certain welfare measures in the United States since 1935. For instance, the 1935 Social Security Act, heralding the welfare state, American style, reportedly was—as is, for that matter, the 1996 welfare reform—a conservative measure linking social insurance benefits to work participation, as the government operates as a mediating body incorporating labor demands into legislation on capital terms (Quadagno 1984).

Evidence also is available for the interest-group politics hypothesis emphasizing the interrelations between state institutions and economic actors (Pampel 1988) and for the class-based paradigm positing class determination of welfare policies and their redistribution effects (Korpi 1989), including some paradoxes of redistribution due to its unexpectedly weak (and even negative) effects on reducing income inequality and poverty (Korpi and Palme 1998). Still, in many cases (e.g., economies with credit constraints), low redistribution translates into a more persistent income inequality, with the two mutually reinforcing each other (Benabou 2000). Alternatively, in other cases (viz, economies with imperfect credit and insurance markets), redistributive policies can by decreasing income inequality enhance (ex ante) social welfare (though political support for such policies is expected to decline with increasing inequality).

Historically, there have been several distinct routes in the emergence of welfare state policies, each with specific implications for exchange processes, especially distribution. These routes include the following (Hicks, Misra, and Ng 1995). One is the Bismarck-type, which resorts to strategic co-optive responses of patriarchal states and state elites to working-class mobilization. Another is the Lib-Lab, with its strategic incorporation of labor parties and/or unions into governing Liberal coalitions. And still another is the Catholic, as found in patriarchal, unitary states confronting working-class challenges. At this juncture, a significant positive effect is obtained regarding social democratic as well as Demo-Christian political systems on welfare policies and through them on exchange. Specifically, both social democratic and Christian democratic incumbency are pertinent predictors of welfare state strategies, though social democracy is linked less to social security benefits and transfer payments than to the public sector's overall size, with Christian democracy displaying an opposite, yet an even more relevant, pattern for the expansion of the welfare state (Huber, Ragin, and Stephens 1993).

In addition to short-term economic policies and welfare measures, mod-



ern states often engage in the direct regulation of economic processes, which affects exchange actors in many ways. In turn, actors' reactions to such regulations can range from acceptance to indifference to opposition, depending on their position in exchange networks in the market. Specifically, the actors occupying central positions (nodes) in these networks tend to resist state and any exogenous regulations that will adversely affect these positions. For example, most members of the economic group with the highest degree of centrality in the exchange system (large capitalists) resisted the introduction of the New Deal as a measure par excellence of state economic regulation. More precisely, since by 1936 most members of the capitalist class opposed the New Deal, its reforms were initiated and implemented by government officials over such opposition of organized capital (Allen 1991).

Another avenue of state regulation of exchange processes is government property rights interventions, by which certain exchange processes and actors are encouraged and others are discouraged. For example, the U.S. government has historically had a strategy to encourage via property right actions large exchange processes and organizations at the expense of small ones, though such a strategy may weaken this capacity of state action in the long run. Thus, far from its having a feeble capability for economic intervention, property rights actions afford the U.S. government a previously unrecognized or unutilized source of strength by transforming and shaping the organization of the economy through such actions (Campbell and Linberg 1990). On the other hand, some governments have supported for political expedience small exchange actors, as in the case of authoritarian or conservative political regimes. Historically, such states as Imperial Germany during Wilhelm II, Italian and German fascism, and Spain, Portugal, and Greece under authoritarian or military rule (until the mid-1970s) have more or less courted, by legislative and other measures, small businesses in order to consolidate political support (Steinmetz and Wright 1989).

## **POLITICAL IDEOLOGY AND ECONOMIC EXCHANGE**

This section's purpose is to examine the influence of political ideology on economic exchange. The hypothesis that exchange actors are hardly politically neutral or unaffected by political-ideological considerations is supported by ample evidence, thus dispelling the ruling myth of the end of ideology in the economy and society. Presented are three instances of the influence of political ideology on exchange transactions and related economic processes. One instance is the impact of ideology on the behavior of exchange actors as well as those political subjects regulating economic processes. Another is the effect of ideological and related values on health spending in an exchange economy. And still another is the bearing of cur-

rent political ideology on distribution, especially on efficiency and income equality.

### **Ideology and Economic Behavior**

One example of the salience of ideological factors in economic processes is provided by the behavior of large corporate actors in the United States in the 1980s and 1990s. Reportedly, this behavior has conformed with the East–West (Yankee–Cowboy) hypothesis of political-ideological divergences and with the hypothesis that differential attitudes to government intervention shape the political conduct of exchange actors. Specifically, judging from research findings, no evidence of corporate liberalism was found in the 1980s—and even less so in the 1990s—a period of reportedly unparalleled hegemony of capital, especially the business elite, in American politics and society, with its liberal counterpart being restricted to periods such as the early post–World War II era (Burriss 1987).

The common ideological thread of these attitudes was thus increasing conservatism to the point that shared Conservative ideology among these exchange actors generated a higher degree of unity than any other variable, economic or non-economic. As an illustration, in the 1980 U.S. presidential and parliamentary elections, shared Conservative ideology generated a larger degree of unity than any other factors, as corporations, through sharing a strategy of donating to key Conservative candidates, succeeded to unify in a large, cohesive group (Clawson and Neudstadt 1989).

Other historical and empirical findings also support the hypothesis of the pertinence of political-ideological considerations for exchange actors and systems. For instance, in the 1972 U.S. elections, most members of wealthy capitalist families contributed overwhelmingly to the Republican candidates (Allen and Broyles 1989). A similar pattern was found in the 1936 elections: 1 out of 3 capitalists contributed to the U.S. presidential campaign, one 1 out of 12 contributed to the Democratic Party (Allen 1991). Data also point to the tendency for (large) exchange actors in the United States to use wealth as the instrument for gaining political power and influence. As reported, increasing aggregate concentration is instrumental in corporations' successful mobilization to reach their political goals, so the evidence corroborates the suspicion that the great resources or economic power of corporations can be translated into overwhelming influence in the polity or political power (Etzioni 1988:217–36), as conditions enhancing their organizational capacities are conducive to public policies favoring their “core political interests” (Jacobs 1988). This suggests that profit or wealth cannot, even in American capitalism, always be considered ultimate goals in economic exchange but immediate objectives and thus the means to further the ends of a political and generally non-economic character. Historically, the political and social aspirations of the various business (or

robber) barons in the United States and elsewhere indicate this tendency to ultimately convert wealth into political power as well as social honor. In retrospect, such a tendency exposes the fallacy of imputing exclusively materialist interests to economic and other social actors, as committed both by the purely economic theory of exchange and rational choice models of social exchange.

In turn, political-ideological views often are grounded in definite cultural patterns. Specifically, cultural origins can be more pertinent for exchange actors' ideological attitudes and exchange behaviors than economic or class positions. As some studies (Barton 1985) report, for explaining the U.S. business elite's ideological differences—ranging from extreme right-wing conservatism to redistributive liberalism—class origins are less relevant than cultural, including religious and ethnic, ones. This suggests that for the variation of economic attitudes and activities within the American business elite, present economic status, along with corporate size and type, has secondary explanatory value (Barton 1985).

In addition to economic agents, ideological considerations matter in the behavior of those political subjects and institutions that regulate and otherwise influence exchange. For instance, a study (Levitt 1996) reports that in the behavior (decision functions) of U.S. political representatives (senators), ideology weighs far more than anything else, including voter preferences and constituencies. Given estimate weights or shares in U.S. senators' decision functions, especially voting behaviors in Congress, this study indicates that overall state voter preferences and support constituency both weigh a certain amount (13%, or .13, in probability terms), as does party line (14%) and senator ideology (60%). Thus, the likelihood that U.S. senators will vote and generally politically act driven by their personal ideology is higher (60%) than all other factors combined (40%). Moreover, the variable party line can be deemed as more or less reflecting ideological preferences. This is even more true the more the party is ideological as, for example, the Republican Party has admittedly been since the 1994 Conservative revolution (especially in the House of Representatives, suggesting that the eventual estimates of the representatives' decision functions might give an even higher weight to ideology). If so, then the weight of ideology in senator voting behaviors can be considered higher (at around, say, 70%) by adjusting for the amount of party line's share (with a range of 2% to 25%), as both parties have increasingly become ideological since 1994.

Generally, these findings indicate that ideological considerations are more important in senator decision functions (voting) than in all other considerations. Overall, around three thirds (e.g., 60% to 70%, depending on the inclusion or not of party line) of the variation in these voting functions is explained by ideology and thus by what Weber calls ideal interests or transcendental values, rather than by material interests or economic rationality (as argued by public choice theory). For instance, the argument

for balanced budgets has taken on properties of an ideological-religious crusade battle in the United States, especially since the 1994 Republican electoral victory. Often the instant budget balance is treated, particularly by Conservative ideologues and politicians, as a “fetish overriding all other concerns” (Musgrave 1997:158).

Moreover, such ideological zealotry<sup>2</sup> concerning the balanced budget can be self-defeating and irresponsible in the very economic terms in which it usually is couched. This is especially likely, given the possibility that sometimes counter-cyclical fluctuations and thus unbalanced budgets may be, in fact, what is needed to dampen the cycle (Musgrave 1997:163), that is, to prevent or remedy major economic crises, especially depressions, thus casting doubt on the notion that budget balancing must be a primary economic concern (Shaffer 1999). More generally, the recently established American dogma of balanced budgets is an aspect of the nirvana approach to the economy (and society) by orthodox economists and Conservative politicians in the United States, especially regarding their fiscal and monetary Puritanism. Not surprisingly, prominent economists (Samuelson 1997b: 156) warn<sup>3</sup> about the probable pernicious economic consequences (similar to those in the 1930s) of the ideologically charged and yet economically irresponsible behavior of such a populist majority in the American Congress and outside of it (*viz.*, most states since 1994).

All of this suggests that political bodies such as parliaments (including Congress) are more ideological than the end-of-ideology thesis assumes and thus more irrational than the economic (public choice) model of politics claims. More important to the question under examination, it implies that, as these bodies have not only technical monetary relevance but substantive economic significance (Weber 1968:193), such ideological orientations extend over and influence the realm of exchange (Morishima 1990:52–53), including organizational behavior, for example, maximization of shareholder value as a “new ideology for corporate governance” in the United States (and elsewhere) in recent years (Lazonick and O’Sullivan 2000). No wonder even economists call a free exchange economy an ideological-political desideratum (Myrdal 1953:3), specifically an offspring of the doctrine of *laissez-faire*, as in the Church of England (Keynes 1972).

### **Ideological Values and Health Spending**

Furthermore, divergences in ideological values can constitute a major factor, often an impediment, in the functioning of the exchange economy and rational decision making. This is shown by the ideological-political controversies surrounding the form and direction of the U.S. economy and society, particularly its health care system. For instance, value differences among policy makers as well as most Americans are reportedly a key obstacle in effective decision making in various domains, including health care

(Fuchs 1996:1), as are those among economists themselves<sup>4</sup> (and sociologists).

A sample of this debate of the U.S. health care system exemplifies the relevance of such ideological cleavages in terms of rational reconstruction of this and related segments of the economy (and society). On the one hand, starting from definite ideological positions, some authors expose the contradictions of state liberal intervention in the health care system, and generally the economy, and treat the attempt to expand health care as one of the most controversial issues in the development of the U.S. welfare state. In the United States, observers remark that this step-by-step growth of government regulation in a political climate endorsing private enterprise and markets in health care is the paradox of liberal intervention (Ruggie 1992). On the other hand, others with different ideological preferences observe the continuing commodification of the American health care system as a result of this state intervention that generates a new legitimation crisis of the economy and polity. Arguably, in light of the spiraling health care costs and the (in)human consequences of (not) being insured, the idea that health care is to be regarded as any other private commercial product or commodity versus a public right (Shaffer 1999) will tend to produce a new crisis of legitimacy (Imesshein, Rond, and Mathis 1992). In passing, the experience of Canada versus the United States supports a positive relationship between a national health care system and positive health outcomes. For example, in Canada, the introduction of national health insurance has been related to a 4 percent decline in the infant mortality rate, as well as to an average decrease of 1.3 percent in the incidence of low birth weight for the total population and 8.9 percent for single parents (Hanratty 1996: 276).

More important for economic sociology, one can identify the political, ideological-cultural, and other social conditions for the absence of a national health care system and generally the character of the economy in the United States. Economic sociology's question is thus, "Why is the United States the only major industrialized nation without national health insurance?" (Fuchs 1996:22). Some analysts suggest four possible reasons for America's lack of national health insurance: a distrust of government, the heterogeneity of the population, a weak sense of noblesse oblige, and strong private voluntary organizations (Fuchs 1996:22), alongside proverbial special interests or patronage politics.<sup>5</sup>

These divergent ideological values or interpretations of researchers, just as of policy makers, often reflect the underlying ideological-political cleavages among individuals and groups in the economy and society. Such differences affect significantly the nature, structure, and operation of a given economy or a part of it, including the American health care system. The relevance of political-ideological and other extra-economic variables for

economic processes holds at the cross-national level as well, especially when comparing American and European health care systems.

### **Ideology and Economic Efficiency/Equity**

As suggested earlier, orthodox economic ideology in the United States and elsewhere includes head-in-sand (Frank 1996:123) economic theories assuming a necessary trade-off between efficiency and equity. In practical terms, such an ideology is reportedly instrumental in politically and scientifically sustaining a fiscal structure that is the least progressive, the least fair (Frank 1996:122), and with the lowest tax-GDP ratio (Musgrave 1997: 156) among industrial countries, with further trends in this direction from 1994 on.

However, real-life economic behaviors seem to cast doubt on such orthodoxy. People evidently seek not only absolute income by comparing their own income in intertemporal terms (e.g., over years), they also pursue relative income by comparing their absolute income levels with those of others, including neighbors and other reference groups. Thereby, they engage in Veblenian pecuniary emulation or invidious comparisons, thus constructing social comparison functions (Markovsky et al. 1984). These functions can be viewed as variations on the theme that happiness is a comparative category. However, this dictum would not apply to Robinson Crusoes or socially isolated monads (Frank 1996) living in a Hobbesian anti-social state of nature, but to humans as social creatures in the Veblen-Weber sense of seeking status honor and generally approval within society.

On the assumption of pecuniary emulation (seeking relative income) and generally a ubiquitous human concern for social approval, taxes on the highest (absolute) incomes would not greatly diminish work and economic efficiency. On the contrary, if economic satisfaction and generally happiness hinge on relative as well as absolute income, this implies that people will tend to work too much<sup>6</sup> (Frank 1996:122). Therefore, no tax rates (short of confiscation) could eliminate this tendency toward Veblenian invidious social comparisons through striving for relative income, though the negative effects of high taxation on pursuing absolute income cannot be ruled out. However, conventional wisdom conflates the impact of taxes on seeking absolute and relative income in that the assumed (and empirically possible) trade-off between efficiency and equity with respect to *absolute* income is posited for *relative* income as well. But this does not seem defensible. If people tend to engage in pecuniary emulation and other social (invidious or not) comparisons, high taxes (below the maximum threshold of extortion) are not likely to reduce their willingness to work and economic efficiency. Moreover, if the Veblenian status hypothesis is correct, high taxation would, ironically, enhance work and economic efficiency to

the extent that increases in taxes stimulate further emulation in *relative* income to compensate for these tax increases and loss of absolute income.

This inverts the cherished premise of economic orthodoxy, that there is a trade-off between efficiency and equity, so taxes on the highest absolute income, as vehicles of distributive justice, would make people work less and less efficiently. If people care not only about absolute income in intertemporal (over years) and accounting terms but about relative income or pecuniary standing in interpersonal or intergroup comparisons, then they would work longer and more efficiently, regardless of the level of taxation (except for state predation). In sum, while taxation would critically affect seeking absolute revenue in an economy of Robinson Crusoes<sup>7</sup> (Conlisk 1996), it is less likely to have such an effect on the pursuit of relative income in that society—and economic actors exist and act in a societal economy.

The aforesaid suggests how the presence of ideological-political factors in the epistemology of conventional economic theory and in the ontology of exchange tends to obfuscate a simple fact. This is that economic actors are complex social creatures that seek not only money or wealth per se (absolute income) but social approval or prestige (via relative income). Notwithstanding, orthodox political-economic ideology resorts to Paretian derivations to rationalize a tax (and politico-economic) system based on a spurious trade-off between economic efficiency and social equity.

## MARKETS AS POWER CONSTELLATIONS

Evidence and theory suggest that exchange transactions are profoundly affected by power and domination. To the extent that these transactions are forms of social action, they are not only, to paraphrase Weber, economically oriented but power oriented and determined. In theoretical terms, this assumption differs both from the pure economic treatment of exchange transactions as devoid of political and other extra-economic elements, and from the rational choice model of political (and social) life as an extension of these transactions. Hence, we assume that exchange transactions are contingent upon definite power variables rather than being invariant vis-à-vis these.

This assumption seems *prima facie* plausible, given the fact that political factors, particularly the state, are of primary relevance among those social structures that impact on economic actions (Weber 1949:45). At this juncture, the impact of political power on exchange transactions has been a particularly salient fact. In addition to the historical precedence of power over market exchange (Myrdal 1953; Polanyi 1944), in the modern economy, exchange variables such as prices often are outcomes of power relations and related political factors (Weber 1968:85–86). Hence, the market can be characterized not just as an instrument of considerable political

(corporate) power but also as a domain of exercising and translating this power (e.g., control of and influence on government) into its economic forms, including monopolistic domination in the economy (Etzioni 1988: 217–36). In Weber's (1968:939) terms, exchange is based not just on domination by constellations of interests or economic domination but also on domination by authority or political domination. This is especially so given the historical tendency (Weber 1968:939–42) of the former, especially capitalistic monopolies, to transform itself into the latter as a way to politically legitimate economic domination, including monopolization. Such a tendency is associated with the possibility that institutional arrangements determining the structure and operation of markets can be altered if those seeking change possess sufficient political power (Myrdal 1953:197). On the one hand, the salience presence of such arrangements indicates the relevance of the institutional setting within which economic exchanges are generated (Wagner 1997:162). On the other hand, such settings and thus economic exchange can reflect power relations between various political actors.

For instance, the current (and perhaps perennial) issue of free international trade versus protectionism often is more of a political matter than a purely economic one, and thus is decided by largely extra-economic considerations. This was partly indicated by the virtual irrelevance of the free trade issue in the U.S. 1996 presidential elections, with the public almost ignoring both the pro and con arguments in this regard. Such non-economic considerations in the free trade case include the opinion of the broader public (Levy 1997:508–9), as well as that of certain narrow constituencies, state officials, parliaments, and other political actors, including interest groups. Such a decision often expresses the opinion of the public, usually poorly informed or apathetic in such macroeconomic matters. The case of the North American Free Trade Agreement (NAFTA) and its impact on public attitude toward free trade suggest that political support for multilateral free trade treaties presupposes understanding the “political situations in all participant countries” (Levy 1997:519). The outcome of the free trade debate will usually depend on the relative or bargaining power (McLaren 1997) of the actors involved rather than on exact calculations of the benefits (or costs) of such markets. Taking the United States and Canada as examples, analysts (McLaren (1997:400) observe that since the loss of bargaining power completely influences the relations between the two countries, the trade-off “might be a price the small country must pay in ‘sovereignty’ for the benefits of free trade.”

Such neglect of economic calculations usually happens in the political arena, even though these gains from free trade (Krugman 1997; Rosen 1997) should presumably be obvious not only for laissez-faire economists but also for rational policy makers or power holders. Since the decision about free trade or not (protectionism) is ultimately more political in char-



acter than economic, it reflects power relations or authority patterns among actors (e.g., big and small firms). Particularly, the free trade decision can express the domination of ruling classes, elites, or oligarchies rather than a rational choice in terms of gains and losses made by a perfectly neutral and enlightened economist engaged in endless calculations and derivations to prove (or refute) the case of free trade. For example, the underlying goal of infamous U.S. international trade negotiations is protecting domestic firms from themselves rather than from “unfair” foreign competition (Krugman 1997), contrary to what the American government routinely claims. To take one example, when the United States imposed “utterly indefensible restrictions on Mexican tomato exports, an official remarked that Florida has a lot of electoral votes while Mexico has none [though] the economically correct rebuttal is to point out that the other forty-nine states contain a lot of pizza lovers” (Krugman 1997:120). Political considerations thus discourage or even preclude free trade and many other forms of international economic (and non-economic) relations (e.g., foreign takeovers) (Gordon and Bovenberg 1996).

Since power and other political elements have permeated free exchange economies in Western societies, an absolutely free exchange economy based on perfect exchange or pure competition is an ideal-typical concept (i.e., a rationally correct utopia or an ideal) (Weber 1949:42–43). Specifically, such an exchange economy amounts to a political-ideological construction. As such, it embodies the doctrine of *laissez-faire* and its underlying power considerations—for example, power relations between capitalists and other actors, including the state and laborers rather than an “obvious and simple system of natural liberty” (Buchanan 1991b:24–27).

On the one hand, conventional economic wisdom says that the state is not an entrepreneur (*l'état n'est pas un entrepreneur*) (Walras 1926:449) and thus an economic agent, including producer and trader, in the strict sense. However, the exchange economy cannot admittedly function without some intervention of state authority (Walras 1926:449–50), as an indispensable regulatory agency (Marshall 1961:593–94). For instance, comparative research shows that in many assumedly *laissez-faire* economies, certain types of production (e.g., food and related industries) are less contingent upon strictly economic factors than on government policies (Harrigan 1997:485). Such findings support the argument that no purely *laissez-faire* exchange economies presently exist, especially after the Great Depression, which spelled the end of *laissez-faire* (Keynes 1972:276–83). Nor have they ever existed contrary to the picture of a traditional night watchman state. These findings also corroborate the thesis that, at least in most Western societies, political or social choice is “never between a number of abstract, logically coherent social orders” (Myrdal 1953:197) but between various combinations of elements of these orders (mixed systems).

Although there are logical and practical limits to such interference, the

modern state must, as a general rule, engage in promoting citizens' economic endeavors as well as their welfare (Menger 1994:31). The rationale for defining and justifying the state's economic role in voluntary exchange (Wagner 1997:161) is given by private-exchange failure. The latter is exemplified by social inefficiencies, including externalities<sup>8</sup> (i.e., negative differentials between social benefits and private profits in exchange transactions) (Pigou 1960:172). In this regard, some contemporary economists concur that such a role of the state in exchange transactions is indispensable, conceding that though private exchange failure "is not complete, it may be significant enough to support relying on taxes and generally [government intervention]" (Cordes 1997:170). At this juncture, one can envisage or determine a socially optimal level of social evils resulting from such exchange failures. Ideally, this level would equal zero, but realistically it would not. Hence, it seems *prima facie* legitimate and socially rational to entrust the state with the function of formulating and enforcing policies to attain this level (Cordes 1997:170–71).

At this juncture, one can suggest (Keynes 1960:380) that the primary item of the economic agenda of the state is to determine the aggregate amount of resources to be devoted to investment and the basic rate of rewards to this investment. In addition, this agenda would include: the reduction of risk; uncertainty and ignorance by the deliberate control of money and credit by a central institution, as well as data collection and dissemination to assist individuals in their transactions; the regulation of savings and investments on the grounds that they should not be left completely to the chances of individual judgments and private profits; and other possible improvements of the modern system by collective action<sup>9</sup> (Keynes 1972:291–93). Regardless of the intentions or goals involved in this agenda as a more or less normative proposition, such regulations have a critical political influence, positive or negative, on exchange transactions. Generally, these regulations and other exercises of political power possess what Weber named in value-neutral terms non-monetary, substantive relevance of the body politic for the exchange system.

In turn, the monetary function of political bodies is even more direct and transparent. This is shown by their defining and influencing money as an exchange medium par excellence in an exchange economy. Specifically, rather than being a purely economic phenomenon, money is the result of the state's declaration of a legal discharge of exchange transactions (Keynes 1972:63). In historical terms, this non-economic determination of exchange media is evidenced by the progressive deterioration of the value of money. This deterioration is most often caused by the behavior of the state as well as by those social groups that have enough political power (Myrdal 1953: 197–98) to bring about such alterations, rather than just by the operation of the law of exchange (supply and demand).

For instance, since its invention in the sixth and seventh centuries B.C.

(Keynes 1972:64; Weber 1927:240–42), money has been subject to continuous politically conditioned changes in its value (*viz.*, inflation and deflation). In particular, money inflation has been subject not only to the impact of government's financial needs but also to the "political influence of the debtor class" (Keynes 1972:64). In this regard, the value of money as an exchange medium, just as the values (prices) of objects exchanged, can be considered an effect of relative power positions or dominance relations (Weber 1968:939–43). Hence, like the doctrine of *laissez-faire* exchange transactions, an equivalent policy toward the value of money seems not only unfeasible but socially undesirable (*i.e.*, "not safe or fair") (Keynes 1972:67).

Hence, exchange media and transactions have salient power dimensions and factors to the effect that they are allowed and secured by the state and otherwise reflect a structure of social groups and relations of their power (Perroux 1960:76). In general, markets and entire economic systems are "politically shaped" (Schumpeter 1939:113). This was dramatically shown during the Great Depression in the 1930s and during similar prior or subsequent events. Historically, these events have ranged from the speculative Tulip craze in seventeenth-century Holland (Weber 1927:286; Yeager 1997:154) and the economic crises caused by the Napoleonic Wars in the early nineteenth century to the trade wars preceding World War I to the oil shocks in the 1970s and the supply-side economics in the 1980s and 1990s.

Such events thus confirm the power hypothesis that assumes the impact of the current political condition and information on future supply and demand (Jevons 1965). This influence reflects the overall tendency for the polity and society to hardly ever leave the operation of markets on their own (Wicksteed 1933:783). In this connection, power and related extra-economic phenomena represent exogenous factors, or economically relevant phenomena in Weber's (1949:64) terms, causing corresponding movements in exchange transactions, including the turning point of the trade cycle, so the latter are adaptations to such phenomena (Tinbergen 1950:99–102). As presumably a purely economic mechanism of exchange transactions, price formation, and resource allocation, even a perfectly free exchange is influenced by power struggles, political upheavals, and other social changes (Hicks 1961:135). The experience of an ostensibly free and pure exchange economy in the United States and elsewhere in Western society, especially in the wake of the 1929–1933 depression, demonstrates that influence of power and other extra-economic conditions on exchange processes, including trade cycles. In consequence, the character and operation of modern economies have tended to be critically shaped by the relative power positions and relations of various social actors.

The latter range from economic or class-based, such as capital and labor, to non-economic or power and status-based, including political, ethnic, ra-

cial, religious, ideological, and others. Such economic salience of power factors indicates a tendency toward the increasing politicization (in a value-neutral sense) of the modern economy, including the American. (Of course, this *a fortiori* applies to past or present socialist economies, from the former Soviet Union's non-exchange economy and Yugoslavia's semi-exchange economy to modern China's pseudo-exchange economy.) In the United States, this politicization has been especially exemplified and intensified since the 1994 Conservative revolution. Such a tendency has reached the point that American politicians place almost every economic issue in the arena of religious and other cultural wars, rather than in reason generally and economic rationality particularly. Such economic issues include, for example, taxes, balanced budgets, public debt, government spending, welfare, social security, health and education spending, domestic competition, international free trade, price and other state regulations, tobacco production and marketing, and food production and protection. The debate and rhetoric concerning economic matters in Congress during the 1990s was especially indicative of this politicization, reflecting the deep penetration of power factors in the American economy.

The sociopolitical construction of exchange transactions also is expressed in the fact that exchange presupposes certain political consensus among exchange actors and is thus homologous to a process of formation of political opinion (Boulding 1970). For actors to engage in exchange transactions, there must first exist definite social rule systems (Burns 1990). Some of these rules are defined and institutionalized by the state that is politically controlled in forms of laws and regulations. Rather than a (democratic) political system being a simple extension of exchange (as assumed by public choice theory), markets are better viewed as political or at least politicized entities (Collins 1990; Fligstein 1996a). Like democracies markets form a general judgment (Boulding 1970) out of a majority of individual opinions. Instead of reducing political liberties to forms of economic freedom, it seems more (or equally) plausible to treat freedom of exchange (*laissez-faire*) as a political or civil right, in the same way as freedom of opinion, belief, association, and so on. Thus, one can suggest (Walras 1936:58) that freedom of exchange is an "economic liberty, analogous to the freedom of thinking and all the other political and civil liberties." Hence, the free exchange economy can be characterized as a democracy in which the use of resources resembles political actions seeking or legitimizing power. More precisely, the exchange economy constitutes a democracy in which "every penny spent gives to its owner a right to vote" (Mises 1957:25–26).

Moreover, in Weber's framework, exchange transactions such as selling and buying can involve the explicit pursuit of power as an end in itself (Weber 1968:926), just as of social prestige and other non-economic goals. Relatedly, these transactions can entail attempts at conversion of exchange power or economic domination (domination by interest constellations) into

political power (domination by authorities). This justifies a neo-Weberian treatment of markets as politically and ideologically conditioned entities, especially as phenomena of power. Overall, the metaphor “markets as politics,” within a sociological-political approach to exchange transactions, suggests that markets and political factors, especially states, are closely linked, as these operate during various phases of the exchange process, namely, formation, stability, and transformation (Fligstein 1996a).

One historical illustration of the operation of such factors in the formation of markets is provided by the reported importance of non-economic (political) rationality in the emergence of a stock exchange in England. Reportedly, in the England stock exchange of the eighteenth century not only economic goals but also political objectives were pursued, as trading was imbedded in domestic and international politics, suggesting that economic models of rational trading do not fully explain stock exchange behaviors (Carruthers 1994). Specifically, in its formative period (1672–1712), the London stock market’s (the city’s) emergence and development were greatly affected by political factors, as evidenced by the political (partisan) setting of the establishment and operation of joint-stock companies. Just as in other Western European countries (e.g., Holland, France, Spain, and Sweden) at the time, such financial developments, namely, developed stock markets, were linked with and relevant for state formation. Notably, English public and private financial property rights played a crucial role in the rapid growth of stock markets in Britain. Examining the patterns of share ownership/trading (e.g., of the East India Company and the Bank of England in 1712) suggests the strong impact of both domestic political allegiances and international political commitments on stock markets (Carruthers 1996). The preceding historical illustration suggests that economic rationality or *homo economicus* can sometimes be counteracted and even overridden by political rationale or *homo politicus* (Carruthers 1994) rather than vice versa, as usually supposed by economists (Rodrik 1996). Next, we further illustrate this sociopolitical co-determination of exchange transactions by reexamining the relations between economy and politics in nineteenth- and twentieth-century America.

## AN INSTANCE OF THE POLITICAL STRUCTURATION OF ECONOMIC EXCHANGE

The connection between economy and democracy in nineteenth-century America, as depicted by Tocqueville, shows that democratic institutions are the main cause of the prodigious commercial activity, rather than vice versa, as implied in Marxian and rational choice paradigms. In the view of Tocqueville, this is because, though democracy does not necessarily result in the most skillful form of government, its true advantages lie in producing

pervasive and restless exchange transactions, with vast private as well as public benefits.

However, such commercial hyperactivity reportedly produced some unintended consequences on economic exchange and social life in modern America. Analysts (Blau 1993; Galbraith 1997) note that the United States has become an exception in the lineup of developed nations by avoiding sensible social intervention in exchange (the welfare state) in favor of a *laissez-faire* ideology—though not necessarily a practice (Shaffer 1999)—of free enterprise, unfettered markets, individualism, and the like. Weak safety nets and a less activist government (Gottschalk and Smeeding 1997) are combined with cut-throat competition in exchange processes. Presumably, the result is a series of first places in the developed world in terms of infant mortality, homelessness, the low minimum wage, stagnant incomes of the majority of the population since the 1970s, the weakest labor and other countervailing popular power, the largest income inequality, the largest percentage of population without basic health insurance, the highest rate of violent assaults and deaths, the largest prison population, the highest military spending after the Cold War, the highest military aid to underdeveloped countries, the least humanitarian aid per capita to these same countries, and so on.

However, these facts and tendencies are only instrumental to the purpose at hand, analyzing the social organization of exchange and related economic processes. Hence, what is at issue is not the causes and solutions of such social problems but their implications for market-economic processes. As an illustration, we consider prisoner rates and estimate their impact on economic exchange in the United States. Prisoner rates have skyrocketed since the 1970s, more than tripling in a quarter of a century (e.g., from 96.7 per 100,000 in 1970 to 330.2 in 1994). More precisely, the growth in the prisoner population was relatively slow between 1970 and 1980, with the rates increasing by only (at today's standards) about 40 percent (from 96.7 to 139.2). The process picked up the pace in the 1980s, as prisoner rates doubled in ten years (from 139.2 to 295) and culminated in the 1990s by reaching record levels in 1994. These levels were, moreover, exceeded in every year after 1994, with the total prison population reaching 2 million in 2000, the highest figure not only among OECD countries, but also in the world.

While the investigation of the causes of this increase is a topic for a criminological study and thus is outside the scope of this analysis, the pertinent question here is what are the economic effects of this trend. First and foremost, in the United States over this period, the prison industry has become the fastest growing industry in terms of both market-economic and political-ideological entrepreneurship. This is evidenced by, in comparative and historical terms, the unparalleled state and federal spending on prison construction and development in the 1980s, which culminated in the 1990s.

We estimate that the economic implications of this trend can be more relevant and complex than it may seem. In the prevalence of political-ideological entrepreneurship, this process can be subsumed under what analysts (Sutton 1991) call the institutional production of insanity and general deviance in the United States. More important to this analysis, the process also can have relevant economic repercussions, especially when driven by market-economic entrepreneurship.

These repercussions include increased employment in the prison industry and related sectors via the proliferation of exchange transactions between them (i.e., they operate like Keynesian income multipliers). In addition, overall unemployment can be decreased, especially in the short run, by putting the potentially unemployed in prison. This can partly account for the decreasing unemployment rate over this period, especially in the 1990s. During that period, the prison population exploded at unprecedented levels, with a concomitant decrease in unemployment to the lowest level in decades. For instance, the unemployment rate was between 4 percent and 5 percent in the mid-1990s, approaching 4 percent in 2000, with the average of 6.5 percent for the 1983–1986 period (Nickell 1997:56). This suggests that the impact of social, especially stringent, crime control, American style, on labor markets is salient by using the penal system as a labor market institution. In the United States, there are large, coercive interventions into the presumably unregulated labor market through the expansion of the penal system (incarceration), with two contradictory effects: lowering unemployment in the short run by removing working-age people from labor force counts, and increasing it in the long run by reducing ex-convicts' job prospects (Western and Beckett 1999). (Interviews with parolees in New Jersey and New York suggest that the social stigma of incarceration is one of the primary factors for the high unemployment rate of 50 percent of unskilled black men; cf. Western, Beckett, and Harding 1998.) Moreover, data indicate that the U.S. unemployment rate was higher than Europe's during the period 1975–1997, when an account was taken of the prison population (Western et al. 1998), which exposes the mirage of American low unemployment and generally free labor markets in recent decades.<sup>10</sup> Generally, many analysts of the U.S. economy note that the complex reality of economic exchange often is hidden behind the laissez-faire dogma and rhetoric of a perfectly free market, obsessive individualism, unmitigated self-interest, and cut-throat competition (i.e., of "hard-nosed" capitalism) (Dore 1992:174).

One somewhat unexpected instance of American exceptionalism lies in the realm of international economic exchange. Despite the rhetoric of free exchange, data suggest that the United States only slowly is moving away from the Hamilton-type infant protectionist economy and related isolationism predicated upon the Fichte–List idea of a closed commercial state. This is indicated by the comparatively low share of foreign trade (e.g., the per-

centage of exports) in America's GDP or total manufacturing during a century or so. As figures show (Irwin 1996:42), the share of U.S. exports in the GDP has been constant, staying within a relatively narrow range (between around four and eight percentage points) over the period of a century. Also, this share has been historically low, especially when compared to the respective figures (usually double-digit) of the most advanced countries over the period, except Japan. (This exception seems surprising, given the bashing in the United States in the early 1990s of Japanese unfair and expansive export practices.)

According to data (Feenstra 1998), the United States (along with Japan) consistently had the lowest ratio of foreign merchandise trade to the GDP, and to that extent, the lowest coefficient of economic openness, over the period of one century (1890–1990). For example, these figures suggest that over the entire period, even a dirigist and protectionist France had a more open economy using the ratio of foreign trade to GDP (17.1% in 1990) than a bastion of free trade (the ratio was 8% in 1990). Generally, the European countries exhibit higher foreign trade/GNP ratios, and to that extent more competitiveness/openness than the United States. For example, the ratios of big European countries such as Germany (24%) and the United Kingdom (20.6%) and of small ones such as Denmark (24.3%) and Norway (28.8%) are higher than the United States' ratios.

Some other foreign trade data reinforce this impression: thus, the United States (alongside Japan) has by far the lowest ratio of imported to domestic goods such as textiles, apparel, footwear, and related intermediate inputs (raw materials) during the early 1970s and mid-1980s (Feenstra 1998:33). For instance, in the mid-1980s, the ratio of such imports to their domestic equivalents was several times lower (13%) in the United States in comparison to countries such as Canada (60%), France (42%), Germany (64%), and the United Kingdom (48%).

Similar and more general figures also are for the ratio of imported to total intermediate inputs in all manufacturing industries. These figures (Feenstra 1998:33) show that in 1993 this share was lower for the United States (8.2%) than for most other countries, including Canada (20.2%) and the United Kingdom (21.6%). For illustration, over time, the differential between the United States and Canada in the share of imported to total intermediate inputs increased (e.g., from 8.2% in 1984 to 12% in 1993), indicating a relative increase in the second country and a decrease in the first. Such a differential between the United States and the United Kingdom also increased (e.g., from 9.3% in 1974 to 13.4% in 1993), suggesting a comparative reduction (in foreign trade) in the first and expansion in the second country.

In retrospect, these findings cast doubt on the popular argument that small countries, by necessity of their limited economies and markets, tend to be more open than their bigger counterparts. Presumably, by virtue of



their vast economy and market, big countries have no need to rely on foreign trade and generally the world. This has been the standard justification for the economic self-sufficiency and inward focus of big (geographically and economically) countries such as the United States as well as Russia in its pre-, post-, and communist periods alike. However, such an argument boils down to a rationale for an economically irrational economic and other isolationism or autarchy, particularly the defense of trade protectionism. Against this theoretical conception, the data presented here indicate that there is no necessary association of the size of a country and its economy with the degree of economic openness.

In the 1980s and 1990s, the low import ratios of industrial goods, including intermediate inputs, were the justification, in the United States and in Europe, for the widespread criticism of Japan for its closed market. However, figures reported earlier indicate that, at least in regard to intermediate goods, the American economy was as closed as the Japanese economy, and yet American politicians (and presidents) kept making fervent pronouncements for free and fair trade, open markets, and so on. If such findings justify the Japanese bashing in terms of the openness of its markets, then using the same criteria, the U.S. economy appears hardly more open, especially in comparison to European and Canadian markets.

In retrospect, research (Chase-Dunn, Kawano, and Brewer 2000) indicates that the United States usually has been a poor reflector of world trade globalization or liberalization and the concomitant economic openness. Reportedly, only in the 1960s did the United States experience some degree of increased economic openness. Moreover, while the world was going through one or two waves of trade globalization during the last two centuries (e.g. between 1830 and 1929), data show that the United States was in this—as in many other respects, namely, the modernization of social values/liberties (Inglehart and Baker 2000) and health care and welfare services—a deviant case featuring low and even declining levels of trade dependence or economic openness (Chase-Dunn et al. 2000). Yet, such tendencies toward low trade openness denying the sacred ideological dogma of free competition/enterprise are not usually associated with American exceptionalism. To the extent that trade closure in the United States and elsewhere is a result of the operation of extra-economic, including political, factors, this supports the economic sociology argument of the social construction of exchange transactions, including the degree of their openness in comparative or international terms.

In this connection, one can assume various economic and non-economic factors and consequences of trade closure and parochialism generally as found in the U.S. economy. First, we consider the factors of trade closure, and then the consequences. Most important from a sociological perspective on the economy, economic parochialism, including foreign trade closure, can be both generated by and generative of social, cultural, and political

provincialism, as often observed in many parts and times of the United States. This is especially true, insofar as a Fichte-type closed commercial state or economic autarchy is an element or outcome of a self-contained and ideal political-social system. Social nativism here generates and feeds back upon an economic closure, as historically shown by the incidence of trade protectionism as a form of cultural and ideological xenophobia. Alternatively, an open political and civil society would be propitious for establishing and sustaining an economy that is less nativistic (“proudly made in the USA”) and more cosmopolitan in its orientation.

More generally, economic sociology’s assumption that economic closure, including trade protectionism, is an expression/result of social-systemic and cultural closure, including political-ideological nativism, is in contrast to the implied Marxian and rational choice premises of the opposite causal or functional relationship. This contrast is particularly sharp if the latter argue, albeit in different ways, that an open/closed society, especially a social superstructure, is an epiphenomenon or an adjunct of an economy with corresponding properties. However, within the framework of neo-Weberian economic sociology as an analysis of the institutional-social setting of the market, an open/closed economy is a component and consequence of an open/closed social-institutional structure, not vice versa. How much a country’s economy is open or closed would be a function of how much its polity, culture, and society are open or closed. This holds true, though it is often tempting (but not accurate) to say that an open economy unambiguously produces democratic politics and a free society. For example, traditional despotism, with many of its contemporary variations (including fascism), was an admixture of a relatively open economy and a rigidly closed society, including a dictatorial polity, as the “despotic regime is often associated with the promotion of the money economy” (Simmel 1990:398).

Thus, one can predict that democratic polities and open societies will make for an open economy, and vice versa. Empirically, most democratic polities and open societies are more or less open economies, but the opposite is less evident. Not all exchange economies are democracies and open societies, as shown by cases of Franco’s Spain, Pinochet’s Chile (with his Chicago-trained economists), China, South Korea, Taiwan, and other Asian countries. A free-exchange economy is a political objective or desire (Myrdal 1953:4–6) and thus grounded on power configurations, institutional arrangements, cultural patterns, and other social-historical conditions. Economic openness or closure seems to be a dependent variable and a particular aspect of societal openness or closure, not the other way round, as posited by what Weber would term one-sided historical materialism, featuring the one-sidedness of the rational choice approach.

Economic sociology’s assumption of an association of economic closure/openness with sociopolitical closure/openness seems indirectly confirmed by

comparing data on the ratio of foreign trade to the GDP for major industrial countries with their political democracy indexes as estimated earlier (Bollen 1990). A comparison of these indexes with the data for the ratio of foreign trade to the GDP reveals the general relationship. The greater the sociopolitical openness of a country, as indicated by its democracy index, the greater the economic openness of that country, as indicated by its ratio of foreign merchandise to the GDP. Thus, those countries with higher democracy indexes than the United States also have higher foreign trade ratios, suggesting that their economies' openness to the world tends to be a function of their democratic polities and open societies generally.

For instance, political democracy indexes for Australia, Canada, Sweden, Norway, and Denmark are higher (100) than the U.S. index (92), as are their foreign trade ratios (e.g., 13.4%, 22%, 24.3%, 28.8%, 23.5%, respectively, in 1990) compared to the U.S. ratio (8%). In comparative terms, most, if not all, Western countries thus rank higher than the United States in both democracy indexes and foreign trade ratios, thus displaying their greater economic openness and political liberties. Alternatively, since the U.S. lowest foreign trade ratio (8% in 1990) is correlated with the lowest democracy index (92) among industrial countries, this would suggest an association of apparent economic parochialism with relative sociopolitical closure in American society.

Therefore, these findings cast doubt on the political-ideological construction of the American economy as a completely open economy guided by the venerable axiom of free international trade and world competition, thus highlighting the divergence between the capitalist, free enterprise system in theory and in practice (Shaffer 1999). Rather, they indicate that the American economy has traditionally been less open than claimed by conventional wisdom, especially the rhetorics of free trade. More significantly from the stance of economic sociology, they suggest that such an economy may reflect a corresponding society, including the polity. In particular, data on democracy reveal that a relative economic parochialism is linked to political provincialism, given that in comparative terms, the United States has both the smallest foreign trade ratio and among the lowest democracy indexes among Western societies.

Finally, we examine some possible consequences of trade closure and economic parochialism generally. One possible result of economic provincialism is the lower quality of many American goods in comparison to others, as reported by various consumer surveys. If foreign competition in the world economy is a major engine of quality control and improvement—as indicated by many Japanese goods, especially cars and home electronics marketed worldwide—then one can assume a positive relationship between the ratio of foreign trade to the GNP and the quality of domestic goods. The higher the ratio of merchandise exports and imports to the GDP, the higher the quality of this merchandise. This may shed some light, though

may not fully explain, the reported comparatively low quality of many American goods, ranging from food and clothing to home electronics and cars. Alternatively, the more the production and marketing of these goods center on the world market, rather than on the American one, one can expect an increase in the quality of these goods.

The identical would be the effect of foreign competition, as shown by the relatively improved quality of American cars in recent years under the spur of foreign (especially, Japanese) competition. However, such an effect is likely to be negligible insofar as the share of foreign goods is relatively small in the American market, dominated in most cases by domestic companies enjoying monopolistic (or oligopolistic) advantages. The more this domestic domination by virtue of a constellation of economic interests is eroded by extraneous competition, the more likely the lower quality of those American goods with virtually no foreign substitutions will increase. Selling (purchasing) low-quality goods, or lowering their quality (*viz.*, the planned obsolescence of American cars), signifies charging (paying) a higher real price than the nominal, and vice versa. This exposes what Keynes would term the money illusion of low prices (and quality), good deals or bargains prevalent in the American market, especially during the shopping season ritual following Thanksgiving. On the other hand, the high quality of some American goods (e.g., computers and related products) can be attributed to the outward, world-system orientation competition of their producers as well as to the inflow and contribution of foreign talents. At this juncture, the solution to the problem of merchandise quality in economic exchange would seem readily provided to the United States and comparable economies.

In sum, the vast and historically relatively closed American economy (and society) seems to have been both a blessing and a curse. It has been a blessing for the process of initial industrialization and expansion, especially for pseudo-monopolistic domestic manufacturers, and a curse in terms of global competitiveness, product quality and sophistication, and outward business orientation. The chronic and enormous U.S. trade deficit in recent years can be seen as reflecting, in part, such a curse. This holds true especially insofar as the trade deficit is mainly due to the comparatively low competitiveness, including the inferior quality, lack of sophistication, and (provincial) peculiarity of many American goods and services (except for Hollywood-made movies as a major export) in the world market.<sup>11</sup> Reportedly, a major source of the U.S. trade deficit in the 1980s–1990s is that the American economy “has been losing competitiveness internationally” (Bowles, Gordon, and Weisskopf 1990:204). This deficit has persisted, despite a myriad of attempts by the U.S. government (and private businesses) to increase American exports, sometimes by violating the very rules of international free trade that it declaratively (or perhaps hypocritically) promoted and adopted within, for example, the World Trade Organization.<sup>12</sup>

## NOTES

1. Of course, the Cold War was the standard rationale for the exorbitant military spending in the United States. However, the resumption of the explosive growth of U.S. military expenditures in the late 1990s and in the early 2000s, just as of the spending on prisons, for example, indicates that America's conservative politicians (from both parties), like fascists and communists elsewhere, are always able to find ever-new justifications for their virtually unlimited financial funding of strident social control within (and outside) the United States. For example, the \$288 billion "defense" budget for 2000–2001 passed by virtual acclamation in the Senate, with 90 yes votes out of 100. Alternatively, American economic and social conservatives never seem to lack rationales for reducing expenditures on social services, as indicated by the politico-ideologically conditioned trend to the dramatic reduction of public spending on welfare and in part education and science (unless it has military and other social control applications) in the United States in recent years.

2. Another instance—though presumably less relevant if Americans are assumed not to care much about foreign affairs—of the weight of ideological religious zealotry in those decision functions is provided by the (Republican) Congress's use of the anti-abortion position in its refusal to pay the outstanding dues to the United Nations (UN) (more than \$1 billion at the end of 1999) and even to the International Monetary Fund (later paid). In the first case, this ideological stringency can be politically unreasonable, given that the UN has increasingly been perceived around the world, especially after the 1991 Gulf War, as the promoter of American political interests. In the second case, such stringency can be economically irrational, since the International Monetary Fund has traditionally been the arm of American business and capitalism generally. Both cases seem thus to confirm the tendency for American foreign policy (in this case, as dictated or restrained by Congress) to be its own worst enemy.

3. Samuelson's (1997b:156) warning is that "Maybe future college sophomores will learn this hard way—perhaps after a populist majority has temporarily put a balanced-budget amendment into the Constitution and when real-and-nominal exogenous forces cause securities markets to clear at low interest rates like those prevailing in the late 1930s."

4. For instance, the (in)famous dispute between Keynes and Hayek/Mises (and their successors in the Chicago School) concerning a myriad of economic issues (e.g., business cycles, unemployment, inflation, etc.) was rooted in deep political (and ethical) differences rather than in those on scientific analysis and evidence (Dostaler 1999).

5. Fuchs (1996:22) comments that though a factor the opposition of special interests is not a fully satisfactory explanation for the lack of a national health insurance system in the United States, noting that special interests also are known in countries with such a system, including Sweden, England, and Canada.

6. As Frank (1996:122) elaborates, "In the face of overwhelming evidence of the contrary, our prevailing theories [. . .] continue to be grounded on the view that satisfaction depends on absolute not relative income. These head-in-sand theories insist that higher taxes on highest earners will diminish welfare by causing people to work too little. Although evidence favors the latter formulation, the cel-

eberrated trade-off between equity and efficiency remains a cornerstone of the conventional wisdom.”

7. Conlisk (1996:696) remarks that mainstream economics tends to “model Robinson Crusoe and pretend that he’s a \$7 trillion economy.”

8. The original definition of externalities and generally market failure refers to discrepancies between private and social welfare, specifically to situations in which private marginal product is smaller than social marginal product, as in the case of the pollution as well as the depletion, the dilapidation, and other tragedies of the commons (Pigou 1960:172–93).

9. The key element of the economic (rational choice) model of collective action is the free rider problem (i.e., that rational individuals will free ride on the efforts of others, especially in large social groups). However, as some of its exponents admit, this strong version of the free rider problem “is not supported by experimental evidence” (Cordes 1997:176). Rather, the actual extent of free riding that would correspond to maximal free riding is “much less than the term might suggest” (Wagner 1997:162); here reference is to free riding in the provision of public goods (i.e., in taxation).

10. One can speculate that in the limiting case the U.S. unemployment rate could be brought to zero if this trend in the prison population continued indefinitely by imprisoning, say, all of the unemployed on the American conservatives’ underlying assumption that the unemployed, especially the minorities, are potential criminals. (Incidentally, German fascists and Soviet communists also harbored such an assumption.) This would imply a curious solution to the major economic problem in modern market economies.

11. For instance, even the workers of an American automotive company (now merged with a European one) have sometimes characterized its cars as “ridiculous.”

12. For illustration, in February 2000, the World Trade Organization (WTO) ruled that the U.S. federal government, by establishing the so-called Foreign Sales Corporation tax break system for American exporters, violated global free trade rules.



## *Chapter 5*

# *The Cultural Constitution of Economic Exchange*

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### EXCHANGE AS A CULTURAL CREATION

A key hypothesis of a cultural analysis of exchange is variability in the cultural specification of market transactions (Fiske 1991:392), reflecting the general and persistent influence of culture on the economy (DiMaggio 1990). Specifically, this analysis views market exchange not as a natural, invariant phenomenon but rather as a cultural creation. It is such in the sense of being contingent on definite sociocultural conditions and having certain cultural dimensions<sup>1</sup>—that is, markets are seen as cultures (Abolafia 1996). Instances of the sociocultural conditions and dimensions of exchange represent economic cultures (Weber 1968:43–44) or work ethics as ideal or spiritual prerequisites of practical economic activities, especially exchange transactions. Hence, as part of an overall social structure, economic culture represents a sociocultural matrix for undertaking economic activities and establishing economic institutions, thus being a highly relevant precondition of the economy (Berger 1991:xx). Economic culture is exemplified in various historical-empirical forms, especially the Weberian spirit of capitalism, or the capitalist work ethic, with its origins in the ethic of ascetic Protestantism.

In a Weberian context, the practice or structure of modern capitalism, featuring a definite work style, has its historical source or cause in the spirit of capitalism, and thus in specific religious, ethical, ideal, and other cultural patterns. More precisely, Weber searched for the origin of the new capitalist ethos and practice in the Protestant religion. In retrospect, such a search turns on its head the materialistic conception positing only the causal effects of the economic base on the sociocultural superstructure, as well as rational



choice theory that views culture as a mere effect of individual utility-optimizing actions. Other instances of economic culture include the work ethic of Confucianism (Berger and Hsiao 1993), Catholicism (La Porta et al. 1997), Buddhism (Collins 1997), and Islam (Kuran 1996:438–40). Historically, various cultures differ in their orientation to economic exchange, particularly in the extent that they have high esteem or disdain for it (Fiske 1991:396). In addition, the pursuit and exchange of material goods are not necessarily, in historical terms, carried out in the market-pricing mode (Fiske 1991:396–98).

Within a Weberian framework, the major feature of modern economic culture, as grounded and exemplified in the *Protestant ethic*, is the mastery of reality (Weber 1958:293–94), especially an ascetic mastery of mundane affairs (Weber 1968:596). Such mastery is attempted through systematic, methodical, and continuous exchange and productive and other economic activities by capitalist enterprises. As an illustration, the Protestant religious ethic, especially Puritanism, harbors the ethos of the rational organization of capital and labor (Weber 1976:166) in production and exchange processes. Hence, what Weber (1976:17) calls capitalistic economic action, as pursued by early members of the Protestant religion, is based on the expectations of gain by utilizing opportunities for exchange, and thus on chances of profit.

Comparatively, this feature of the Protestant ethic contrasts with traditional economic culture or economic traditionalism (Weber 1976:36) oriented toward adaptation to the world, and thus a different type of exchange or production transaction (i.e., secondary, accidental, and discontinuous). The latter have historically taken forms of capitalism in trade, war, politics, or administration as sources of profit, distinguished from bourgeois capitalism resting on the rational organization of free labor (Weber 1976:23–24). The type of economic system associated with economic traditionalism was essentially different from that related to modern economic culture, exemplified in Protestant and related work ethics. The first type relied on non-economic or non-rational, including violent, methods of exchange and gain seeking, and thus represented a politically oriented or robber capitalism. In contrast, the second type was based on the pursuit of gains through continuous, rational, capitalistic enterprise, as the essence of modern Protestant capitalism. As Weber (1968:1118) put it, the “structure and spirit of robber capitalism” is drastically different from capitalist enterprise, while resembling such old practices as huge rapacious enterprises and occasional trade mixing piracy and slave hunting. In general, these relationships between modern Protestant ethic and capitalist exchange on the one hand, and traditional cultures and pre-capitalist exchange on the other hand, demonstrate the differential effects of various types of economic culture on exchange transactions and other economic processes.

In turn, the impact of the *laissez-faire* doctrine on the structure and func-

tion of capitalism exemplifies the bearing of ideational, ideological, and related spiritual factors on exchange processes (Morishima 1991). This would apply to the influence of Marxist doctrines on socialist economies as specific socioeconomic structures intended to supplant laissez-faire systems and to that of other economic ideologies (e.g., the impact of Japan's economic ideology or culture on its industrial policy during the 1930s–1960s; cf. Bai 1997). Despite the important differences in the character of economic exchange, the role of doctrinal and other idealist factors has been significant in both capitalist and socialist economies, which thus can be considered partly ideological creations. Alongside ideology and religion, other cultural patterns, such as morals, justice, trust, customs, traditions, and the like, influence exchange transactions, as shown next.

## EXCHANGE AND MORAL NORMS

Individual and social morality often is instrumental in defining the rules and limits of exchange transactions in the economy (Perroux 1960:76). These moral influences on exchange transactions have historically been exemplified by the extraneous imposition of the just price—and its derivatives, such as fair wages and profits—as an ethical imperative/sanction (Weber 1949:95). Such an imposition, just as the prohibition of interest on capital or usury, was motivated by attempts to enforce what Thomas Aquinas and other scholastics considered equality of justice on these transactions. The just price was intended to achieve commutative justice, that is, justice in the pricing of exchange objects (a concept traced back to Aristotle; cf. Schumpeter 1954a:61–62), as discussed in more detail later.

Also, the association between trust or honesty and economic performance is indicative of the impact of moral variables on exchange transactions. Conventional wisdom in pure economics or rational choice sociology implies that trust has no relevance in exchange transactions. The key assumption is that exchange actors are utility/profit maximizers who thus try in various ways to outsmart their partners by breaching trust, promises, or contracts. This behavior has been called self-seeking with guile or post-contractual opportunism (Williamson 1983). Actors are conceived of as Machiavellian-like distrustful creatures. Hence, trust in exchange relations is assumed to be more or less inefficient in economic terms, and thus is seen as an extraneous intrusion into these relations. Simply, trust or fairness as an ethical norm of behavior does not pay off in economic transactions. At best, trust would pay off only in the long run in the case of continuous exchange transactions (Buchanan 1991b:210), but not in single ones—only in the first case, honesty is the best policy. In game-theoretic terms, trust would be efficient in a repeated prisoner's dilemma, but not in a one-shot prisoner's dilemma.

However, both causal observation and systematic research show that

trust is positively associated with economic performance in the sense that trust greatly affects the performance of a society's institutions, including firms as well as governments. For instance, a study (La Porta et al. 1997) shows that both economic and social performance are positively affected by trust in exchange and other social relations. The higher the level of trust among actors, the more efficient their combined actions.<sup>2</sup> This is indicated by the (regression) coefficients, showing that mutual trust has significant positive effects on economic performance (e.g., sales in large organization), as well as on social (and government) efficiency and public participation. For example, the plus sign coefficient (.493) suggests that trust in people positively and significantly affects large organizations' sales (of the top twenty firms) as a share of the GNP, to the effect that an organization with higher trust is more likely to achieve higher sales than other organizations. Higher levels of trust also exert positive effects on GNP growth, so a society with high trust is more likely to attain faster GNP growth than other societies. In a similar vein, other observers (Fukuyama 1996:12) note that industrialized societies such as the United States, Japan, and Germany have been capable to build an efficient corporate economy as a result of social cooperation underscored by high levels of trust.

Most importantly, from the perspective of Weberian economic sociology, these findings suggest that mutual trust within large economic organizations represents a major explanatory variable of their success in the market, as measured by the volume of exchange. Alternatively, low trust or lack of it appears to have negative effects on economic as well as non-economic performance (La Porta et al. 1997). Reportedly, hierarchical religion is used as an indicator or a proxy for low trust on the basis of finding a positive association between the two (viz., that hierarchical religion tends to generate low trust in people, and vice versa). The findings of the study indicate that hierarchical religion and therefore low trust have negative effects on economic and social efficiency. For example, the coefficient on hierarchical religion indicates that this negatively and significantly affects organizational performance in the market, as expressed in the sales/GNP ratio. More precisely, organizations whose members belong to a hierarchical religion are more likely to perform worse in the economy than other organizations.

In macro terms, hierarchical religions negatively (though not statistically significant) affect GDP growth. Societies with a hierarchical or centralized religion (e.g., Catholicism) are reportedly less likely to achieve rapid GDP growth than those with a different type of religion (Protestantism), thus supporting the Weberian positive association between the Protestant religion and the emergence/development of capitalism. The overall finding emerging from the study is that the effects of hierarchical religion and thus distrust, as long as the latter is associated with the former, on economic as well as non-economic efficiency, are decidedly negative.

In general, whereas mutual trust has beneficial effects on the efficiency

of exchange transactions, the lack of it is detrimental, as are moral hazards, the reduction of which can be attained by promoting reciprocal assistance within social networks (Arnott and Stiglitz 1991). For example, when mutual trust is lacking or opportunistic behavior (self-seeking with guile) is unrestrained, financial markets<sup>3</sup> tend to collapse in a “sour tangle of distrust, recrimination, finger-pointing, and rational paranoia” (Carruthers 1997b). As an antidote, exchange actors set elaborate rules (e.g., informal reputations, formal rules, and legal regulations) restraining distrust and opportunistic predilections. Economic competition thus hinges on rather than undermines cooperation (and trust), since only by cooperating with these rules (establishing mutual trust) can actors compete effectively. In turn, opportunism in financial (and other) markets is socially and culturally constructed. Agents behave opportunistically or not—and thus are sanctioned for such behavior or not—depending on the post hoc social construction of opportunism. This makes opportunism a social fact, the incidence of which is particularly conditioned by the hermeneutic ability and political clout of competing exchange agents (Abolafia 1996). In consequence, there exists the dynamic tension or temporal oscillation between exchange opportunism and social restraint, that is, some kind of Polanyi cycle (Carruthers 1997b).

In light of these findings, one might reaffirm that in efficiency terms, trust or honesty is the best policy, and that distrust or dishonesty is the worst strategy. However, this is just one economic effect or aspect of trust. Trust can have not only an extrinsic effect (economic and other efficiency) but also an intrinsic value. In a Weberian framework, trust can be not only instrumentally rational but also intrinsically or value rational.

Hence, trust and honesty are not just matters of the formal (economic) rationality of cost-benefit calculation (capital accounting) but of the substantive (non-economic) rationality of ultimate values (Weber 1968:108–9). Trust and honesty may well be the most efficacious policies or recipes for economic success, and this is how economists or rational choice sociologists usually conceive of these phenomena. However, from a Weberian perspective, there is much more to trust, for it involves a set of non-economic values which like types or elements of social action have an autocephalous nature following its own logic or law (Weber 1968:340–41). Its intrinsic nature is displayed in that trust, just like power, prestige, or other non-economic goals can be valued for “its own sake” (Weber 1968: 926), not only as an instrument to some extrinsic end, including economic efficiency. Either as an extrinsic incentive (best policy) or an intrinsic motivation (warm glow), honesty or trust has relevant side effects on economic efficiency and exchange processes, effects assumed by economic sociology.

Accordingly, trust often permeates exchange transactions, not only because honesty is the best policy in instrumentally rational or economic-efficiency terms, but in value-rational or non-economic ones. This is true

insofar as trust and honesty represent ethical or religious values and norms to be observed, regardless of cost-benefit considerations (Weber 1968:24–25). Such autonomous influences of these values on exchange transactions are indicated by the fact that if an exchange contract has the force to bind, it derives from the fact that society endows it with such a power (Durkheim 1966:113–14) by sanctioning breaches of trust, honesty, loyalty, or promise in contracts. This thus expresses the non-contractual and generally non-economic, social elements of exchange contract. Contrary to the rational choice assumption of self-seeking with guile or post-contractual opportunism (Williamson 1983), adhering to exchange contracts can occur not just because of legal enforcement, though this may be a prominent consideration in conservative societies, such as the United States, with strict laws (and typically Draconic sanctions for their violations) and elaborate social control. Such contract adherence can also take place because of considerations of reciprocity<sup>4</sup> (Posner 1997:366), that is, mutual trust and simple honesty. As even some economists (Bergstrom 1996) would acknowledge, the formation and observance of many social norms is an independent process relative to attaining economic goals (*viz.*, profit maximization). Others recognize the important role that social norms of trust play in (short-term discrete) exchange transactions between firms and consumers as well as between firms (Maxwell 1999).

Hence, trust or honesty in exchange transactions not only pays off in the long run as economists think, but *also* may be instances of a Kantian categorical imperative, grounded in the primeval and universal (though un-sentimental) ethic, as manifested in the golden rule of moral behavior (Weber 1968:361). For the implementation of this imperative allows one to reap, in moral or non-economic terms, the priceless reward of ethical equilibrium and inner satisfaction. Thus, even neoclassical economists such as Arrow (1997:761–63) admit the existence and pertinence of such invaluable goods in economic terms. In turn, Weber (1968:302) identifies one of the defining elements and rewards of social action (specifically, class situation) in finding inner satisfaction. The latter resembles what economists would (in thinking that every satisfaction is income) call psychic income, including warm glow. Such income helps avoid the crime-and-punishment sequence of a sense of guilt or shame (Posner 1997:365) characteristic in normal or non-economic terms, in rational (reasonable) humans. For instance, as research on the behavior of exchange actors in modern Japan indicates, benevolence, trust, or honesty is not just the best policy but also a sense of obligation, “over and above the terms of written contract”<sup>5</sup> (Dore 1992:169).

Similarly, the Protestant (Calvinist) notion of the calling, in the sense of full dedication to a certain type of economic (or other) activity, was underscored by ideas of duty. Historically, the behavior of the early Protestant actors was guided by such ideas. For them, mutual trust or elementary

human honesty was more than just a business policy, regardless of any moral and other transcendental underpinnings (Buchanan 1991b:208). It was something more, namely, an ethical imperative or obligation with definite extra-economic rewards (religious salvation).

Although most economists and rational choice sociologists may not be able to transcend conceiving of trust, honesty, benevolence, and other ethical variables in instrumentalist terms,<sup>6</sup> the fact that social actors often are more willing to lose money than what Veblen and Weber call good name, reputation, or status honor indicates that the latter also can be pursued as intrinsic or immanent motivation. As intrinsic motivation, trust and honesty can independently, as moral rules or social expectations, greatly affect actors' behavior in exchange transactions. In sum, trust and honesty, like most cultural variables in exchange relations, can be associated not only with economic or instrumental rationality but also with non-economic, value rationality, for they can be both instruments to other (economic) goals and independent criteria of ultimate value (Weber 1968:25). The same can be said of traditions, conventions, and related cultural practices.

## EXCHANGE AND TRADITIONS

Exchange transactions also can be influenced by traditions and conventions. Weber's (1968:66–71) concept of traditional economic action is particularly indicative of this influence, for it postulates that exchange transactions can be matters not only of rational calculation but also of traditional orientation. Although this applies especially to pre-capitalist exchange, even modern capitalist markets are not immune to such orientations (Mises 1962:82). This is demonstrated by the reported importance of customs (Sethi and Somanathan 1996) and related cultural norms in economic and other social conduct, including the use of the commons<sup>7</sup> (Miller 1997:1181–82).

At any rate, traditions or customs often have gradual and cumulative, but profound and controlling, effects on new production and organization methods, as well as on the "character of producers" (Marshall 1961:465). An aggregate effect of this influence can be that the creation of a new economic space (Schumpeter 1939:107) is slowed down or precluded. This corroborates Weber's (1976:36–37) thesis that economic traditionalism was historically the strongest hostile force to a modern capitalist economy (Collins 1997:846–47).

In general, social customs and practices strongly affect individual behavior and motivation in exchange transactions. This is indicated by their impact on the "distribution of economic wealth and economic rewards and penalties" (Keynes 1972:329). First, this means that such distribution is not a purely market-economic process but a social relation in which extra-economic considerations often are paramount. In retrospect, this has been,

somewhat unexpectedly, implied in some classical economists' (Mill 1884: 155–56) statements that distribution is an institutional problem rather than one of natural laws in turn assumed to operate in production. However, Durkheim, Weber, and other classical sociologists have argued that not only the laws of distribution but all economic laws are far from being natural ones. For instance, Durkheim called the law of supply and demand a practical maxim for action, and Weber treated economic laws (e.g., Gresham's law) merely as ideal types or empirical generalizations.

The notions of customary wages, customary profits, and customary exchange values or prices illuminate the effect of customs and traditions on exchange transactions. Also, this means that motivation in economic exchange is a matter of social traditions, customs, conventions, and institutions (i.e., of sociocultural structure). Economic motivation is thus an effect of habituation or traditional determination (Weber 1968:25–26), and thus represents a conventionalized or an institutionalized value (Smelser 1976:34).

The influence of customary and other cultural variables on individual motivation in exchange transactions is probably best condensed in Weber's (1976:60) assertion that people are not "by nature" money seekers or profit makers but are creatures of customs and traditions, as they become "accustomed to live and earn" in a certain manner. As an illustration, within a guild structure of economic exchange, individual members are enticed to the traditional standard of life, which is the analogue of the living wage of modern times (Weber 1927:138). Some recent studies of the behavior of American workers in the 1980s and 1990s confirm Weber's assertions, reporting that this behavior often is a matter of social customs and conventions. For example, in the United States and elsewhere in developed societies, reportedly "people get accustomed to a certain rate of increase in their standard of living" (Stiglitz 1997:7). To that extent, consumption and leisure can be deemed matters of habit formation (Lettau and Uhlig 2000), as Veblen and Weber originally implied in their depictions of leisure classes and status groups, respectively, as being driven by traditions and especially conventions.

In addition, traditions and conventions can greatly influence the formation of relative exchange values in a society. For example, Weber (1927: 240) describes that, like any traditional and modern society, in Java a scale of relative values exists (e.g., the value unit is a valuable stone and twenty pearl shells), resting on the "traditionally imposed social significance" of various goods. Generally, the operation of both traditional and modern economies is governed by various customary rules and social conventions. Regarding conventions, for example, while acknowledging that they influence economic behavior, their function or significance is too narrowly defined to reduce transaction costs in economic exchange by most economists (Young 1996:105). But, as Weber and Durkheim have shown, the nature and function of social conventions and related institutions transcend merely

facilitating exchange transactions. For one thing, conventions, including those with economic implications, such as money, credit, accounting rules, technical standards, contracts, and so on, have cultural, symbolic, political, and other extra-economic elements and functions. Simply, like other institutions, conventions are complex social arrangements (Yeager 1997:154), not just instruments of such transactions.

Recent studies report similar findings concerning the pertinence of traditional and other social considerations in the formation of exchange values in various societies. These include today's primitive societies (Fiske 1991), the Oriental bazaar economy (Geertz 1992), modern Asian societies (Berger and Hsiao 1993; Dore 1992), some contemporary Islamic countries (Kranton 1996), and even the Western economy (Okun 1981). These findings thus confirm Weber's (1927:354–55) early assertion that traditions have historically been the original force in all ethical patterns and the resulting economic relations and systems.

In general, such findings support a major assumption of economic sociology, namely, that individual exchange transactions and choices are context-contingent and socially embedded. In particular, they suggest that such actions and choices are imbedded in the normative setting of roles (Boudon 1981:162), and that preferences or tastes are a function of social norms, especially moral standards (Etzioni 1988:93–113). In terms of Kantian ethical imperative and generally Weberian value-rational action, momentary preferences are formed under the influence of meta-preferences or prevailing social values (Etzioni 1988:93–113). Hence, rational or non-rational economic (and non-economic) choices are made in light of values (Firth 1961:122), held by actors as well as by others whose values influence these choices. Since this influence of other people's values on individual behavior is exerted through a process of social interaction (Simmel's sociality), the fact of sociality is "vitaly important" regarding one's choices and activities, rational and non-rational, being conditioned by those of others (Firth 1961:125).

In a Weberian framework, the instrumental or formal rationality of gain-loss accounting is guided by the substantive rationality under a criterion of ultimate values, as in the case of the early Protestant entrepreneurs. Simply, utility is affected by or fused with morality (Etzioni 1988:23–35). This contradicts the opposite assumption of today's neoclassical economics, as well of rational choice theory, which reduces all social values to rational instrumentalities, and thus morals to ordered utilities<sup>8</sup> (Willer 1992), as another instance of modern theoretical reductionism.

## **CULTURAL FOUNDATIONS OF THE SPIRIT AND PRACTICE OF CAPITALISM**

This section explores the cultural, especially the religious or ideal, and the historical construction of the spirit of capitalism within the context of



economic exchange. As introduced by Weber (1976:52–53), the concept of the spirit of capitalism designates a tendency toward the acquisition of wealth, including money, in conjunction with the “strict avoidance of all spontaneous enjoyment of life.” The spirit of capitalism thus includes a set of “ideas and habits that favor a rational pursuit of economic gain” (Bendix 1977:54). The concept thus pertains to orientations toward gain-seeking activities: the spirit of (modern) capitalism describes an attitude that strives for profit rationally and systematically (Weber 1976:64). As such, the spirit of capitalism was in sharp historical opposition to medieval and generally primeval economic ethics. This opposition was especially pronounced to the extent that the latter ethics precluded haggling, overpricing, and free competition and rested upon the principle of just price and the assurance to all of a “chance to live” (Weber 1927:358).

What is at issue here, however, is not defining the spirit of capitalism as such but exploring its sociocultural bases. In contrast to the economic grounding of this phenomenon in innate impulses or propensities to trade or calculate, it is a key proposition of this exploration that the distinctiveness of this gain-seeking spirit is its sociocultural foundation and historical relativity. Rather than being immutable human nature, the spirit of capitalism is an attitude of mind (Weber 1976:64) that reflects the modern institutional system (Parsons 1947:79). That the spirit of capitalism is far from being a social universal (natural) is indicated by the fact stressed by Weber (1976:60), that people are just habituated and otherwise socially conditioned to earn as much as necessary for maintaining their status and are not natural-born moneymakers as orthodox economics describes them. Being accustomed to a definite type of behavior (or lifestyle) implies the influence of traditions and other sociocultural factors, such as habits, conventions, moral rules, religious values, and institutions, as well as the confluence of concrete historical circumstances. No wonder that in a Weberian frame of reference, traditions, customs, conventional rules, and related phenomena are among the most potent, persistent forces in economic and all human behavior, indicated by the place of traditional action as an autonomous category of social action. The same can be said of the economic relevance of cultural values, especially moral and religious ones, as subsumed under the concept of value-rational action. It is precisely this concept of value or substantive rationality of ultimate values, with an emphasis on its moral-religious components, that is critical for understanding the sociocultural and historical construction of the spirit of capitalism, and ensuing exchange.

Manifesting a type of feeling intertwined with certain religious ideas, the spirit of capitalism has historically indicated the impact of religious beliefs on the emergence and expansion of (the ethos of) an economy in general, particularly the rational ethic of ascetic Protestantism on the idea and practice of modern capitalism (Weber 1976:26–27, 52–53). Especially strong

was the influence of radical Calvinism as rationalism seeking the divine or ascetic control of worldly, including business, affairs (Weber 1968:594–96), characterized by other features such as ethical universalism, and functional differentiation and specialization (Parsons 1947:79–80). On account of its (positive) attitude toward capitalism, radical Calvinism differed not only from Catholicism but also from other Protestant sects, such as Lutheranism (Weber 1927:357).

However, to the extent that economic acquisition tended to be pursued for its own sake, in historical terms the spirit and practice of capitalism seemed to be non-rational rather than rational from the viewpoint of the individual's happiness. In the words of Weber (1976:52–53), if money or profit is seen as a goal in itself, from the viewpoint of the individual's happiness, it appears as “entirely transcendental” and “absolutely irrational” insofar as economic acquisition becomes an end in itself rather than an instrument for other ends (*viz.*, satisfaction of material and ideal needs). In this regard, the operation of the spirit of capitalism in the form of profitable exchange reversed the normal or natural relationship between human ends and means (Weber 1976:53) rather than being a phenomenon consistent with human nature, as economists usually assume. In a Weberian framework, this operation implies an inversion of the typical relationship between instrumental actions and value-rational (and emotional/traditional) actions, as well as between formal and substantive rationality. In retrospect, this is a relationship in which instrumental action and formal rationality historically have been secondary to their counterparts. However, this inversion needs to be qualified.

Rather than being an inexorable product of an immanent economic logic, however, this reversal of the natural relationship between money or gain and human needs or wants has been sociohistorically conditioned. Far from being universal and invariable, capitalist exchange, including its industrial-technological components, was historically specific as it occurred in Western Europe, a fact neglected in standard economic theory (Findlay 1996: 50). Such specificity of capitalist exchange supports the thesis that the spirit of capitalism underlying such exchange was historically and socioculturally variable, not immutable. The historical evidence indicates that the supremacy of the spirit of capitalism in Western Europe and elsewhere was the result of a long struggle against a myriad of countervailing forces, traditionalism being the strongest and most persistent of them (Weber 1976: 36–37). It also suggests that realizing monetary gains through exchange transactions and the spirit of capitalism may occur separately (Weber 1976: 64–65), albeit the latter achieved its most suitable expression in such transactions, which drew their most suitable motive force from it. The possibility of such disjunction between the spirit of (modern) capitalism and the practice of capitalism in the broadest Weberian sense (money seeking) is evi-

denced by historical instances of non-capitalist and generally non-rational forms of gain-seeking exchange transactions, including trade in money.

For example, Weber (1927:248) reports that an “irrational trade” in coins in the Middle Ages extended well into the sixteenth century. In another historical illustration, Weber (1927:354) also finds that status groups’ luxury conspicuous consumption in the late Middle Ages was instrumental in the development of irrational economic forms, such as small workshops in France, rather than modern rational capitalism based on mass production and consumption. Further back in history, still another instance of irrational economic exchange is provided by what Weber calls chieftain trade, which is a distant precursor of politically oriented or robber capitalism as a non-rational type in relation to modern capitalism. A key reason for such irrationality of chieftain trade is reportedly its origin in gifts, what Weber calls quasi-commercial exchange. According to Weber’s (1927:238) historical description, chieftain trade evolved from the regular gifts between the rulers, which maintained peace in ancient societies (e.g., Egypt), for omitting such gifts would be an act of war. Also, Weber (1968:73) finds that cases of conventional exchange included exchanges of gifts between friends, heroes, chiefs, and princes, adducing the exchange of armors between Diomedes and Glaucos. Thus, in both ancient chieftain trade and in feudal coin trade and luxury consumption there is a disjuncture between profit-making exchange transactions and the spirit of capitalism in its modern sense, as defined by Weber (continuous business enterprise).

What also is historically specific to the (Protestant) spirit of capitalism is that exchange has been transformed into a calling or a vocation as a life-long activity. Such a vocation is permeated by a sense of duty and thus constitutes the most important trait of the social ethic of capitalistic culture (Weber 1976:53–54). This vocation is not just a business career voluntarily and rationally chosen to earn more and more money via exchange transactions but is more than that. To the extent of being dominated by the sense of duty, a calling of successful businessmen (traders) appears less a problem of free rational choice to attain individual ends than a normative-institutional imperative of upholding certain religious, ethical, and related values. This especially holds true for the Calvinist imposition and interpretation of such a calling, because Calvinism was the “most absolutely unbearable form of ecclesiastical control” of individuals (Weber 1968:37). The notion of secular calling was an outcome of such transcendental control in which individuals were only administrators of God-given facilities and possessions. And the notion of calling or vocation, expressing positive valuation of systematic business (and other) activities undertaken in accordance with rational capitalist principles, emerged from this pattern of religious thinking (Weber 1927:367).

At this juncture, Weber (1927:368–69), somewhat disenchanted, observes that the concept of calling, as the realization of God-given tasks, is

a *caput mortuum* in modern capitalism and thus the religious core of the modern economy is “dead” in consequence to the weakened or lost religious content of economic practice/ethic. However, such a religious root and import of economic behavior do not seem to be quite extinct if one believes reports that among modern American (fundamentalist) Protestants, seeking material gain is secondary in relation to many cultural values, thus sharing such an anti-materialist orientation with a variety of different religious groups (Darnell and Sherkat 1997:314).

This would qualify Weber’s statement concerning the inversion of the “natural relationship” between instrumentally rational action or formal rationality and value-rational action or substantive rationality implied in the spirit of capitalism and exchange. The latter can often display even in modern capitalism elements not just of instrumentally rational action and formal rationality but also of value-rational (and traditional-affective) and substantive rationality. The presence or prevalence of these elements is implied in that reportedly economic actors often seek wealth because of concerns for social status rather than consumption<sup>9</sup> (Bakshi and Chen 1996).

In general, findings about the dominance of extra-economic values in the operation of the spirit of capitalism suggest that certain social ethics or economic cultures have historically predated or are autonomous relative to the market-economic realm, rather than being appendices of (or intrusions into) the latter, as assumed by economic (and orthodox Marxist) conceptions. In other words, the (probably unintended) effect of the notion of vocation in Calvinism and other ascetic Protestantism was the rationalization of economic (and other) behavior within the social world, and yet for the “sake of the world beyond” (Weber 1976:154).

The discussion thus far suggests that rational choice and Marxian conceptions view, though in different ways, the spirit of capitalism and the entire cultural superstructure as a necessary effect or reflection of the economy. For instance, rational choice theory or neoclassical economics assumes that moral, religious, and other sociocultural institutions are combined outcomes of rational individual exchange, just as these institutions are viewed as epiphenomena of economic structure in orthodox Marxism. In both cases, the spirit of capitalism, the work ethic, and the (economic) culture generally is a causal effect of universal and objective economic rationality<sup>10</sup> (Turner 1991).

In a departure from both conceptions, within the Weberian framework a certain religious ethic with definite attitudes toward economic exchange harbors or is conducive to a particular economic culture, namely, the spirit of capitalism. The latter thus has sociohistorical (and thus causal) priority in relation to the (modern) capitalist economy. For economists and Marx, first there was the *economy* of capitalism and then the *culture* of capitalism as the necessary product. This causal or temporal order is radically reversed in Weber. For capitalism as a *practice* of profit-seeking exchange to emerge

and develop, there must first exist capitalism as a *spirit* (i.e., as a definite work ethic or an economic culture historically grounded in a religious, an ethical, an ideological, and a sociocultural matrix). In particular, such an economic ethic emerged against the background of the ascetic ideal, of the Calvinist asceticism in the realm of economic ideas (Weber 1927:369). In any event, the structure and spirit (Weber 1968:1118), that is, the ontology and epistemology, the socioeconomy and culture, of (modern) capitalism are closely intertwined. In a Weberian framework, the former is a function of the latter, rather than vice versa, as assumed by orthodox historical materialism and rational choice sociology.

Thus understood, the spirit of capitalism can be deemed a cultural, sociopsychological, and historical prerequisite of capitalist profit-seeking exchange, and thus of capitalism as a global socioeconomic order, though one should not confuse the origin of modern capitalism with its later functioning and development. To summarize, instead of being an innate human proclivity to make a profit, the spirit of capitalism is a social construction grounded in a particular cultural phenomena and historical conditions, such as the Protestant (especially Calvinist) ethic in the wake of the Reformation. In consequence, its operation expresses the fact that capitalist exchange was historically and culturally contingent. Insofar as the spirit of capitalism was permeated by extra-economic incentives such as the Calvinist quest for religious grace or ethical impeccability, as well as for social honor and power, such an exchange was not just a rational activity in the sense of instrumental or formal economic rationality (gain-loss calculation) but also economically non-rational or non-economically rational (value rationality). Generally, the sociocultural construction of the spirit and structure of capitalism suggests that the relationship of capitalist transactions and economic rationality is, at least in the early Protestant phase, more complex than conventional exchange theory in economics and sociology suspected.

## INSTANCES OF THE CULTURAL CONSTRUCTION OF EXCHANGE

### The Cultural Determination of Exchange Value

As hinted at earlier, an important historical form of the cultural, especially the ethical-religious, determination of exchange value is the just price. The just price represents a special case of exchange-value determination (Barrera 1997) by extra-economic, and especially moral (Michel 1999), considerations. Historically, in Medieval Europe, a just price was customary or legally imputed to any product (and to labor as the fair wage). It consisted of a quantitative equivalence between money value and real value (the cost or labor), governing thus price fluctuations by legal means. Just

price was intended to be a real value or a money equivalent reflecting this value, and as such a labor-cost magnitude. Specifically, the just price of a commodity corresponds to its long-run normal value as determined by the cost of production, or to its price, insofar as the latter fluctuates around that value (Worland 1977).

Historically, the roots of the just price can be traced to early civilization. For instance, Hammurabi's laws envisioned some kind of just price as well as deviations of actual prices from it. Also, Indian law implied some notions of just price, consisting of costs plus reasonable profit (Spengler 1980:34–44). The most visible origins of the concept of just price can be found in ancient Greece and Rome. Namely, the concept passed from Greece into Roman law, stipulating just economic value or price (*verum pretium*) so that exchange transactions outside of this range were unjust (Spengler 1980:129). As an instance of early determination of it, by the edict *De pretis verum venalium* (A.D. 301), Roman Emperor Diocletian fixed the just price using the customary costs of production as the basis. Later on, Aquinas provided the standard medieval conception of just price by stipulating that no equality of justice exists insofar as the price of a commodity is in excess of the amount of its costs (worth) as well as its costs in excess of its price (Friedman 1991).

By assumption, the just price was intended to attain justice (Hamouda and Price 1997) in an apparently unjust world (Johnson 1991), namely, the equivalence of commutative justice (Schumpeter 1956:93) in exchange or/and distributive justice (Worland 1977). Consequently, exchange transactions were to be conducted in accordance with such an imperative of justice implied in the just price (Spengler 1980:131). From an economic standpoint, the just price amounted to arbitrary and inadequate valuations as opposed to the objective ones reflected in actual competitive prices determined by supply and demand (Wilson 1991).

Still, the just price was on ethical, religious, customary, and other non-economic grounds juxtaposed or meant to replace competitive prices. This was so, although in retrospect, no just prices could efficiently be established by moral or legal injunctions and by any means other than supply and demand as price-determining factors. But in this medieval endeavor, as in the modern ones, to fix a fair price or to stipulate fair exchange including free and fair international trade the consideration of economic efficiency was secondary and subordinated to the ideal of fairness and other non-economic variables expected to regulate prices and other aspects of exchange transactions. In this medieval endeavor, an account was taken not only of the profit of the producer but also of the purchasing power of the consumer, for example, rules against price gauging. Just price, an assumed embodiment of distributive justice, often may have unintended or paradoxical consequences in terms of justice. This is shown when the price is the same for everyone. Wealthy consumers end up paying effectively less

for the same goods than others. This injustice of just price—as well as of any fixed price—often has been remedied by various forms of price differentiation, as in the case when a doctor charges his or her patients according to their circumstances (Simmel 1990:317).

In this connection, the just price seemingly appears as an antipode to competitive prices, and so completely alien in a competitive economy. For example, the operation of competition often can make impossible or meaningless the realization of the ideal of (distributive and commutative) justice, for example, the natural right of producers to the full (labor) value of their product, as implied by Aquinas and other scholastics. Presumably, in a capitalist economy, actual prices and incomes (in fact, factor prices) are formed by a freely competitive economy rather than by ethical, religious, or political factors operating in determining just prices/wages in pre-capitalist economies. Yet, the reality of price formation and income distribution is more complex than this presumption implies.

Not surprisingly, then, for most economists (yet for an attempt to defend Aquinas' just price, cf. Friedman 1991), the just price is a spurious ethical sanction, some kind of nuisance or disturbance of the natural exchange processes. Arguably, medieval moralists' just price falls within the province of the "ethics of political economy" (Keynes 1955:62) rather than positive economic analysis. But such qualifications seem redundant, because dismissing such sanctions and generally passing value judgments are not necessary in this regard. The issue now is whether such ethical and other extra-economic determinations (Barrera 1997; Michel 1999) of exchange value are undesirable or not, from a meta-theoretical perspective, whether economic or ideological. What is at issue is their objective influence in this regard, and spurious or not, the just price expressed this very influence.

Next, one specific extension of the just price was and still is just or fair wage. Fair or natural wage (as termed by Adam Smith; cf. Stabile 1997) was reduced to the notion of a living wage based on the standard of living defined by social position/distance or a subsistence principle reflecting customary wants. As such, fair wage represented a particular variation of the just price with respect to labor, as just profit is thus relative to capital. For the main consideration guiding ecclesiastical ethics in fixing the just price was establishing such a standard of living of various social groups which was appropriate to their social status. The medieval just price, as requested by the ecclesiastical ethic, was determined by ascertaining whether (at certain prices) the economic agents (e.g., craftsmen) were able to retain an adequate standard of living in terms of their social status (Weber 1968: 872). In other words, the just price was commonly deemed to provide an income to the craftsman or trader sufficient to and "at a proper and customary way adequate to this station of life" (Clark 1962:4).

Thus understood, the just price was an integral and even the most relevant natural law component of the scholastic economic doctrine of Aquinas

(Friedman 1991). Just price was viewed as a natural value. Hence, the fate of this element was linked to the whole doctrine. This was shown in the gradual substitution, with the development of exchange, of the competitive price as the new natural price for just price, even in canonistic economic discussions. The outcome of this process is that the just price and any other (such as monopoly) price fixed by arbitrary human intervention is now perceived and stigmatized as unnatural, relative to the prices resulting from free exchange as a natural state of affairs. Ironically, such canons of natural law provided higher dignity and a more solid ground to the ideal of free exchange than did neoclassical economic theories (Weber 1968:873).

The earliest causes of the conception of just price as well as of the prohibition of interest can be found in the primeval ethic of neighborhood or tribal brotherhood (Nelson 1969). This ethic stipulated economic exchange only as the exchange of occasional surpluses of the producers, money lending as help in need, and mutual work assistance. Then it proscribed any bargaining or haggling among brothers allowing only for just compensation for or restitution, in the form of a living wage, of the effort made. It also prohibited the profit from lending disposable goods and prescribed mutual help in work with no recompense, as well as an invitation to a meal with no return. The social norm is that brothers do not make a profit from each other in a zero-sum game, but rather on tribal aliens. It is the distant ruler, not the brother or the neighbor, who is charged with interest for the money lent.

In sum, the conception of just price has represented an ethical imperative reflecting the idea of an objectively valid value in exchange, though increasingly mixed with secondary economic insights from the competitive process of price formation. Like the more general conception that an exchange rate can be determined by the postulates of natural law, this exemplifies the profound influence of ethical, religious, traditional, ideational, legal, political, and other non-economic forces on economic-exchange Medieval Europe (Weber 1949:95). This also is the case with the Islamic economy, especially its financial system (Mills and Presley 1999), based on the strict Kuranic prohibition against the payment and receipt of interest (Choudhry and Mirakhor 1997) or *riba* (Presley and Sessions 1994), as well as on notions cognate to the just price. Thus, contrary to economic theories that view exchange values as independent categories, price formation in the Middle Ages and in Islamic societies was subject to the impact of these cultural and other non-economic variables expressed in the notion of just price.

### **The Cultural Determination of Exchange Returns**

In historical terms, the cultural determination of exchange returns has been exemplified by the prohibition of interest or usury. In retrospect, the



prohibition of interest was “merely a particular case of the just price; it covered likewise any injustice in trade, any violation of just price” (Gray 1963:40–42). Such a prohibition manifests these cultural variables by assuming as an essential element in most religious, ethical, customary, or legal systems that seek not just to describe or explain but also to master or regulate life. The custom of tribal or universal brotherhood (Nelson 1969) and the obligation of mutual economic assistance constituted the original basis of the injunction against charging interest among brothers, as this was seen as a violation of such customs and obligations (Weber 1968:1188) (albeit some contend that such brotherhood is a myth and that the Old Testament anti-usury laws are just utopian ethical ideals; cf. Moser 1999).

This helps in understanding the ecclesiastical rejection and persecution of usurious lending and lenders in the Middle Ages as well as in the phases of the early development of capitalism. Such an opposition represents a particular aspect of the general struggle in those times between traditional religious or ethical imperatives and economic rationalization. In this struggle expressing the negative position of pre-Protestant religious ethics on rational profit making in exchange may lie the real reason for such hostility to interest or usury.

The advancement of commercial transactions and capitalism as a whole only intensified such an attitude to interest taking, for it took a form of conscious protest against this process. This occurred in a barter economy in which increasing economic rationalization came in conflict with and eventually substituted the traditions and authority of the sacred law on which such an economy had been grounded. It was the prevailing tendency, although there have been exceptions, such as Japan’s peculiar admixture of traditions and a capitalist economy. By virtue of this effect on religious authority, the pursuit of money, including interest taking and profit making, in economic exchange became an intense object of religious suspicion and opprobrium. However, the major reason for arousing this attitude of ethical religions, above all, Christianity and Islam, seemed to be the impersonal and rationalized character of exchange. This impersonality was regarded as an actual or a potential challenge to the authority of sacred law with its personalities (priests and followers), personifications (gods and saints), and the relations between all of these. For now individuals are to follow, under the specter of economic ruin for failing to do so, the dictates of exchange as opposed to those of the sacred law. This has been the prevailing attitude, mostly within the Catholic Church, as well as Islam, in contrast to Protestantism and Judaism, where no such opposition was perceived.

In retrospect, this opposition was grounded on the perception among the incumbents of the authority of sacred law that the traditional order was in grave danger. The danger was seen as arising from the inherent tendency

of rational economic exchange to depersonalization, and the expected ineffectiveness of charitable appeals in controlling the new universe of instrumentally rational activities culminating in the functional-utilitarian world of modern capitalism. However, such expectations seem to have been to some extent overrated, because charitable appeals have a place, though a secondary one, even in modern capitalism (as discussed elsewhere in this work). An outcome of this religious opposition to economic exchange and rationalization can be the anti-economic rejection of the world as practiced by religious perfectionists.

A particular manifestation of such an anti-economic rejection of the world was the religious prohibition of interest. For the rejection of usury seems an explanation of this “central religious mood in almost all ethical systems purporting to regulate life [as] the original basis for the rejection of usury was generally the primitive custom of economic assistance to one’s fellows, in accordance to which the taking of usury among brothers was regarded as a serious breach against the obligation to promote assistance” (Weber 1968:583–85). Hence, the earliest roots of the prohibition of interest can be traced to what Weber used to call the ethic of brotherliness, characteristic of tribal and other ancient societies, in his historical depiction (1927:267).

The religious opposition, especially on the part of the Catholic Church, toward lending with interest intensified with the expansion of capitalism in Western Europe, if one follows Weber’s (1968:583–84) account. It is curious that this ecclesiastical (Catholic) persecution of capital interest, just as of the heretics during the Inquisition, was not formally revoked by the religious authorities. Still, the latter came to become more tolerant by turning a blind eye to the previously persecuted practices of usury. Thus, while a formal suspension of the prohibition was never issued, some ecclesiastical depositions of the nineteenth century envisioned specific circumstances under which charging interest would be legal or at least legally neutral (Weber 1927:270–71). Such recognition reflected the ascendance of the modern exchange economy, in which the religious institutions (the Catholic Church) that nominally prohibited usury often engaged in lending or borrowing with interest (Weber 1927:270).

This mainly applied to Italy and the other Catholic countries of Southern Europe during the late Medieval period, with the situation in Protestant Northern Europe being different in terms of the prohibition of usury. In Northern Europe, like many Catholic dogmas and practices, the prohibition was broken up by Protestantism, but not immediately. This is shown by Calvin’s declaration that the purpose of the prohibition of interest was only the “protection of the poor against destitution” rather than of the rich undertaking their businesses with borrowed capital (Weber 1927:271).

### Ramifications of the Cultural Determination of Exchange Values and Returns

The aforesaid regarding just price and prohibition of interest partly applies to their contemporary functional equivalents, ramifications, or remnants, such as fair prices, fair wages, fair trade, fair interest rates, and the like. These ramifications of just price and prohibition of interest indicate that ethical-religious as well as ideological-political sanctions of exchange variables are far from being absent in modern capitalist economies. Presumably, by interfering with the operation of free markets, including free international trade, these sanctions might be undesirable or spurious from an economic stance, as modern *laissez-faire* economists (Krugman 1997) lament about the idea and practice of fair trade. However, observations cast doubts on such a presumption. Reportedly, no necessary contradiction exists between ethical imperatives and rational self-interest in exchange transactions, because justice and egoism are equally compatible with market pricing (Fiske 1991:396). A case in point is the behavior of Japanese (and other Asian) economic agents that reportedly are far from being individualistic. As reported, market pricing operates between Japanese and non-Japanese firms, but not between individuals in firms, and even in situations where individuals are the main protagonists in the process of market pricing, they are not necessarily or fully egoistic, given that this process is largely devoid of maximizing attitudes, concerns with efficiency, and even profit seeking (Fiske 1991:396–97). Also, the various constraints on individual choices exist, so voluntarism and freedom of choice are not necessarily attributes of market pricing, since people often are restrained without any reasonable or genuine choices (Fiske 1991:396).

On the other hand, fair wage or profit as well as the ban of interest was meant to attain distributive justice (i.e., justice in the distribution of exchange objects or rewards) (Schumpeter 1956:93; Spengler 1980:131–32). The contemporary notion of fair wages is a variation on this theme of distributive justice. Moreover, the labor market's *efficient* operation often is predicated upon the presence of moral and other sociocultural conventions similar to the traditional concept of fair or just wage, given that many laborers are remunerated based on subjectively appraised performances, something neglected by the neoclassical (shirking) model of efficiency wages<sup>11</sup> (MacLeod and Malcomson 1998). Admittedly, any set of prices and incomes is to meet standards of economic efficiency and of equity alike (Hicks 1977:115), including to some degree the "ethic equality" (Stewart 1998), for example, fair wage considerations (de la Collard and Croix 2000). The fact that modern disputes over earnings often are couched in notions of fairness (Smith 1990), namely, that one should maintain some fair level of wages (Arrow 1998), suggests that these notions influence labor-capital outcomes, and thus ethical sanctions in exchange transactions

are still salient. Hence, as analysis suggest, fair wage considerations can help resolve or highlight many puzzles in the labor market, including the business cycle puzzle, especially when intertemporal or interpersonal wage comparisons are taken into account (de la Collard and Croix 2000).

In addition to consumer and labor markets, notions of fairness reportedly influence exchange transactions, even in hard-core financial (bond, future, and stock) markets (Abolafia 1996; Carruthers 1997b). Thus, in a variety of empirical as well as experimental markets exchange actors (e.g., negotiators) tend to be strongly averse to come to terms below their perceived level of fairness (Babcock and Loewenstein 1997:123). They thereby seek to attain the fairness equilibrium (Camerer 1997:180). This indicates that exchange actors are guided not only by utility-optimizing preferences but by preferences for fair outcomes.

In turn, economic exchange fairness evaluation can be a matter of subjective definitions, sometimes reflecting self-serving bias rather than an objective, universal yardstick of fairness, despite the marginal productivity-income rule of fair distribution or distributive justice of economics. Thus, some economists (Babcock and Loewenstein 1997:110) claim that individuals seek fairness with a “self-serving bias to conflate what is fair with what benefits oneself.” Yet, such claims commit the economic conflation between (the perception of) justice or equity and rational egoism or efficiency to the extent that self-serving biases are far from being universal or even prevalent. This is shown by various instances in which individuals seek fair outcomes which are not necessarily optimal in cost-benefit terms and which even may be ruinous in such terms. Simply, it is hardly true that individuals tend to be fair only when it is in their own interest. Hence, fairness considerations cannot be subsumed under the heading of the pursuit of self-interest.

In any event, violations of these standards of distributive justice often are experienced as feelings of discrimination, exploitation, unfairness, or injustice. Analogously, violating the ethical rule of commutative justice is involved in price discrimination by which different actors or groups are charged different prices for the same exchange object (Pigou 1960:460–63). The persistent role of fairness and related moral considerations in economic exchange may confirm Keynes’ (1972:293–94) prediction that in the future the “fiercest” conflicts will revolve around ethical and sociopsychological rather than purely economic and technical issues, as incidentally suggested by post-materialist tendencies in modern societies in recent years (Abramson and Inglehart 1995).

## NOTES

1. According to some economic sociologists (Spillman 1999), the cultural dimensions of exchange are expressed in that rather than being abstractly opposed

to other social relations and institutions, markets are to be understood as embedded in these and thus amenable to the same type of analysis. In this view, since in the new economic sociology the prevalent structural or network concepts of embeddedness neglect or have an impoverished notion of culture, in a proposed alternative markets are examined in terms of the cultural construction of the following elements of economic exchange: objects, parties, and norms of exchange. In turn, norms of exchange derive from a richer symbolic repertoire of cultural rules and values and operate in conjunction with those of reciprocity and redistribution in actual exchange.

2. This study also reports a negative association between mutual trust and hierarchical religions, such as Catholicism, the latter generating less trust than other religions (La Porta et al. 1997). However, this finding seems surprising in light of the classical (Durkheimian) positive association of Catholicism and other hierarchical religions to social integration and thus mutual trust. But this empirical study seems unaware of such a theory, so the finding is not placed within a proper theoretical context.

3. According to Carruthers (1997b), the operation of financial markets is a good test case for economic sociology, as the pursuit of economic self-interest is less disreputable or more respectable in these than in any other social realms.

4. Ironically, this admission is made by a principled advocate of the economic approach to social norms (especially law), in which obeying norms is simply a matter of cost-benefit calculations (Arrow 1997:762). In this view, the four incentives for obeying social norms other than law include cost-benefit calculation, emotions, social (dis)approval, and internalization (Posner 1997:365–66).

5. Dore (1992:159) purports to question the sharp opposition between benevolence and self-interest as found in Adam Smith. Referring to the economic behavior of the Japanese, he reports that they have usually insisted that the “butcher and the baker and the brewer need to be benevolent as well as self-interested. They need to be able to take some personal pleasure in the satisfaction of the diners quite over and above any expectation of future orders” (Dore 1992:169).

6. There are some exceptions. For example, some Austrian economists and sociologists, such as Hayek (Caldwell 1997:1871) adopt the Kantian notion of moral rules as universal categorical imperatives (duties) with their autonomous force versus materialist or instrumentalist considerations, a notion rejecting the utilitarian equation of morality with efficiency, instrumentality, or utility. In this, these economists also were influenced by Weber’s (1958:122) concept of the “ethic of absolute ends.”

7. For example, contrary to the rational choice hypothesis of the tragedy of the commons—attributed to rational, self-interested individual behavior—evidence emerges that “success or disaster in the commons cannot be predicted or described by reference to individual decisions alone. Rather, outcomes are contingent on complex group-level arrangements, norms, and expectations” (Miller 1997:1181).

8. For instance, some rational choice theorists (Harsanyi 1977:625–26) define moral behavior as a “special form of rational [utility-optimizing] behavior” (i.e., as the pursuit of interest). They thus merely reiterate the Bentamite utilitarian view that simply what is useful or (self-) interested is moral or ethical.

9. Bakshi and Chen (1996:135) state that “Weber refers to this desire for wealth [because of its status] as the spirit of capitalism.” This seems to be a peculiar,

Veblenian reinterpretation of Weber's concept of the spirit of capitalism, by infusing it with prestige and related non-economic ends rather than profit or economic components.

10. Turner (1991) emphasized this commonality between rational choice theory and orthodox Marxism, which thus tended to merge into rational choice Marxism.

11. In some opinions (Stiglitz 1991), conventional economic theory, especially welfare economics (its second fundamental theorem), is unable to separate concerns of equity or fairness and efficiency.



## Chapter 6

# *The Institutional Organization of Labor Markets (Income Distribution)*

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### THE (NEO)CLASSICAL ECONOMIC THEORY OF DISTRIBUTION

The theory of distribution within classical political economy is predicated upon the doctrine of three (or four) factors of production and their distributive shares. Production factors usually are grouped into labor, capital, and land, and sometimes, explicitly or implicitly, entrepreneurship (cf. Say 1964). Their distributive shares are wages, profits, and rent, respectively, as the three original sources of all revenues, with interest being part of profits and thus a derivative revenue (Smith 1939). Thus, the total product, as derived from the “united application” of labor, capital, and land, is distributed or divided among three classes (viz., landowners, capitalists (or entrepreneurs), and workers (Ricardo 1975). Determining the laws that govern distribution thus understood is for some classical economists (Ricardo 1975) the chief problem of political economy, defined as the study of the nature of wealth and the laws of its production, distribution, exchange, and consumption (Senior 1951).

Within classical political economy, the relations between production factors, especially labor and capital, involve substitution or/and competition, and thus their distributive shares (viz., wages and profits) move in opposite directions. As some classical economists (Ricardo 1975) argue, high (low) profits depend on low (high) wages to the effect that no rise in the value<sup>1</sup> or price of labor can take place without a fall in profits. In turn, profits are seen as a “fair remuneration” for the contribution of the capitalist or/entrepreneur, determined in the identical manner as the laborer (Senior 1951:76). And through the inequality of profits, capital and other produc-



tion factors move among various industries or markets, thus leading to the equalization of profits and other distributive shares, including wages assumed to move toward, according to an iron or brazen law, the subsistence level (Ricardo 1975), or the value (reproduction cost) of the labor force (Marx 1967), especially in the long run. Overall, much of classical political economy postulates that income distribution is principally influenced by exchange (Senior 1951:87) and thus by market-economic variables, and only secondarily, or not at all, by social factors (alongside dissident classical economists such as Marx, certain exceptions in this regard are Mill and Cairnes). In short, just as in exchange, income distribution is a question of catallactics or pure economics rather than economic sociology.

Neoclassical or marginalist economics continues and further solidifies the classical treatment of income distribution as a purely economic process. Even more explicitly and consistently than within classical political economy (Knight 1958), in the neoclassical framework, distribution theory amounts to part of the theory of markets and prices. Particularly indicative in this respect is the argument that the only adequate theory of distribution is the market, because there is a single law of distribution, the market, rather than many such laws (Wicksteed 1933:6, 788–89). Arguably, the nature of income distribution is always determined by the formation of prices for the factors of production via the operation of the capitalist forces of supply and demand (Cassel 1929:201). Hence, distributive payments, including wages, are competitively determined factor prices, and income distribution becomes an economic process of pricing productive factors (Knight 1958:76). Factor prices thus formed then determine the distribution of the total income between contributing agents (Friedman 1976:9).

Consequently, theories of income distribution and exchange are “intimately connected” (Marshall 1961:678). Specifically, the theory of income distribution “resolves itself immediately” (Keynes 1955:104) into a theory of price or exchange value, as distributive shares into which the net product (income) is divided are seen as prices for certain services, with the interest rate being the “most pervasive price” in the economic system (Fisher 1954: 33). Presumably, a sound distribution theory represents an exposition of the operation of the market mechanism, especially the forces of price competition, by which resources are allocated between different employments, and thus has meaning only within a theory of general economic equilibrium (Knight 1958:42, 61–63). The theory of general economic equilibrium thus fuses price and distribution theories as parts of a single pricing problem involving the simultaneous (automatic) determination of prices and incomes (Friedman 1976:153). Thus, the assumption beneath the neoclassical subsuming the theory of income distribution under the heading of a special case of price theory focusing on the pricing of production service or factor markets is that the principles of price formation in product markets also account for wages and other distributive shares in labor and other factor

markets. The same analytical apparatus would be applicable to price formation as well as income distribution, so that both are expressed in terms of supply and demand, marginal utility, and so on. (Friedman 1976:153). In this connection, some neoclassical economists distinguish functional and personal distribution linking the first with rewards for performing functions and the second with incomes from selling individual services (Boulding 1966:198). By treating wages, profits, and other income as prices (of services), to them the question of functional distribution “is merely a part of the general theory of prices” (Boulding 1966:201).

Notably, the preceding suggests that in the neoclassical framework, distributive shares, redefined as factor prices, derive from product prices, rather than vice versa, as implied in classical, cost of production theories of value and prices. Assumedly, the price of final products determines their cost-price (*prix de revient*) as a sum of expenditures in productive services from the entrepreneurial viewpoint or of distributive shares (incomes) from the stance of labor and other production factors (Walras 1926:395). For example, in the case of products, the cost-price of which is higher (lower) than their price, entrepreneurs’ demand for labor and other productive services declines (increases), and as a result, wages and other distributive shares or factor prices fall (rise). Alternatively, the latter are assumedly non-determinative in regard to prices, based on the argument that the magnitude of production costs, being determined, cannot determine product values formed in turn by the operation of utility (demand) and quantity (supply) (Walras 1926:395). Particularly, this is assumed for the relations between wages and prices, by arguing that since labor is variable rather than constant, its value is determined by product value, and not the other way round (Jevons 1965), as in classical political economy, especially in Ricardo and Marx. More generally, the values or prices of all production factors—and thus all distributive shares or incomes—are derivatives of the values or prices of products (Wicksteed 1933:798; also Knight 1951:87). To be more precise, in the marginalist context, the price of labor and other production factors rests on the marginal utility of their products (i.e., on their marginal productivity) and thus is derived from the product price given value determination by the marginal utility principle (Hayek 1950:434; see also Friedman 1976:153).

This implies the operation of some principle of derived or determined demand/value of production factors, including labor, in relation to consumer products. His labor-cost theory of value notwithstanding, Adam Smith (1939:50) adumbrated this principle by observing that if the supply of a commodity exceeds the effectual demand, resulting in a price decrease, some elements of its price, such as wages, profit, and rent, will be less than their natural rates—and vice versa, if its supply is lower than its demand. Thus, profits, wages, and other income are assumed to be distributed according to the “law of consumption for final products” (Cournot 1960:

99). The underlying logic behind the derived factor demand principle runs as follows: those who demand certain quantities and kinds of commodities demand by implication certain amounts and types of productive factors indispensable for producing those commodities (Wicksell 1954:93). In consequence, the demand/value and thus distributive shares of the factors production are “indirect and derived” in relation to the “direct” demand for those goods produced by these factors (Wicksteed 1933:396). In other words, the demand schedule of any factor of production of a commodity is “derived” from that for those commodities or things in the making of which the factor is employed<sup>2</sup> (Marshall 1961:318, 479). Alternatively, processes or activities preventing variations in the demand for commodities to be expressed by those in the demand for productive resources tend to weaken the relative variations of demand for these resources (Pigou 1960: 168). In Keynes’ theory (1960:233–34), this involves the derivation of investment demand schedules from consumption demand schedules, as induced by the propensity to consume, insofar as all production is for the sake of consumption (Marshall 1961:434). Hence, consumer demand is viewed by most neoclassical economists as the “ultimate regulator” of all demand, including labor and other productive services (Wicksteed 1933: 78). Thus, neoclassical economists argue that consumers rather than entrepreneurs are those who decide in the last analysis about the character and direction of production and distribution in a capitalist economy (Böhm-Bawerk 1929:259). In a similar vein, some contemporary economists (Friedman 1976:14) maintain that consumer demand for products is the “ultimate source” of the demand for productive resources, so the demand for a factor is derived from that for final goods. The demand for final goods directly expresses the attached (marginal) utility, and that for production factors indirectly, given its derivation from the first (Friedman 1976:153).

In retrospect, the principle of derived demand for production factors has become the basis for formulating the acceleration principle (Hayek 1950: 435) applied to account for the (asymmetric) movements in the relative demand for producer and consumer goods. Specifically, the acceleration principle predicts that changes in consumption demand will generate more than proportionate changes in investment demand (Keynes 1960:287–90), especially through its operation in interaction with the income multiplier (Samuelson 1997a). In particular, the demand for capital or investment goods will increase more than proportionally to an increase in the demand for the consumption or final goods (Tinbergen 1950:164).

In the neoclassical framework, the distributive shares of labor and other production services are determined by or equated to their marginal productivity (in mathematical terms, the partial derivatives of the production function) by analogy to product prices’ determination by or equation to marginal utilities. Presumably, in economic equilibrium, incomes or the prices of productive services are equal or proportional to marginal prod-

activities or the “partial functions of fabrication” (Walras 1926:375), and thus the total cost of production, as a sum of these prices, of a product equals its price (Pareto 1927:223). This implies estimating or imputing values and thus distributive shares to labor and other factors based on their marginal productive contribution (Wieser 1956). As in commodities (goods of lower order), the value of production factors (goods of higher order) is subject to estimation or imputation in accordance with their marginal utility in production (i.e., the value of a marginal product generated by a factor unit, for example, an extra worker) (Böhm-Bawerk 1929).

Such a theory of imputation—as termed by analogy to legal imputation of guilt (or innocence) (Wieser 1956)—would afford determining or estimating the marginal utility of any production factor based on its productive application and contribution, with marginal utility thus becoming, in the form of marginal or final productivity, the basic concept of the neoclassical theory of both distribution and price (Schumpeter 1956:171). In retrospect, in some interpretations (Schumpeter 1956:197) the marginalist theory of imputation or distribution was intended to be a bridge between the prices of products and the means of production, particularly to establish the principles (e.g., marginal utility, derived demand) by which the former are reflected in the latter. Thereby, the theory of imputation leads to viewing the law of cost as a special case of the law of marginal utility or supply and demand (Schumpeter 1956:171).

In light of its grounding in the principle of marginal productivity, distribution theory is regarded as being inseparable from production theory, in the sense that the values or distributive shares of production factors are determined in accordance with their marginal productivity or “productive effectiveness at the margin” (Wicksteed 1933:799). In this sense, wages correspond to the marginal productivity of labor, profits to the marginal productivity of entrepreneurs, rent to the marginal productivity of land, and so on (Clark 1956), and interest to the marginal productivity or efficiency of capital (Keynes 1960:136–37), and so on.

The argument is that simply every factor receives what it contributes in production, with labor, for example, receiving some kind of productivity or efficiency wages (sometimes viewed as exceeding the market-clearing level; cf. Akerlof 1982) equivalent to its estimated productive contribution. Establishing the neoclassical theory of distribution thus demands determining the relative marginal productivities (“differential equivalences”) of all production factors in the belief that the law of distribution is one and given by the identity of marginal productivity or “differential effect” (Wicksteed 1933:789–92). When all production factors are rewarded according to their marginal productivity or efficiency, the product is fully distributed or exhausted, and no surplus value is left (contrary to Marx’s distribution theory). Namely, as marginal (last) increments measure the distributive share of a factor in the product, when differential or marginal-productivity dis-

tribution is implemented, no surplus or residuum is left over (Wicksteed 1933:792), incidentally a principle (Euler's rule of distribution) sometimes limited to perfect competition, by theories of imperfect competition. Under perfect competition, the total product is then equal to the sum of the amounts of factors, each factor multiplied by its marginal productivity as the wage of each corresponds to its marginal value product, with no residue being left for employers (Robinson 1969:103). Also, under free and perfect competition with constant elasticities of the production function, the distribution of the product among the different factors of production is expected to be in constant proportion (Tinbergen 1950:129).

In contrast, under imperfect or monopolistic competition, wages tend to be less than the value of marginal productivity and instead equal or proportional to the marginal revenue product that is lower than the marginal value product (Chamberlin 1948). While the condition that production factors, such as labor, receive the value of their physical marginal product under perfect competition is fulfilled regardless of whether entrepreneurial profits are positive or negative, in imperfect competition, entrepreneurs receive more (and workers less) than their marginal productivity (Robinson 1969).

Next, like consumer goods, production factors are assumed to be subject to diminishing marginal utility—in the form of marginal productivity—and thus to decreasing value or return at the margin. By analogy to products, the marginal utility (productivity) of an abundant or increasing productive factor decreases, while a scarce or decreasing factor increases (Wicksteed 1933:362). In consequence, the distributive share of labor or any other factor of production in the output is seen as being determined by the relative rarity of that factor (Cassel 1929:202).

Finally, whereas some earlier neoclassical economists acknowledge the existence of and distinction between the economic problems or dimensions of income distribution from its social ones, namely, the question of property rights of various production factors<sup>3</sup> (Wicksell 1934:7), most contemporary economists focus on the first and neglect or even deny the second. Thus, some of them contend that the marginal productivity analysis of the determination of wages and other returns has no ethical and other extra-economic implications on the grounds that adopting this analysis is not tantamount to accepting the existing distribution of income and wealth or rejecting it (Friedman 1976:200). Also, much of contemporary mainstream economics<sup>4</sup> (see, e.g., Friedman 1976), by assuming fair distribution or distributive justice (Edgeworth 1967:77–78), including non-exploitation—as suggested by the prevailing notions of efficiency or equilibrium wages (Lloyd-Ellis and Bernhardt 2000), market-determined incomes, and thus inequality (Clark and Taylor 1999), and so on—usually tends to dismiss or treat with benign neglect such phenomena as labor exploitation in distribution. Still, some early neoclassical writers<sup>5</sup> (Pigou 1960)—and, of

course, dissident classical economists such as Marx—were more attentive in this regard.

## INSTITUTIONAL INFLUENCES ON INCOME DISTRIBUTION

Wage formation and income distribution in general in labor markets is far from being a purely economic process ruled by the laws of supply and demand, (marginal) productivity, or the cost of reproduction, and thus devoid of extra-economic elements, as in conventional economics. For example, classical political economy assumed, as mentioned earlier, some iron law of wages, according to which labor income would never exceed its costs of reproduction and thus a subsistence level, especially in the long run. However, the process of income distribution is considerably affected by institutional and related non-economic variables, as evidenced by the impact of these latter on wage formation, especially on increasing income inequality in the United States.

### Wage Formation and Institutional Factors

In contemporary societies, including the United States, the extra-economic variables of distribution include institutional changes such as the decline in unionization rate, the decline in the real value of the minimum wage, and economic deregulation, this focus on institutional forces being distinguished from supply and demand explanations (Fortin and Lemieux 1997:75). Reportedly, the decline in the real value of the minimum wage, for example, explains a significant part (39.3%) of the variation in wages or income inequality in the United States during the 1979–1988 period. Such a decline can be considered an institutional change often dictated by political, ideological, and other extra-economic considerations, for the minimum wage in the United States is fixed by what Weber (1968:193) calls political bodies such as the American Congress rather than by impersonal economic forces. For example, the minimum wage is fixed at certain (high or low) levels, depending on the concrete structure (Republican or Democratic control) and *Weltanschauung* (Conservative or Liberal) of Congress. As such, the level of the minimum wage usually becomes a political-ideological rather than an economic issue. Hardly any economic argument about the (beneficent or pernicious) effects on (un)employment, real income, and productivity of a certain level of the minimum wage is likely to prevail over the political opportunism (election) and ideological beliefs (*laissez-faire* versus government) of decision makers. This has been witnessed many times in Congress and elsewhere (including state legislatures and the White House).

As studies (Levitt 1996) report, in this and most other issues, the decision

functions of people's representatives (e.g., U.S. senators) are driven by ideology and politics more than anything else, including their constituencies' interests. In this connection, some authors' (Wilson 2000) proposals for coalition politics based on organized national political constituency to reverse the tendencies to rising inequality in the United States are premised on the implicit assumption that these trends have been to a large degree generated or reinforced by politics of a different kind (viz., the "politics of envy"), in conjunction with the "economics of greed" (Stewart 1998).

At any rate, the figure indicates that the impact of decline in the U.S. minimum wage on increasing income inequality has been substantial during the concrete period, as the former explains almost half of the variance in wages. On the other hand, changes in unionization account for a certain portion (10.3%) of the variation in wages. More precisely, the steadily declining rates of unionization in the United States during the 1980s and 1990s tended to increase income inequality by that amount. (For example, deregulation explains 5.5 percent of the increase in income inequality for all workers with a wage of more than \$3 per hour and 4.4 percent for non-union workers with the same wage.)

Generally, the effects of institutional and other extra-economic variables on income distribution, particularly labor price, also can be inferred or estimated in an indirect manner, by the degree of wage flexibility. This latter indicates relative changes in wages (the price of labor) to changes in unemployment (the demand for labor). The greater the wage flexibility or responsiveness, the more wages would be subject to the operation of economic forces than non-economic ones. Alternatively, lower wage flexibility would suggest greater relevance of institutional and other extra-economic forces, especially political domination (domination by authority) or positional power (Perrone 1984).

As some studies report (Nickell 1997), in countries such as the United States and the United Kingdom, wages appear to be far less upwardly flexible, especially in the long run, than most European countries. To that extent, the steady decline of unemployment does not seem to be very good news for those already *employed* in the United States (as well as in the United Kingdom), for their earnings are hardly affected (increased) by the process in the short and long run alike. This can shed some light on the puzzle of the stagnant or even declining (by 13%) real incomes of most American employees in the 1980s and 1990s (Boskin and Jorgenson 1997) in the presence of a declining unemployment rate (e.g., from 8.7% in 1992 to around 4% in the late 1990s and in early 2000) as well as increasing labor (and total-factor) productivity (Dougherty and Jorgenson 1996). The increasing demand for labor associated with lower unemployment does not translate into higher labor prices (wages) as orthodox economic theory (i.e., what the law of supply and demand would require). Such wage inflexibility means that the American labor market is, at present, more rigid and partly

inoperative in terms of automatic supply-demand laws than usually is thought.

In turn, in much of Europe during the 1990s, the process of declining unemployment is absent or too weak to materialize itself in higher wages. There is no sufficient demand for labor to translate into higher prices for it, so wage flexibility and thus the operation of the European labor market have been virtually suspended. The focus has been shifted from how much wages would respond (increase) to a declining unemployment rate—a path of increasing living standards followed in 1960s' and 1970s' Europe—to how to diminish this rate, given wage levels. In standard (but misleading from a sociological viewpoint) economic terminology, this would be a shift from forming labor price by (labor) demand and supply to determining labor demand (employment) by wages.

One would expect wage flexibility in the U.S. labor market to be the highest, given conventional wisdom that wage formation or generally income distribution is governed strictly by market-economic forces as opposed to institutional-political (and other non-economic) ones thought to prevail in labor markets in other countries. However, the data show the opposite. Among developed countries, wage flexibility in the long run is actually the lowest (0.94) in the United States, with its short-term flexibility being the second from the bottom (0.32), after Spain (0.17). Using the criterion of wage flexibility, income distribution in the American labor market would be more institutional-political or non-economic in character than in any other industrial country. This seems to dispel the ruling myth in this regard, since the United States leans toward the “inflexible end of the spectrum” (Nickell 1997:59). Hence, one can argue that what Weber called power constellations have a stronger impact on wage formation in the U.S. labor market than purely economic factors. This implies that the nature of power relations between firms and workers will lead to wage levels different from competitive ones (Blanchard and Katz 1997).

These power relations are implied or expressed in data for the institutional-political features of labor markets in OECD countries (Flanagan 1999; Nickell 1997). Such features include direct labor market rigidities, such as employment protection and labor standards for developed (OECD) countries. For example, estimates for employment protection are given (Nickell 1997) on a 0–20 scale (from 1 for the United States, 2 for New Zealand, and 3 for Canada to 17 for Belgium, 18 for Portugal, 19 for Spain, and 20 for Italy), and those for labor standards on a 0–10 scale (0 meaning no labor standards in the United States and the United Kingdom, and 1 in Japan to 6 in Germany and France and 7 in Sweden, Spain, and Italy).

Labor markets' institutional-political features also entail the treatment of the unemployed by using three criteria: benefit replacement rates, benefit duration, and active labor market policies. For instance, benefit replace-



ment rates (as a percentage of median wage) vary greatly across the developed countries, as does benefit duration (in years) and active labor market policies. Additional institutional features of labor markets include the following: union density (i.e., of union membership as a percentage of the total labor force), union coverage index, which pertains to the labor force covered (regardless of membership) by union contracts on a 1–3 scale, indices of union-employer coordination in wage formation, and payroll and total tax rates on labor income.

The respective figures and estimates show that the U.S. labor market has the most peculiar institutional features in relation to those of other OECD countries. In turn, such features critically determine income distribution between various actors (e.g., employees and employers). For example, the U.S. labor market has the lowest employment protection of the order of magnitude of 1 (the maximum range being 20), has no labor standards (index 0), is among the lowest in unemployment compensation (50% versus Denmark's 90%), has the shortest duration of these benefits (0.5 years versus 4 in the United Kingdom), has the index of least active labor market policies (3 versus Sweden's 59), is among the lowest in union density (15.6 versus Sweden's 82.5), has the lowest union coverage index (1 versus 3 for most other countries), has the weakest coordination (cooperation) between unions and employers in wage formation (1), and so on.

Presumably, such institutional features of U.S. labor markets translate into lower wage flexibility as well as growing income inequality, which escalates into a distribution problem only insofar as it leads to a decline in the economic situation of those at the lower end of the income distribution (Gottschalk 1997), as happened in the United States during the 1980s and 1990s. For instance, the low level of employment protection, the absence of any labor standards, the short duration of unemployment benefits, and the low union density and coverage imply a disproportionately weak positional power of labor in relation to capital, management, or the state. It would be plausible to expect that these differentials in positional power in labor markets would translate into differences in earnings between these actors, as in the 1980s and 1990s.

Such differentials also can translate in differences in responses to industrial turbulence or structural economic change (DiPrete and Nonnemaker 1997). For illustration, research reports that the structural effects linked to industrial turbulence "were felt especially strongly by workers whose labor market resources were limited" (DiPrete and Nonnemaker 1997:402). Thus, the conception of power configurations and related institutional-structural factors offers better explanations for the increase of income inequality<sup>6</sup> in the United States in the last decades (Gottschalk and Smeeding 1997:665) and generally for the functioning of its labor market than economic theories relying on the law of supply and demand, physical (and human) capital and investment, technology, and so on.

Within the American labor market, these institutional factors include conservative government policy and ideology with long-term (especially since the 1980s) tendencies to favor capital versus labor, or with latent functions (unintended effects) in this regard. This has been partly indicated by the declining real value of the minimum wage accompanied by the soaring management salaries and capital gains, the sharply increasing gap (of an order of magnitude of 200 or so in the late 1990s) between the average executive compensation and the average worker wage, and decreasing tax progressivity, even reducing federal tax rates at the top and increasing those at the bottom of the tax base (Gottschalk and Smeeding 1997:675). In addition, such institutional-structural factors in the United States include labor market dualism (DiPrete and Nonnemaker 1997:402) splitting the economy into two sectors (primary and secondary), as well as racial dualism (Nielsen and Alderson 1997:26), including income inequality and economic discrimination in terms of race.

The evidence that U.S. labor markets are more decentralized in their institutional features—especially by enterprise-level wage negotiation and the absence of union centralization (Alesina and Perotti 1997a:930)—does not necessarily translate into a higher social mobility relative to, for example, the United Kingdom and other European countries, and vice versa: social mobility is not necessarily lower in countries with more centralized markets, such as in Germany or in Scandinavian countries, than in those with decentralized ones such as the United States (Gottschalk 1997:38). Rather, some comparative studies of, for instance, the United States and Sweden adduce evidence to the contrary (Bjorklund and Jani 1997:1016–17), namely, that the second features a higher level of social mobility than the first. At this juncture, according to the degree of centralization, national labor markets can be divided (Alesina and Perotti 1997a:930) into three groups: centralized (Scandinavian countries), decentralized (the United States, Canada), and intermediate (much of Western Europe) markets.

The impact of institutional and other social variables on the composition, functioning, and outcomes, including income distribution, of labor markets, whether in the United States or Europe, is beyond doubt. Also, some researchers (DiPrete and Nonnemaker 1997) examine the effects of economic structural change or industrial turbulence on labor outcomes, namely, job mobility. However, despite the term *structural*, such research does not usually examine the effects of institutional and other social-structural variables but is limited to endogenous economic processes. The hallmark of the sociology of labor markets is precisely the examination of the influence of such exogenous variables on them, rather than an endogenous model which assumes the association between economic phenomena, including industrial fluctuations or business cycles, and processes in these markets, including income distribution. The later model is a feature of pure economic theory, including mainstream labor economics (Ashenfelter and

Card 1999), with its neglect of non-economic structural change. Generally, economic sociology does not study intraeconomic relations (i.e., those between economic variables) but rather interrelations (economic-social), particularly the impact of social phenomena on the economy. It is this which distinguishes economic sociology from pure economics that deals with intraeconomy relations at a given point (comparative statics) or through time (comparative dynamics).

At any rate, the discussion so far suggests the need for a realistic treatment of the structure and operation of labor markets, in the form of the assumption of non-competitive labor markets. Such a treatment is especially justified given the salience of centralization or decentralization and their other institutional features. For illustration, some analysts (Alesina and Perotti 1997a) report that the role of institutional factors in the transmission of the effects of taxation is often crucial. Specifically, in very centralized labor markets, the distortionary effects are lower than in their decentralized counterparts. Moreover, the assumption of non-competitive labor markets sometimes takes the form of an argument that no aggregate labor market exists, which is thus a failed metaphor<sup>7</sup> (Galbraith 1997:95) but only multiple, segmented ones. Dualistic, organization-based labor markets (DiPrete and Nonnemaker 1997:402) exemplify such a segmentation of the American labor market.

On the other hand, these comparative institutional features of labor markets in developed countries have divergent effects on their rates of unemployment. For example, the institutional setting of European labor markets, characterized by rigidities, often was invoked as the cause for the persistence of high unemployment in Europe in the 1990s in relation to the United States (Blanchard and Katz 1997; Saint-Paul 1997; Siebert 1997). Observers note that because of a vast array of institutional regulations, such as constitutional rules on collective bargaining, minimum wages, and employment protection legislation in Germany and in many other countries, Europe has a less mobile labor force and thus higher unemployment than the United States. It is particularly evident here that employment-protection legislation is more salient in Europe than in the United States (Saint-Paul 1997:290). Such legislation, while having positive effects on job security and loyalty or satisfaction, exerts a negative impact on job creation and mobility in Europe.

Generally, the labor market's institutional environment (Andolfatto 1996:112–14) in Europe seems to be less propitious to creating and finding new employment than in the United States. However, the agreement on this issue is far from being complete. For instance, observers (Nickell 1997:56–57) invoke the fact, based on unemployment rates in Europe and in the United States during the 1983–1996 period, that almost one-third of the population of OECD Europe “lives in countries and operates in labor markets with average unemployment rates lower than that of the United

States,” as indicated by unemployment rates for OECD countries over 1983–1996 period (OECD Employment Outlook 1997). These rates show that European countries such as Austria, West Germany, Norway, Portugal, Sweden, and Switzerland (in addition to Japan) had lower unemployment rates than did the United States over the 1983–1996 period. The irony is that the European countries with the lowest unemployment rates (e.g., Austria, West Germany, Norway, Sweden, and Switzerland) are not known for the flexibility of their labor markets in contrast to Britain, which “has always had the most flexible labor market in Europe and yet has an average unemployment rate higher than half of its European neighbors” (Nickell 1997:55–57).

The same can be said of Japan in relation to the United States. Japan is characterized by a peculiar institutional structure of its labor (and other) markets, including properties such as job protection and even lifelong employment, employee loyalty, and so on, yet it had, and still has, a far lower unemployment rate (2.8%) over the period than the United States (6.5%), with radically opposite properties of its labor market. For instance, in Japan’s labor market, the job contract is reportedly not a sort of bilateral bargain as in the U.S. market but an “act of admission” to an economic community in which trust, benevolence, goodwill, and sincerity are requested or expected for the sake of tempering self-seeking (Dore 1992:170). Whereas employers and employees also can get “divorced” in Japan’s labor market, it is like traditional divorce in societies based on the sense of duty and trust versus the “‘sorry I like someone else better: let’s be friends divorce’ of modern California” (Dore 1992:163). The mutual obligation and loyalty of both parties in Japan’s labor market is sharply contrasted to their absence and the resulting lack of job dignity and security, in conjunction with overall economic uncertainty, in the U.S. economy. At any rate, the relationship between rigidities in labor markets and outcomes such as unemployment and earnings dispersion seems more complicated than conventional wisdom, assuming invariably their negative correlation.

At this juncture, the question arises about how individual actors search and find employment at the micro-level. Sociological factors, such as social networks or ties, are particularly pertinent, often more so than economic ones (performance, skills, etc.) in this process. This is shown by the use of weak or indirect ties (Granovetter 1992b) providing relevant information, as well as strong ties involving direct personal links to and the influence of such close friends and relatives (e.g., in China, according to Bian 1997) in finding job opportunities and achieving promotion. Both types of ties exemplify the pertinence of social capital in processes and outcomes in labor markets. The use of a definite type of ties is in turn conditioned by institutional and economic contexts (Bian 1997; Zhou, Tuma, and Moen 1997). On the one hand, actors rely on (mostly weak) social ties in their attempts to achieve intraorganizational mobility. On the other hand, they can keep

these ties even when these are no longer necessary in terms of extrinsic instrumental rationality. Actors maintain such ties because of definite normative expectations or intrinsic values attached to such relations at the workplace and generally in the labor market. Given the possibility that, because of normative restraints, employees can maintain social relations with no instrumental value, the impact of these constraints casts doubt on modeling networks in organizations in economic, strategic, and voluntary terms (Podolny and Baron 1997:690–91).

However, of those getting jobs or being promoted via social networks or otherwise, not all keep their jobs (promotions) in the long term (e.g., three or more years), depending on their education, occupation, and industry, as reported by empirical studies (Farber 1997). These studies identify a general time trend toward an increasing percentage of workers with job loss in most occupations and industries, as well as different educational levels. As to the latter, the percentage of workers with a college degree or higher who lost their jobs increased significantly. The same trend is observed for workers with high school degrees. Consistent with expectations, those with higher educational levels had lower percentages of job loss than those with lower education levels. Somewhat surprisingly, the data indicate that men are more likely to suffer job displacement than are women, in all periods and at both educational levels, thus calling into question the standard thesis of gender discrimination in the workplace. At least women appear to have been more successful in keeping their jobs than men. (For example, in the 1991–1993 period, 15.4% of men with a high school diploma and 10.9% of those with a college degree or higher lost their jobs, versus 11.6% and 7.9% of women, respectively.) The same pattern is found in the remaining time periods between 1983 and 1995. Moreover, according to some observations, the pendulum “has probably swung too far so that men are the ones currently being discriminated against” (Friedman 1998:199; here reference is made to gender discrimination at U.S. universities<sup>8</sup>).

On the other hand, whereas most occupations exhibit a long-time trend toward job displacement, blue-collar workers were more likely than white-collar workers to lose their jobs, which seems consistent with theoretical expectations and earlier historical tendencies. Also, most industries evince tendencies toward growing job displacement, with an unexpected exception, manufacturing, where restructuring, downsizing, and the resulting layoffs are commonly perceived to be most pronounced. Moreover, the massive layoffs of the 1990s in some big American manufacturing companies were likely to reinforce such a perception. By type of industry, however, manufacturing has consistently been, alongside trade and non-professional services, the sector with the highest percentage of displaced workers over the 1983–1995 period. On the opposite side, professional services and transportation and communications and public utilities

sectors have had the lowest percentage of job displacement. In retrospect, such trends seem consistent with theoretical predictions (*viz.*, the secular shift from a decreasing relative share of manufacturing and an increasing one of services, the tertiary sector, in a modern industrial economy).

The preceding suggests that, in macro-level terms, the current institutional framework of U.S. labor markets tends to generate more income disparity (or exploitation) as well as higher employment, though mostly through low-paid job creation in the service sector. In contrast, the institutional framework of Europe, especially in the late 1990s, seemed to have opposite effects on both income disparity and unemployment. For example, the recent changes in the institutional structure of the U.S. labor market, especially the declining unionization in conjunction with the increasing competitiveness, are estimated to account for a 0.5 percent decline in the natural or equilibrium unemployment rate, or NAIRU<sup>9</sup> since the 1980s (Stiglitz 1997:7). Now the apparent trade-off between American greater income inequality (or job exploitation) and lower unemployment versus European lower income inequality but higher unemployment invokes a peculiar choice, if not a depressing picture, of current labor markets and their institutional settings in developed countries. Overall, concerns about earnings inequality and unemployment have moved to the top of the social agenda of most OECD countries (Gottschalk and Smeeding 1997:675).

In contrast to the United States, Europe's labor market is characterized and governed by four institutional layers held responsible for high unemployment. These include, for example, intrusion of institutional factors in the labor-market process, the constitutional and rules affecting the wage formation process, the legal system as a whole, and the system of unemployment insurance (Siebert 1997:39). The resulting situation in European labor markets has recently been called hysteresis (Blanchard and Katz 1997:68), a concept, as many others, derived from physics and then applied in (labor) economics (Gallegati and Kirman 1999). That is, the previous high unemployment results in persistent current unemployment, which indicates some kind of inertia or status quo bias (Saint-Paul 1997:290), while some American economists attribute such inertia to the long-run movement of inflation but not of unemployment in the United States (Stiglitz 1997).

However, what is relevant for a sociological approach to labor markets is not this hysteresis *per se*, but rather that it is produced not only by economic processes (supply and demand, competition) but also by institutional and other exogenous non-economic conditions. For instance, sociological factors also may increase unemployment, as when a long history of it affects society's attitudes toward the unemployed in the sense that it can become "socially more acceptable to be unemployed and to use existing benefits to their utmost" (Blanchard and Katz 1997:69). Among these sociological factors, political ones often are of particular importance, both as causes and possible solutions to the problem. For example, in today's Eu-

rope, employee's wages (or rents) would probably have to fall in order to get political support for removing rigidities in labor markets, thus reducing unemployment (Saint-Paul 1997:290). In this sense, hysteresis would be a political problem rather than a purely economic one. For hysteresis also may reflect the political response to unemployment to the effect that protracted high unemployment can force government policies to offer more generous programs to help the unemployed (Blanchard and Katz 1997:69) and thus contribute to its persistence.

In general, these findings suggest that social institutions have strong effects (Nickell 1997) on unemployment and generally on the structure and operation of labor markets in Western Europe, the United States, and elsewhere, including some developing countries<sup>10</sup> (Zhou et al. 1997). Hence, the labor market appears to be an array of institutional arrangements, in that it is being shaped both by formal and traditional rules and institutions (Siebert 1997:39).

### **Institutional Influences on Labor Conflicts**

Evidence of the political-organizational and institutional, rather than the economic, structuration of labor actions and conflicts in the labor market, including strikes, has been provided by historical and comparative data. As an illustration, historical studies of the behavior of various groups of workers in mid-nineteenth-century France<sup>11</sup> document a "disjuncture" between the conditions where the polarization of labor and capital was the most intense and those in which capabilities for collective action (e.g., industrial protests) were the strongest (Aminzade 1984). In consequence, material interests and preferences cannot be treated as parametric and fixed, nor can the possibilities for labor collective action be seen as non-problematic, as logically deriving from these interests. Relatedly, comparative data indicate a major impact of the institutional setting, including union membership, relative to economic factors, on strike activities in several Western countries, for example, France (1876–1966), Italy (1901–1970), and the United States (1900–1970). Since workers, in their decisions to strike, reportedly are not simply driven by (short-term) cost-benefit calculation, thus making the rational (bargaining) model invalid, research suggests that more salience be given to organizational-political and other extra-economic than economic factors (Snyder 1975).

Also, studies report that labor organization in trade unions in the United States before the New Deal was more affected by class struggle and other social conflicts, including the counter-mobilization of labor adversaries, than by individual cost-benefit calculations to join a union. Specifically, while relative costs and benefits may be an element of workers' decisions to join unions, it presumes that union membership was their preexisting right and that their choice was made on the basis of rational economic

calculus. Historically this was not so, at least in the United States, where robber barons such as the Carnegies, Rockefellers, Morgans, and Vanderbilts determined the path of the labor movement by providing injunctions and convictions, breaking strikes, and so on (Griffin, Wallace, and Rubin 1986). Invoked and used in this regard has been the theoretical concept of the positional power of exchange actors as a critical variable determining outcomes in the labor market and the sociopolitical system as a whole (Perrone 1984). Empirically, the positional power of labor actors has three components: the ability of workers in an industry to disrupt operations of other industries upstream in the production process, the ability to disrupt operations downstream, and the ability to disrupt production locally within their industry (Wallace, Griffin, and Rubin 1989).

In expressing such power differentiation or positional centrality, certain outcomes of labor-capital relations and conflicts can ensue, ranging from defeat to bargaining. Examining labor-capital relations in some business organizations (e.g., British Coal and Italian Fiat), a study (Olberg 1995) identifies specific strategies and outcomes of these relations. Specifically, both labor and capital have two alternative strategies: acquiescence and intransigence. For example, if both labor and capital choose acquiescence, the aggregate outcome is concession bargaining. However, if labor chooses acquiescence, and capital intransigence, then labor experiences passive defeat. Contrarily, a conjuncture of labor's intransigence and capital's acquiescence is conducive to labor victory. Finally, when both labor and capital opt for intransigence, the result is labor's heroic defeat.

A pertinent mechanism of labor-capital relations represents the corporatist system involving national-level negotiations between the two over exchange rates (e.g., wages and prices). Research shows that the development of such corporatist institutions in eighteen OECD countries has been the outcome of class conflicts in mostly peaceful forms, such as parliamentary struggles rather than economic collaboration supposedly based on material interests and precise cost-benefit calculations. Specifically, as research findings suggest, corporatism has been more the outcome of parliamentary class conflict than industrial class collaboration, as corporatist institutions tend to develop mostly in smaller countries with centralized powerful labor movements and open economies (Western 1991). In this connection, a measure of the scope of collective bargaining, capturing the horizontal relationships of corporatism, ranges from 0 to 1 (e.g., 0.5 for the United States and 1 for France, Austria, and Norway). In turn, a union centralization index measures the vertical relationships of corporatism and has a range from 0 (United States and France) to 0.8 (Austria). Findings also suggest that in the United States during the period 1947–1987, earnings, especially wages, differed in various sectors of its labor market. This stresses the influence of exchange segmentation, to the effect that different (man-



agerial) systems of labor control affect labor positional power (Weakliem 1990).

## POST-MATERIALISTIC TENDENCIES IN LABOR MARKETS AND SOCIETY

The tendency toward the increasing relevance of conflicts over non-material issues in relation to economic conflicts has been acknowledged but characterized as a common trend among all classes rather than as a dramatic change in class structure. As research reports, there is significant evidence of a post-materialist dimension (e.g., France, Italy, and the Netherlands), and its salience is stable across time and cohorts, so recent political developments are better understood in terms of a general shift in attitudes and values among most or all classes than as changes in the relative salience of various class divisions (Weakliem 1991).

This trend toward the increasing relevance of non-materialist variables in labor actions and conflicts also has been manifested in the decreasing pertinence of monetary parameters relative to non-monetary ones in job evaluations. For example, although money payoff is still perceived as a principal component of a good job, a combination of non-monetary ones is found to override it. More precisely, if earnings are a critical determinant of a job's desirability, the various non-monetary determinants together are reportedly twice as important as earnings (Jencks, Perman, and Rainwater 1988).

Generally, some studies and surveys report a global trend toward the increasing relevance of post-materialism (and perhaps of supra-individualism or collectivism;<sup>12</sup> cf. Pampel 1998) versus its counterpart. This was, for example, reported by the World Values Survey (WVS), undertaken in 1990–1991 by investigators of forty countries on five continents for the purpose of identifying changes in global attitudes along the materialist-nonmaterialist dimension (Inglehart and Baker 2000). On the basis of such findings, analysts (Abramson and Inglehart 1995) construct a post-materialism index or scale composed of five items versus other (seven) materialist or ambiguous items. For example, five items comprise the post-materialist index, and the cumulative index of post-materialism scores ranges from 0 to 5, depending on how many of these five items participants have chosen (in total, they were allowed to choose 6 out of 12).

Results show (Abramson and Inglehart 1995) that the five items load (in the terminology of factor analysis) on the first principal component (post-materialism) in the vast majority of (39 out of 40) countries (Poland being the only exception in this regard), that is, these items are preferred to the others. More specifically, such findings indicate a worldwide trend “away from concerns with material well-being toward a post-materialist value sys-

tem that emphasizes the free expression of ideas, greater democratization, and development of more humane societies” (MacIntosh 1998:452). In Weber’s words, this is a trend from the dominance of material interests to ideal interests, including transcendental values (Alexander 1990).

However, despite its reportedly global character, such a post-materialist trend is not uniform in intensity but displays some comparative differences in developed and developing (underdeveloped) societies. Notably, the materialist/post-materialist dimension is “significantly less crystallized in poor countries than in rich ones [as] values are more highly structured in relatively wealthy societies than in relatively poor societies” (Abramson and Inglehart 1995:117). A consequence of this differential structuring of materialist versus non-materialist values is that the post-materialist trend has been relatively more intense in developed/rich societies, especially the Western (continental) European, than in the backward/poor. At this juncture, the post-materialism thesis argues that greater economic prosperity and security in youth, which is more likely in developed societies, will lead to a “postmaterialist orientation that values free expression and greater democratization over material success” (MacIntosh 1998:452). In this sense, in such economically successful individuals and societies materialism would be a victim and post-materialism an outcome, of its own success and limits. This sheds additional light on the increasing salience of non-materialist, including political and cultural, factors (e.g., items 1–5 of the WVS) versus the materialist in labor markets, including labor-capital conflicts and job satisfaction in developed Western societies. To that extent, one can infer that even the capitalist economy, as a conventionally assumed sphere of the dominance of materialist dimensions, often is permeated by such post-materialist tendencies within modern society.

In terms of classical sociology, if post-materialistic tendencies obtain in comparative labor markets, this trend would imply an unexpected evolution from Sorokin’s sensate social-cultural systems to ideational and even idealistic ones (i.e., from Comte’s positive to the metaphysical age, from Tonnies’ *Gesellschaft* to *Gemeinschaft*). In retrospect, if as widespread and intense as reported, this trend would reverse the old sociological evolutionary scheme positing the opposite path of social development from the idealist to the materialist (viz., from status to contract systems, that is, in Weber’s terms, from status to class society, including modern bourgeois capitalism). Instead, by virtue of its properties, the trend would usher in post-capitalism, post-industrialism (Block 1990) and, generally, post-modernism. The latter would be characterized by the growing pertinence of the non-economic versus the economic, particularly of power relations and status gradations relative to capital accumulation and mere wealth.

Incidentally, Weber, to some degree, anticipates this post-materialist trend. He allows that domination, on the basis of constellations of material interests, especially monopolistic control of the market, can become dom-

ination on the basis of authority (as well as status honor), thus evolving from an economic to a sociopolitical category. Specifically, Weber (1968: 943–44) states that all modes of domination by virtue interest constellations can more or less gradually evolve into domination by authority, which especially holds true of the mode initially grounded on a monopolistic position. Of course, Marxian communism is, like most utopias, predicted to be a post-materialist society built on the materialist foundations of developed capitalism.

### **(LABOR) MARKETS AS INSTITUTIONAL ARRANGEMENTS**

The preceding indicates that labor market processes exist and function under definite institutional conditions, which make labor markets specific institutional arrangements. Reportedly, social institutions filter the influence of external economic conditions on labor markets and affect collective action, which suggests an institutional approach to labor markets (Western 1998). Hence, a realistic treatment of the structure and functioning of labor markets requires consideration of their institutional features (*viz.*, degree of centralization [the inverse of the number of unions in the economy], the role of institutional factors in the transmission of the effects of taxation, etc.) (Alesina and Perotti 1997a). Thus, the centralization or institutionalization of relations in labor markets has aggregate-level (mainly positive) effects for income distribution and social welfare. Notably, in societies (e.g., Western Europe) in which classes are highly institutionalized, labor markets tend to attain higher employment levels, equality, and security from external economic shocks than in those that are not, for example, the United States of America (Western 1998). As to the effect of (de)centralization on socioeconomic mobility, for example, the United States' less centralized labor market relative to the United Kingdom does not lead to higher economic mobility, just as Continental Europe's (e.g., Germany) more centralized markets are not conducive to less mobility<sup>13</sup> (Gottschalk 1997).

Therefore, social institutions determined the nature and operation of income distribution. In retrospect, this supports the classical insight of economic sociology or social economics, that economic distribution constitutes a "matter of human institution only" (Mill 1884:155) rather than the automatic operation of natural economic laws. In other words, it is a problem of society's laws, conventions and other rules expressing the "opinions and feelings of the ruling portion" (Mill 1884:155–56), and thus of power relations.<sup>14</sup> The outcome of such institutional and other extra-economic influences is the "arbitrary and inequitable" character of the distribution of income and wealth (Allais 1997:4; Keynes 1960:375). More particularly, institutional factors can become important sources of growing income/

wealth inequality, as dramatically witnessed in the United States since the early 1970s (Stewart 1998; Wilson 2000), a trend virtually shattering the prior American experience (or myth) of “shared prosperity” (Marshall 2000). Reportedly, the weakening of institutional forces such as the decline of unions and bargaining power of labor in the 1980s and 1990s was unprecedented in recent U.S. history, so attempts to understand the recent rise in wage inequality in the U.S. economy cannot overlook such institutional changes (Fortin and Lemieux 1997; Western 1997). More generally, such institutional forces were instrumental in the wage slowdown that took place in most developed (OECD) countries during the 1980s and 1990s. Thus, the wage slowdown in these countries was linked to the declining positional power of labor movements (Western and Healy 1999), namely, working-class disorganization and union decline since the 1980s (Western 1998). This suggests the salience of the social environment,<sup>15</sup> organization, and regulation of labor markets. Since labor (as a fictive commodity in Polanyi’s sense) is embedded in and shaped by its social context, labor markets are institutionally and locally embedded, so they are socially rather than wage regulated, with the result of systemic spatial variability in their structure and dynamics (Peck 1996).

In turn, the impact of social institutions on labor markets epitomizes the institutional origins and context of the economy overall. In this sense, the market has been redefined as a social institution with a certain role or function in the economy and society, namely, facilitating economic exchange (Coase 1988:8). Particularly, as the previous discussion indicates, labor markets manifest themselves as social institutions, as any labor market is embedded in or surrounded by an array of institutional arrangements forming a complex locus of (dis)incentives for agents. For instance, wage flexibility can (as shown earlier) be constrained by the institutional setup of the labor market (Siebert 1997), as can income distribution overall, thus reflecting the strong effect of social institutions on the functioning of this and other markets (Nickell 1997).

In this connection, the notion of an institution-free (labor and other) market seems highly implausible in both logical and historical-empirical terms. For one thing, such a notion is unable to plausibly answer the question of where markets come from (White 1981). From the stance of economic sociology, labor and other markets originate, presuppose, and are embedded in certain institutional and related social, including cultural-historical, preconditions rather than being natural (or Divine) creations, as assumed in orthodox economics. In short, for economic sociology, the market is an outcome and a process of social-institutional evolution, not of physical-biological evolution in Darwin’s sense (or Divinity’s creationism). And sociological, including economic, evolution is admittedly (Samuelson 1993) a radically different phenomenon from its biological counterpart,

despite many orthodox and other (e.g., evolutionary) economists' reductions or at least spurious analogies of the first to the second.

In addition to orthodox economic theory, the new economic institutionalism seems to often hold the untenable assumption of an original, institution-free market or state of nature (Hodgson 1998). Ostensibly, according to such neo-institutionalist creationism, the beginning was in the market (Williamson 1975:20), despite the evidence for its social-institutional origins (viz., the historical precedence of power over market transactions) (Myrdal 1953:197). Since the market itself is a social institution, in that it involves social norms, it seems dubious to speak of the genesis of markets as being institution-free, as in any original hypothetical state of nature, definite rules must be created and followed (Hodgson 1998:182). In epistemological terms, the issue of infinite regress (i.e., the chicken-egg problem) undermines the institution-free or individualistic explanation of the genesis, evolution, and existence of markets (Hodgson 1998:183).

The influence of social institutions on the economy is also exemplified by the role of institutional forces in the formation and change of exchange values or prices. In contrast to neoclassical price theory being mainly non-institutional, there are institutionalist specific theories of pricing, each related to factual markets (Hodgson 1998:170), including oligopoly, markup, full-cost, and administered (Stanfield 1995). Thus, an institutional approach to markets centers on exploring social institutions within which prices are formed (Hodgson 1998:170).

Another example in this regard is found in the impact of social institutions on transaction costs or costs of market exchange. Transaction, including information, costs are the function of social institutions (viz., legal systems, political systems, social systems, educational systems, cultures, etc.). Overall, social institutions govern the nature, operation, and performance of an economy, thus giving institutional and generally sociological economics (or economic sociology) an important place within economic analysis. Admittedly, the mainstream approach to the functioning of the market-economic system has been extraordinarily static and has indulged in theory formalization, neglecting the dynamics and complex influence of laws, the social system, and culture on the system, including transaction costs (Coase 1998). Presumably, non-market social institutions emerge to economize on exchange or transaction costs, as argued by the new institutional economics. Yet, admittedly, transaction costs are not independent of those social institutions governing exchange transactions (Williamson 1998). Also, even though some non-market institutions may emerge to economize on transaction costs, their continual existence can perpetuate or even increase those costs. Thus, institutions that ostensibly save on transaction costs (e.g., those distributing price information, setting standards, or certifying quality) may not emerge at all or could deploy more slowly when exchange transactions do not occur in markets (Kranton 1996).

Summarizing, the social-institutional origin, evolution, and embeddedness of labor and other markets are expressed in the fact that these “must be embedded in a set of other institutions—a democratic polity, with strong constitutional protection of a private sphere of individual activity, with enforced and exchangeable property rights—if it is to work” (Caldwell 1997:1871). Notably, competition is a major institutional rather than biological property in labor markets and generally within a capitalist economy, and entrepreneurship or management, while an essential actor of the exchange process, including price formation, occurs and is embedded within a specific institutional framework (Burt 1992). In this connection, social institutions impact on entrepreneurs,’ workers,’ and all economic agents’ incentives for certain kinds of actions (Caldwell 1997:1878). Hence, institutions operate as conditions *sine qua non* of the process of social organization and cooperation in the economy generally, and in labor markets particularly, for this process requires social institutions as well as values and other cultural patterns underscoring these institutions.

## NOTES

1. However, Marx (1967) objects to theories of Ricardo and other classical economists, that labor has no value. To Marx, since labor is the source or substance of value, it is tautological to say that labor has value. Then Marx replaces the notion of the value of labor by the value (cost of reproduction) of the labor force as a commodity, contending that wages express the latter, not the former.

2. In this connection, Marshall (1961:320) warns that one factor of production can exert “tyranny” over another through the action of derived demand, and that this tyranny can be tempered by the principle of substitution or competition between different factors.

3. Predictably, for a marginalist economist, Wicksell (1934:147, 125) defines the economic problem of distribution in the sense that the share of any factor of production in the total product is estimated according to the “law of marginal productivity.”

4. Thus, some leading contemporary economists argue that “dispassionate logic” leads to the following verdict: “macro and micro economically, the surplus value [exploitation] paradigm has negative merit for the understanding of class distribution and laws of motion of competitive capitalism” (Samuelson 1983:582). Specifically, they claim that “because Marx ensnared himself early in the notion that exploitation of labor could be understood only recognizing that capital is dead labor which cannot be productive of value in the way that live labor can, he condemned himself to a schizophrenic understanding of productivity and wage determination” (Samuelson 1994:623–27). Resorting to the identical neoclassical logic, others also contend that the Marxian theory of exploitation “is logically fallacious [as] the fundamental injustice is the original distribution of resources—the fact that one man was born blind, and the other not” (Friedman 1976:199–200).

5. For instance, Pigou (1960:551) redefined unfair wage distribution or labor exploitation in marginalist terms as follows: “Wages can be unfair because workers

are exploited in the sense that they are paid less than the value which their marginal net product has for the firms which employ them.”

6. For instance, the Gini coefficient, the usual measure of income inequality, has increased in the United States from 0.313 in 1979 to 0.426 in 1994, and is by far the highest among developed countries, the average for which was .0274 in the 1990s (Gottschalk and Smeeding 1997:644, 661). In some views, the Gini index of income inequality captures relative deprivation, and Gini-based tax progressivity (or horizontal inequity) indices individual perceptions of relative fiscal harshness and ill fortune (Duclos 2000).

7. In this connection, Galbraith (1997) emphasizes the pernicious effects of unemployment by splitting the wage structure on income inequality, and hence advocates full employment. This assumption has been supported by studies (Nielsen and Alderson 1997) showing such effects of unemployment on inequality in U.S. counties.

8. Milton Friedman (1998:199) then adds that, “I would not today write, as I did then [in 1973], ‘I have no doubt that there has been discrimination against women [on university campuses in the United States].’”

9. The full name is NAIRU—nonaccelerating inflation rate of unemployment, that is, the rate of unemployment consistent with an unchanging rate of inflation (Stiglitz 1997:3). However, some (Galbraith 1997:106–07) argue that it is time to ditch NAIRU as a sociopsychological disability of colossal proportions that prevents solving the central economic problem of unemployment/stagnation and inequality of wealth/incomes and thus major social and political problems caused by it (Marshall 2000).

10. For instance, Zhou et al. (1997) report the salience of institutional conditions for job shifts in today’s China to the effect that such shifts reflect institutional transformation.

11. More generally, a historical overview of income inequality in France from the beginning of the eighteenth century (1715) through 1985 can be found in Morisson and Snyder (2000).

12. Based on collectivism scores, Pempel (1998) suggests that about half of contemporary Western societies can be characterized as collectivist or non-individualist. These scores are constructed by taking into account variables positively related to collectivism, such as corporatism, consensus government, years of leftist rule, universalism in public benefits, and absence of violent political conflict.

13. In turn, some authors postulate a positive impact on socioeconomic mobility of the extent of entrepreneurship assumed in turn to affect savings and thus wealth distribution (Quadrini 2000). Such a model claims to generate wealth concentration almost identical to that observed in the United States—thus implicating that this concentration is natural, almost God given—and replicates the main pattern of (American) wealth mobility with entrepreneurs experiencing higher upward mobility than workers (Quadrini 2000). Others (Lloyd-Ellis and Bernhardt 2000) imply that the abundance of efficient entrepreneurs lowers income inequality in long terms, a la the Kuznets curve, and that their scarcity produces long-run distributional cycles underscored by endogenous interactions of entrepreneurial efficiency and equilibrium wages (and credit constraints).

14. According to some observers (Peoples 1998), income distribution often amounts to rent sharing based on relative power (of labor and capital), rather than

being the pure market process of pricing production factors, with rent sharing being pervasive above all in unionized industries.

15. As hinted at earlier, the social environment often is essential in labor-market search (Andolfatto 1996). Thus, getting a job often hinges on having and using social ties, namely, weak, as in developed societies (Granovetter 1992b), strong, as in some developing countries (e.g., China; see Bian 1997), or both.





## Chapter 7

# *The Social Construction of Exchange (Business) Cycles*

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### EXCHANGE CYCLES IN (NEO)CLASSICAL ECONOMICS

In neoclassical economics, exchange or business cycles are viewed as phenomena immanent to the capitalist economy. Thus, most neoclassical economists regard business cycles as economic changes, more precisely fluctuations or oscillations, inherent to the operation of the market-economic system (Haberler 1943:392; Pareto 1927:532–34; Schumpeter 1939:7). Also, some non-orthodox (historical) economists regard business cycles as being inherent to the capitalist economy, stating that the economic process becomes understandable only if one analyzes it from the stance of “rhythmic movements” manifested in the “influx and reflux” of the periods of expansion and depression (Sombart 1932:60). In this connection, even heterodox economists such as Keynes (1936:293) acknowledge that trade or business cycles, albeit responsible for “disastrous excesses and grave crimes,” have a role to play in a “progressive” society and warn that efforts to eliminate these cycles can produce stagnation and stability (i.e., a stationary state). However, such an outcome may be unattainable and undesirable insofar as expansion, instability, and dynamics are a natural state of a modern capitalist economy. From this perspective, “stabilized capitalism” is seen as a contradiction in terms, because such a stabilization would be generative of its own “abnormalities and instabilities,” and thus a capitalist economy could not attain a stationary state without being “vitaly affected” (Schumpeter 1939:1033). Simply, business cycles, including crises or depressions as their particular stages can be more useful than harmful (Pareto 1927:532).

Traditional economic theory usually defines business cycles as expres-

sions or consequences of the rhythmic movement of the capitalist economy. Thus, early neoclassical economists define business cycles—also called oscillatory economic movements, or simply crises—as particular forms of what is called the “great law of rhythm,” which dominates all social phenomena (Pareto 1927:529). En passant, in Continental Europe, including France and Germany, and generally the non-English-speaking world, business cycles also are called conjunctures. In this usage, business cycles represent sets of conditions or conjunctures in the market (viz., the “conjuncture of depression and the conjuncture of expansion”) (Sombart 1932:59). Also, some leading neoclassical economists such as Marshall (1961:103) use the term *conjunctures* by relying on a historical economist’s (Wagner’s) broader definition of them as sets of various technological, economic, and legal conditions determining economic variables independent of particular agents. Economic conjunctures or business cycles are at least assumed to display a pseudo-rhythmical character.

In a similar vein, other neoclassical economists define business cycles as waves in economic activity or exchange fluctuations featuring an undulating or a wavelike movement in absolute figures or rates of change (Schumpeter 1939:22, 138). At this juncture, business cycles or fluctuations of the economic system are compared to a pendulum (Haberler 1943:9, 291), and hence defined as movements of a pendulous form affecting all economic life. Specifically, business cycles involve an alteration or a succession between two principal movements, namely, economic depression or crisis and prosperity or expansion (Haberler 1943:299), with two intermediate secondary phases, recession and recovery (Schumpeter 1939). Simply, business cycles involve booms following slumps, and slumps following booms, as upward phases are produced as reactions from prior downward ones, and downward phases as reactions from previous upward ones (Keynes 1936:287).

More particularly, in a Keynesian framework business cycles thus understood often reflect investment disturbances or discrepancies between aggregate investment and aggregate saving. Such disturbances are called credit cycles, defined as the “alterations of excess and defect in the cost of investment over the volume of saving and the accompanying see-saw in the purchasing power of money due to these alterations” (Keynes 1936:276–77). Thus, an excess (defect) of investment over saving characterizes a boom (slump), so that when overinvestment (oversaving) ends, the boom (slump) can cease (Keynes 1936:290).

Generally, Keynes (1936:313–4) characterizes business cycles by the following attributes: successive upward and downward movements in the economic system, which have cumulative effects within themselves and countervailing ones in relation to each other; a degree of regularity in the time-sequence and duration of such movements; and the sudden and violent substitution of a downward for an upward tendency (crisis) versus lack of a sharp turning point in substituting an upward for a downward tendency

(prosperity). At this juncture, Keynes (1936:278) justifies the use of the term *trade* or *business cycle* by the tendency for excess economic movements in one direction (e.g., contraction) to lead both to their own remedies and stimuli to such movements in the opposite direction (e.g., expansion)—that is, by pendulum-like swings in economic activity. In a similar vein, some economists, in part anticipating Keynes, stress the cumulative nature of the business cycle by noting that whenever the economy moves in one direction, such movements gain a momentum by strengthening in a cumulative manner and continuing at an accelerating rate until they go beyond the “point of equilibrium” (Clark 1962:388). In short, cycles of economic activity or/and price levels are associated with the “elusive phenomenon known as the business cycle” (Klein 1983:182).

Also, business cycles sometimes are defined as certain manifestations of exchange disequilibria based on the recognition that the economy “is chronically in a state of disequilibrium” (Schumpeter 1939:69). Alternatively, they are defined as deviations from or oscillations around exchange equilibrium on the grounds that these are fluctuations “around something” (viz., equilibrium as a “theoretical norm” of economic processes), including business cycles (Schumpeter 1939:69–70). In reality, since the economic system admittedly “never attains” the state of equilibrium, business cycles appear as fluctuations around “neighborhoods of equilibrium” or ranges within which the economy approximates equilibrium (Schumpeter 1939:71).

Regarding the relations between business cycles and economic growth or development (progress), most economists treat the first as the natural form that the second assumes over time, especially in medium (e.g., eight to twelve years) and long periods. Thus, some classical economists maintain that the economic progress of society consists of such irregular movements as business cycles, so omitting the examination of factors “which for eight or ten years will give a great stimulus to production and consumption, or a great check to them, is to omit the causes of the wealth and poverty of nations” (Malthus 1968:437). Also, leading neoclassical economists stress the non-constant or irregular character of business cycles. For example, some of them (Schumpeter (1939:143) make the disclaimer to the effect that their model of business cycles does not postulate periodicity, especially constancy, in the “cyclical process of economic evolution.” Similarly, others (Tinbergen 1950:202) observe that in reality business cycles hardly display smooth, uniform patterns, so no regular cycle is reportedly found<sup>1</sup> (Villa 1999). On the other hand, some early economists attribute to business cycles some degree of regularity or periodicity (explained by physical factors by, for example, see Jevons 1997a), particularly a recurrence of crises at certain time intervals, for example, eight-year generating cycles (Moore 1997).

At any rate, since growth or progress is destabilizing to the economy, it

represents by virtue of its mechanism what is called a “cyclical process of economic evolution” (Schumpeter 1939:138–43). At this juncture, particularly emphasized is the endogenous nature of business cycles and thus of economic growth, namely, “endogenous growth cycles” (Bohm and Kaas 2000), under capitalism on the assumption that the latter is in essence a “process of (endogenous) economic change” as a necessary condition of the existence and development of capitalist society (Schumpeter 1939: 1033). Further, economic historians using neoclassical paradigms claim that historically the business cycle was the form that economic growth (especially after the takeoff stage) took on during the last two centuries (Rostow 1990:259, 477). Also, some contemporary economists establish strong, positive relations between long-term growth rates and the persistence of output fluctuations, arguing that growth dynamics, as an endogenous process, is a relevant element of the transmission of business cycles<sup>2</sup> (Fatas 2000). Then Keynesian economists at least suggest that the analysis of growth—and, for that matter, other economic processes—cannot neglect the trade cycle, because the latter is said to be indispensable in understanding the relationship between exchange processes and the requirements for economic growth either in the form of “steady advance” (Harrod 1956: 77) or “unstable steady states and fluctuations” (Bohm and Kaas 2000).

In retrospect, some orthodox economists have denied the possibility or severity of business cycles in aggregate terms, especially of general crises. For example, Say’s law of markets (*le loi de débouchés*) is premised on the idea of some kind of permanent equilibrium between total supply and total demand, and thus it negates that a general depression is possible or at least severe (Keynes 1960; see also Marx 1967; and for a different interpretation, see Baumol 1999). General depressions or crises are deemed unlikely or at least transitory on the grounds that production “opens a demand for products” (Say 1964:133), that is, “supply creates its own demand” (Say quoted in Schumpeter 1954a:618). Thus, the aggregate demand for products is assumed to be always “brisk in proportion to the activity of production” (Say 1964:139) and thus to aggregate supply, which would preclude an excess of the latter as a feature of general depression.

In the terms of Say (1964:133–39), a general glut, as a crisis in the economy’s whole, is ruled out, because products are “always ultimately” bought with other products (even using money as the agent for transferring values) and the invention of a new product means opening a new outlet for others, thus giving rise to “various degrees of demand.” In short, demand is assumed to be limited solely by production or supply, as products are purchased by other products (Ricardo 1975). At most, the classical law of markets acknowledges the incidence of limited depression in an industry, that is, “a glut of a particular commodity” (Say 1964:139). Thus, some classical economists, while characterizing such gluts as ones of the “most ordinary commercial occurrences,” deny the possibility of “universal gluts”

(Senior 1951:29). Admittedly, too much of a particular commodity can be produced, leading to a glut in the market, and yet this is deemed impossible for all or most commodities (Ricardo 1975).

However, Say's law of markets, especially its underlying assumption or implication ruling out depressions or crises and to that extent business cycles, has been challenged or disputed by many economists (on Say's "social economics," cf. Forget 1999). Notably, even some classical economists rejected or expressed misgivings about such assumptions and implications and instead allowed for the possibility of crisis in the form of a "general glut" of commodities. According to these economists, "a very serious error" is committed in assuming that production or capital accumulation automatically generates demand (Malthus 1968:322). On the contrary, they argue that an "inordinate passion" for accumulation tends to bring about a supply of commodities in excess of effective demand (i.e., beyond what a society's character, structure, and customs would allow to be "profitably consumed") (Malthus 1968:325). The outcome can be a "depression of wealth and population," as the conversion of revenue into capital when pushed beyond certain limits tends to diminish effectual demand and thus increase the unemployment of labor, which suggests that adopting "parsimonious habits" beyond some point can have the "most distressing effects" (Malthus 1968:327) in contrast to habits in consumption and leisure<sup>3</sup> (Lettau and Uhlig 2000). Instead, effectual demand is suggested to be created or increased before the growth of capital and population takes place, since it is seen as "vain with a view to the permanent increase of wealth" to keep pursuing capital accumulation when no adequate general demand exists for the resulting products (Malthus 1968:328–30). This latter situation is expected to lead to what is called "inevitably general, not partial" glut, which then can be permanent as well as temporary (Malthus 1968:62, 316).

Despite the prevalent tendency toward mono-factorial explanations of business cycles and related exchange phenomena within orthodox economics, some broad neoclassical economists admit that there exists a pluralism of factors in this respect. Admittedly, no single cause or set thereof can be considered a prime mover that completely explains the character and occurrence of business cycles, so monistic accounts are termed "surely erroneous" (Schumpeter 1939:34). In this connection, some economists note that in historical terms business cycles display features of similarity and peculiarity alike. Thus, they observe that, historically, business cycles, while possessing similar features and thus expressing the workings of the "regular laws" in the economy, no two are exactly identical, which suggests the "appreciable" role of "outside disturbances" or "special causes" of an extra-economic character (Clark 1962:388). In short, each business cycle is a "historical individual," different both from its predecessors and successors (Hansen 1964).

The causes or factors of business cycles have been classified as follows. An early classification comprises objective and subjective factors of business cycles (Pareto 1927:531–32). The first factors include those “objective” changes in the conditions of production that can lead to “oscillatory movements” in the economy, and to a “crisis” in particular. The second factors involve what is called the “subjective synchronicity” of economic movements, transforming into an “intense crisis” these movements that, in turn, without such synchronicity would lead to weaker changes in economic equilibrium. Thus understood, subjective causes are assumed to exert strong effects, with people being full of confidence in certain periods and discouraged in others (Pareto 1927:531). As such, the subjective causes of business cycles operate through what Keynes (1960:379) called the “mass psychology of the market,” underscored by recurrent waves of (largely irrational) optimism or overconfidence and pessimism or lack of confidence. In this regard, while business cycles are supposed to have a “more rational basis in objective economic facts” (e.g., investment in fixed capital), mass or mob psychology admittedly accounts for a large part of them (Clark 1962:389). In particular, that aspect of the mass psychology of exchange expressed in the generalized lack of confidence has been, at least since Keynes, viewed as a major explanatory factor of depressions or crises. Moreover, some early neoclassical economists singled out “a want of confidence” as the “chief cause of the evil,” arguing that the latter “could be removed almost in an instant if confidence could return, touch all industries with her magic” (Marshall quoted in Rostow 1990:175).

Another taxonomy is comprised of endogenous and exogenous factors of business cycles. The first factors are characterized as being immanent to the assumed inner logic of the operation of the (capitalist) economic system, as a result of which business cycles (and growth) represent an endogenous economic process (Schumpeter 1939:1033–34). For illustration, such endogenous factors include prices, costs, supply, demand, the capacity of the credit system for expansion and shrinkage (Clark 1962:387–88), and sufficient income dispersion and differential savings (e.g., different factor shares and savings propensities of shareholders and workers), a result of which the economy displays “topological chaos” (Bohm and Kaas 2000). These factors operate in such a way that they come from the preceding stages of the business cycle (e.g., recovery and boom) and lead to the next phases (e.g., recession and depression), and vice versa: the cycle proceeds from recession and depression to recovery and prosperity (Tinbergen 1950:256). For example, recovery or the (upward) turning point of a business cycle can be the effect of new inventions, opening up new markets, the growth of new industries (Clark 1962:387), and causes flowing from the prior depression, such as depletion of stocks, growth in labor productivity, increases in profitability, the reversal of the price decline of commodities and shares, and the like (Tinbergen 1950:256).

In turn, the second factors are deemed, so to speak, transcendental to the economic system. They range from natural causes (e.g., weather and the ensuing crop or harvest cycles) (Beveridge 1997) and sunspots (Jevons 1997b) to political events, wars, and institutional arrangements to cultural changes, for example, those in people's values and preferences (Clark 1962: 387–88; Tinbergen 1950:256–57). Usually exogenous and endogenous forces are intertwined and interact or cooperate to produce their effects (Tinbergen 1950:257). In particular, what is called the “disease of intermittent paralysis” (crisis) of the economy is regarded as a combined outcome of “special disturbing forces” of mostly extraneous, non-economic character and the “internal laws” of the business mechanism (Clark 1962: 388). On the basis of this taxonomy, models of business cycles have been divided into endogenous, exogenous, and mixed endogenous-exogenous (Samuelson 1983:335–42).

The preceding taxonomy to some overlaps with that involving economic and social factors in business cycles, insofar as endogenous factors are considered economic and exogenous extra-economic or social (to the exclusion of the non-social or physical). Most mainstream economists tend to overlook or minimize the social factors of business cycles and focus on the economic ones. Yet, in rare exceptions, some acknowledge the presence and salience of what is called “sociological reasons” (Schumpeter 1939: 499). The importance of sociological factors is reflected in that the operation and evolution of the capitalist economy tends to increasingly depend on the “typical capitalist pattern of cultural values and motives,” and these factors can particularly account for the “slackening of entrepreneurial effort” and related phenomena (Schumpeter 1939:499).

In turn, neoclassical economists have advanced and emphasized a variety of economic factors of business cycles, to be summarized. One of these factors includes the disequilibrium between total supply and total demand as the presumed general cause of business cycles. In particular, the “immediate cause” of depressions or economic breakdowns is considered the insufficiency of general demand in relation to aggregate supply and thus downward fluctuations in the price level (Haberler 1943:150). However, leading neoclassical economists qualify the importance of this cause, stating that price movements are “not the all-important factor” in business cycles (Schumpeter 1939:449), while some contemporary economists regard price stickiness as an endogenous generator of persistent output fluctuations in reaction to random aggregate demand (and other) shocks<sup>4</sup> (Kiley 2000; also Demery and Duck 2000; Hartley 2000; Villa 1999). Admittedly, rather than being self-reinforcing, the economic forces of supply, demand, price, and competition—or competitive illusion (Mitchell 1997)—are self-limiting in the sense that as they prevail more, they tend to get weaker, with countervailing or resisting factors becoming stronger (Clark 1962:388), the



result being less self-sustaining business cycles in economic terms (Chatterjee 2000).

Another related factor of business cycles has traditionally been considered overproduction or/and underconsumption, as an effect of the process of adaptation of productive capacity to demand, in which the first tends to outstrip the second. A particularly strong force in this regard is sometimes the overproduction of new products, which in the form of “generalized partial overproduction” is assumed to propagate over the economy as a whole, though some economists remark that new goods have relatively minor importance in the aggregate demand for products (Tinbergen 1950: 191). In some views, overproduction contrasts with what is called “balanced profitable production”—the first thus ensuing from the failure of the second—as a phenomenon of short duration characteristic for the height of prosperity only, even though such an ideal is never actually being realized (Spiethoff quoted in Rostow 1990:262). In this sense, overproduction is some kind of permanent or chronic state of the capitalist economy, as is disequilibrium, and balanced production is a transitory one. However, some economists object that the notion of permanent overproduction (or alternatively, underconsumption) as a cause of economic crises (Marx 1967; Rodbertus 1971) is “pure nonsense” (Pareto 1927) or a fallacy (Veblen 1997). In this view, what is called “overproduction” is in fact the tendency for entrepreneurs to offer at a certain price more commodities than consumption requires and thus a force stimulating consumption (Pareto 1927:533–34).

As suggested earlier, still another concrete economic factor of business cycles is associated, especially within Keynesian economics, with the disequilibrium between aggregate investment and aggregate saving. Thus, according to Keynes (1936:278), the initial impetus to business cycles comes from investment disequilibria, with booms (and inflations) resulting from an excess of investment over saving and depressions (and deflations) from the opposite imbalance.<sup>5</sup> In this scenario, since the decisions about investment and saving, respectively, are made by two different sets of actors (*viz.*, entrepreneurs and the public) induced by different sets of motivations, the disequilibrium between these two variables in aggregate terms “is nothing to wonder at” (Keynes 1936:279). Here Keynes (1960:313) also observes that, historically, “fluctuations in the propensity to consume, in the state of liquidity-preference and in the marginal efficiency of capital all played a part.” In particular, he regards the latter as a crucial factor to the effect that business cycles are mostly caused by cyclical changes in the marginal efficiency of capital (Keynes 1960:313), especially in relation to changes in the rate of interest.<sup>6</sup>

At this juncture, Keynes takes into account time factors in business cycles and links their operation with the marginal efficiency of capital. Thus, he notes that the “explanation of the time-element in the trade cycle, of the

fact that an interval of time of a particular order of magnitude must usually elapse before recovery begins, is to be sought in the influence which governs the recovery of the marginal efficiency of capital" (Keynes 1960:320). In this connection, some economists working in a different framework treat investment in prosperity (but not in recovery) as the "propeller" of economic activity and saving (accumulation) as only supplying resources for consolidation rather than construction of "industrial adventures," thus serving "induced expansion" versus the creation of the new, due to the fact that it derives its relevance solely from previous entrepreneurial successes (Schumpeter 1939:600–601).

Finally, the economic factors of business cycles have conventionally been divided into real (e.g., aggregate production and consumption, productivity, technical innovation, physical [and human] capital, etc.) and monetary ones, such as the volume and velocity of money, the level of credit and debt, the rate of interest, exchange rates, and the like. By assumption, real business cycle models, prevalent in (neo)classical economic theory—as indicated by the prominence of Say's law of markets and its various sequels—and remaining important in contemporary economics, center on the first economic factors. Notably, these models attempt to account for business cycles in terms of technology (de la Collard and Croix 2000), especially technological change (thought to be) measured by the growth (Solow) residual in the aggregate production function (Greenwood et al. 1997, but cf. Hartley 2000).

In turn, with its origins in the quantity theory of money, monetarism (on its current status in economics, cf. DeLong 2000) puts emphasis on monetary factors<sup>7</sup> (Friedman 1956; cf. also Hawtrey 1997), for example, the volume and velocity of currency assumed to make the business cycle a "dance of the dollar" (Fisher 1997a), particularly great depressions outcomes of (debt) deflations (Fisher 1997b). However, a common trait of both models is their overemphasis on the purely market-economic causes and dimensions of business cycles, to the exclusion or benign neglect of their extra-economic factors. In contrast, neo-Weberian economic sociology takes these factors into account and treats business cycles as complex social rather than simple economic phenomena.

## EXCHANGE CYCLES AS SOCIAL PHENOMENA

From the perspective of neo-Weberian economic sociology, business cycles or economic swings are often the result of particular political, social, and economic factors and events<sup>8</sup> (Spree 1991). More particularly, the extra-economic factors include those of a political character (Wallerstein 1984) as well as a macrohistorical and geographic framework within which business cycles, especially long economic waves, take place (Berry 1997). Moreover, some would argue that transitions between the different phases

of a business cycle are political rather than purely economic issues (Wallerstejn 1984). In other words, the turning points of a business cycle (viz., from a boom into a recession, or from a depression into a recovery) often can be produced or at least reinforced by political events and other extraneous causes (e.g., harvests) rather than solely by economic processes (Tinbergen 1950:256). In terms of neo-Weberian economic sociology, business cycles thus appear in part as political and generally social rather than as strictly market-economic phenomena.

However, the notion (and explanation) of business cycles in economic sociology is to be clearly distinguished from that in public choice theory (or the economics of politics), namely, "political business cycles." According to public choice theorists, the interactions between economy and polity, especially political variations (e.g., party identification), reportedly bring about short-term as well as long-term (Kondratieff) business cycles (Van Winden, Schram, and Groot 1987). For example, they observe that in the United States the unemployment rate has been relatively low in the months prior to presidential elections (Wasserman 1983), and that American stock prices and returns display a "distinct and robust political business cycle," though not interest rates (Gartner and Wellershoff 1999). Notably, such business cycles are associated with government approval management, as American presidents are seen to seek relatively high (non-minimum winning) approval ratings (Freeman and Houser 1998). In short, business cycles are the results of the intentional political manipulation of the economy by governments, especially presidents, to get reelected in office, on the assumption that if this manipulation is successful (e.g., increasing the growth rate or reducing unemployment and inflation), they will achieve this goal.

This adumbrates a crucial difference between economic sociology's and public choice's explanations of business cycles. For economic sociology business cycles can be not only intended, planned, or desired, as assumed in public choice theory, but also and (more often) unintended, unplanned, and undesired, even the perverse effects of political actors and their actions. As such, business cycles can express the peculiarity of social constructions (Merton 1968), namely, irrational sociopolitical definitions and solutions of economic situations (e.g., during the 1929 Great Depression) rather than the rationality, calculation, and economic logic of political officials. To that extent, business cycles appear as outcomes of non-rational or unknowledgeable *homo politicus* (Carruthers 1994) rather than of a rational and fully informed *homo economicus* acting in the political marketplace (Rodrik 1996). In addition, by centering only on the deliberate political manipulation of the economy to the exclusion of other social factors of business cycles, public choice theory is too narrow from the stance of a sociological explanation that incorporates a wide range of such social factors. At best, public choice theory can shed light on only short-term (four-year) and usually minor fluctuations in economic activity (e.g., unemployment

and inflation) associated or overlapping with elections, but not on the most important and prevalent type (viz., medium-run eight to twelve business cycles), let alone long swings in the economy (Kondratieff waves). In contrast, economic sociology can at least in part account for short-, medium-, and long-run business cycles, as can, for that matter, traditional macroeconomic, especially Keynesian, theory. Moreover, as an explanation of short-term economic fluctuations linked to four-year elections, the public choice theory of political business cycles is far from being always successful, even in the case of the United States which usually is invoked to support the theory.

As documented and well known, in 1968, the incumbent party's president lost, despite a quite high growth rate (4.9) one year prior to the election and contrary to the opposite prediction of public choice theory that such a rate would lead to reelection. In a similar scenario, despite a relatively high growth rate (3.7) one year prior to the election, the incumbent president did not win in 1992, again frustrating public choice theorists' expectations. Then, some public choice theorists (Alesina, Londregan, and Rosenthal 1996:115) even predicted that in the 1996 presidential election President Clinton's chances "look dim [yes] given the current modest growth rate." One wonders whatever happened to the celebrated predictive potency of public choice models of politics and "political business cycles."<sup>9</sup> This and other failures often are results of misspecification in modeling business cycles and political processes (viz., a simplistic [bivariate] model of the "relationship between elections and the economy") (Alesina et al. 1996:115), to the exclusion of other extra-economic variables, even though these admittedly play an important role (Mueller 1978:155). This suggests that public choice explanations of business cycles are in some respects even less adequate than traditional macroeconomics and cannot be taken as a serious or complete explanation of the phenomenon in question, at least within the framework of economic sociology.

For instance, one class of extra-economic influences in business cycles and related phenomena that economic sociology takes into account, and public choice theory largely neglects, is the impact of capital-labor relations, especially their relative positional and thus bargaining power. Thus, current public choice or politico-economic models center on the macroeconomic implications of the behavior of political officials during the electoral cycle (manipulation of the economy) and decenter on the inherent conflicts between capital and labor stressed in turn by economic sociologists as well as by some heterodox economists (such as Kalecki; see Snowdon 1997).

Generally, a sociological approach to business cycles considers and emphasizes the institutional conditions of business cycles, especially long waves, in contrast to both traditional economics that instead assumes some deterministic economic laws and to public choice theory that, while not fully abandoning such laws, usually overlooks such conditions (or struc-

ture) in favor of calculating political subjects (or agency, though this may sound fashionable). Included in these conditions are reportedly institutional contradictions (*viz.*, evolutionary dialectics between technology, social institutions, and feedback processes) as a factor of business cycles. A related factor pertains to the social structures of accumulation, as business expectations and profitability hinge upon the structured stability of the institutional setting, so the successive waves of expansion and contraction are linked to fundamentally restructured sets of institutions (O'Hara 1994). In consequence, the impact of business cycles, including depression or crises, has been and is likely to be reduced in the future by various institutional conditions and changes as those taking place during and in the aftermath of the Great Depression (Hamil 1979).

### EXCHANGE CYCLES IN RETROSPECT

That economic exchange is subject to fluctuations, oscillations, or cycles has been a historical fact at least since the Napoleonic Wars, with their recurring booms and slumps (crises) in the beginning of the nineteenth century. Moreover, the earlier periods of exchange also are plagued by economic crises, especially speculative crazes, such as the Tulip craze of Holland in the 1630s (Yeager 1997:154). As to the latter, this event was induced by the tendency for tulips to become a status symbol for the higher class in early capitalistic Holland, and by the resulting increase in their demand and price. This in turn prompted frantic production and speculation. In consequence of such proliferation, tulips gradually lost this status, as a result of which the demand and prices fell, and the collapse of production was inevitable (Weber 1927:286). This historical event seems to give right to the argument that, so to speak, exaggerated booms, including stock-exchange and other speculative crazes, are always the cause of deep slumps in economic activity.

In turn, these crazes are driven not just by rational and accurate calculation/foresight but also by fads and fancies<sup>10</sup> (Blinder 1997:12), all kinds of animal spirits (Keynes 1960:161–62), including excessive optimism or pessimism, and other irrational forces with no firm foundation in a given reality of economic exchange. In general, crises in the broadest sense of chronic unemployment, destitution, gluts, and political disturbances, which are destructive to all economic life, have existed “always and everywhere” (Weber 1927:291), including traditional societies both in the West (the Roman Empire) and in the East (Japan and China).

However, the first modern crises in rational speculation and exchange occurred after the Wars of Liberation (1812) and coincided with the fact that “exchange dealing” originated in transactions involving negotiable paper and money rather than commodities (Weber 1927:293–94). These crises have been characterized by the periodic recurrence at intervals of about

ten years, for example, 1815, 1825, 1835, 1847, and so on, as depicted in many details by Marx. Historically, such crises in exchange transactions were caused by an intricate mixture of both economic factors, especially speculative, and extra-economic, particularly political, ones. The first of such crises, and their periodic recurrence, was driven by the possibility of speculation and the participation of outside interests in exchange undertakings, with the overall outcome that since then crises have become endemic elements of the economic system (Weber 1927:290). Thus, in a historical depiction somewhat reminiscent of Marx, Weber (1927:290) says that most crises have been the result of the tendency for the means of production (but not production as such) to increase more than the demand for consumption goods, a tendency that is a consequence of over-speculation. In another reminiscence, Weber (1927:291) concurs that the notion and practice of rational socialism never would have emerged without the incidence and severity of such crises.

Observing that the cyclical periods of prosperity have coincided with the rapid development of the capitalist economy, some economists, as suggested before, draw the generalization that business cycles are the main form of progress in this economic system (Rostow 1990:259; Schumpeter 1951:24–25). This generalization requires additional qualifications, such as that this applies only to prosperity accompanied by moderate inflation, rather than to depressions with their deflations inhibiting the growth of wealth (Keynes 1936:206–7). Presumably the periods of depression are merely intervals between two recurring phases of prosperity in the cycle of economic exchange, thus reversing the Marxian treatment of prosperity as only a short period between two long depressions or crises. The tendencies after the Great Depression of 1929–1933, and especially after World War II, exhibiting longer periods of prosperity than depression, give more weight to the first view. This is suggested by the fact that the periods of expansion usually have been longer than those of contraction (recession) in the entire U.S. economic history from 1854 to 1991. Notably, during the 1945–1991 period, there were nine trade cycles in the United States, with the average duration of contraction eleven months and of expansion fifty months (i.e., sixty-one months per trade cycle). Compared to previous periods, data also suggest that contractions have become shorter (down from eighteen to twenty-two months) and expansions longer (up from twenty-seven to thirty-five months) than before.

Due to longer expansions, the average duration of U.S. trade cycles has increased from forty-nine to fifty-three to sixty-one (five years) months over the 1854–1991 period, albeit still falling short of the Malthus–Marx–Weber–Keynes observation or expectation of a length of eight to twelve years as a time frame within which economic crisis is expected to recur. Also, the length of business cycles, including expansions and contractions after 1991, indicates that the trend toward longer duration seems to have con-

tinued thereafter as well. For example, the last 1991–1992 recession lasted less than a year (ten months, e.g., April 1991–February 1992), as President Bush was always quick to point out in his unsuccessful reelection endeavors in 1992. And the ensuing recovery/prosperity since 1992 has been one of the longest (almost seven years or eighty-four months, as of April 1999) in U.S. postwar history, with a tendency to exceed the previous record of ninety-two months (i.e., from November 1982 to July 1990). Among other things, this has been an expansion propelling or/and propelled by probably the longest period of a bullish (buying) stock exchange in the United States, having reached ever-new record levels since 1992, despite some occasional adjustments or outbursts of bearish sentiments (selling). For example, the Dow-Jones industrial average, the most widely cited measure of stock prices, increased from about 3,000 in 1992 to above 10,000 in the late 1990s and early 2000.

Moreover, if the post-1992 expansion continues, as expected, in the next couple of years, this can far exceed any previous duration of this upswing phase of the business cycle, at least in the United States. As a result, the latest business cycle's length of about eight years or ninety-six months (1991–1999) has far exceeded the historical average of five years (sixty-one months). Hence, this would suggest the tendency for business cycles to continue to be longer, perhaps approaching the length of around eight to twelve years, thus conforming to Marx's and Weber's predictions in this regard. Concerning the recent and generally postwar contractions in the United States, they seem a far cry from the Great Depression in 1930, at least in terms of their duration. Recently, for instance, the last (1991–1992) recession with a duration of ten months was four times shorter than the Great Depression, which lasted forty-three months (e.g., from March 1933 to May 1937). Overall, none of the postwar recessions has come close to the duration (and severity) of the Great Depression, which thus merits a special reconsideration regarding its social causes and effects.

With regards to the determinants of the 1929 depression, the breakdown, frenzy, or panic in stock exchange speculation probably had not been a real underlying cause of it (Keynes 1972:126–27; Schumpeter 1939:98). This is so although these events had the effect of intensifying it or as the immediate cause might locate the turning point (Tinbergen 1950:102), for example, the black October 1929 (or October 1987 and 1997–1998). In this sense, this event, and the exchange cycle in general, is not even a strictly economic problem but a larger social, especially political, one, which necessitates a “blend of theory with statesmanship, a problem of political economy” (Keynes 1972:336).

In terms of this analysis, the phenomenon of exchange cycles is a problem of the economic sociology of exchange, to the extent that it is influenced by a plurality of social factors. The evidence on the salience of these factors supports this assumption during the Great Depression. The 1929–1933 ep-

isode in the modern economy showed the influence of social, institutional, political, and other non-economic factors on economic exchange. It demonstrated that exchange transactions are always situated within a social-political environment full of disturbances of its own, with spillover effects far beyond. As a result, forces mainly exogenous to the economic system caused this major event in the capitalist exchange cycle. The 1929–1933 crisis was peculiar in relation to the previous disturbances, such as those in 1825 and 1873, in that the major players in its drama were non-economic ones. This diagnosis of the situation suggests an appropriate therapy for the future, but this is outside the scope of this analysis.<sup>11</sup> Taking into consideration all of the contributing endogenous (economic) and exogenous (extra-economic), especially political and institutional, factors, such a crisis of unusual intensity and duration as that of 1929–1933 was almost destined to occur.

First and foremost, this crisis reflected the general fact that the economy is constantly affected by social-political factors, as it is situated in a complex and changing sociopolitical environment replete with disturbances of its own (Schumpeter 1939:113–15). Thus, the distinctive trait of the Great Depression resided in that extra-economic social factors played a “dominant role in its drama” (Schumpeter 1939:113). Generally, what economic and other social actors face is never a mere business depression but always one shaped by “forces not inherent to the working of the economic engine” (Schumpeter 1939:113).

In this connection, the Thomas theorem can be used to explain such a social, non-economic construction of the Great Depression and related instances of trade cycles. As one of what Weber deemed rare sociological uniformities or generalizations, the Thomas theorem (“if men define situations as real, they are real in their consequences”) implies that many economic as well as non-economic phenomena are outcomes of social representations and interpretations made by actors. In terms of their economic as well as non-economic effects, such social representations and constructions of reality can become self-fulfilling prophecies. In this sense, business cycles can be considered the result of swings in social representations of exchange and other economic processes.<sup>12</sup>

Sociologically, the 1929 Great Depression was the outcome of a social representation of the economic reality, which operated as a self-fulfilling prophecy with ultimately perverse consequences. For instance, the prophecy of stock exchange and bank collapse “led to its own fulfillment [showing] perversities of social logic” (Merton 1968:477). This evidenced the critical role of social expectations and constructions—often irrational in the form of social imitation and social contagion, including panics—in economic crises and other phases of trade cycles. Although economic studies are prone to minimize the salience of social definitions/constructions in trade cycles and the economy generally, the self-fulfilling process (in the form of



a widespread irrational panic) of the Great Depression was indicative, even for economists. Thus, based on the findings about the Chicago banking panic in June 1932, some economic studies acknowledge that, albeit a short-lived phenomenon, a panic “can have important long-lived costs if it results in the disappearance of solvent banking institutions” (Calomiris and Mason 1997:863).

In terms of its socioeconomic costs and sacrifices, the crisis of the capitalist economy in 1929–1933 can be deemed one of the greatest economic catastrophes in social history. It implicated modern society in a muddle of colossal proportions resulting from the blunders (such as those committed by the Hoover administration) in control of a “delicate machine” called the capitalist economy, whose operation was not yet fully grasped. One peculiarity of the Great Depression was the magnitude of the catastrophe and the extreme violence as manifested in the historically unprecedented violent fall of all prices (Keynes 1972:126–27). Additionally, psychological reasons such as pessimistic expectations of the actors aggravated and prolonged the duration of the breakdown in the exchange system. For example, just as lenders have lost their readiness to lend on easier terms, so borrowers have not recovered their confidence in the exchange cycle, thus hindering a real recovery.

Parenthetically, in economic terms during the 1929–1933 depression in the capitalist exchange system, the agrarian crisis, as manifested in the declining volume and price of farm produce, had further aggravated the situation, though the severity of the latter can only partly be attributed to it. And the role of monetary policy in these events, though significant, should not be exaggerated, since all prices would fall more in 1929 than in 1913 had a monetary system equivalent to the restrictive system prior to World War I been established. Also the part played by declining wages, though not primary, was one of the contributing factors of the depression, as shown in the gap between the fall in short-time labor costs and the fall in long-time ones, with the effect of delaying actions conducive to the revival of economic exchange. In consequence, the flexibility of the system of economic exchange, in particular, of the price level and system, was greatly diminished.

In standard business cycle terminology, the 1929–1933 collapse of the exchange system was, first, a serious form of recession, then a dramatic slump, and finally a depression of catastrophic proportions with its unprecedented level of unemployment prompted by falling exchange values. Not only material wealth and economic exchange systems but also social stability and relations were endangered. Modern exchange systems have never witnessed such a deep slump in economic exchange and employment, business losses and failures, and disturbances in the social fabric at such a large scale.

Contrary to conventional wisdom in neoclassical economic theory, sav-

ing not accompanied by investment (hoarding), as distinguished from spending both on consumption and investment goods, only made the situation worse, because saving increased unemployment by adding to the already available, large, unemployed surplus of capital, and thus of the labor force (Keynes 1972:133–37). In Weber's (1927:290) terms, saving increased the means of production and eventually production much faster than the need for the consumption of goods. This indicates that crises are generally a matter of a severe aggregate imbalance in this regard (general disequilibrium). Hence, the opposite approach favoring spending seemed (to Keynes as well as to FDR) more sensible and eventually was implemented in the New Deal, and thus perhaps saved the capitalist economy. The approach was based on the realization that, since the chief agency in initializing the depression was the collapse of expenditure covered by U.S. loans, only by increasing loan-expenditure could plummeting prices (as the major cause of unemployment) be restored at their previous level (Keynes 1972:351–52). The curious (unexpected in neoclassical economics) influence of saving on the occurrence and intensity of the Great Depression demonstrated the paradox of thrift, that is, shades of liquidity traps (Samuelson 1997b:157) and other serious economic and social malaise resulting from this process.

The 1929–1933 rupture in the capitalist exchange system, with its enormous anomaly of unemployment and misery and insecurity and instability, may, however, hide the deeper and long-run processes unfolding under the surface of the system. Economic history suggests that the average standard of living experienced sluggish or no progress from 2000 B.C. to the beginning of the eighteenth century. It seemed that two factors were largely responsible for this, namely, the failure of substantial capital accumulation and the lack of significant technological progress. Capital accumulation in the fifteenth and sixteenth centuries of the form of what Marx called “primitive accumulation” heralded, in conjunction with the technological discoveries of the times, the coming of the modern age of economic exchange. This modern age featured a dramatic rise in the standard of living, which was, for instance, increased fourfold in Western Europe and in the United States.

These tendencies lend justification to the historical generalization that society has shown a remarkable capacity for solving its economic problem or the problem of economic exchange. This is especially so in the long run, though since in the long run, as Keynesians say, “we are all dead” (Galbraith 1997:96), the question remains, who will enjoy the benefits of this capacity? The rise also may give some ground to the projection that this trend in the field of economic exchange will continue in the future at an even more rapid rate (e.g., by four to eight times in the standard of living of developed nations during a century). Thereby the economic problem could be reasonably resolved or substantially mitigated in 100 or so years,

on the condition of a stable social environment devoid of major wars, population explosions, and the like. This implies that the economic issues of material wealth, gain, and utility may not be the permanent problem of humankind (Keynes 1972:326).

## INFLATION VERSUS UNEMPLOYMENT

In connection with cyclical movements in the exchange system and their remedies, the idea of constitutional or institutional change in the system often arises, especially in its regulatory part. This idea is premised on the assumption that if they are not subject to strict constitutional rules built into institutions and guiding policies, decision makers would not behave as though they were bound by such (nonexistent) rules. Only insofar as such rules are in existence will the decision makers act in accordance with them. The recent major monetary disturbances such as inflations in the 1970s and the early 1980s are attributed to the nonexistence of such rules as shown in unrestrained monetary monopoly, viewed as the institutional explanation of these events. Thus, the presumed need of institutional reform of the money sector of exchange systems by enforcing constitutional rules that will constrain the discretionary powers of the monetary authorities and thus ensure efficient control of inflation (Buchanan 1991a:86–87).

Two objections can be advanced regarding such constitutional solutions. First, promulgating and enforcing constitutional principles is not sufficient per se to prevent inflation or deflation and other disturbances in exchange systems. For example, the U.S. Constitution did not prevent deflation (the Great Depression) in the 1930s or inflation in the 1970s. This is because in economic terms, no constitution needs to bind: for example, “No constitutional amendment has taken the United States off of the metallic standard, even though it in practice has been abandoned a long time ago” (Jensen 1997:912). Second, the receding importance of inflation can reduce the urgency of such institutional reforms in modern exchange economies. This tendency in inflation relative to unemployment (or deflation) in the industrial world since the 1960s and 1970s is well evidenced. Thus, a common trend toward decreasing inflation and increasing (or constant) unemployment can be observed in most other countries (Mueller 1996:25).

Generally, the inflation rate was further lowered and the unemployment rate increased in most European countries during the 1990s, with such a situation of persistent high unemployment versus low inflation being recently termed *hysteresis* (Saint-Paul 1997). These data pertain to European countries, but the overall trends toward the receding salience of inflation relative to unemployment (or recession) are convergent in other countries. This applies to the United States, albeit it attained the best of all possible scenarios—that is, both low unemployment and low inflation since the 1980s through early 2000 (e.g., around 4% and 2%, respectively, in 2000).

For example, although in this period the unemployment rate fell below its assumed natural rate consistent with low inflation, inflation was persistently low or decreased (e.g., from 10% in 1980 to 3.8% in 1988 and around 2% to 3% in 1990–2000) (Kahn 1997:1004). All of this happened contrary to the rational expectations of monetarist economists, the Federal Reserve Board (FRB), and others who dogmatically associate low unemployment with raising inflation (this trade-off is implied in the so-called Philips curve). The seriousness of unemployment (i.e., of deflation or recession) in relation to inflation also is indicated by the average unemployment rates for OECD countries from 1983 to 1996, compared to their rates in the 1960s (Mueller 1996:25; Nickell 1997:56). Evidently, unemployment rates have substantially and in some cases (Spain, France, and the rest of Europe) dramatically increased in developed countries over the period since the 1960s. This was accompanied by corresponding decreases in inflation from its high levels in the 1970s.

These tendencies suggest the diagnosis that unemployment was the main economic problem in the Western world (and beyond) at the end of the twentieth century, with the real possibility to continue such a status well into the twenty-first century. Hence, deflation accompanied by recession/depression and thus by the central macroeconomic problems of unemployment and stagnation (Galbraith 1997:103) may be a more real and graver socioeconomic long-run problem than inflation. For instance, involuntary unemployment during a deflationary phase of exchange cycles is probably a greater evil than the overtime of the inflationary booms is a benefit (Keynes 1936:294). Such an assumption was confirmed in the 1970s and generally since the 1930s: the social-economic cost of inflation in the 1970s was low in comparison to another deflation similar to the Great Depression (DeLong 1996:51). This in turn casts doubts on the obsession of most economists and many policy makers, especially those from Central Banks, with control of inflation on doctrinaire or ideological grounds (monetary stability). But this often blinds them to other more serious issues, such as involuntary unemployment, poverty, and political upheavals accompanying the latter (Weber 1927:291).

In retrospect, these processes give right to Keynes' (1972:60) dictum that on the balance deflation is more injurious to the production of wealth than (moderate) inflation within exchange cycles. Deflation, by causing prices to fall, impoverishes most of society, in that it prompts entrepreneurs to, in an effort to avoid losses, reduce production, thus being "disastrous to employment" (Keynes 1972:75). On the balance, then, such deflation is a greater evil than inflation insofar as it is irrational or "worse" in economic terms to produce unemployment for the large section of the population than to "disappoint the rentier" (Keynes 1972:75). These considerations also corroborate Weber's (1927:282–91) earlier premonitions in this respect. For instance, for Weber (1927:291), economic crises, as the lowest

point of exchange cycles, are problems of deflation, unemployment, and lack of effective demand. After all, one of the “greatest economic catastrophes of modern history” (Keynes 1972:126), namely, the Great Depression in the 1930s, was a crisis of deflation, not inflation.

The fundamental Keynesian rationale is that (moderate) inflation entails, albeit often overstimulating, the creation of aggregate wealth, and deflation its destruction with far-reaching economic and social consequences. In an ideal world, both inflation and deflation are, of course, to be avoided, as Keynes (1972:75) is careful to point out that it is not indispensable that one evil ought to be weighted against another, since both are evils to be “shunned.” In a less than ideal world, however, one sometimes has to make choices—as policy makers in the United States and elsewhere know—between (moderate) inflation or growth and deflation or unemployment. The behavior of the FRB in the late 1990s and early 2000 was indicative in this regard. For all of their economic (and other) conservatism, especially fiscal-monetary purist dogma, Greenspan and others were sometimes cautious, even reluctant, to raise the interest rate, a traditional weapon to fight inflation, because of the adverse effects on such deflationary measures on growth and unemployment.

Not surprisingly, since the New Deal (and until the 1980s and 1990s), the FRB, Congress, and U.S. administrations have been more centered on fighting deflation or unemployment than inflation. This was indicated by the adoption of the Employment Act in 1946, under Keynesian influences (DeLong 1996). Although not irrelevant, concerns about inflation have been largely secondary in postwar U.S. history, with the exception of the late 1970s. This largely holds true of much of the industrial world after World War I, perhaps with the exception of Germany, with its *Deutchbank*'s obsession with keeping inflation low at any cost, given its traumatic historical experience of hyperinflation in the 1920s. However, this obsession and corresponding deflationary policies can partly explain Germany's record-high unemployment (around 10% in the late 1990s). A similar explanation can probably be adduced with regard to Japan's economic troubles in the 1990s. For instance, its stagnation in the late 1990s can to some degree be attributed to its overreliance on traditional deflationary medicine (including excessive saving).

In general, the discussion so far suggests the existence of a vicious circle of deflation and thus depression: once initiated, it tends to progress in a cumulative fashion, causing great losses<sup>13</sup> in social wealth or national income, and thus leaving behind, like a hurricane, devastation as well as social injustice (Keynes 1972:225). This is demonstrated by various historical instances of tolerable inflation—though not hyperinflation—accompanied by the multiplication of wealth versus those of deep deflation, with its opposite repercussions. For instance, in the nineteenth century reportedly increasing wealth was accumulated mainly during the periods of (com-

modity) inflations and suffered “abnormal losses” during cyclical deflations (Keynes 1936:294).

Such an association between wealth creation and the various phases of the exchange cycle implies that the view that wealth increases at a faster pace in depressions or deflations than booms or inflations is historically fallacious insofar as material progress could have been slower or impossible in the absence of “artificial stimulus” to capital accumulation given successive booms or/and inflations (Keynes 1936:273–74). Hence, the economic rise and decline of nations can partly be historically associated with the inflationary and deflationary phases of the exchange cycle, respectively. Specifically, as Keynes (1936:154–64) asserts, since the wealth of societies is often increased during periods of profit inflations (featuring higher prices than costs of production), the “extraordinary correspondence” exists between these periods with the times of national rise, and vice versa, profit deflations with national decline.

No wonder that after the Great Depression and World War II the consensus was established, within Western exchange economies, including the United States, that maintaining high unemployment, despite or combined with moderate inflation, would be the foremost objective of national policy. In the United States, such concerns were exemplified by the Employment Act of 1946, with its (originally) simpleminded Keynesianism, focusing on achieving maximum employment, production, and purchasing power (DeLong 1996).

At this juncture, not only Marx but also Weber (1927:291) anticipated Keynes by arguing that crises in the sense of deflation tend to destroy all economic life. Hence, in Weber’s terms, actors are likely to attribute more negative subjective meanings to chronic unemployment, destitution, glutting of the market, and political disturbance and related symptoms of a deflationary stage of the exchange cycle than to rising prices and other signs of an inflationary phase.

In passing, hyperinflation would be more complicated, but even the worst hyperinflation seems socioeconomically less destructive than a deep depression. This was shown by the German hyperinflation from December 1921 to October 1923 and Soviet Russia’s hyperinflation from January 1922 to February 1924 (Allais 1997:7) in relation to the German depression in the 1930s and the Soviet stagnation in the 1970s and 1980s. No doubt, the former plunged the Weimar republic into a serious crisis. However, the latter meant the virtual destruction of a socioeconomic and political system and the concomitant rise of Nazism. The same can *ceteris paribus* be said of the Soviet hyperinflation in comparison to the stagnation in the 1970s and 1980s, albeit one cannot speak here of exchange cycles in the strict sense, given the absence of a capitalist economy. The latter events were far more destructive to the social system than the former, as shown by the complete disintegration of the system in the early 1990s.

Moreover, South American hyperinflations in the 1970s and 1980s looked like minor distractions relative to the full-blown depressions of the 1930s. The same can be said of inflations in Europe during the 1970s and early 1980s in comparison to its deflations (i.e., recession and unemployment in the 1990s, not to mention its depression in the 1930s). It comes as no surprise that for Weber, just as for Keynes and Marx, economic *crisis* is, first and foremost, deflation (falling prices) accompanied by recession or depression in an exchange economy, with the resulting unemployment and social disturbances.

To summarize, the aforesaid suggests that the proposals for some constitutional mechanisms and rules to control inflation, besides often being ideologically or politically motivated, can be more or less ineffective, even self-defeating, on their own economic (let alone social) terms. This is partly witnessed by related concepts such as the natural rate of unemployment, or NAIRU. This rate is always below full employment and is supposedly consistent with low inflation, based on an assumed trade-off between (high) inflation and (low) unemployment. However, despite the rhetoric of economic efficiency and fiscal prudence, the natural rate hypothesis has been in the service of a “conservative cause,” for orthodox macroeconomics has mostly been against policies of full employment, despite stagnant wages, thus making the hypothesis a matter of “curiously irrational, systematic error” (Galbraith 1997:102).

Particularly, many constitutional and other institutional blueprints for stringent anti-inflationary “medicine” (viz., balanced budgets, targeted inflation rates, the fixed annual rate of aggregate money growth, etc.) and their policy implementation might in the long run lead to deflations or depressions, with all of their pernicious economic as well as extra-economic social, including political, effects. To that extent, this medicine resembles the type of remedy that, while curing one illness, creates even more serious side effects that can eventually kill the patient. Again, the experience of the 1929–1933 depression is quite instructive in this regard, given the behavior of the policy makers, including the Hoover administration, resorting to the old deflationary policy that reflected financial purism (Keynes 1936:173–74).

However, to expect that politicians and other relevant social actors in the United States and elsewhere will learn much of such experience is sometimes an exceedingly high expectation. This is evidenced by the proposals for (targeted or not) dis-inflation tending to mutate into deflation, as well as those for invariably balanced budgets and generally for attaining an economic nirvana via constitutional and other legally coercive means. Such legal measures reflect the conservative dogma and fiction of perennial equilibrium (viz., financial purity) in the utopia of a perfect economic world, just as attempts at enacting morality by law in the permanent American

“conservative revolution” (further intensifying after 1994) mirror the Puritan illusion of ethical perfection.

## NOTES

1. In this connection, three interpretations are offered for the lack of regular business cycles since the 1930s: first, “ratchet” effects operate, second, governments have stabilized the economy by Keynesian policies, and third, observed random shocks are expected in real business cycle modes (Villa 1999).

2. Fatas (2000) contends that traditional explanations of the persistence of output fluctuations such as real business cycle models (with exogenous productivity shocks) are unable to explain the positive correlation between such fluctuations and growth rates.

3. According to Lettau and Uhlig (2000), habits in leisure make labor input counterfactually smooth over the business cycle, and those in both leisure and consumption, even countercyclical, with consumption continuing to be excessively smooth. Hence, they suggest that many asset pricing puzzles can be resolved by adding habit formation to standard preferences in the utility function.

4. Citing the role of random shocks and disturbances in causing economic fluctuations, some suggest that the explanation of these fluctuations tends to evolve from a theory of cycles to one of shocks (Chatterjee 2000).

5. Contrary to conventional wisdom in economics, some analysts (Mair and Laramie 2000) contend that increasing taxation (of wages or profits) and thus changing income shares can encourage investment and reduce the amplitude of business cycles. Alternatively, in the absence of significant reversals in these shares, investment is predicted to remain sluggish in light of the changing income distribution in the United Kingdom in recent decades.

6. By assumption, Keynes assumes that the volume of aggregate saving was sensitive to the rate of interest—that is, that the elasticity of saving in respect to the interest rate is positive or greater than zero. Incidentally, some staunch orthodox economists (Hayek 1931) reacting to Keynesian heterodoxy argued or implied that the elasticity of saving to the interest rate was exactly equal to zero (Longuet 1999).

7. As an illustration of a typical monetarist explanation of business cycles, especially depressions, Friedman (1956: 97–100) argues that “Every severe contraction has been accompanied by an absolute decline in the stock of money, and the severity of the contraction has been in the roughly same order as the decline in the stock of money. The Great Contraction is tragic testimony to the power of monetary policy—not as Keynes believed, of its impotence.”

8. According to Spree (1991) such a conjunction of economic and extra-economic factors makes economic swings of variable duration, which casts doubt on the assumption of fixed-length cycles. In this view, in contrast to short cycles (from several months to a few years), the existence of long cycles (ten to 100+ years) has not yet been established. Problems in data collection over long periods make doubtful the existence of classical long waves or swings (Kuznez waves of twelve to thirty years, prevalent in Anglo-Saxon countries).

9. In addition, one can object that the (public choice) theory of political business cycles rests on some questionable assumptions about voters and policy makers:



the first are assumed to have short memories and to ground their expectations on their immediate experiences only, and the second are credited with a greater capacity to manage or manipulate the economy than experience suggests.

10. At this juncture, Blinder's (1997:12) law of speculative markets states that these "get the sign right, but exaggerate the magnitude by the order of magnitude between 3 and 10."

11. For example, the therapy in a Keynesian way would include steps toward mitigating state and other extra-economic interventions in the exchange system, though this can be impossible on political grounds. It also includes relief to the victims as imperative on moral-social grounds and fueling the flow of economic exchange by steadying effective demand. It involves, too, remedies treating depressions and recessions, not just as evils but as an aspect of the unavoidable phenomenon of adaptation to economic change. In addition, institutional reforms can be urged by moral, social, and economic evils of depressions in an exchange cycle, though such steps may preclude or slow down revival, as experienced by the European Union in the 1990s.

12. As to the overall impact of the cyclical fluctuations in economic exchange on social interaction, the latter is no doubt affected by the former. But the latter is probably affected to a lesser degree than is economic behavior and than is sometimes thought, as in the view that "when there is economic decline social contracts are constricted [and] during growth, we are generous in our social dealings" (Blau 1993:108). Thus, in the bad times of a recession or depression, actors can more easily reduce or postpone consumption, resuming it at good times, than their social relationships. Simply, people "do not interrupt social relationships in a recession and then resume them when times get better. It is much easier to interrupt direct consumption" (Davis 1992:52).

13. According to Keynes (1936:295), these great losses in wealth during deflation are to be attributed to the loss of savings and to the "involuntary idleness" of production factors.

## *Chapter 8*

# *Economic Exchange in Comparative Social Systems*

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### **SOCIAL PROCESSES IN THE RISE OF CAPITALISM**

Historically, the emergence and subsequent development of the modern economy or capitalism was largely determined by social, especially institutional, factors. This was classically demonstrated by Weber, who provided the fullest picture of these institutional requirements (Collins 1997) for the emergence of capitalist exchange.<sup>1</sup> Specifically, what Weber (1927: 275–76) called general presuppositions and prerequisites of modern capitalism include: appropriation of the physical means of production by the entrepreneur (private property), rational capital accounting, freedom of the market, rational technology, calculable law, including bureaucratic administration), free labor, the commercialization of economic life (including speculation), and a rational economic ethic. In this connection, some contemporary sociologists (Collins 1997) influenced by Weber subsume all of these variables under the following three: markets for products and factors, entrepreneurial control of these factors, and an economic ethic. On the other hand, the key obstacle to modern capitalism was what Weber (1976: 36–37) called economic traditionalism. For in economic traditionalism or pre-capitalism, material interests can be linked to maintaining traditions (Weber 1927:355).

This picture indicates that the ethic of ascetic Protestantism was not the only institutional or sociocultural precondition for the emergence of capitalism, but one among a variety of such factors, though a critical one. At this juncture, the question arises as to whether the impact of Protestantism and religion in general on capitalism has been largely spiritual through its religious ethic, as Weber assumed, or material through its religious econ-

omy, especially monasteries, as one may argue (Collins 1997:849). Thus, in reexamining the role of religion in the emergence of capitalism, some neo-Weberians (Collins 1997:848) modify Weber's original premise by arguing that religion "initially contributed to capitalism not primarily in inspiring laypeople's beliefs and motivations, but through the material expansion of religious organization. In Schumpeter's terms, monasteries were the first entrepreneurs." For Weber, the second path of influence was secondary in relation to the first, however. While those in monasteries led a very rational economic life, this cannot be called a capitalistic economy (Weber 1927:345), since it remained restricted to the monastic circles. It was precisely the Reformation that made a decisive break with this system (Weber 1927:365). This effect of the Reformation on secular economic behavior was summed up in the underlying Protestant (Calvinist or Puritan) message: "You think you have escaped from the monastery, but everyone must now be a monk throughout his life" (Weber 1927:366).

Weber's picture also shows that economic exchange, free competition, and capitalist relations are insufficient to cause major economic and social changes (Collins 1997:843), such as the rise and expansion of modern capitalism. For instance, in Weber's (1927:355, 367) original depiction, traditional obstructions are not eliminated by economic factors only but also by non-economic conditions. Of these conditions, a major one was Protestant ascetic religiosity, with its idea of calling as the fulfillment of a God-given task. An unintended consequence of this system of religious thought was a strong, refined organization for the (unintentional) "production of capitalistic individuals" (Weber 1927:368), an organization of such efficiency and magnitude that it was unparalleled in any other church or religion. Weber's description and explanation of the institutional prerequisites of modern capitalism suggest that economic institutions, such as markets, money, accounting, property, or enterprise, as well as non-economic ones, such as law, ethics, families, conventions, values, traditions, or religions, are complex social arrangements, not givens to be represented by a few parameters in pure economic models (Yeager 1997:154).

Weber talked mostly about the emergence or genesis rather than the development or evolution of modern capitalism. However, if there was a positive relationship (elective affinity, similarity, or confluence) between the genesis of capitalism and the Protestant ethic, there is no logical and empirical reason such a relationship should not also exist in the subsequent development of capitalism. In this case, the determinants of the birth can be plausibly assumed to be factors of growth as well. In fact, there is large evidence demonstrating the persistence of such a positive relationship between modern capitalism's development and Protestantism, as indicated by many reformulations of the Weberian model. Thus, these reformulations mostly deal with the association between capitalist and generally economic development with the Protestant ethic and other instances of economic cul-

ture. Moreover, even when dealing only with the emergence of modern capitalism, such an emergence can hardly be described as merely a sudden outbreak or a single act, like a cosmic Big Bang, but rather as a gradual cumulative (evolutionary) process (viz., the primitive accumulation), which makes the distinction between genesis and development fluid, if not irrelevant. After all, in a Weberian framework, though a unique phenomenon, modern capitalism was just another form of capitalism, succeeding or even coexisting with the old, politically oriented, robber capitalism. In Marx's words, industrial capitalism as equivalent to Weber's modern capitalism evolved from merchant or trade capitalism (a term that Weber also used) and generally feudalism. In Weber's terms, economic modernism emerged or/and developed from economic traditionalism. In any event, of the institutional-cultural preconditions of the advent and establishment of modern capitalism, two are of particular historical relevance: the state and the Protestant religion.

## THE STATE AND THE EXPANSION OF CAPITALISM

Within Weber's classical model of the establishment of modern capitalism, the state plays a critical role. Since the emergence of the modern economy, the state has tended to become the greatest entrepreneur in economic life (Weber 1949:46–47). Historically, this casts doubt on the neoclassical premise that the "state is not an entrepreneur" (Walras 1926:449). On the other hand, Weber seems to have in mind, above all, government ownership and control of the means of production (i.e., entrepreneurship in the strict sense) and less growth in public expenditures, since this latter tendency was still weak at the time (the early twentieth century). The tendency for government to become the greatest entrepreneur has been in operation not only during wartime but also peacetime. Such a tendency has been particularly salient in the latter stages of the development of the capitalist economy, following World War I and the Great Depression, exemplified in the transformation of the capitalist government from a traditional night-watchman's state with minimal economic functions to a more (Western Europe) or less (United States) social welfare state with a broad array of such functions. Such global transformation of the state has been indicated by the well-documented (for most economists, notorious) tendency toward what American conservatives call big government as an ultimate evil. It also has been expressed in the increasing government property and control of economic resources since World War I and the Great Depression, albeit in today's capitalism this tendency has been greatly slowed down and even reversed since the 1980s with the resurgence of privatization and deregulation, so it can presently be deemed a secondary means by which the economic significance of the modern state is asserted. More often, the tendency toward an increasing economic role of government is expressed in increased public

expenditure and taxation, in most industrial societies (with some recent slowdowns).

Historical trends in public expenditure and taxation in industrial societies from 1913 to 1990 (Tanzi and Schuknecht 1997) probably give right to the U.S. conservative opponents of “big” (federal) government. For instance, in the U.S. federal government, spending increased from less than one-tenth (7.5%) to one-third (33.3%) of the GDP during the 1913–1990 period. Equally or more dramatic increases have occurred in most other industrial and democratic countries. On the other hand, comparative data show that according to the level of public expenditure as well as taxation, the American federal government is still—as it was in 1913—the smallest among Western industrial societies, despite all of this growth. For instance, just as it has traditionally been (among) the lowest in comparative-historical terms, U.S. government expenditures as a percent of the GNP were still (in 1990) far below the average for developed countries (45%), including Canada (46%) as another example of putatively hard-core (Dore 1992) or *laissez-faire* North American capitalism.

Such growth in government expenditures seems to be a secular trend in global terms, despite some recent reversals toward a smaller government, especially in the United States and the United Kingdom, and regardless of whether its economic effects are positive or negative (a problem of value judgments). In a sense, this trend can be irreversible. A purely *laissez-faire* government limited to the mere enforcement of a formal order is an ideal type, in that only in theory is it feasibly a rigorous limitation to strictly formal principles (Weber 1968:75). On the contrary, even formal and general legal principles, including constitutions and other rules of the game, can involve, to a considerable extent, important limitations to the extent and content of economic activity (Weber 1968:75). By analogy, the same can be said of a total, all-omniscient (communist) state with complete control and regulation of economic and other human activities, given the practical limits of such control (e.g., abandonment of some types of economic activity, evasion, smuggling, bootlegging, and other elements of an underground economy) (Weber 1968:75). Just as its *laissez-faire* counterpart, such a state is a conceptual construction. As ideal-typical constructs, the former implies a positive (including an anarchist) utopia, and the latter a negative utopia. At this juncture, a digression on ideal types is in order. In a sense, Weber’s ideal types are generally no more than abstract utopias. If the tendencies away from a traditional minimalist state are in economic terms irreversible, despite the neoliberalism since the 1980s, so are those away from a maximalist government. The second tendencies are especially likely in light of the collapse of the overcontrolled, hyperregulated socialist economies of the late 1980s, as well as the crises in capitalist welfare states (e.g., Sweden, Germany, France, etc.). However, the first tendencies can hardly be reversed, insofar as a night-watchman government of the nine-

teenth century is unsuitable or unfeasible for complex modern economies and societies.

In any event, the aforesaid pertains to the economic role of government at normal times of peace since the emergence of the modern exchange economy. However, this role has been even more prominent during times of war, as shown by the various military conflicts between nations and international coalitions. For instance, an increasing government economic role during periods of war has historically been evidenced by government's ability to increase tax rates substantially, sometimes exercising almost arbitrary power. This applies even to the U.S. government as a putative exemplar of a minimalist state, and is illustrated by the levels of government spending as well as of capital and labor tax rates during World War II and the Korean War in comparison with their anterior magnitudes. As research (Ohanian 1997) shows, during the Korean War and World War II, U.S. government spending per year was substantially higher (by 29% and 124%, respectively) than the prewar annual average (the least-squares trend). Also, wartime tax rates were higher: for example, during World War II, the average capital tax rate increased (to 60.2%), well above its prewar level (43.8%), as did the labor tax rate (to 17.5% from 8.7%). Likewise, during the Korean War, the average capital tax rate was higher (62.6%) than prior to the war (51.5%), as was the average labor tax rate (19.8% versus 16.2%).

In broader comparative-historical terms, what Weber (1968:353) denoted as the memorable alliance between the absolutist state and the rising capitalists in the fifteenth and sixteenth centuries was propelled by the political exigencies of the former and the economic appetites of the latter. In retrospect, such an alliance was a major factor in the transition from politically oriented capitalism to rational bourgeois capitalism (i.e., in the establishment of the exchange economy). Next we reexamine the role of Protestantism as another key force in this process in Weber's approach to the emergence of modern capitalism.

## PROTESTANTISM AND MODERN CAPITALISM

Within Weber's model of the institutional conditions of modern capitalism, the relationship between exchange transactions and religion is more intricate than usually thought in current exchange theories in sociology and economics. In relation to the materialistic conception of history and the economic (rational choice) approach (Weber 1949:75; 1976:183), a particularly original feature of this model is its treatment of religion as an explaining variable and capitalism as an explained variable. In contrast, in orthodox historical materialism and the economic approach, capitalism or the economic factor is the explanatory variable and religion or culture the dependent one. In the Weberian model of the birth and maturation of mod-

ern capitalism, a peculiar religion is linked to continuously and rationally undertaken economic exchange involving profit making.

The model identifies exemplars of the linkage between religious organizations and economic exchange in the various Protestant sects in Western Europe at the dawn of the modern era (the fifteenth and sixteenth centuries). The association between Protestantism and capitalist exchange can be represented in rational choice terms in three types of relations (Coleman 1990:6–11): micro-micro relations, that is, between individual values and individual orientations to economic behavior (Type-1); macro-micro relations, namely, between Protestant religious doctrine and individual values (Type-2); and micro-macro relations, for example, between orientations to economic behavior and capitalist economy (Type-3). In this regard, rational choice sociologists criticize Weber for not conceptually developing Type-3 relations. They regard the Type-3 relation as the main intellectual stumbling block, alleging that Weber demonstrates the impact of Protestantism on individual values (Type-2 relation) and that of the latter on individual orientations to economic behavior but fails to demonstrate how these orientations jointly operated to generate capitalism as a structure of economic organization. As a corrective to this oversight, rational choice models emphasize Type-3 relations (i.e., the presumed causal path from individual orientations to economic behavior to the capitalist economy and society).

However, this rational choice modeling of the link between Protestantism and capitalist economies is not without objections. Particularly, the rational choice critique of Weber's model of the emergence of capitalism does not seem grounded. Far from amending Weber's analysis of the connection and similarity (elective affinity) between Protestantism and modern capitalism, rational choice modeling is plagued by many defects. First, Type-1 relations, as illustrated by the impact of Protestant values on individual economic conduct, evince psychological rather than sociological properties. Hence, the explanation of the underlying association is not properly sociological, because it omits social variables such as political, legal, religious, cultural, and other institutional arrangements (Collins 1997:844–46). In this sense, such an explanatory model is handicapped by misspecification. By viewing individual goals and preferences as utilitarian and invariant vis-à-vis cultural and historical conditions, it shows an ahistorical and acultural bias. The concept of *homo economicus*, with its reductionism, still looms large, especially in (rational) orientations to economic behavior<sup>2</sup> (Sewell 1987).

Thus, various macro-level variables mediate the relations between the religious values and exchange behavior of Protestant actors (Type-1 relations) and their combined effects on capitalist exchange structures (Type-3 relations). The interrelations of these variables form a causal chain or sequence ensuing in a distinct exchange economy<sup>3</sup> (Collins 1980:924–25). Type-3 relations intended to solve the micro-macro problem of continuity

by positing combined effects of Protestant individual economic actions on capitalism as an exchange structure proven to be no more than arithmetical operations of aggregation or summation. Yet, this summation does not bring expected continuities, but rather rational discontinuities emerge to the effect that individual actors are rational, and society is not, so the model collapses by applying arithmetical methods ("counting heads") to attain social choices or collective outcomes (Frohock 1987:37–38). As a result, just-so stories of how the aggregate effects of individual agency generate structures, without considering effects in the opposite direction (structuration), replace explanations of the transition from the exchange transactions of individual Protestants to a capitalist economy. They thereby overlook or downplay the opposite influence of a capitalist economy and society, including ethics and religion, on Protestant individual behavior in exchange. This impact represents an instance of Type-2 relations, as recognized originally by Weber and subsequently by modern heterodox economists, but hardly by rational choice sociologists.

Furthermore, from the perspective of neo-Weberian economic sociology, Type-2 relations seem particularly prominent, for the effects of society and culture on individual economic actors and actions (i.e., Type-2 (macro-to-micro) relations constitute one of the building blocks of neo-Weberian economic sociology as well as substantive economic anthropology. This is probably the reason why rational choice theorists (Coleman 1990:6–11) complain that Weber's explanation of the rise of modern capitalism emphasizes Type-2 relations (i.e., the impact of Protestant religious institutions on individual values and behaviors), and thus is too macro. In turn, some social exchange theorists (Willer et al. 1989) approvingly stress the perceived macro crust of Weber's (economic) sociology, including his conception of domination/power. Needless to say, Weber's idea of economic sociology involves an integration of micro and macro components, individual agency and social structure, and a dual (or pluralist) conception by taking into account economic and ideal determinants in the genesis of modern capitalism.

However, by downplaying the sociocultural effects on individual behaviors, rational choice theorists display their disaffinity with or lack of awareness of a neo-Weberian economic sociology, as do social exchange theorists vis-à-vis the sociology of markets. Moreover, there have been virtually no efforts within sociology to conceptualize and specify these disciplinary relations (i.e., the essential differences between rational choice theory and economic sociology generally and between social exchange theory and the sociology of markets particularly). Thereby, an overall theoretical or epistemological contribution of the present analysis is to help clarify such disciplinary confluences.

Next, the rational choice modeling of the association between Protestantism and capitalism neglects macro-to-macro relations. This is a major



omission, at least from the stance of a neo-Weberian model, which implies not only micro-to-micro relationships but also interrelations between macro variables (e.g., institutional-structural parameters, including definite religious ethics and capitalist economies). The only or main objective of such a model is, as Weber (1968:480) points out, establishing an affinity or association between economic rationalism or capitalism and specific modes of “rigoristic ethical religion” such as Protestantism.<sup>4</sup> These macro-to-macro relations represent a possible Type-4 and can be represented as relations between the Protestant ethic as a religious institution or cultural pattern and capitalist economies as economic systems.

The impact of the Protestant ethic on capitalist economies represents a path of influence of religious institutions or cultural structures to economic systems, as implied in Weber’s original model of the rise of modern capitalism. In micro-terms (i.e., Type-1 relations), for individual Protestants (especially Calvinists), profit, wealth, and other economic goals are means to non-economic ends, such as religious salvation. In Weber’s (1968:25–26) terms, Protestant actors treat instrumental rationality as an intermediate step to attaining some ultimate values or value rationality rather than vice versa, as assumed by Marxist and rational choice interpretations. A recent taxonomy of social action (Alexander 1990) conceptualizes these and other relationships between means and ends, which to a degree is influenced by Weber’s typology. This taxonomy, premised upon the general idea of rationality as a means-ends nexus, suggests that ends or motives of social action can be empirical or extrinsic and transcendent or intrinsic (i.e., what Weber termed material and ideal interests, respectively). In turn, the means for attaining these ends are practical/logical and symbolic. Various combinations of ends and means will produce different (ideal) types of social action.

For instance, a combination of empirical (extrinsic) ends and logical/practical means defines rational behavior in Weber’s sense of instrumental action and calculative rationality, or of Pareto’s logico-rational actions. When empirical ends are conjoined with symbolic means for their realization, this involves magical action (as well as conversation). Then, conjunctions of non-empirical (transcendental) ends and empirical means include variegated instances of social action, such as economic consumption, political campaigns, and organizational interactions. Finally, attaining non-empirical ends through symbolic means is a defining feature of religion and tradition, as well as of secular rituals.

The typology indicates limitations in rational choice critiques of Weber’s analysis of the historical relationship between the Protestant religion and modern capitalism, namely, that the notion of rational action has limited scope, indicating the narrow significance of the rational choice model and the pertinence of other types of action (Alexander 1990:343–44). Even

when they promote economic exchange, as with the early Protestant sects, religious beliefs and practices cannot be conceived of in terms of invariably rational choices. This is *a fortiori* true of the Calvinist path to religious salvation, in which rational action, as exemplified by profit-making exchange, is an instrument to this end.

Finally, Weber's hypothesis of a positive association between Protestantism (Calvinism) and the emergence of modern capitalist exchange has been subject to various reformulations, reexaminations, and reinterpretations. For illustration, in a Weberian vein, some studies emphasize the economic pertinence of Protestant disciplinary revolution aiming to create a rigid ethic of social discipline in countries such as Holland and Prussia, predating similar trends in France and the United States. Specifically, two features of Calvinism as a collective organization have been of decisive importance for the economy and society (*viz.*, the ethic of social, including economic, discipline and the unique use of surveillance as a technique of mass political organization) (Gorski 1993). This process of Calvinist disciplinary revolution in conjunction with economic processes has thus been greatly instrumental in the rise and expansion of capitalism as an economic as well as a political and social system.

Many contemporary analysts agree that Weber's account of the emergence of capitalist exchange institutions (*i.e.*, the Rise of the West) is most adequate and superior to the alternatives, including world systems and rational choice models. More precisely, Weber's explanation of the rise of Western society often is seen as the "best available" (Chirot 1985), as is his depiction of economic conduct as both rational and individualistic on the one hand and non-rational and contextual in social-cultural terms on the other (Mingione 1999). Thus, the most complete taxonomy and explanation of the institutional imperatives for a capitalist exchange economy and their corresponding obstacles is sometimes still thought to be Weber's (Collins 1997:845).

Parenthetically, historical findings often provide conflicting evidence for the hypothesis positing a positive association between Protestant sects and modern science, however. For example, some studies have reaffirmed the assumed positive role of Pietism, as a branch of Protestantism, in the development of science and technology, as in seventeenth-century England (Merton 1984). But other studies (Becker 1984) contest this assumption, offering evidence for the opposite role of Pietism and Protestantism generally in the process of scientific-technological development. In fact, Weber (1927:368) himself admonished that, far from being in a historically symbiotic relationship, scientific progress and Protestantism are not to be unquestioningly identified, with the latter placing science in the service of technology and economics.

## EXCHANGE IN TRADITIONAL AND CAPITALIST SOCIETIES

In this section we compare the social constitution of economic exchange in traditional societies with contemporary counterparts. In classical sociological theory, Spencer (1969:116–29) denoted traditional societies as militant (or rather military) and distinguished them from contemporary society as industrial. In the former, the military is society mobilized, and the latter a “quiescent army,” thus establishing a social structure common to the army and nation alike (Spencer 1969:116–17). In consequence, compulsory cooperation is the main form of exchange, so individuals and groups are forced into combined actions for societal, mainly military, purposes. Its polar opposite would be the industrial type, a system of industrial-commercial activities, thus characterized by voluntary exchange between social units. Economic exchange in traditional, militant societies often is based on status (i.e., on successive grades of subordination and the ultimate subjection of the individual to the society or state). In contrast, in modern, industrial societies economic exchange is grounded on the system of contract, in which the state’s essential duty is to protect individual liberties in exchange relations.

Economic exchange in the militant social type is coterminous with that in which Tönnies (1955) termed *Gemeinschaft* (a small community), and exchange in the industrial type with *Gesellschaft* (complex society). Economic exchange in *Gemeinschaft* is characterized by the primacy of non-rational forces (natural will), of the self immersed in a web of social relations, of possession as a mere means to other ends, of land as the main form of property and medium of exchange, and of family law. The dominance of utilitarian factors (rational will), the person in the sense of an independent individual, wealth as an end in itself, money as the chief form of property and medium of exchange, and the law of contracts—all of this undergirds exchange in *Gesellschaft*. The legal form of this opposition between *Gemeinschaft* and *Gesellschaft* in terms of economic exchange is that between status and contract.

Generally, *Gemeinschaft* involves the following properties of economic (and social) life. First, family life is based on concord, in which everyone is involved with all of his or her sentiments. Yet, the people (*Volk*), not the individual, represent the controlling agent of the exchange within the family (Curtis 1986). Second, community (village) life is grounded on traditions and myths and folkways and mores and involves individuals’ complete participation in it, with all of their minds and hearts. In consequence, the controlling agent of exchange transactions is the commonwealth, patriarchal, regional, and urban. Third, religion constitutes the basis of town life, in which humans participate with their entire conscience. Consequently, the church represents the real agent of economic exchange

within this societal type. Fourth, the joy of creating and conserving, not material gain, drives the (household) economy founded thus on liking or preference, as well as understanding from which the respective norms develop. In this setting, habits govern agriculture, and customs guide cooperation in economic exchange.

In contrast, economic (and social) life in *Gesellschaft* evinces these properties. First, city life dominating village life is grounded on conventions conditioned in turn by actors' intentions. As a result, economic exchange is controlled by the agency of association and contract. Then legal rules seen as conditioned by actors' calculations constitute the basis of the entire national life, hence the state is the controlling agent. Also, cosmopolitan life is governed by public opinion viewed as evolving from an actor's consciousness, and the respective controlling agent of exchange is the republic of scholars. Economic exchange or trade rests on deliberation and calculation and is carried out through contracts as the new custom and creed of business. Production involves decision making as to the intelligent productive use of the factors of production (viz., capital and labor), accompanied by certain factory regulations (Tönnies 1955:211–71).

However, some rational choice sociologists argue that the distinction between *Gemeinschaft* and *Gesellschaft* is important only because it justifies the (erroneous) view that different theories are needed to explain different types of groups and social relations. This argument proposes that, by rejecting the view that “whereas ‘utilitarianism’ [read rational choice theory] may be appropriate for analysis of the *gesellschaft*, it is inadequate of the *gemeinschaft* [processes] in both *gesellschaften* and *gemeinschaften* can be accounted for on the basis of a single [economic] theory” (Hechter 1990: 144, 153). However, given the essential differences between these two comparative societies, it does not seem plausible to subsume both under a single rational choice or utilitarian principle. Thus, to argue that *Gemeinschaft* is grounded on the same principle as *Gesellschaft* may well be a historical simplification. Moreover, this rational choice principle often is inapplicable even to *Gesellschaft* itself: Thus, “in our *gesellschaftlich* social life, we rarely plan in 20-year segments” (Stinchcombe 1990:214–15). This absence of long-term planning implies time preferences in the sense of discounting the future (Simon 1976:64–66). Since rationality implies forward-looking behavior, such depreciation of the future implies non-rationality in *Gesellschaft*. From the stance of rational actors, to have time preferences is “irrational” (Elster 1979:67). For instance, the findings of some studies (Kanter 1972) examining the determinants of community survival (with data on ninety-one American communes from 1780 to 1860) hardly support the rational choice hypothesis of *Gemeinschaft* or warrant interpretations along such lines (Hechter 1990:144–45).

Generally, these findings suggest that actually all of the determinants (i.e., ethnicity, spiritual hierarchy, confession, and homogeneity) related to suc-

cess in community survival can be considered economically non-rational rather than rational. Of course, this holds true unless one dissolves the former, including ethnicity, into the latter, as is often done by rational choice theorists. Reportedly, among the factors unrelated to community survival or success is such a purely economic variable as financial contribution, contrary to the rational choice expectation of the opposite. Overall, the findings are far less supportive of the rational choice hypothesis of *Gemeinschaft* survival than expected by its proponents.

Further economic (and other) differences between *Gemeinschaft* and *Gesellschaft* are explored within Weber's framework of forms of appropriation, types of want satisfaction, and economic exchange in traditionalism and modernism. In passing, in this context the term *modernism* or *modern society* is understood as the period since the eighteenth century, characterized by industrialization with its technical basis in inventions (Bendix 1970: 250). Differences in economic exchange between *Gemeinschaft* or traditional societies and *Gesellschaft* or contemporary society also are implied in Weber's historical-empirical forms of appropriation. These forms correspond to the modes of economic exchange. For example, the appropriation of land can take forms such as temporary cultivation, sedentary agriculture, centralized manor with dependent peasant farms, feudal or fiscal monopoly, including absolute proprietorship, the plantation, the estate economy, and seignorial ownership. With regard to the latter, for example, Weber (1927:47) observes that the usual form of "seignorial development" has been the patriarchal system with inherited and lifelong despotic positions. More importantly for economic sociology, he makes the observation that the inner development of seignorial proprietorship has been, first and foremost, shaped by political and social class influences (Weber 1927:65) rather than by purely economic factors, as implied by the materialistic conception of history.

All of these modalities entail specific relations of exchange, as do the corresponding modalities in industry, such as household business, craft production for direct customers, free (non-agricultural) trade, and so on. The same can be said of Weber's or Marx's processes (or stages) in the development toward capitalism as the most developed form of economic exchange. In Weber's context, these processes have comparatively and historically been, for instance: the monopolization of capital or means of production by capitalists (primitive accumulation); the monopolization of the right to exchange products predated by the knowledge of the economy and economic opportunities; the disciplining of laborers; the establishment of manufactures lacking rational specialization of labor; and the mechanization of production in factories relying on capital accounting (Weber 1968: 144–48).

Also, each of Weber's types of want satisfaction involves a specific form or relationship of economic exchange. For instance, the *oikos* (household)

type, based on a collective natural economy producing goods meeting only the household's needs, not the market's, is underlined by endogenous exchange relations. Market-oriented assessments, such as taxes, tributes, booties, duties, or fees, imply exchange relations with strong political connotations between a producing unit (e.g., an *oikos* or a firm) and a consuming unit (e.g., the *polis* or the state). Exogenous exchange relations between regular economic actors (e.g., sellers and buyers) comprise the next type, the production for the market. The maecenic type consisting of voluntary contributions based on material or ideal interests involves asymmetrical exchange relations between the benefactor and the beneficiary. The element of asymmetry in exchange relations is even more pronounced in the last type involving contributions and services associated with privileges, either positive, such as monopoly, favoritism, inheritance, or ascription, or negative, such as exploitation, oppression, liturgy, or welfare (Weber 1968: 348–50). In historical terms, the oldest mode of economic exchange was, in Weber's (1927:195) depiction, an exchange relation between alien tribes. Specifically, in its early stages, commerce is an extraneous phenomenon directed only toward foreign tribes, thus being a relationship between ethnic groups rather than an internal transaction between members of the same tribe or community (Weber 1927:197). In turn, such commerce historically originated in gifts and related pseudo-commercial exchange (Weber 1927:238). Next we examine the social construction of such forms of quasi-commercial exchange as gifts in traditional and modern societies.

Within economic sociology, gifts are better defined as an example of what Weber (1927:238) termed quasi-commercial or pseudo-economic or non-market exchange dominated by non-economic considerations than as social exchange guided by economic principles. Hence, gift exchange represents a social phenomenon *sui generis*. Gift exchange is an example of pseudo-economic exchange, in the sense of involving an exchange of a material object, dominated by *non-economic* dimensions. Reciprocal gifts are thus not cases of social exchange insofar as these latter are assumedly governed by economic factors, as in current exchange theory in sociology. Rather, gift exchange is a mode of social interaction relatively independent of such factors. Hence, it represents a special case of social action that has an essential autonomy in relation to economic action/rationality. Alternatively, in contrast to their purely economic treatment as forms of exchange, gifts represent non-economic forms of social relations, since economic considerations are secondary here, as shown by the nature of Christmas and related gifts (Levi-Strauss 1971). Thus understood, the gift represents, in Weber's (1927:195–97) view, the first historical form of exchange phenomena, thus preceding money trade and other exchange.

Comparatively and historically, in gift (and trade) patterns in the Orient, for example, reciprocity is so pervasive that no gift, service, commodity, or favor is to be received if it cannot be reciprocated. This is conducive to a

network of regular exchange in which the receiver accepts the object but is urged by the giver to reciprocate, as in the case of free labor in urgent occasions, such as rebuilding a destroyed house. In this case, the participants often can be given lavish entertainments and feasts, and hence, as Simmel (1990:97–101) noticed in some nations in Southeastern Europe (e.g., Serbs), using such labor is affordable only by the wealthier members of society. At this juncture, Simmel (1990:97–101) also observes that the idea of fair price and wage outlining the subjective advantages of the exchange parties has not existed in the Orient and Italy, thus indicating lack of restrictions about how dearly to sell and how cheaply to buy. Also, the emphasis often was placed on consumption versus production, as shown by the ancient communities in Greece and Rome working for short-term consumption rather than for long-run accumulation of wealth. Overall, in traditional societies, general economic interest was directed more toward consumption than production, as native peoples worked exclusively or mostly for immediate consumption and gratification rather than for possession and accumulation (Simmel 1990:232–33). In Simmel's view, that pseudo-economic exchange is a social phenomenon is manifested in that the subjective forms of appropriation (e.g., robbery, spoils, extortion, and unilateral presents) tend to be transcended by objective exchange within a societal setting.

A special mode of economic exchange includes transactions associated with the production for exchange (Weber 1968:349) as a social structure, including a status order (Podolny 1993). Included also are what Weber (1968:349) terms market-oriented assessments such as compulsory taxes and regular duties or fees. For example, compulsory taxation replaced the gifts (often voluntary) that the subjects gave to the chief in traditional societies in exchange for protection and often subsequent redistribution (Polanyi 1944). Such social dimensions of gifts and other pseudo-economic exchange also are exemplified in the possession of luxurious presents such as jewelry, for only in relation to other people do these gifts have significance for the possessors, and therefore social rather than individual value. According to Simmel (1990:97–100), this implies that most persons hide in themselves both a miser and a spendthrift, thus resembling some kind of *sociologicus oeconomicus* (Tilman 1997). As to spending behavior, particularly dispensing gifts, presumably most individuals depart from the average pattern of their cultural sphere or social circle. As Simmel (1990:97–101, 310) observes, such departures reflect the individual's impression based on subjective evaluations that others either give and spend too little (misers) or too much (the profligate).

In Weberian–Keynesian terms, they vary in their effective demand or their propensity to consume (as discussed more in analyzing the social construction of trade cycles). Particularly, under a capitalist economy, giving and receiving gifts presupposes prior demand and spending not only on the

part of givers but also, under the assumption of reciprocity, receivers. This process of gift exchange thus reflects Keynesian income multiplication and general economic dynamics through induced demand and spending in the market.

More particularly, gift exchange in contemporary society, though not an exact replica of that in economic traditionalism, retains (Blau 1994:160–62) many of its original traits, as shown in the pertinence of obligations, reciprocity, and spontaneity in this quasi-commercial exchange. Moreover, in contemporary societies, the objects of gift exchange are attributed not only material meaning or value but also, and sometimes predominantly, ideal, moral, or emotional ones. The effect of the principle of reciprocity on the actors in modern exchange is often so strong that the countergifts can be of a higher value than the initial gift. Also the actors tend to give more in return than they receive in an attempt to increase their social prestige or power, this behavior often escalating in a cycle of status competition reminiscent of the traditional potlatch. Since rendering services involves claims to superior social status, reciprocation negates such claims and excessive returns make counterclaims, thus leading to a potlatch-like war, with failure to reciprocate validating these claims and admitting the other's superiority (Blau 1994:160–61).

Such properties tend to make a gift or reciprocal exchange a self-sustaining system, as reported for some developing countries (Kranton 1996:837–38). Notably, the operation of gift exchange as a self-sustaining system also is witnessed in Western societies, especially in the practice of Christmas and related religiously or culturally based gifts. These gifts appear irrational in economic terms, resulting in dead-weight losses as the difference between their (higher) prices and the (lower) value recipients put on them. For example, some researchers (Waldfogel 1996:1306) have calculated that between one-tenth and one-third of the value of Christmas gifts is destroyed by giving, and they find the reason for this is that people “do not especially value the objects they receive.” This computation seems to reflect the view of human actor as *homo economicus* or cynic—that is, as one who “knows the price of everything but the value of nothing” and thus puts a money tag on gifts and no other valuation. However, from a sociological perspective that emphasizes individual values or subjective meanings rather than prices or objective money costs in this regard, a different picture may emerge. Thus, such gifts may be quite rational in non-economic terms, because a gift received “is often far more valuable to the recipient than its market price” (Solnick and Hemenway 1996:1304), given various non-economic considerations, including the emotional value of gifts, such as those received from significant others. Consequently, what economic or rational choice theorists call the dead-weight loss of Christmas gifts is not only lower in economic terms but actually nonexistent in sociological (or psychological) terms.



Relatedly, as in many traditional societies, gift exchange in modern societies is often governed by various social rituals. Thus, what some sociologists (Levi-Strauss 1971) call a modern potlatch of huge proportions, involving millions of individuals, periodically takes place in Western capitalist economies, through an exchange of such Christmas gifts. The latter thus receive an additional trans-economic dimension and rationale in the form of social prestige, rather than involving dead-weight losses. Like the original modes of gift exchange, a massive destruction of economic resources undergirds these modern types induced by status considerations in the vanity market (Weber 1976:183).

As in traditional society, a major instrument for achieving social honor in contemporary society is the extravagant display of wealth or pecuniary strength. As observers note, like traditional communities in modern societies, various ceremonies govern the “periodic recurrence” and the “traditional style of vast exchange operations”: for example, the exchange of Christmas presents “is nothing but a gigantic *potlatch* implicating millions of individuals [for] by the vanity of the gifts, these exchanges take also the form of a vast and collective destruction of wealth” (Levi-Strauss 1971:65). In short, in modern society, the accumulation and then consumption or destruction of wealth “is a means of prestige” (Levi-Strauss 1971:66), as well as one of the cornerstones of social bond<sup>5</sup> (Delobelle 1995).

In particular, such destruction includes large expenditures on luxury goods, for these have for individuals a primary positive value as status symbols, and only a secondary negative one as expenses (Homans 1969:16–17). Simply, under a modern exchange economy, buying luxury goods is “all about demonstration” (Bagwell and Bernheim 1996:349–50), which is reminiscent of ceremonial gift exchange in traditional economies. Alternatively, certain modern forms of conspicuous consumption can be viewed as variations on the old theme of noble expenditure insofar as both are based on *noblesse*. In some traditional societies, chieftains (e.g., Indian rajahs and Merovingian kings), wishing to retain their social rank are expected to be able to support their followers by gift giving on certain special occasions, so wealth (money) does not represent a means of exchange but an “object of class possession” acquired for the sake of maintaining social prestige or self-esteem (Weber 1927:237). Hence, gift exchange represents the original historical form of economic exchange in the broad sense. Specifically, gift relations as pseudo-commercial transactions preceded money exchange such as trade and commerce. For instance, in the ancient Eastern empires, the ruling groups kept peace by mutual voluntary gifts, as in the gift trade between the Pharaohs and the Levantine rulers after 1400 B.C., with gold and silver against horses and slaves being the common objects of exchange (Weber 1927:197). As Weber (1927:238) further describes this process, the source of trade is a regular exchange by gifts outside of the group (as in ancient Egypt), and a state of peace between two societies

hinges on their rulers' continuing gifts as forms of quasi-commercial exchange that engendered chieftain trade. Since the omission of gifts would mean an act of war, in ancient times many political authorities maintained peace with each other by making mutual voluntary gifts (Weber 1927:197). Hence, in historical terms, the oldest type of economic exchange probably was the relation between alien tribes taking the form of reciprocal gifts, with genuine exchange its "accurate quantitative basis" (money, accounting) being derived from such gifts (Weber 1927:195–97).

In this connection, gift and other non-market allocation systems can be contrasted to markets<sup>6</sup> (i.e., in the terms of Polanyi, reciprocal versus market exchange). As the preceding suggests, in historical terms reciprocal exchange (gift) is an alternative non-market form of economic exchange, alongside redistribution or hierarchy (Polanyi 1944; Williamson 1998) or a non-market allocation system. Reportedly, introducing market exchange tends to weaken reciprocal exchange insofar as opportunities for exchange decrease punishments for breaching reciprocal exchange agreements and permit access to new and differentiated products. In many countries (e.g., Egypt and other Arabic countries, cf. Geertz 1992; Kranton 1996), people enter into reciprocal exchange relationships with friends and relatives to gain goods or services and to find jobs. Since such relationships tend to limit access to goods and services to those having the right connections, they generate incentives for agents to form and retain them. Being unlikely when products and services are heterogeneous and actors do not interact frequently, reciprocal exchange tends to persist when occurring among many interconnected individuals forming social networks, which can increase the variety of goods available. In consequence, contrary to the expectations of the new institutionalist economists, not all economies will necessarily move toward the most efficient model of economic exchange or allocation system in terms of minimizing market transaction costs (Kranton 1996).

Specifically, economically inefficient gift exchange—and for that matter, redistribution—can and does persist alongside presumably efficient exchange, not only in developing countries but also in developed societies. However, a common trait of reciprocal and market forms of economic exchange (as well as redistribution) is that they are socially embedded and structured. In particular, both gift and exchange, as two "simultaneous elements of the social contract," take place and are embedded within an institutional framework (Delobelle 1995).

Now, as suggested earlier, the question can arise as to the market and non-market dimensions of such non- or quasi-economic allocation systems as reciprocal exchange. According to orthodox economic theory, receiving money is the same as or even preferable to receiving a gift of equivalent monetary value. Yet, often gifts can have a higher (non-market) value for the recipient than their price insofar as gifts reflect some kinds of intangibles

highly valued by the recipient. Particularly, as mentioned before, to the extent that actors value gifts higher than their price, the dead-weight loss of Christmas presents exchanged during a mega-potlatch in Western societies may not be so large (Solnick and Hemenway 1996) as often estimated (Waldfoegel 1996). Finally, even in modern capitalist society, gift giving and money coexist uneasily (Carruthers and Espeland 1998; Zelizer 1996).

In sum, gift or reciprocal exchange, while perhaps historically preceding market-economic exchange in the strict sense (e.g., money trade), often represents a distinctive (e.g., self-sustaining) phenomenon in relation to the latter. Further, rather than conceiving of a gift as just a form or appendix of exchange, it is sometimes more plausible to conceive of some aspects or elements of the latter (e.g., job contracts, firm-consumer transactions) as gift relationships (Akerlof 1982).

In sum, far from being discontinuous or entirely novel, many capitalist exchange patterns find their starting point in the exchange structures of pre-capitalist society (i.e., what Weber called economic traditionalism) including political capitalism. From Weber's perspective, the latter can be characterized as pre-bureaucratic, though bureaucratic variables within them are far from being insignificant (Marsh 1961:547–56). However, some historical data suggest that certain bureaucratic societies (e.g., Prussia) were efficient to the extent that they did not conform completely with the ideal type of bureaucracy, a surprising finding from Weber's standpoint. Namely, the Prussian tax system reportedly was a deviation from the bureaucratic ideal type, and its efficiency was caused by definite departures from the ideal-typical bureaucracy (Kiser and Schneider 1994). More consistent with Weber's perspective is treating the emergence and multiplication of corporate institutions (e.g., joint stock corporations, trade unions, professional and trade associations, non-profit corporations, etc.) during the thirteenth to eighteenth centuries (Coleman 1974:35–36) as a special case of the development of bureaucratic organizations.

## EXCHANGE IN POST-SOCIALIST SOCIETIES

In the long run, socialist societies often appear to some sociologists (Collins 1990) as a historical curiosity, given their disintegration in Eastern Europe, the Soviet Union, and elsewhere, especially their built-in tendency for breakdown in economic and political terms. In the short or even medium term, however, they are likely to still be around (e.g., China, North Korea, Vietnam, or Cuba), reformed or unreformed. In retrospect, most historical findings indicate that socialist societies as established in Eastern Europe and Russia have been unsustainable as strategic projects within or outside of the world system, either in secular terms (long *durée* in centuries) or Kondratieff's waves (fifty to sixty years). Specific reasons for this self-defeating tendency in socialist economies can be offered as follows. One of

the main reasons is that the resistance of old agrarian societies turned out socialist ones such as Russia and China to expanding capitalization, rationalization, and modernization in a Weber-like scenario of the conflict between traditionalism and modernism. Thus, socialism would not constitute a higher stage of development than capitalism but rather would reflect the resistance of some coercive agrarian societies (e.g., Russia, China) to being integrated into the world capitalist system (Collins 1990).

Another reason resides in the economic failure of socialist systems (although here, China would now be an exception), as shown by the agony of East European and Soviet development. These systems have experienced, after some initial success, though overinflated in various statistics, the slowdown and even collapse of economic growth. In this regard, some analysts contend that the principal cause for the breakdown of socialism was the “death by slow torture” of its economic growth, in combination with such ideological shifts as the loss of faith in the concept and practice of centrally planned economies (Weitzman 1996:207–8).

Rigid social inequalities in socialist societies, as exemplified by the impact of state property actions through revenue extraction or taxation on stratification among individual and organizational exchange actors, can be invoked as another cause in this regard (Walder 1992). These inequalities often have been reproduced by the system of honors and privileges rewarding mostly political elites, either on the basis of ascription or achievement (on Yugoslavia, cf. Taylor 1987). Such distributions of honors, rewards, and privileges were pervasive in most past socialist societies, particularly those within the Soviet orbit, given their greater degree of economic and political rigidity. Moreover, they are still widespread in the few remaining pseudo-socialist countries, such as China (Walder 1992).

Another explanatory variable of the collapse of socialist societies is ethnic rivalry and conflict, though even capitalist societies are not immune to this, as shown with Quebec (Belanger and Pinard 1991). For example, this factor often has overruled all other countervailing forces, such as economic development and modernization, political democratization, and state (federal) nationalism, as demonstrated by the Yugoslav experience. More specifically, the expectation that a “shared political agenda and the modernization of the society would weaken nationalism as a political force was not met [and] none of these factors, however, proved significant to override the centrifugal forces of rising nationalism” (Sekulic, Massey, and Hodson 1994:95). For example, these forces were reflected in the relatively moderate incidence of ethnic endogamy in the 1980s, though this was probably more widespread prior to this period than sometimes suggested (Botev 1994).

These non-economic causes of the breakdown of socialist systems in the revolutionary convulsions during 1989–1991 can be subsumed under, by invoking Weber and Durkheim, both individual agency and charisma and

social anomie and collective action. In other words, a satisfactory description and explanation of such dramatic historical changes as the (un)expected implosion of the Soviet empire in the late 1880s can be provided by “recombining aspects of the sociology of religion of Weber and Durkheim [e.g.,] their complementary notions of charisma and collective effervescence” (Tiryakian 1995:278). In turn, all of these actors, strategies, and actions have originated largely in the domain of civic society, public sphere, and political and general culture, as distinguished from official state institutions. Thus, what was prominent in the 1980s in Eastern Europe was a civic zone centered on “political issues and public life but free of the direct control of the official state. From this third sphere—the public sphere, civil society, or political society—the Eastern European revolutions of 1989 were launched” (Somers 1995:137–38). Most of these revolutions aimed at implementing the transition from a command to a capitalist economy (as well as a political democracy), to which we now turn.

The experience and evidence thus far suggest that the economic transition in post-socialist societies is likely to be affected both by economic variables, such as efficiency and growth, and by political ones, including the power relations among various players (including ethnic groups), elite conflicts or settlements, government policies, and the political repercussions it generates. Namely, in post-socialist systems, the outcome of economic reform is admittedly a function not merely of achieved economic performance (e.g., faster growth, increased incomes, or improving living standards) but ultimately of the battle over the “distribution of power and privilege” (Nee 1989). The fate of economic and other reforms in the former Yugoslavia in the 1970s and 1980s as well as in the Soviet Union in the 1980s can be adduced to illustrate this. Namely, these two cases can be considered indicative of the situation in which economic considerations, though initially and ostensibly primary, were eventually subordinated and sacrificed to political, national, religious, or historical ones leading ultimately to the breakdown of the system. The economic rewards of the transition to a market-based exchange system were not sufficient to ensure that this path within the existing system would be preferred to that of pursuing political, ethnic, or religious goals outside of the system at the price of severe economic deprivation.

This indicates that the process of transition to a new exchange system is more complicated and perhaps less irreversible—symptoms of effective reversals in economic and political terms can be found in some Eastern European countries—than hoped. Hence, despite the failure of socialist societies and the ostensible triumph of capitalist ones, it is still premature to declare the end of history or ideology. Arguably, in the long or even medium term, socialism or more precisely communism has been predestined to disappear as a viable economic, political, and cultural structure in relation to capitalism. Yet, some economic sociologists imply that this failure

will not automatically mean a complete triumph of capitalism, especially in its pure *laissez-faire* form and in the long run, on the grounds that markets systems tend toward crises, reversals of growth, transformation, and the like (Collins 1990). Some recent proposals for a “third-way” between *laissez-faire* capitalism and bureaucratic socialism (or the traditional welfare state) suggest that such expectations are probably exaggerated, thus the current predominance of social democratic, labor, and other left-of-center governments in Western Europe.

Aside from such future projections, the transition is particularly vulnerable in Russia, not just in terms of inherent political instability but also in economic terms, as witnessed by some sort of market exchange chaos, perhaps culminating in the summer of 1998 with the stock exchange and currency (ruble) collapse, with all of the economic and social factors and repercussions. This latter situation has sometimes been regarded as a transition to merchant rather than industrial capitalism as an assumedly indispensable evolutionary phase or desirable destination (Burawoy and Krotov 1992). In this view, both production and exchange (market) relations are characterized by either planning and anarchy. Thus, a combination of planning in both production and exchange relations defines communism versus state socialism characterized by a fusion of planning in the first and anarchy in the second. However, such a designation is not accurate, because this fusion has been a feature of market socialism, as introduced in former Yugoslavia, and later in Hungary, China, and so on rather than of state (or real) socialism in the Soviet Union and most of its satellites. The latter system was in fact one of central planning in both production and exchange relations (i.e., communism). Hence, what is called state socialism is better termed market socialism, with communism being coterminous with state socialism. Then industrial capitalism would be defined by combining anarchy (deregulation) of production relations with planning and regulation of exchange relations on the part of particular organizations, especially big corporations (but not, as a rule, by the state). Insofar as this organizational planning implies the mastery of exchange relations, it can lead to what Weber (1968:938) termed capitalist monopolies, including monopoloids or oligopolies (Schumpeter 1950). This can thus establish monopolist capitalism, dominated by mergers and acquisitions by big corporations (Etzioni 1988). In contrast, an admixture of anarchy in both production and exchange would be a defining trait of merchant capitalism as equivalent to the capitalism of trade (Weber 1976:3–19) as an early form predating modern bourgeois capitalism.

In these terms, Eastern European countries abandoned communism/state socialism (most of the Soviet Bloc) or/and market socialism (Yugoslavia, Hungary) and have not established capitalism proper (i.e., its industrial mode) but merchant capitalism instead. In merchant capitalism observed in Eastern Europe and Russia, trade, commerce, and quick money mak-

ing—often within an expanding informal or unofficial economy<sup>7</sup> (Rosser, Rosser, and Ahmed 2000)—take precedence over industry, manufacturing, and long-term investment. Retail commerce, wholesale trade, and other exchange transactions thrive, and traders and dealers of all kinds rule in such a system, with manufacturers vanishing under the competition of foreign trade (imports) or turning into merchants themselves. Some countries, such as Russia, Bulgaria, Romania, Ukraine, Poland, and some Yugoslav states (e.g., Macedonia, Serbia), conform more, and others, namely, the Czech Republic, Hungary, Slovenia and, for that matter, China, less to this pattern of revived merchant capitalism. One could argue (Burawoy and Krotov 1992) that from the evolutionary viewpoint (*viz.*, mature developed capitalism), such a pattern is a step backward in the economic transition in Eastern Europe. Insofar as such a pattern appears as pre-modern, pre-Protestant, pre-bourgeois capitalism, then it can be deemed evolutionarily more remote than its industrial counterpart. In Weber's analytical setting, this implies that the various social, especially institutional, preconditions for the emergence and development of modern dynamic capitalism (Collins 1997) in Eastern Europe have not been fulfilled. It remains to be seen if such merchant capitalism will consolidate and remain predominant as in some neighboring countries, including Turkey and partly Greece, or consolidate as an economic pattern, as in most Islamic societies (Kuran 1996), or eventually evolve into industrial capitalism, as economists and policy makers expect. In Weber's terms, this is the question of rationalization along the path from partly impulsive or irrational capitalism in trade to sober, rational capitalism in industry.

Next, some recent studies of the process and results of the economic transition in post-socialist countries conclude that the findings support more institutional arguments of economic sociology or organizational perspectives than those of neoclassical economics (Spenner et al. 1998; see also Sedaitis<sup>8</sup> 2000). Reportedly, the present level of relative economic efficiency (of state enterprises) is found to be positively and significantly associated with the previous level in 1989 (the last year of socialism), indicating a strong carryover effect or path dependence. This signifies that efficient socialist enterprises tend to resemble efficient capitalist firms as well, and vice versa. Perhaps most surprisingly, from the perspective of pure exchange theory, the impact of competition (competitive environment) on economic efficiency is found to be virtually nonexistent or nonsignificant. For example, the number of competitors or the density of competition showed no negative effect on economic efficiency (of state-owned enterprises in 1993), even though economic theory regularly assumes a positive one. Alternatively, the reported impact of the degree of economic concentration or power on efficiency is nonsignificant, thus conflicting with the standard economic hypothesis of negative effects in this regard. The related economic assumption that less competitive industries negatively affect economic ef-

efficiency is questioned by the finding that there are no important differences between more and less competitive industries in their relative efficiency. Overall, the findings indicate that “by far the strongest signal in [the] data is path dependence in organizational performance” (Spenner et al. 1998: 613).

In terms of a neo-Weberian model, this reaffirms the salience of institutional conditions (Collins 1997) in the origin and development of modern capitalism, including the economic transition in Eastern Europe and Russia. Hence, given the salience of such social factors—and thus of economic sociology—of economic transitions, it is implausible to assume (as objected to some rational choice sociologists by Fligstein 1996b) that no social structure exists and operates in capitalist economies, old or emerging, including those in the former socialist countries. Since such an assumption involves the specious argument that state institutions have no control over the capitalist economy, a more integrated study of economic transitions takes into account both the creation of and changes within such and other social institutions (Fligstein 1996b).

Moreover, economic reforms in most post-socialist societies reportedly tend to evolve into sociopolitical and cultural questions and thus ones of economic sociology, including political economy (Kornai 1997), rather than purely economic operations to be carried out or analyzed only by applying the tools of standard economics. This can be illustrated by welfare reform in Eastern Europe. As reported (for Hungary), welfare reform is influenced and complicated by the fact that there is no majority view, let alone a consensus, concerning political-ideological values and options (including the neo-liberal) for such a reform (Kornai 1997). No wonder some economists propose in this regard gradual evolutionary changes and dismiss neoclassical shock therapies in the form of the great leap to the market as being out of question (Kornai 1997). In a similar vein, other economists, observing the strong (negative) effects of the old (Soviet) sociopolitical institutions and ideologies on the economic transition in Russia, suggest that these extra-economic variables be considered in order to devise a “realistic” economic reform program, and that using standard economic tools would be unworkable (North 1992:477).

The aforesaid perhaps warrants the following tentative empirical generalizations. Despite some setbacks and reversals, change in these transition countries is in political terms, from authoritarian to democratic systems (this does not apply to China), not just from a command system of economic exchange to a capitalist system, as economists and International Monetary Fund (IMF) advisers are prone to think. Although the two processes in an ideal scenario (tend to) go hand in hand, as in some countries (the Czech Republic, Hungary, Poland), this is not always so. Sometimes the transition to an exchange system can be fast and successful, and that to democratic political arrangements almost nonexistent (as in China, Vi-



etnam, or Cuba today, as well as hitherto in Korea, Taiwan, Chile, or Singapore), and vice versa: liberalization in political institutions can be more far-reaching than in economic exchange, as shown by the Soviet Union in the 1980s and Russia in the 1990s, as well as partly by Bulgaria, Romania, or Ukraine. In general, economic and political liberalization tends to be positively associated, with the second often influencing and being reflected in the liberalization index, the inflation rate, and other aspects of the first (Fischer, Sahay, and Vegh 1996:232–33). The factors and processes underlying the economic and democratic transition, as well as its possible reversal, in post-socialist and other exchange economic systems can be summarized as follows (Heuhooser 1993).

The transition from a command to a capitalist economy (economic liberalization), as well as from (a communist or a conservative) dictatorship to democracy (political liberalization) can be induced by definite factors and processes. These include, for example, blocked structural opportunities (most of Eastern Europe, with the exception of the former Yugoslavia, Poland, and Hungary), repressed consumption, and other demands (e.g., Romania, East Germany, Bulgaria, and Albania), declining living standards (most socialist countries), the crisis in capital accumulation as profit rates are threatened by limited domestic markets (partly applicable to market socialism, namely, the former Yugoslavia, Hungary, but above all, to conservative capitalist dictatorships), and democratic transition that is supported by middle classes (Yugoslavia, Hungary) or capitalists (Chile, Korea, Taiwan, Singapore, and other conservative capitalist dictatorships). The transition in the opposite direction (reversal), that is, toward economic closure and political repression, can be propelled or precipitated by factors such as expanding structural opportunities for working-class mobilization (rights to vote, association, etc.), increases in consumption demands through organized (union) labor actions, rises in the living standards (real wages) of the working class and radicalization of its consumption demands (e.g., via collective bargaining in modern Continental Europe), the accumulation crisis, as profit rates are threatened by consumption demands (e.g., France, and Germany in the 1990s), and authoritarian reaction with little mass resistance (Nazi Germany, Fascist Italy, etc.). The preceding implies and illustrates a neo-Weberian, ideal-typical pattern of transition from one social-economic system to another, and vice versa, rather than particular empirical examples.

In conclusion, it is possible that most socialist societies of Eastern Europe (and Russia) may have failed for a variety of social, political, and other non-economic (internal and external) rather than strictly economic factors (Szelenyi and Szelenyi 1994). For example, political factors such as conflicts among the elites, intellectual dissents with demands for greater freedom, and increased military competition (in the 1980s) reducing domestic consumption were operative and in turn exacerbated by internal economic

problems. Hence, one can speculate that Eastern Europe probably would not have been the object of a shock therapy that, to paraphrase Keynes (1960:324), “cures the disease by killing the patient,” namely, massive recession<sup>9</sup> (Poznanski 1999), had Western economic advisors acknowledged this and the fact that the people of these societies sought greater personal freedoms, political voice, security, and cultural identities, not only wealth (Pressman and Montecinos 1996; Szelenyi and Szelenyi 1994). In addition, such a cure might have been avoided by their acknowledging *ex ante* rather than *ex post* that many institutional requisites for a capitalist economy, just as for political democracy (Lipset 1994), were not in place in much of Eastern Europe and Russia. Instead, most of them treated the economic transition as a natural automatic rather than an institutionalized process (Polanyi 1968), embedded in and affected by the institutional, political, cultural, and other social conditions, thus committing the familiar (for pure economists) Ricardian vice<sup>10</sup> (Schumpeter 1950) of abstracting the economy from society (Stanfield 1999).

Consequently, as some analysts comment (Stanfield 1999), those “amateur” institutional economists should have considered before rather than afterward the economic, psychological, cultural, and other social “side-effects” (including “collateral damage”) of their “shock therapeutic advice” on the people of Eastern Europe. In that event, the economic transition probably would have been more gradual, humane, and successful, and the present backlash against or disappointment in the capitalist economy in these countries avoided or reduced (Pressman and Montecinos 1996). This, one might say, is *passé*—bygones are forever bygones. Looking to the future, many expect that Eastern Europe will further its economic performance to levels approaching those of Western Europe by, first and foremost, undergoing definite institutional changes, including integration into the European Union (Piazolo 1999). In sum, the preceding confirms a crucial insight of economic sociology with relevance to the process of economic transition in Eastern Europe, namely, a capitalist economy is (to be) embedded in a definite societal structure, including institutions, the political-legal system, and culture rather than isolated from society.

## NOTES

1. The standard Weberian reference, alongside the monumental *Economy and Society*, is *The Protestant Ethic and the Spirit of Capitalism*, though some (Collins 1997:845) suggest that Weber’s *General Economic History* is even more pertinent in this regard.

2. As critics further elaborate, “It is not easy to grasp what Coleman means by Type-1 relations [though] one example [is] Weber’s treatment of how Protestant values affect individual orientations to economic behavior. But this causal relation either is not sociological, or purely micro to micro [psychological]. If the effect is

to be explained sociologically, then macro-level variables must be introduced [e.g., the money economy]. Sociological causal relations of a supposedly micro-to-micro type require the positing of macro conditions affecting actors no less than causal relations of a macro-to-macro type require the positing of a link through individual actors. Any attempt at sociological Type-1 explanation is impossible without a detour through Type-2 relations—that is, how macrostructures produce actors with particular capacities and propensities—or Type-3 relations—that is, how the actions of a multiplicity of actors impinge on one another. Coleman rejects any model of a culturally and historically constituted actor for a more abstract model of a slightly modified economic man” (Sewell 1987:169).

3. Specifically, “the outcome of the sequence is capitalism characterized by the entrepreneurial organization of capital, rationalized technology, free labor, and unrestrained markets. Intermediate conditions are a calculable legal system and an economic ethic combining universal commercialization with the moderate pursuit of repetitive gains. These conditions are fostered by the bureaucratic state and legal citizenship, and more remotely by a complex of administrative, military, and religious factors. These variables include a calculable legal system, the bureaucratic state and legal citizenship, and more remotely by a complex of administrative, military, and religious factors” (Collins 1980:924–25).

4. According to Collins (1997), Weber presented such a macro-model in *General Economic History*.

5. In this view, gift exchange represents the cornerstone of social bond in contrast to exchange (buying and selling) involving relations of hierarchical power, especially between groups (organizations) and individuals (Delobelle 1995).

6. In game-theoretic terms, market interactions can be modeled as games characterized by small numbers, hidden information, hidden actions, or incomplete, while non-market interactions involve, for example, a regulator and a firm, a boss and a worker (Gibbons 1997).

7. Rosser et al. (2000) find that in transition economies, the share of output produced in the unofficial sector tends to increase income inequality owing to falling tax revenues and weakened social safety nets, with increasing inequality reinforcing informal activities due to the decline of trust and social solidarity.

8. Sedaitis (2000) suggests (based on data from Russian research institutes) the importance of an organizational perspective on restructuring the mostly military R&D sectors in transitional economies, stressing the role of interfirm relations (e.g., spin-offs) in technology commercialization and transfers.

9. Poznanski (1999) links, by comparing Poland and Russia, massive recessions in transition societies to a decline in the state’s capability or willingness to macro-manage the economy to the effect that the severity of these recessions is in direct proportion to the extent of this decline. This is contrasted to the recent experience of China, whose recession-free conversion from socialism to capitalism is associated with a strong, though reformed, state.

10. Such a Ricardian vice is to be distinguished from Ricardo’s effect, which refers to the reallocation of production factors over time in response to changes in the profit rate (Birner 1999).

## Chapter 9

# *Exchange, Economic Development, and Social Variables*

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### ECONOMIC DEVELOPMENT IN (NEO)CLASSICAL ECONOMICS

The classical approach to economic growth, development, and progress is generally premised on the initial idea of economics or (as called then) political economy as the science of the wealth of societies or nations, more precisely, as an inquiry into the nature, as well as the laws, of production, distribution, and consumption of wealth<sup>1</sup> (Mill 1884). Thus, according to early classical economists (Smith 1939), the “great object” of political economy is to increase the wealth (as well as the power) of a society and thereby to promote economic growth. In this connection, the prime mover of economic growth is considered the (technical and social) division of labor. This is justified by the argument that the division of labor has been the main cause of the greatest improvement in the productive capacity as well as the “skill, dexterity, and judgment” of labor (Smith 1939). Whereas the division of labor, through a “large multiplication of productions of all different arts,” is assumed to cause “universal opulence” extending over the “lowest ranks of the populace,” it is seen as being limited by the extent of the market (Smith 1939:10–15).

At this juncture, early classical political economy postulates a positive association of economic growth with capital (also called stock), or saving, and a negative one with consumption, or income. Arguably, the numerical relationship between saving (capital) and consumption (revenue) governs the “proportion of industry and idleness,” in the sense that the predominance of capital causes industry to prevail, and that of income, idleness<sup>2</sup> (Smith 1939:301). Non-private income or public consumption is deemed

particularly pernicious to economic growth, and thus to the wealth of societies. The idea is properly expressed in the statement that great nations are never impoverished by private spending but rather by “public prodigality and misconduct” (Smith 1939:306). On the other hand, some classical economists (Ricardo 1975) propose that the wealth of a country can be increased, and thus economic growth furthered, in two ways. One is by employing the largest part of income in maintaining “productive labor,” and the other is by making the same amount of labor more productive, without using any additional quantity of it, with the second being preferred to the first (Ricardo 1975:278–79).

Concerning the relations between competition and economic growth, classical political economy typically treats the second as an effect of the first as the cause. And, since the latter represents a necessary condition—though not the “best imaginable stimulus” (Smith 1939:445)—of economic growth, any reduction of free competition would be an “evil” and any extension “always an ultimate good.” Particularly, any obstruction to the “free circulation of labor” among alternative employment also has the effect of obstructing capital (Smith 1939:129). Alternatively, monopoly is regarded as the “greatest enemy of good management” (Smith 1939:134), and thus of the growth of the wealth of nations.

The classical theory of (the effect of competition on) economic growth is perhaps most famously and eloquently condensed in the invisible hand doctrine of exchange predicated in turn on the private vices–public virtues parable or fable (e.g., Mandeville’s fable of the bees). Presumably, individual actors, while pursuing only their self-interest, are guided by an “invisible hand” to further interests not entailed in their intentions, so seeking their gains they enhance society’s interest “more effectively” than when they really intend to do so (Smith 1939:406).

In addition to the restrictions on competition, especially monopoly, some classical economists (Malthus 1968) incorporate population into the impediments or limits to economic growth. The underlying argument behind such incorporation is that human population increases at a “geometrical ratio,” so it doubles every twenty-five years when “unchecked” by some physical and social checks such as moral restraints (e.g., abstinence), vices, and misery resulting from the scarce means of subsistence (Malthus 1968: 198–200). In turn, since the means of subsistence and production overall are assumed to increase at just an “arithmetical ratio” (Malthus 1968:198–200), the excess of the population over such means would retard and eventually stifle economic growth, especially wealth per person. Hence, in this somewhat idiosyncratic view (especially from Smith’s and, in part, Ricardo’s perspective), economic growth/development is made dependent on the “relative proportion” between the population and the means of subsistence, above all, food (Malthus 1968:269). In retrospect, this involved a peculiar evolution in the analytical treatment of population within classical

political economy (viz., from an asset or at least a neutral factor in economic development, as assumed by Smith and to some degree by Ricardo and others), into a liability or an obstacle, which adumbrates contemporary themes of the demographic and other limits to growth.

In contrast to classical political economy's emphasis on production, neoclassical economics, especially marginalism, involves a shifting focus on consumption and thus, by implication, a peculiar kind of growth theory. Thus, some leading marginalist economists suggest that economics should start with an "exact" theory of consumption (Jevons 1965; Wicksell 1934) rather than of production, as pleaded by most classical economists. The underlying argument beneath such a suggestion seems to be that the operation of the economy generally and the increase of wealth or economic growth particularly is to a significant degree conditioned by consumption as the prime mover in this regard. More precisely, as some neoclassical economists<sup>3</sup> imply, economic growth, including the quantity and allocation of productive resources (e.g., labor and capital), depends on the "imperial throne of Human [consumer] Demand" (Wicksteed 1933:393).

Since in a capitalist economy the latter takes on a form of what Smith (1939:55) termed *effectual demand*, this implies a causal or functional relationship between the latter and economic growth. In this relationship, the volume, rate of increase (growth), and structure (kind) of production are presumed to be defined by "effective demand" (Wicksell 1934:228). At this juncture, a major operating principle is that of derived factor demand (and thus value) in relation to product demand, postulating that those wanting commodities want by implication productive inputs indispensable to the growth of production (Wicksell 1934:93).

The underlying logic of this principle is that the final goal of any production is the creation of objects able to satisfy human wants (Böhm-Bawerk 1929:20). Hence, the basic purpose of economic growth is considered the satisfaction of ultimate consumers' wants<sup>4</sup> (Kuznets 1972: 7). All production and growth, as well as productive factors ("goods of higher order") employed, thus serve to obtain and multiply the consumption or enjoyment of products ("goods of lower order"), so that the extension or reduction of supply persists until national production is equal to society's consumer demand (Böhm-Bawerk 1929:186, 259).

In passing, the concept of partial (or Marshallian) or general (or Walrasian) equilibrium has been very prominent and widely used in neoclassical and contemporary economics, though some economists admit that an economy in perfect equilibrium in time is "like the sun in Faust" (Hicks 1961: 132), and others try to transcend the concept by locating an intermediate phase between a stationary state, or statics, and disequilibrium, or dynamics (Hayek 1950:17). Yet, many contemporary economists analyze economic growth in equilibrium rather than disequilibrium terms (viz., as a competitive "equilibrium development process" induced, for example, by

the endogenous interaction of the allocation of entrepreneurship, the distribution of wealth, and credit constraints) (Lloyd-Ellis and Bernhardt 2000). Others, however, argue that competitive equilibrium features suboptimal, even too slow, economic growth due particularly to low levels of learning (Hendricks 2000), contrary to the general equation of equilibrium with optimum as such (Samuelson 1983).

In any event, contrasting to classical political economy's focus on and celebration of entrepreneurs or capitalists as the prime movers by virtue of their adventurous creativity (Say 1964), investment and risk taking (Smith 1939; Ricardo 1975), and saving or abstinence (Mill 1884; Senior 1951), much of neoclassical (especially Austrian) economics holds the position that consumers rather than entrepreneurs guide the "direction of national production," and thus economic growth (Böhm-Bawerk 1929:259). At least, the activities of consumption "ministering to the current satisfaction" of wants and those, such as entrepreneurship, instrumental in future economic growth, are supposed to "interact in complicated ways" (Knight 1958:39–40). Thus, in interaction and conjunction with consumer demand, entrepreneurship is viewed as a major contributor to economic growth. In this view, entrepreneurs are those agents projecting the creation of a branch of production, as well as directing and establishing evaluations of current and future production (Jevons 1965), thus contributing to economic growth. Particularly, entrepreneurship is treated as a critical determinant of economic growth by virtue of being a source and an impetus of technical progress or inventions,<sup>5</sup> namely, capital saving (reducing the ratio of capital to labor), labor saving (increasing the ratio), and neutral (no change) (Pigou 1960:674). The underlying assumption is that most inventions or innovations<sup>6</sup> promote economic growth by increasing "aggregate national dividend," including the "real income of labor" (Pigou 1960:680), as well as being a large source of investment opportunities (Schumpeter 1939:1034) and capital stock/productivity<sup>7</sup> (Dewey 1967:50).

Further, some neoclassical economists argue that innovation represents a "chief" and self-perpetuating basis for economic progress (Fisher 1954: 354), with an "economy in progress" characterized by a long-term or secular tendency to continuous increases in the total volume of production or real consumer income (Haberler 1943:306). The argument is simply that innovation is the prime mover of economic development in a capitalist economy (Schumpeter 1939:107). Arguably, the "picture of capitalist life" is dominated by innovation defined as the "intrusion into the system of new production functions," with enterprise or entrepreneurship being a set of actions centered on innovations, and those individuals thus acting as entrepreneurs (Schumpeter 1939:100–102). In this sense, entrepreneurial activity and thus innovation and economic growth under capitalism represent an endogenous process of creative adaptation/destruction (Schumpeter 1939:973). Specifically, industrial mutation revolutionizing the

economic system from within, by destroying the old and creating the new—for example, novel consumer goods, methods of production, markets, forms of industrial organization, and so on—defines creative destruction as an essential fact about economic development, making this an essentially endogenous process in capitalism. Thus, creative destruction as propelled by entrepreneurial innovation is viewed as the fundamental impulse setting and keeping the “capitalist machine in motion” (Schumpeter 1950:83), which requests a dynamic and holistic framework for analyzing development as well as competition and entrepreneurship (Bloch 2000). The abundance of innovative and otherwise efficient entrepreneurs is thus conducive to a traditional process of development, with the evolution of the economy according to “empirical regularities” (Lloyd-Ellis and Bernhardt 2000).

Hence, the entire problem of economic growth is being treated as one of “smoothing out the fluctuations in the rate of innovation” (Hicks 1961: 301) or in the stages of technical progress (e.g., research,<sup>8</sup> construction, utilization) (Hicks 1977:25). In this sense, innovation or technical progress (defined as growth of knowledge) is said to provide the “only common road to development” (Dewey 1967:47), including the transition between the different (early and late, and presumably irreversible) stages of economic growth (e.g., traditional society, conditions prior to the takeoff, the takeoff, maturity, and the mass consumption era) (Rostow 1991:16–30). Specifically, economic growth is seen as a function of a favorable “social climate for new knowledge and innovation” and thus a “rapidly rising supply” of inventors/innovators, in addition to the operation of an exchange mechanism<sup>9</sup> allocating economic activities and rewards, an increasing supply of capital, and a rich potential demand (Kuznets 1972:332).

As suggested above, neoclassical economics follows classical political economy in treating capital accumulation or investment as a major determinant of economic growth, in conjunction with innovation or technical progress as well as free exchange and competition. Parenthetically, in the neoclassical framework, investment or capital accumulation often is understood as the “act of applying a unit of input in any process of production,” with investment or production periods being intervals between the application of such inputs and the maturation of a quantity of output due to them (Hayek 1950:66–68). Thus understood, net accumulations as well as net decumulations of capital<sup>10</sup> are assumed to affect economic growth either directly or indirectly by causing phenomena akin to expansions and depressions (Hayek 1950:349). Assumedly, any indefinite expansion leading to a long process of growth eventually must encounter resource, including labor, scarcities and thus slow down or even reverse such a process (Hicks 1977:30), a somewhat unexpected neoclassical variation on the theme of “unsustainable” development (the limits to growth).

Also, neoclassical economics fully embraces the classical argument for the existence of a necessary linkage between exchange competition and



economic growth, in which the latter is a function of the former. In general, like their classical and utilitarian (Benthamite) counterparts most neoclassical (marginalist) economists argue that the market, especially free competition, is an “automatic mechanism” that generates the “maximum of utility” in society (Walras 1926:286–87). Arguably, under free competition, there is an “absolute maximum” (Pareto 1927:199) of ophelimité (utility) for society, as distinguished from ophelimité *of* society as a presumably nonexistent magnitude (Pareto 1963:1469–1473). In plain English, “maximal satisfaction” is obtained by encouraging all individuals to spend their resources in the way that suits them best (Marshall 1961:393).

Further, such a “system of economic freedom” is regarded as the best, not only from a material viewpoint but also from a moral one (Marshall 1961:594). In particular, it is argued that free competition represents a “superior and general” rule of the production of wealth and thus of economic growth (Walras 1926:390). In other words, the principle of *laissez-faire, laissez-passer* is termed the “superior formula” of the production of social wealth<sup>11</sup> (Walras 1936:47). In addition to allocating economic resources to equalize rates of return, the “free play” of competition and self-interest is predicted to produce a distribution of these resources to increase “national dividend, and hence, the sum of economic welfare, to a maximum” (Pigou 1960:143). Then, since under “universal free competition” production is assumed to reach its maximum and thus to lead to maximization of the means for satisfaction of human wants (Wicksell 1934:83, 142), it is suggested that economists (as well as policy makers) observe the “practical solution” (as distinguished from the “mathematical solution”) to economic growth that the market provides (Pareto 1927:234).

Alternatively, restricting, deforming (“arraigning”), or destroying free competition, as entailed in “spoiling the market,” can make its “anti-social forms” salient, so if economic rivalry is essential for maintaining “energy and spontaneity,” its cessation is likely to be harmful to the “balance of social well-being” (Marshall 1961:5), including economic welfare and growth as the main subject of economic science (Pigou 1960:11). Generally, any obstacles to the “free play” of competition/self-interest are expected to harm the “national dividend,” especially when so-called marginal private and marginal social products (i.e., private and public interests) coincide (Pigou 1960:143). In particular, government extensions or intrusions in the working of free competition are deemed a “danger” for economic growth and “social progress,” and thus “prima facie anti-social,” especially in those areas of production requiring “intermittent invention,” the “fertility of resource,” and “creation and initiative” (Pigou 1960:79–81). First and foremost, assuming ownership and control by the government of the means of production is denounced, contending that there is a “prima facie cause” to believe that this process is likely to cut deep into the “roots of social prosperity” by deadening the “energies of mankind” and halting economic

progress/growth (Marshall 1961:593). In short, state interference with, especially that intended to alter, the operation of free competition is presumably predestined to injure the growth of “national dividend” (Pigou 1960:229). Hence, in a comparative evaluation of the relative contribution of private enterprise operating under free competition and government, neoclassical economics attributes “genius” to the first, on the grounds that the second creates virtually nothing. For example, leading neoclassical economists (see, e.g., Marshall, quoted in Pigou 1960:399) argue that a government “could print a good edition of Shakespeare’s works but it could not make them written” (though this seems to be more of an argument for freedom in arts rather than for free competition in the economy).

In addition to or in conjunction with government as a regular culprit, neoclassical economics treats monopoly—especially public monopoly<sup>12</sup>—as the “enemy” of economic welfare and efficiency, including growth (Walras 1936:201; Pareto 1927:502; Wicksteed 1933:256–57; Wicksell 1934:89; Marshall 1961:395), and thus as an unmitigated evil. What is the sin of monopoly? The neoclassical answer<sup>13</sup> to this question is almost identical to that in classical political economy: “Misdirection of resources,” in addition to that owing to the “simple exercise of monopoly power,” so the “transitional advantage” of monopoly is seen as unimportant in comparison to its “long-run disadvantages” (Pigou 1960:271–72).

Within Keynesian and related contemporary frameworks, economic growth is generally conceptualized as a function of aggregate effective demand induced in turn by the propensity to consume and the inducement to invest. A key assumption in this respect is that the insufficiency of effective demand, and thus the low propensity to consume, as well as the low inducement to invest, will work to inhibit, at least in the short term, the process of production and thus economic growth (Keynes 1960:31), and vice versa. Notably, the volume and possibilities of employment are deemed to be limited by the extent of aggregate effective demand (Keynes 1960:104), thus inhibiting economic growth. Reportedly, the insufficiency of aggregate demand, (i.e., the weakness of the propensity to consume and the inducement to invest<sup>14</sup>) has always been the “key of [the] economic problem” (Keynes 1960:348), namely, unemployment, slow growth or lack of growth, poverty, inequity, and the like (Galbraith 1997). In particular, the level, growth, and kind of production are viewed as being determined by consumer or primary demand on the assumption (or observation) that stocks of capital or investment goods immediately adjust to the demand for commodities, with the first even accelerating more rapidly than the second (Tinbergen 1950:113, 165). In short, this process reflects the interrelations between capital-goods production and consumer demand (Frisch 1997). Hence, the acceleration principle—based on the “simple principle of derived demand” (Hayek 1950:435) for capital and other production

factors—“must come into play” (Harrod 1956:74) in the process of growth within the Keynesian framework of economic dynamics.

Economic dynamics then centers on economies with steady changes (the first derivatives) in the rate of output or the GNP<sup>15</sup> per year, with acceleration (or deceleration) being a change (the second derivative) in the growth rate (Harrod 1956:4). In a (neo)Keynesian framework, the key determinant of growth in a dynamic economic system is the “rate of change of expectations” (Harrod 1956:8). In other words, growth is seen as the “aggregate effect of a great number of individual decisions,” and thus its rate is a magnitude determined by “the collective trials and errors of vast numbers of people” (Harrod 1956:86). In the terms of Keynes (1960:379–80), economic growth is essentially the outcome of the “mass psychology of the market,” especially economic agents’ “animal spirits,” including the “spontaneous urge” to activity for its own sake, recurrent waves of optimism or confidence and of pessimism or diffidence, and so on.

Finally, a terminological note is in order. In (neo)classical economics, the terms economic growth, development, and progress are used interchangeably, often without clear differentiations or definitions of these and related notions. However, after World War II, many economists and sociologists applied “growth” to developed and “development” to developing countries (Rostow 1990), though some retained the earlier usage. The distinction is especially pronounced in the field of development economics centering on developing countries versus growth theory focusing on developed societies, though some economists see no “unbridgeable gap” between the two (Lewis 1988). In this regard, development is viewed as a long-run, broader, and more qualitative and complex social-economic process, of which growth expressed in the annual rate of increase in the GNP is part<sup>16</sup> (Ranis, Stewart, and Ramirez 2000; Sen 1988). Still, many contemporary neoclassical economists continue to use “growth” and “development” as almost interchangeable terms with reference to both developed and developing societies.

## **SOCIAL AND OTHER DETERMINANTS OF ECONOMIC DEVELOPMENT**

Comparative research reports a number of determinants of economic growth or development (for our purposes, no substantive distinction is made) in advanced as well as developing countries. For illustration, some studies (Barro 1996; Sachs and Warner 1997; Sala-I-Martin 1997) summarize the determinants of cross-national economic development during the 1960–1996 period as follows. Among economic determinants of growth equipment investment<sup>17</sup> is reported to have the strongest impact. Next, the most important political determinants of economic development are the number of years of open economy (insofar as this is a political decision in

most countries, developing and developed alike, including the United States) and the rule of law (Buscaglia and Cooter 1997). And of cultural determinants, fraction Confucian and fraction Muslim (in the total population of a country) reportedly have the strongest effects on economic development, and so on. Reported also are some unexpected results from the perspective of a neo-Weberian sociological theory of development.

From the stance of the Weberian sociology of capitalism and development, the most unexpected result is the reported *negative* impact of the Protestant religion on economic growth, as opposed to the *positive* effect of Confucianism, Buddhism, and Islam. More precisely, the coefficient on the variable "fraction Protestant" (Sala-I-Martin 1997) indicates that an increase in this fraction in a country's population (by, say, 10%) will decrease [sic] its growth rate correspondingly (e.g., by 1.3%). In contrast, the coefficients on variables such as fraction Confucian, fraction Muslim, and fraction Buddhist signify that increasing these in the country's population will result in certain increases in the growth rate. Simply, Confucian, Muslim, and Buddhist countries would experience faster economic growth than Protestant ones. On the other hand, the coefficient on fraction Catholic seems more consistent with theoretical expectations, at least within the original Weberian model, assuming a largely negative impact of Catholic versus Protestant religion on the rise and development of capitalism (Collins 1997). Reportedly, the growth rate of a country will decline with an increase in fraction Catholic in its total population. Notably, consistent with Weber's theoretical expectations is the finding of a positive effect of the degree of capitalism on economic growth, insofar as the former can be deemed equivalent or proximate to the spirit of capitalism. The degree/spirit of capitalism is operationalized or measured by indicators such as the share of private property, the level of company profits, the percentage of the population holding equities or securities (popular capitalism), and the stock exchange index.

Also unexpected are the findings reporting the negative effects of such political variables as civil liberties and political rights on economic growth. Reportedly, increasing civil liberties and political rights, as represented or measured by certain scales or indexes (Bollen and Paxton 1998), will lower economic growth, accordingly, in both cases (Sala-I-Martin 1997). These coefficients are inconsistent with expectations in light of the prevalence of the opposite view among theorists, policy makers, and the lay public, namely, that political democracy is a key prerequisite in this regard (Lipset 1994). Also, some analysts (Barro 1996) find the existence of positive effects of political democracy as well as related political-legal variables (e.g., rule of law) on economic growth per capita.

Political-legal and other extra-economic variables often have been subsumed under or operationalized by the institutional quality index, reflecting the strong effect of social organization (Biggart and Guillen 1999), espe-

cially institutions or “institutional capital” (Trebilcock 1997) on economic development. For instance, studies (Sachs and Warner 1997:187) have found that if the institutional quality index is increased (by, say, 10%), the growth rate will increase considerably (by 3.2%). Such an index would include those social institutions favorable to development and generally economic effort as well as government strategies and policies as an important factor in this regard<sup>18</sup> (Johnston 1997:10), namely, the politics of growth (Alesina and Perotti 1997b). Though most economists or public choice theorists entertain an a priori axiom of government failure in a capitalist economy, in reality, states or public bureaucracies do not seem to be necessarily detrimental to economic growth. On the contrary, some would argue that cross-national differences in growth rates are linked to the capability of the state (and the polity overall) to create, reflecting its embedded autonomy, a political environment conducive to development (Luiz 2000). As research (Evans and Rauch 1999) reports, the existence of strong positive effects of a specific type of the state (*viz.*, Weberian bureaucratic authority structures, as operationalized by scores on “Weberianness”) on economic growth and investment levels in developing countries explains at least in part the successful development of countries such as South Korea, Taiwan, Singapore, and Hong Kong.

Thus, it is not only that economic or technical variables (including equipment investment, price, and adoption of new technologies) drive economic growth, with cross-national variations in the latter being attributed to the differences in the former (Hendricks 2000); in addition, non-economic factors such as a country’s legal system (Buscaglia and Cooter 1997) and its social capabilities (Hansson and Henrekson 1997) critically affect economic development, as do, for that matter, politically regulated financial institutions<sup>19</sup> (Khan 2000; Levine 1997).

Similarly, other empirical evidence suggests strong positive effects of economic freedom, as also implied in the degree and spirit of capitalism, and indirectly, of political liberties on economic growth. Although such effects of the degree of capitalism on economic growth can be deemed more or less consistent with theoretical expectations, they are not unambiguous, especially in terms of strength. For example, a study (Hall and Jones 1997) finds that the degree of capitalism, as opposed to socialism, is of low predictive value in regard to economic growth, unlike all other measures of infrastructure. Curiously, this study reports that “distance from the equator is the single strongest prediction of long-term economic success” (Hall and Jones 1997:177). The study also indicates that the difference in the level of development between countries with the lowest and the highest economic freedom index is considerable (\$7,199), with one standard deviation change in this index resulting in a certain (\$1,556) change in GDP per capita. This would suggest that changes in economic freedom exert substantial effects on income (Easton and Walker 1997:332). Such results seem to contradict

the previous findings that political and related liberties have negative effects on growth, as well as other observations suggesting similar effects. For example, one such observation is that a one-party political system, with limited economic and other freedom, is congruent with a capitalist economy, as “evident from China, Taiwan (until recently), Korea, and Singapore, all of which practice a one-party system [and] although Japan had a multi-party system, the country was ruled by the Liberal party from 1958 to 1994”<sup>20</sup> (Chow 1997:325).

Studies also suggest that education and investment (Graff 1999; Hall and Jones 1997), that is, endogenous human and physical capital accumulation (Bond and Trask 1997), positively affect economic growth. Alternatively, the overall positive effect of education on economic development can be greatly reduced by educational imbalances in tertiary education, as income inequalities and repression of political rights decrease social returns to lower educational levels (Graff 1999). Reportedly (Hall and Jones 1997), the difference in the level of development between the countries with the highest and the lowest average numbers of schooling is salient (\$5,077) in the favor of the first, and a certain (\$1,366) change in income is due to one standard deviation change in schooling. Similarly, the effect of one standard deviation change in investment or saving is a certain change (\$2,419) in income per capita, with the differential in income between the countries with maximum and minimum values (of investment) being quite high (\$10,157). In addition, reported is the positive effect of the growth of the labor force on economic growth. Thus, income per capita is altered (by \$1,801) as an effect of one standard deviation change in the working-age population growth ( $n + 5$ ), and those countries with maximum and minimum values of the latter variable differ (by \$6,037) in income (Hall and Jones 1997). If the growth of the working-age population unambiguously and positively affects economic growth, this seems less unequivocal in regard to the population growth in general, with the Malthusian hypothesis positing even strong negative effects in this regard.

Overall, research reports that the association between population growth and production growth is characterized by complex effects of the former on the latter. More precisely, these effects, while negative for the growth of the youth population, are positive for the adult population, age fifteen and higher<sup>21</sup> (Crenshaw, Ameen, and Christenson 1997). Moreover, population growth as a whole can be a critical exogenous factor in enhancing productive improvements and hence economic growth (Kremer 1993). This possibility is based on the evidence that, historically, periods of rapid economic growth have coincided with periods of rapid population growth. For instance, during most of history, the rate of population growth was lower than 0.2 percent per annum and did not exceed 0.5 percent until the middle of the eighteenth century<sup>22</sup> (Johnston 1997:10). At minimum, contrary to neo-Malthusian theories of negative correlation between the two

variables, theory and research suggest relatively small overall effects on the increase of population on production growth (Jones 1997:27). Thus, the minimalist assumption is that in the long run, rapid population increases at least have not spoiled per capita economic growth (Johnston 1997:10).

On the other hand, while conventional wisdom assumes an invariably positive impact of income inequality on economic efficiency, and thus on development, much of current research finds negative effects (Ranis et al. 2000; Rodrik 1996; Sylwester 1999).<sup>23</sup> These findings show that income inequality adversely and significantly affects aggregate economic growth, as the growth rate is shown to decline as an effect of an increase in income inequality (e.g., the Gini index). The same holds true for the effects of land and educational inequality on economic growth. Alternatively, such findings imply a positive relationship between income equality and subsequent economic growth<sup>24</sup> (Rodrik 1996:26). Moreover, the adverse influence of income disparity on development reportedly leads to the creation of a genuine vicious circle (Ranis et al. 2000). In such a situation, economic inequality and (lower) social mobility feed upon each other, to the effect that the social barriers to mobility also generate economic impediments (Galor and Tsiddon 1997:380), and the other way round. This interrelation is evidenced by the finding (for fifteen OECD countries) that economic equality is associated with higher social mobility (Erikson and Goldthorpe 1993), rather than vice versa, as conventional wisdom in the United States implies.

For instance, recent studies comparing income disparities and social mobility in the United States and Sweden report findings that conflict with the American conventional wisdom that the United States has the highest intergenerational mobility. On the contrary, countries like Sweden are found to have not only less income inequality but also greater intergenerational mobility, which “raises the question as to whether the equality of opportunity and the equality of outcome are independent of each other [as] economic equality in a country tends to be associated with higher social mobility” (Bjorklund and Janti 1997:1016–17).

Hence, as the United States also has the highest income disparity in the developed world, this unexpected finding highlights the wisdom of American conventional or folk wisdom, that the equality of initial positions or life chances is unrelated to the (approximate) equality of destination or success. The result thus casts doubts on the seemingly plausible analogy of this process with a race, namely, that starting a race at the same time does not guarantee that all of the players will finish in the same position. So this provides a strong rationale for the inequality of outcomes, including income disparity, to the effect that the latter does not supposedly result from the inequality of opportunity but from some other mysterious factors, ranging from abilities, performances, and merits to marketability, chance, and luck. The implied myth of equal opportunity—that anyone can become a millionaire or president—thus states that (economic) success is simply a matter

of hard work in conjunction with playing by the rules, rather than *also* of differentiation in terms of resource, power, or status at the start (i.e., of unequal opportunities). However, findings on the United States and Sweden suggest that the (in)equality of opportunities and the (in)equality of outcomes are not necessarily neutral to each other. For instance, they imply that large income disparities in the United States can largely, though not entirely, be attributed to an initially sharp differentiation in life opportunities and the lack of such disparities in Sweden in the absence of such a differentiation.

Overall, despite the prevalence of the evidence for the adverse consequences of income disparity on economic growth, this issue is far from being settled within modern economics and the sociology of development. This is shown by parallel attempts to question the argument for a negative correlation between income inequality and economic growth. For instance, some authors (Partridge 1997) report a positive effect of income inequality, as measured by Gini indexes, on economic growth for U.S. states, as well as that a strong middle class, as measured by its share in income, is favorable to economic growth, because it is favorable to a more stable and social environment. Thus, further evidence is needed to specify the concrete nature of the association between income disparities and economic growth, as well as its components, such as saving and investment. In this regard, research finds no systematic effects of income inequality on aggregate household saving and thus investment (Schmidt-Hebbel and Serven 2000), contrary to the argument of orthodox economists that such effects are positive.

The same can be said of the precise impact in terms of the direction (positive or negative) of the type of socioeconomic organization—that is, capitalism versus socialism—on development. For instance, most mainstream economists would contend that the degree of capitalism exerts unambiguously positive effects on the rate of economic development, thus embracing the conventional assumption of an intrinsic association between these two variables. In contrast, as hinted at earlier, other studies find that such effects are weak and insignificant, in the sense that the type of economic organization (capitalist versus socialist) is not a strong predictor of economic performance (Hall and Jones 1997:174).

## DEVELOPED VERSUS DEVELOPING SOCIETIES

A major implication derived from Weber's account of the emergence and establishment of modern capitalism is interdependence between its various parts, such as developed and underdeveloped countries within it as a global economy or world market. Consistent with the framework of economic sociology, especially the sociology of development, we center on the sociological underpinnings of these matters. For instance, what is of interest to the sociological approach to the matter is not the (dis)advantages of eco-



conomic backwardness or development as such, but the underlying social underpinnings and influences, including institutions, policies, and culture.

Historically, asymmetry in interdependence between comparative capitalist economies has in a sense always existed. This is evinced by the historical and spatial specificity of scientific and industrial revolutions (in seventeenth- and eighteenth-century Western Europe) and their later diffusion to other systems. Thus, models of asymmetrical interdependence, dividing the world economy into the core or center, and periphery and semi-periphery, can help explain convergence or divergence between developed and underdeveloped societies, especially in the long run. Notably, in contrast to standard development theory in mainstream economics, these models recognize the moment that industrial (and scientific) revolutions “were historically specific: they occurred in Western Europe” (Findlay 1996:47–48).

Now, some Weberian sociologists would suggest that such asymmetrical interdependence—that is, dependence of the (semi)periphery on the core—and its corollary of late development is not necessarily detrimental, given certain advantages of backwardness or of latecomers (Bendix 1984:117–18). In this view, such advantages result from the diffusion of developmental prerequisites and outcomes, especially capital, technology, and organization, from early to latecomers. Such a proposition implies the idea that the last train runs the fastest (i.e., the penalty of taking the lead versus the advantages of relative backwardness). Specifically, these advantages of relative economic backwardness are related to the historical tendency that often the process of industrialization, when occurring in a developing society, displays many variations in comparison to advanced societies, both in terms of the “speed of development” or the rate of industrial growth and the “productive and organizational structures” of industry emerging from this process (Gerschenkron 1992:112).

A case in point is the relationship between Japan and the United States after World War II. The development of Japan in the 1950s and 1960s was based mostly on technological borrowing from early developers, such as the United States or Western Europe. The same can be said of the current relationships between Japan and the new Asian tigers, the latter (e.g., Hong Kong, Korea, Singapore, or Taiwan) benefiting from their backwardness relative to the former. For instance, such advantages of initial comparative backwardness or late development can be illustrated by the growth of the automotive industry. This instance is appropriate, given the current shape of this industry of the early comers (Europe and the United States) relative to the latecomers (Japan and partly Korea).<sup>25</sup> These early developers cannot even afford unrestricted exchange with such late developers, above all, Japan, so the latter’s cars are subject to restrictive quotas (in Europe) or “voluntary” export restraints (in the United States), reflecting the expectation that free exchange can ruin their own old industry. Incidentally, in

Europe, above all, the European Union, these quotas are supposed to be removed in the near future (after 2000), but not “voluntary” export restraints by Japanese car manufacturers in the U.S. “free” market. With regard to Europe, such restrictions are ironic, since the density and resulting legitimization of competition (the car market) have been historically high in Europe, as an early developer (Hannan et al. 1995), and are still higher than in the United States and Japan. Thus, based on the number of domestic manufacturers (more than ten), Europe presently features the highest density and legitimization of competition in the car market, the United States (with only three manufacturers) the lowest, and Japan (with less than ten) the intermediate.

Alternatively, the case of Great Britain can be invoked as illustrating (some) disadvantages of early development vis-à-vis the United States, Germany, and the rest of Western Europe, just as of these latter in relation to Japan and other Asian economic miracles. This is because early comers show the blueprint and path, thus exerting demonstration effects (Bendix 1984:119) to those coming later. Still, they do not necessarily adopt all of the elements of this blueprint. This has been shown by the distinctive features of Japanese and Asian economies, despite the technological and other borrowing, relative to the United States, as well as by those of this latter in relation to pioneers such as Great Britain and Western Europe. For example, regarding the first Industrial Revolution, it is important to consider Britain’s social capacity for economic growth (viz., the effect of institutions and policy choices on Total Factor Productivity, or TFP), rather than centering on investments in human and physical capital. Reportedly, this social capacity was exemplified by Great Britain’s “outstanding learning capabilities,” for example, the proliferation of a variety of associations designed to produce and spread technological knowledge and inventions (Crafts 1996:197–98). Then many other countries subsequently benefited from this initial experience, including not only now-industrialized countries, such as France, Germany, the United States, Japan, and other followers, catching up with and eventually overtaking the leader, Great Britain, as the first industrial nation or workshop of the world (Crafts 1998:193).

Comparative data (Crafts 1998; Szreter 1997) cast light on both the rise and relative decline of Great Britain and on America overtaking the position of world economic leader, including technological leadership, from the former. This change of leadership generally was indicated by the fact that the U.S. GDP (\$594 billion) exceeded the UK GDP (\$214 billion), and more accurately, by the former’s higher GDP per capita shortly after 1900. Several factors were particularly relevant in this process of catching up and overtaking between the United Kingdom and the United States. First, the U.S. population and thus the overall labor force increased faster than the UK population (reaching over 100 million in 1913, relative to 40 million in the latter). Alongside the steady growth of the U.S. labor force, the ratio

of university students to the total population was far higher (.56) than in the United Kingdom (.07) in the early 1900s (1913–1920), which would indicate that the growth in human capital was much faster in the former than in the latter. Thus, an important cause of the economic decline of Great Britain was associated with the declining quantity and quality of human resources (Szreter 1997) in conjunction with the impact of institutional factors (Elbaum and Lazonick 1997). In addition, the growth in physical capital was greater in the United States than in the United Kingdom, as shown by the share of investment in the GDP (12.5 in the first case and 7.4 in the second during 1913–1920). Then the United States experienced faster productivity advances—and thus higher rates of economic growth—than the United Kingdom, as indicated by TFP growth rates (1.7 versus .45, respectively). These differential performances in productivity were probably due to the United States' more rapid technological progress associated with the sharply higher ratio of R & D/GDP (.25), as well as the greater share of engineers in the population (.13) relative to the United Kingdom (.02 and .05, respectively).

Additional historical evidence highlights some aspects of the economic process in Great Britain from the start of its industrialization (around 1780) to the eve of World War I (1913). For example, the United Kingdom experienced the fastest economic development, especially industrialization, during the 1820–1870 period (2.4% growth rate of GNP), with a slowdown thereafter (1.4%). In comparative terms, the period of 1780 to 1870 meant the birth and dominance of the first industrial nation (Crafts 1998), and the aftermath marked the start of its relative decline versus, for example, the United States. This was indicated or heralded by the increasingly lower level and rate of productivity in the United Kingdom compared to to the United States. For example, the ratio of U.S./UK manufacturing productivity increased from 1820 (1.5%) to 1913 (2.13%), perhaps largely due to the almost stagnant proportion of investment to the GNP (8.3% to 8.7%) in the United Kingdom after 1820. These differences in productivity translated into those in the growth rate of the GNP and thus in the GDP per capita over this period, with the United States exceeding the United Kingdom in terms of the latter at the turn of the twentieth century.

However, countries benefiting from their relative backwardness by catching up with the leader, in this case, Great Britain, also include today's developing countries. For illustration, one can compare Great Britain and some of these countries in terms of their annual rates of growth and levels of certain variables at different time periods, 1780–1913 for the first and 1960–1985 for the second (Crafts 1996). These variables include: annual growth of real GDP per capita, Total Factor Productivity, share of investment in GDP, share of equipment investment in GDP, and years of schooling. For example, Great Britain has experienced a much lower annual rate of GNP growth (0.4) over the 1780–1913 period compared to Hong Kong

and Korea (6.3%) during 1960–1985. Incidentally, only Chile had the same annual (low) rate (0.4%) of GNP growth as the United Kingdom, which might seem surprising, given the heralded Chilean economic miracle since the mid-1970s, attributed to Pinochet's, laissez-faire University of Chicago-trained economists, apparently trained to mix economic orthodoxy with totalitarian politics (neofascism). Next, Great Britain's annual growth rate of Total Factor Productivity (i.e., of labor and other production factors) also was lower (0.3%) compared to, for example, Hong Kong (2.3%) and Korea (1.7%).

Particularly pronounced are the differences between Great Britain and these developing countries in terms of the share of investment in GDP and years of schooling. For instance, during 1780–1913, the UK share of investment in GDP was a fraction (7.1%) in comparison to countries such as Hong Kong (22.9%), South Korea (23.1%), Taiwan (14.8%), Argentina (14.8%), Chile (14.7%), and Peru (21.1%) in 1960–1985. Similar differences are observed in the average number of years of schooling during these two periods, as this number was lower for the United Kingdom (2.3%) than for Hong Kong (8.5%), South Korea (9.2%), Taiwan (8.2%), Argentina (6.7%), Peru (6.7%), and Chile (6.6%). In turn, such differences (in TFP, Investment, Schooling, etc.) can probably account for the differences in the annual rate of GDP growth (GYP) between Great Britain, the first industrial nation or the leader, and these countries, as latecomers or followers, thus perhaps suggesting certain advantages of backwardness or late development. Thus, the annual rate of GDP growth per capita was higher in most of these developing countries over the period 1960–1985 than in Great Britain during the 1780–1913 period, and the same holds true of the other measures of development (except the TFP measure).

In general, the thesis of advantages of backwardness implies convergence in development between developed and developing countries. This convergence has been documented by the higher frequency of growth miracles than growth disasters since the World War II, especially in the last three decades (Jones 1997:34). These findings would suggest that in the last three decades developing (backward) countries have grown more rapidly than (thus somewhat catching up with) developed ones. Moreover, on the basis of this past convergence, developing countries, or at least some of them, are projected to continue to converge toward and perhaps even to overtake the United States as the wealthiest society (Jones 1997:19). Overall, backward countries or latecomers would tend to catch up or at least to close the gap with the developed countries or leaders, thus exploiting the advantages of initial backwardness.

However, the opposite thesis of disadvantages of backwardness assumes divergence in development between developed and developing countries. This implies that instances of backward countries gaining significantly on development leaders are historically rare (Pritchett 1997:14), thus the di-

vergence hypothesis is an extension of the familiar theme (“the rich get richer, and the poor poorer”) from classes in a society to societies or nations. Notably, the ratio of the GDP of the richest (the United States) to the poorest country has reportedly increased since the end of the nineteenth century (e.g., from 8.7 in 1870 to 38.5 in 1960 and 45.2 in 1990). In turn, the increasing ratio of the richest to the poorest country is assumed to be an indication and a consequence of a country’s long-term divergence, as expressed in different annual growth rates (Pritchett 1997). Also, the average absolute deficit of all countries from the leader (the United States) increased between 1870, 1960, and 1990 (e.g., \$1,286, \$7,650, and \$12,662, respectively, in purchasing parity dollars), as has the average GDP per capita of seventeen advanced countries (\$1,757 in 1870, \$6,689 in 1960, and \$14,845 in 1990) in comparison to that less developed countries (\$740, \$1,579, and \$3,296, respectively). Consequently, the ratio or gap between the average GDP of advanced countries and the average of all other countries has widened (e.g., 2.4 in 1870, 4.2 in 1960, and 4.5 in 1990), and the increasing standard deviation of income per capita from the mean (\$459 in 1870, \$2,112 in 1960, and \$3,998 in 1990) suggests a growing variation or divergence in GDP between (advanced and backward) countries over time. This divergence generally is manifested in that advanced countries as a whole have had consistently higher growth rates than less developed countries as a group (though a selected one) during this period.

Thus, stylized data (Pritchett 1997) show that the average growth rate of advanced capitalist countries has been always comparatively higher (e.g., 1.5 in 1870–1960, 3.2 in 1960–1979, and 1.5 in 1980–1994) than that of less developed countries (1.2, 2.5, and 0.34, respectively). They would thus suggest some degree of general divergence in development between developed and underdeveloped countries: in all three periods, from 1870–1990, the former have experienced more rapid growth rates than the latter. However, a certain selection bias may be involved, insofar as only a relatively small number (e.g., twenty-eight of developing countries have been selected, presumably those with lower growth rates) (viz., India, Egypt, and Argentina, for example). In addition, the growth rates of some less developed countries have not been uniform over time. Particularly striking is the contrast between the virtual stationary state of such Asian countries as China, Korea, or India over a century until 1960 and their subsequent rapid, and even explosive, development. In comparative terms, the 1980–1994 period reveals drastic comparative variations among less developed countries themselves, particularly between Asian and South American ones: compare Korea’s and China’s explosive growth rates (7.7% and 6.45%, respectively) to Argentina’s (0.11%), indicating stagnation, and Brazil’s (–0.54%), signaling decline. Such variations among less developed countries would partly

cast doubt on the thesis of divergence in development between these and developed countries as putatively homogenous groups.

In contrast to the reported and partly controversial divergence in development between developed and backward countries, convergence amongst the richest (Pritchett 1997:3) or at the core seems to be noncontroversial. Reportedly, convergence in growth among developed countries, though not complete, has been relatively high, especially during the period 1870–1960. This pattern of convergence is indicated by the average growth rates of these countries and the relatively low standard deviations from these rates (e.g., the average growth rate was 1.54% during 1870–1960, 3.19% in 1960–1980, and 1.51% in 1980–1994, with standard deviations of 0.33, 1.1, and 0.51, respectively). During 1870–1960, the biggest positive outliers were, for example, Switzerland and Finland (with annual growth rates of 1.94% and 1.91% respectively) and the negative, Australia and the United Kingdom (with rates of 0.90% and 1.08%, respectively). However, both positive and negative variations from the mean (1.54%) are relatively moderate. The next period of 1960–1980 reveals a substantially higher mean growth rate (3.19%)—the highest ever in their history—for developed countries, with somewhat more pronounced but still moderate variations from it. During this period, the biggest positive outliers are Japan (with a growth rate of 6.25%) and, perhaps surprisingly, given its chronic government instability, Italy (4.16%), while the biggest negative ones are New Zealand (1.39%) and Switzerland (2.07%). Overall, this is the period of unprecedented rapid economic growth in the developed world. The last period of 1980–1994 saw a lower average growth rate (1.5%), but historically still respectable (*viz.*, equal to the 1870–1960 period), despite this period being called one of stagnation, slowdown, recession, and so on. With slightly higher average variations ( $SD = 0.51$ ) from this mean rate than during the period 1870–1960 (0.33), the biggest positive outliers now are again Japan, though with a far lower rate (2.87%), and Norway (2.08%), and their negative counterparts are Sweden (0.81%), Switzerland (0.84%), and Canada (0.86%).

These figures suggest that the biggest cumulative advance in the span of the century or so was achieved by Japan, which in fact moved from a position among less developed countries (or the periphery) in 1870—with a GDP<sup>26</sup> (\$622 in 1985 purchasing power parity dollars) even below the average (\$722) for this group—to one in developed countries (the core) in 1980, due mainly to its high growth rate during the period 1960–1980. In contrast, the most conspicuous example of opposite movement from the club of developed to developing countries in the long run is perhaps Argentina. This country probably was in the core (or at least the semi-periphery) by the early 1930s, but found itself in the (semi-)periphery several decades later.<sup>27</sup>

Other big movers upward within the developed club, almost comparable

to Japan, were Finland, Norway, and Sweden, whose GDP per capita was the second, third, and sixth lowest, respectively (\$929, \$1,094, \$1,397) out of seventeen developed countries in 1870, yet is among the highest today. On this account, one can say that these three countries moved from a European (not only geographically) economic semi-periphery in the late nineteenth century to the core in the second half of the twentieth century. Canada's story is similar in terms of its historical GDP levels. Its GNP per capita was the fifth lowest (\$1,360) of the advanced countries in 1870 but is among the highest a century later; so one can say that this country moved from the semi-periphery to the core during this period.

These comparative-historical variations and perturbations among advanced countries would suggest using the utmost caution in postulating complete and invariable convergence in development among them. The relative decline of Great Britain is just one case that warrants such caution. However, more than one century later, not only Great Britain but also its two former possessions moved from the top to the middle of the GDP per capita ladder, which would suggest that the decline of the first industrial nation (Crafts 1998) to a degree affected or was associated with Australia and New Zealand, at least during the period 1870–1960. In any event, these different findings and interpretations suggest that the thesis of advantages of underdevelopment or backwardness needs further historical and empirical scrutiny.

Also, some analysts suggest that by various native attempts at devising original methods of economic development (and political democracy), underdeveloped countries can forego the benefits of being latecomers in development. In this view, if chronological unfairness follows economic development, then these countries can benefit, without incurring the same cost, by the labors of their predecessors (*viz.*, the backlog of technological innovations) (Gerschenkron 1992:113). At the same time, it is suggested that newly modernizing societies have to cope with historically unprecedented and comparatively unique economic, political, and cultural problems (Bendix 1984:118).

The experience of such new economic miracles (“tigers”) as Taiwan, South Korea (despite its dramatic financial problems and IMF rescue program in the fall of 1997), Hong Kong, Singapore, and even China seems to provide support for this suggestion. Historically, all of these have followed relatively unique paths of development that cannot be subsumed under an overall model. In relation to the other parts of the world, especially South America, these countries can be viewed as a group. This is indicated by their similar and higher rates of development since the 1960s compared to other countries. These rates make the magnitude of economic success of Taiwan and Korea transparent, particularly when compared to most African and Latin American countries. Of this group, Korea had the second (after Ghana) lowest GNP per capita in 1960 but the second highest

three decades later; and Taiwan's GNP, only fourth in size in 1960, was the first in 1989. Notably, both countries have overtaken in terms of GNP per capita Latin American countries such as Mexico, Brazil, and Argentina during this period. While in 1960 all of these three countries had a higher GNP per capita than Taiwan and Korea, the situation was the opposite in 1989. How drastic this reversal has been can be shown by comparing Argentina and Korea. In 1960, Argentina's GNP per capita (\$3,294) was four times higher than Korea's (\$883), and yet in 1989, the latter's GNP (\$6,204), was almost twice as high as the former's (\$3,608). Such a reversal in comparative economic fortunes was due to the radically different annual rates of GNP growth over the period (6.82% in Korea and 0.63% in Argentina).

In another instance, whereas Mexico's GNP (\$2,800) was double Taiwan's (\$1,360) in 1960, it was 60 percent lower (\$5,160) than the latter's (\$8,200) thirty years later, owing to the divergent growth rates (6.17% and 2.36%, respectively). The differences appear even more dramatic when comparing African countries to Taiwan and Korea during this period. In 1960, African countries such as Mozambique (\$1,128), Senegal (\$1,017), and Ghana (\$873) had GNP per capita at levels identical or comparable to Taiwan (\$1,359) and Korea (\$883). Three decades later, the former's GNP levels were completely incomparable to the latter's, by being between six and ten times lower, reflecting the critical differences in the rate of GNP growth per year. Particularly dramatic are Mozambique and Ghana: not did only their GNP decline relatively, in comparison to Taiwan and Korea, but also absolutely. For example, in 1989, Mozambique's absolute level of GNP per capita was \$756 and Ghana's was \$813, down by almost \$400 and \$60, respectively, from 1960, owing to the negative growth rates (-2.29 and -.54).

Apart from these stark contrasts with South American/African countries, Taiwan and Korea display almost identical rates of growth (6.82 and 6.17) over the 1960-1989 period as well as comparable levels of GNP per capita (\$880 and \$1360 in 1960 versus \$6,200 and \$8,200 in 1989). But this is only part of the story, because such rates and levels do not necessarily reflect identical capitalist economies and policies. Moreover, the differences in this regard between Taiwan and South Korea are sometimes salient. While the former's economy is driven by small units, the latter's is based on big corporations with transnational links and acquisitions. This holds true although these structural differences are accompanied by less pronounced policy variations (and similarities) between the two countries. As to Korea, these structural and policy characteristics of its economy, especially financial components, may have, in retrospect, contributed to the near-collapse of the system in the fall of 1997. Alternatively, those specifics of Taiwan relative to Korea might explain why such an outcome has not occurred in the former. Such outcomes suggest that some current dramatic



turbulence in the field of economic exchange can have its historical antecedents. This would apply not only to Korea but to other currently troubled Southeast Asian countries, such as Thailand, Indonesia, Hong Kong, and even Japan. Another contributing factor in this regard might have been the relatively low level of human capital indicators, especially education, in this region (except Japan) in comparison to both Western and Eastern Europe (Rodrik 1996:19).

In general, such structural diversity within a supposedly homogeneous (East Asian) socioeconomic model cannot be glossed over, despite many common elements, especially in the domain of economic culture (Berger 1991:xix), including religion, traditions, and morals, propelling hard work. No wonder the expression “an East Asian development model” is often questioned. In turn, this raises the general issue of how and to what extent economic and sociocultural variables are causally or otherwise related (Berger and Hsiao 1993:5).

### THE GROWTH RESIDUAL REINTERPRETED

Estimates indicate that a significant portion of economic development is to be imputed to the growth (Solow) residual, as a measure of unexplained variance in the dependent variable. For illustration, more than half (52%) of the variation in the U.S. aggregate production function or economic growth during the 1909–1949 period is *not* explained by the standard covariates in the model (labor and capital) and thus attributed to the residual containing unknown variables (Griliches 1996:1327). In another illustration, of the variation (growth) in productivity (output per person) during the 1904–1937 period, almost nine-tenths (89%) is unexplained by the model’s variables, and thus indirectly associated with other residual factors omitted. Moreover, the entire variance (100%) in productivity during, for example, the 1870–1914 period is not explained by the standard economic model and thus imputed to the residual, and so on (Griliches 1996:1327).

Apparently, such high figures of the residual (i.e., unexplained variance in the productivity growth) indicate the problem of omitted variables, in conjunction with including irrelevant variables (i.e., overall model misspecification). In the limiting case, if the magnitude of the residual is approaching 100, as during the period 1870–1914, then such a model (function) of economic (and productivity) growth has practically zero explanatory value, as the variance is unexplained. Therefore, as some economists admit, the “lion’s share of growth is accounted for by the ‘residual’ [as] that part of the rate of growth in output not explained by rates of growth of inputs in a standard, neoclassical aggregate production function” (Weitzman 1996: 207). Such an index of unexplained variation in the development process is deemed a measure of ignorance (Griliches 1996:1324), so the all-important residual is given the status of a mystery variable.

At best, the Solow residual is taken as a direct measure of technological progress or technologically induced productivity as an exogenous variable in neoclassical aggregate production (Cobb-Douglas) functions incorporating solely labor and capital as explanatory variables (Dougherty and Jorgenson 1996) and in real business cycle models (Greenwood et al. 1997). However, some authors (Burnside and Eichenbaum 1996; Hartley 2000) suggest that the growth (Solow) residual, as a putatively common measure of technological progress, is unable to capture even changes in technology in the aggregate production function, as no consistent relationship is found between the direction and size of such changes and of the residual.

Nevertheless, these purely economic interpretations of the growth residual seem too narrow within the framework of economic sociology. This latter links the growth residual to (unmeasured or implicit) social influences in the process of development not only to technological change, including innovation. From this sociological perspective, what pure economists experience as a veil of ignorance or torment of mystery seems to be a self-inflicted wound<sup>28</sup> (Galbraith 1997) and thus completely unnecessary. This is insofar as such an unexplained index of variation can be assumed to pertain not only to technical progress and thereby induced productivity or efficiency but to those social influences that, while unmeasured or latent, are overlooked or minimized by the economic approach to growth. It is precisely a sociological approach to economic development that incorporates these influences as salient explanatory variables. Thus, even some economists acknowledge that “without a comprehensive set of Z [non-economic] variables, cross-country growth studies are plagued by left-out-variable errors of great importance” (Sachs and Warner 1997:186).

Furthermore, other less orthodox economists suggest that since production and exchange, and thus economic growth, “are governed by non-economic considerations,” a development theory relying more on history, anthropology, and sociology may be more realistic than pure economics (Lewis 1988:3–4). Admittedly, the problem “is not how to take over relevant history or sociology or anthropology, but how to avoid rushing in with economic answers beyond the units within which they apply”<sup>29</sup> (Lewis 1988:9). Methodologically, the latter approach (viz., the neglect or downplaying of extra-economic social factors in development) commits the fallacy of omission.

And it is the neo-Weberian analysis of the institutional prerequisites of modern capitalism (Collins 1997:850) that exemplifies the sociological approach to development. This analysis conceptualizes the impact of religion on economic activity, demonstrating particularly that the role of Protestantism, especially ascetic Calvinism, in the development of modern capitalism has been evident and significant (Weber 1976:26–27). In this connection, some neoclassical economists recognize that the theory of economic progress is more “subordinate” than are other parts of economics

to sociology (Keynes 1955:145). For the economic sociology of growth, the Schumpeterian multidimensional, economic-sociological theory of development and entrepreneurship represents another pertinent endeavor greatly influenced by (Swedberg 1991), or suggested to integrate (Collins 1997) with Weber. For what Schumpeter (1951:224–25) calls the sociology of enterprise expands into the “structure and the very foundations of capitalist society,” thus penetrating much deeper than analyzing the conditions producing, shaping, favoring, or inhibiting entrepreneurial activity. The same can be said of the economic sociology of the market, which regards exchange transactions as being implicated in and implicating society in its totality (Boulding 1970:153).

Hence, in contrast to purely economic approaches to development, the sociological approach assumes no growth residual in the usual sense, and thus no major mystery pertaining to the social factors of development, as well as entrepreneurship, exchange, and other economic phenomena. Whereas in the former approach, the residual expresses unexplained variance in development, the same category within the latter can indicate explained variation in consequence to definite extra-economic, including institutional and cultural, influences.<sup>30</sup> In a neo-Weberian framework, cultural changes such as those in norms and values often exert strong effects on economic development. Notably, in contemporary society, economic development is reportedly linked to changes from absolute norms and traditional values to a different cultural pattern (viz., “rational, tolerant, trusting, and participatory” attitudes and flexible rules) (Inglehart and Baker 2000).

The preceding sheds a different light on the growth residual: the latter indicating that much of observed economic growth remained unexplained<sup>31</sup> (Griliches 1996:1329) appears to be only a measure of pure economists’ negligence of social influences and underpinnings in development and generally in economic behavior. From a sociological perspective on development, however, this negligence is *prima facie* unjustified. Hence, pure economists’ resort to and interpretation of the Solow residual as an explanatory factor of variations in the development function seems to be a “powerful indictment of the limitations of the neoclassical framework” (Dougherty and Jorgenson 1996:29). In sum, a sociological approach considers growth or development affected not only by economic factors but also by social influences that pure economics implausibly relegates into a residual term.

## EXCHANGE PROCESSES AND ECONOMIC DEVELOPMENT

The preceding section has involved an application of the sociology of economic development. The rationale for such an application is that the

social construction of economic development represents a particular aspect of exchange and related economic processes. Hence, in Weber's and Schumpeter's terms, the sociology of enterprise and development is a branch of economic sociology, including the sociology of the market. For in a modern economy, the process of entrepreneurship and development focuses on or is linked to the exchange realm.

In Weber's and Keynes' terminology, both micro-level profit enterprise and macro-level economic development are dependent, at least in the short term, on effective demand (of course, this is not the only factor). For instance, in a Weberian–Keynesian framework, production growth and employment are a function of aggregate effective demand, especially in the short term (Eichenbaum 1997), as expressed in what Keynes called the mass psychology of the market. Alternatively, in this framework, the insufficiency of effective demand is a major inhibiting factor of growth and employment, and thus a cause of economic crises (depressions and recessions) as recurrent periods of social-economic decline, especially high unemployment, poverty, political unrest, and social anomie (this latter was shown by Durkheim). Overall, aggregate effective demand tends to exert strong as well as nonlinear, asymmetric effects on growth and employment, particularly in inflationary economies, as exemplified by the impact of nominal aggregate demand shocks on output (Demery and Duck 2000; Kiley 2000).

In addition, exchange competition historically has been an important equalizer, especially in the long term, of the differences in economic development, and for that matter, of extra-economic stratification, such as status distinctions. In passing, this latter equalization or leveling often was emphasized or lamented by Weber, Simmel, and other classical sociologists. In this connection, the best known is Weber's (1968:636–38) observation that the market knows no status distinctions but operates via the common language of purchasing power or money as a leveling force in this regard. On this account, some economists and sociologists call the market the most democratic social institution (Schumpeter 1950:184).

In consequence of such a tendency toward equalization, in comparative terms most capitalist economies in the long run have tended to have smaller differences between their parts (states or regions) in terms of economic development (i.e., GNP per capita), than their non-capitalist or socialist counterparts. For example, the differences in terms of GNP per capita between U.S. states have been relatively lower than those between the republics of the former Soviet Union. The same holds true when comparing the corresponding intradevelopment differences between other capitalist economies such as West Germany, France, and England to non-capitalist ones, such as socialist Czechoslovakia, Poland, and Hungary. For illustration, even the differences of this kind between the Italian North and South in a full capitalist environment have been less persistent than those between the

northern (Slovenia) and southern parts of the former Yugoslavia as a pseudo-capitalist economy (market socialism).

On the other hand, the process of long-run, sustained economic development in a modern economy multiplies exchange transactions and thus promotes markets and competition. In retrospect, this was classically demonstrated by Weber in his analysis of the historically strong impact of the emergence/development of modern capitalism on the ever-expanding market, and by Durkheim in regard to the relationship of the division of labor and the ensuing economic development to the expansion of exchange contracts and transactions.

Whereas Weber analyzed both the social factors and effects of economic development (including crises in trade and speculation), Durkheim was mostly concerned with the consequences of the latter on modern society, especially on its moral equilibrium. However, both seem to concord, as implied in the Parsons convergence thesis, with a diagnosis of the root and nature of these consequences. The root is economic development, more generally rationalization, including rational bureaucratic organization, in Weber, and functional differentiation, or the division of labor, in Durkheim, as master trends of social change. And the diagnosed or predicted social fruit of this economic process is almost identical: disenchantment in one case (Weber), social anomie in another (Durkheim), and for that matter, alienation (Marx). Here it seems that Weber and Durkheim, as well as Marx, meet in their diagnosis of the main social-structural or sociopsychological repercussion (malaise) of capitalist development, though they differ in their proposals for therapy, praxis, or policy (even Weber was not completely immune to such temptations). In sum, economic development is a complex social process with a variety of factors and effects, which implicates not only the economy but society as a whole.

Finally, a comment seems to be in order regarding the discrepant findings presented earlier in this chapter. In methodological terms, these findings show the risk of relying on crude empirical data or middle-range generalizations that are not placed within a consistent and broad theoretical framework, such as a neo-Weberian theory of development (Collins 1997). Otherwise, one can derive the theory that economic growth is negatively affected by Protestant ethic and political democracy but positively influenced by, for example, Muslim religion—while some analysts (Kuran 1996) complain that Islamic morality is the key obstacle to development in such countries—as findings presented earlier (for the *historical* period 1960–1996) might imply (Sala-I-Martin 1997). Despite such defects probably due to incomplete or inadequate data, these empirical studies at least illustrate the pluralism of economic and non-economic factors affecting (positively or negatively) economic growth, thus supporting a major premise of a sociology of development and backwardness. Such a premise in turn exposes the methodological misspecification in most economic models of develop-

ment and exchange. This fallacy is exemplified by the omission of relevant explanatory, especially social, variables or their relegation into the residual, as shown in the previous section. Such a fallacy of omission is compounded by commission, by arguing that only purely economic or rational factors matter in the process of development as well as in exchange and other economic activities. These fallacies indicate in turn the need for an economic sociology's approach to exchange, development, and related phenomena, focusing on social-cultural conditions.

## NOTES

1. In this regard, Mill (1884) states that there is a difference between the laws of production and distribution. The difference consists in that the first are (akin to) natural laws, so there is "nothing optional" in production, and the second express social institutions and rules, especially those of the "ruling portion" of society, as a result of which distribution is a question of "human institution" (Mill 1884:156).

2. In the view of Smith (1939:306), "capital of all sorts" tends to find its way into the hands of those who will employ the best by increasing the production of a country. Parenthetically, and somewhat unexpectedly, Smith (1939:434) also contends that the "best condition for human nature is that in which nobody would want to be richer," suggesting some kind of "Pareto-optimum."

3. Parenthetically, some neoclassical economists place theories of economic growth (and "progress") in the "philosophy of economic history" (Keynes 1955: 283).

4. In this regard, Kuznets (1972:10) asserts that the differences in the ability to satisfy human wants as reflected in disparities in economic growth or per capita income are "not statistical illusions" but are embodied in the "flow of goods to consumers" and in the "stock of real capital."

5. In the view of some neoclassical economists such as Fisher (1954:355), the conditions of inventions include, for instance, mental efficiency, the ease of diffusion of knowledge, the size of the population, and the encouragement of invention through early discovery and approval of genius. In this connection, Fisher (1954: 345) maintains that economic growth or progress "constantly requires the writing off of capital value because of obsolescence" due to the stream of inventions. Parenthetically, the interaction effects of impatience and opportunity on the rate of interest are said to be "profoundly influenced by invention and discovery" (Fisher 1954:341).

6. Most neoclassical economists use the terms *inventions* and *innovations* almost interchangeably (Fisher 1954; Hicks 1961), though some try to distinguish between them (e.g., Schumpeter 1939; Kuznets 1972). In the second case, inventions are sometimes seen as the components of innovations, alongside, for example, the supply of material and human capital, and a large potential demand (Kuznets 1972: 326–27). Being selective, a major technological innovation is defined as the application of some invention (i.e., as a "new ingenious combination of existing knowledge to satisfy a large latent demand") (Kuznets 1972:326).

7. In this view, capital stock and (marginal) productivity are "inextricably bound" to technical progress as the "most powerful force" in this regard, defined

as a continuous, unending activity of the creation and utilization of knowledge (Dewey 1967:50).

8. According to some neoclassical economists (Tinbergen 1950:173–74), since the pressure for research can be greater in a depression than in a boom, the aftermath of the first tends to have more important innovations than any other stage of a business cycle, which is a reason new technical possibilities may be “random disturbances of the systematic pattern of the business cycle.”

9. In the view of Kuznets (1972:3), economic growth “is often accompanied by a shift in economic activities from the household to the marketplace; or by a rapid rise in the volume of market or society bound activities.” In addition, he observes that the acceleration in economic growth “may cause acceleration in political adjustments,” while apparently abstracting from the reverse causal or functional path from the polity (and society) to the economy.

10. In some view, capital accumulation or investment is a function of the “taste” for and productivity of investment (Dewey 1967:88).

11. For many economists, the economic case for “complete laissez-faire” is “very strong,” especially under the conditions of diminishing returns, in the belief that laissez-faire or/and free competition “will cause economic resources to be satisfactorily apportioned to different uses” (Clark 1957:ix).

12. In this regard, one sometimes gains the impression that for neoclassical economics, especially for some of its contemporary followers, monopoly is the “enemy” only insofar as it is public or governmental rather than private. Moreover, in a curious argument, private monopoly, and in extension, oligopoly, is given legitimacy and even fervently defended on account of its imputed economic efficiency (e.g., minimization of transaction costs in vertical integration), as is especially done in the new institutional economics. The underlying general idea (or ideological dogma) of orthodox economics thus seems to be of a black-and-white sort: everything private, including monopoly, is a “good,” and everything public is an “evil.”

13. The answer of some contemporary economists (Tse 2000) is that monopoly is an “important barrier” to economic development by restricting the mobility of workers and thus weakening their incentives to invest in human capital, especially in education. In this view, removing these distortions (while setting monopoly markup at modest levels) would lead to an increase in the GDP by 2.6 times!

14. According to Keynes (1960:136–37), the rate of investment will tend to reach to the point of investment schedule at which the marginal efficiency or productivity of capital equals the market rate of interest. Hence, the “stimulus” for the growth of output is dependant on the increasing marginal efficiency of capital in relation to the interest rate (Keynes 1960:143).

15. Leading contemporary unorthodox economists object that if economic growth centers only on GNP per capita, and neglects its distribution, then GNP information remains “inadequate” for the modern conception of development as a broader category than growth (Sen 1988:10). In this view, a key source of difference between economic growth and development relates to externality and non-marketability (Sen 1988:10). In this regard, development theory is defined as an analysis of the “growth of the economy as a whole” (Lewis 1988: 3–6) and is used mostly in reference to developing societies in contrast to growth theory, mostly designed to account for advanced industrial economies.

16. A distinction between economic growth and (human) development identifies

complex interconnections between the two (Ranis et al. 2000). Based on the results of a cross-country analysis, Ranis et al. (2000) found that the connection of economic growth and human development forms two chains. In the chain from growth to development, public expenditures on health and education are found to be particularly relevant, and in the reverse chain, investment rate and income distribution. With performances on growth and development being mutually reinforcing, the outcome can be a virtuous or vicious cycle. Notably, authors suggest that if a choice is to be made, human development ought to be given “sequencing priority,” observing that countries initially preferring growth can fall into a vicious circle, and those with poor growth but good development into a virtuous one.

17. In this connection, some analysts (De Soysa and Oneal 1999) contend that the productivity of foreign direct investment is higher than hitherto thought (especially by world-system theorists) but lower than domestic investment.

18. At this juncture, Johnston (1997:10) finds “enormous differences in the economic performances of the planned and market economies between 1950 and 1990 and the sharp change in the rate of growth in China following the reforms of the late 1970s.”

19. Levine (1997:688) analyzes the influence of financial institutions on economic development and finds “evidence that the level of financial development is a good predictor of future rates of economic growth, capital accumulation, and technological change: Countries with larger banks and more active stock markets grow faster over subsequent decades even after controlling for many other factors underlying economic growth.”

20. In addition, Chow (1997:321) reports that the “successful experience [of public enterprises] in China is sufficient to challenge the dogma that only private enterprise in a capitalist economy can be efficient [as] most assets in China are publicly owned.”

21. For instance, Crenshaw et al. (1997:982) conclude that a society “spared of the costs of children today will be spared their hand and minds tomorrow. Labor force stagnates and the burden of supporting large cohorts of retired people may be just as detrimental to growth as high fertility. Although ‘baby booms’ may slow development, they do not always halt or reverse economic growth.”

22. More precisely, “from 1880 until 1950, the rate was greater in the developed than in the developing countries and so was the growth of real per capita incomes. But after 1950 the population growth rate in the developing countries was the highest ever and so was the growth in real per capita incomes. From 1820 to 1950 the increase in real per capita GDP was only 25% in 11 Asian countries, while their population was increasing at the low annual rate of less than 0.5%. But from 1950 to 1992 the real per capita income increased fivefold while population grew at an annual rate of almost 3%” (Johnston 1997:10).

23. Curiously, Sylwester (1999) argues that the adverse effect of income inequality on economic growth is attributed to public education expenditures as a “potential link” from the first to the second. Arguably, the contemporaneous impact of education expenditures on growth is negative, even though their historical effects are positive. Thus, the absence of strong positive effects of the increase of human capital on economic growth is explained by the large costs of supporting a public education system.

24. According to Rodrik (1996:26), the underlying rationale or mechanism lies



in the realm of political economy or public choice, namely, “assuming that redistributive policies act as a tax on accumulation, societies with lower inequality will resort less to redistribution and grow faster.”

25. Recent research (Biggart and Guillen 1999) stresses the role of institutional factors and other aspects of social organization in the rise of auto industries in South Korea, as well as in Taiwan, Spain, and Argentina.

26. This quite low GDP figure for Japan before the Meiji restoration (1871) seems to indirectly contradict the assertion that “by 1800, Japanese workers’ standard of living was close to that of English workers, which itself was exceptional within Europe” (Collins 1997:861n).

27. Many analysts attribute this economic decline of Argentina to the disastrous policy reforms during the Peron era (Jones 1997:32–33).

28. Here Galbraith (1997) refers to the natural unemployment rate (NAIRU), but the same can be said of interpretations of the residual as a mystery variable.

29. In this view, economic growth generally takes place in consequence of a gap between “capability” (skills, science, and technology) and “opportunity” (markets, access to licenses, and infrastructure), while noting that the market concentrates rather than diffuses the benefits. Hence, the building blocks of a plausible analysis of economic development then would be a theory of government, a theory of class formation and conflict, in conjunction with a theory of entrepreneurship (Lewis 1988:8–9).

30. For example, Fortin and Lemieux (1997:77) warn that it is “dangerous to attribute to institutions or other factors, whatever residual cannot be otherwise explained.” Still, treating the residual as some mysterious force and thus self-inflicting ignorance is less fruitful than such institutional attribution insofar as the latter allows working hypotheses.

31. As Griliches (1996:1324) complains, “the lopsided importance which [the residual] index appears to give to productivity increase (in accounting for the growth in output per man-hour) should be sobering, if not discouraging, to students of economic growth.”

## Conclusion

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Generally, the influence of social actions, processes, and structures on economic behavior constitutes the central idea of economic sociology. More particularly, such social influences on economic exchange provide the analytical basis for a sociology of markets. This work was grounded on Weber's conception of economic sociology, especially the sociology of the market, as an important field of sociology (and economics), more particularly, on his classical insights into the conjunction with new developments and elements in the field. Hence, condensing this conception vis-à-vis the new economic sociology is in order at this point, and so is contrasting Weber's (as often termed) rationalist sociology with modern rational choice, including social exchange, theory.

As a primary observation, we recognize the essential continuity and affinity of classical, including Weber's, economic sociology with its new formulation by tracing the latter's key concept of the social embeddedness of economic action, especially exchange, to the former. Yet, this concept is sometimes used to distance Weber's project of economic sociology from its new formulations, to the effect that, relative to the latter, presumably the former held a much weaker or even no conception of embeddedness. Such distancing seems misguided, because Weber's economic sociology—and for that matter, Durkheim's—presents or implies a social, including an institutional-cultural, embeddedness conception *par excellence*. As a secondary observation, we note the discontinuity or dis-affinity of Weber's rationalist sociology with rational choice/social exchange theory (i.e., the economic approach to social action).

Most importantly for the subject under investigation, the core proposition of both classical and new economic sociology is that the economy is

conditioned by the “autonomous structure of social action within which it exists” (Weber 1968:341). Analogously, at the heart of the sociology of the market is the argument that exchange also is affected by the social structure in which markets emerge, exist, and operate. These classical statements contain roots of the major principle(s) of modern economic sociology/sociology of the market (i.e., sociocultural constructing and structuring of economic action/exchange transactions). Namely, the hypothesized influence of the autonomous nature and operation of social action on the economy implies social constitution, configuration, definition and construction, composition and organization, or structuration of the economic system (macro-terms) and individual economic actions (micro-terms). In essence, all of these terms can be deemed equivalent or proximate from the perspective of neo-Weberian economic sociology or substantivist economic anthropology.

In particular, the assumed existence and operation of the economy within the autonomous structure of social action implies a prototypical conception of the social embeddedness of economic action, including economic exchange. The social structuring of economic exchange is manifested in that societal structures and processes bear on resources and transactions among individuals and groups. Hence, modern economic sociology evinces substantial theoretical congruity with, and even foundation in, its early (especially Weber’s) formulation, despite some recognized (largely secondary) differences. This contrasts with the underlying (i.e., not always visible at first sight) incongruence between modern rational choice, including social exchange theory and Weber’s rationalist sociology.

In this connection, the major tenet of Weber’s “rational choice sociology,” by implication defined as an analysis of the economic (in)determination of social action, is that the latter conforms to its own “laws”; besides, it can be “co-determined by other than economic causes” (Weber 1968:341). Hence, such rational choice sociology is a conceptual opposite to its current type that instead denies that the modes of social action are subject to their own laws and are exclusively determined by economic factors. In this regard, these modes include value-rational, traditional, and emotional actions, as well as some (non-economic) varieties or elements of aim-rational or goal-oriented action.

Notably, since purposive or rational behavior can be economic and non-economic, one should not consider every instrumental, purposeful, or rational action economic (Weber 1968:339). However, contemporary rational choice theory posits an equation of purposeful/rational action to economic action/rationality—by reducing the former to the latter in its social exchange version, purposive human interaction is reduced to an exchange of rewards, epitomizing modern rational choice sociology’s reductionism versus the richness of what Weber (1968:6–7) termed the rationalistic (method of) sociology.

The failure of the current literature to analyze the social and institutional structure of economic exchange exposes the fallacy of commission committed by rational choice models of social exchange, with their depiction of all social behavior as a variation of economic exchange. It also shows the fallacy of omission committed by pure economic theories of markets, that put aside their social components. By virtue of these properties, rational choice models can be deemed inconsequential for this analysis. For what is at stake in economic sociology is to conceptualize economic exchange as a peculiar form of social action by acknowledging its social-cultural explanatory variables, not to portray social action as an economic exchange. In turn, these economic theories are incomplete in that they omit, by relegating to the residual, such social variables of economic exchange. In this regard, rational choice models of social exchange are tautological in that they say no more than that every social behavior is always and everywhere a rational economic exchange. In turn, economic theories of exchange are ill specified in that their model specification rules out non-economic explanatory factors.

The neo-Weberian approach as applied here has tried to remedy both of these fallacies. First, far from assuming that all social action is a rational-economic exchange, it treats this as a particular case of the former, which can be not only rational but non-rational or irrational, as classically demonstrated by Weber, Pareto, and others. For example, Weber (1968:24–25) consistently differentiated economic or instrumentally rational action from non-economic action, such as value-rational action, traditional, and emotional action. In a similar vein, Pareto made a coherent distinction between logico-rational or economic actions driven by material interests and non-rational actions induced by sentiments and rationalizations (residues and derivations). Second, the present approach has rectified the undersocialized (Granovetter 1985) conception of exchange and actors found in pure economics by observing these as embedded in and influenced by social relations and conditions.

Hence, the economic sociology of exchange that treats the latter as a special case of social action would make more sense than a rational choice model of social exchange that portrays human behavior as an economic exchange. Analogously, sociological economics that places economic exchange within a broader social setting seems more sensible than pure economics, which insulates it from this setting. Centering on the social-cultural factors of the economy, Weber's sociological economics (Knight 1958) or economic sociology (Parsons 1947; Swedberg 1998) represents a prototype of such an approach to economic exchange. The work presented here has built on and sometimes further elaborated on this classical exemplar.

In particular, a comparative-historical economic sociology of exchange seems more relevant and realistic than both rational choice models in so-

ciology and pure exchange theory in economics. These models imply an ostensibly universal economic approach or utilitarian paradigm, and thus amount to sociological materialism with dubious validity (Alexander 1982). Hence, leading classical sociologists have frequently rejected such conceptions of economic determinism (e.g., the materialistic conception of history) as being one-sided (Weber 1976:183) or have incorporated them into a general theory of indefinite reciprocity (Simmel 1990:55) between economic and non-economic phenomena. This theory of indefinite reciprocity implies that there is a new layer beneath or beyond materialism, so that economic activities result from “more profound valuations and currents” within a social, including a cultural or an ideal, structure (Simmel 1990:55–56).

On the other hand, conceptions of economic determinism such as rational choice utilitarianism and orthodox historical materialism detach exchange (and other economic) transactions from social processes. No wonder Weber (1949:49) has qualified these conceptions as unrealistic and even (e.g., the economic approach or orthodox economics) fantastic. In retrospect, Weber has originally detected or implied the congruence between rational choice utilitarianism and orthodox historical materialism by his characterization of the latter. According to Weber (1977:87), the materialist conception of history is economic on two accounts: first, by regarding social processes as “unequivocal consequences of the mode of production,” and second, by defining individual behavior as being “unambiguously determined by his ‘material’ (i.e., economic) interests.”

Of these two elements, it is mainly the second that represents a common feature of historical materialism and rational choice utilitarianism, albeit with qualifications. For instance, such qualifications can be made in terms of history and levels of analysis, with rational choice utilitarianism being largely ahistorical and micro in its thrust, versus historical materialism, with its mostly opposite properties. Ironically, if utilitarian rational choice theory were instead also more historical and more macro than commonly perceived, then no essential differences between it and historical materialism could be found (as partly indicated by the emergence of rational choice Marxism). In the terms of Weber’s characterization, both of these senses of materialism—the first being macro, the second micro—can be applied to vulgar Marxism, including socialism, and rational choice utilitarianism, including orthodox economics. Simply, the principle of economic determinism or materialism is at the heart of two seemingly opposed conceptions (Durkheim 1966:255).

Furthermore, an analysis of the social variables of exchange and economic action overall may be a necessary prerequisite for both a rational choice approach to social exchange and a pure economic model of markets. Before engaging in conceptualizations of social actions as expressions of economic exchange, it is necessary, at least for sociologists, to realize that

the latter are specific modes of the former. The realization that economic exchange is social action (Weber 1968:636) *par excellence* and that the market is a social structure and an institution should precede conceiving, if ever, human relations as cost-benefit exchange transactions and societal structures (including institutions) as combined outcomes of these transactions. One cannot overlook that social action includes economic exchange as its special mode (in rational choice models), that exchange transactions are socially constituted (in pure economic theory), and then go on to argue that human interaction is an (economic) exchange as a natural phenomenon. Simply, as some economists suggest, “you cannot first ignore the enormous impact of sociological factors in economics and think that you have succeeded with the economic analysis, and then try to apply this narrow economic analysis outside the field of economics” (Sen 1990:266).

A theory of social exchange (i.e., of human life in society as a market-like exchange) presupposes an analysis of economic exchange in its social variables (i.e., a comparative-historical economic sociology of the market). Since such an analysis is lacking or is neglected in social exchange theory, the latter, especially its rational choice variants, appears a premature endeavor in epistemological terms. In turn, pure economic theory or catallactics is at best incomplete by its treatment of exchange as a formal-technical transaction (of selling and buying) among socially disembedded actors. As a result, social exchange theory treats human action as a set of pseudo-economic transactions driven by rational cost-benefit calculations. Orthodox catallaxy views economic action, especially exchange, as virtually a non-social phenomenon taking place in a social vacuum or desert (Baxter 1993:3–9). This indicates the need for a theoretical-empirical analysis from the perspective of economic sociology. Such a perspective remedies these defects by viewing economic exchange as an ideal type of social action (overlooked by rational choice models of social exchange) and examining the social and institutional impact on this exchange (neglected by the economics of markets). As Weber (1977: 114) pointed out, the sociological meaning of economic exchange is an “ideal type” of social action.

By applying a neo-Weberian approach to exchange phenomena, we have thus turned current social exchange theory, above all of its rational choice variant, on its head. In such an approach, it is not that social action is (an extension or appendix of) economic exchange but that economic exchange is a particular mode of social action. This approach also has made economic theories of exchange more realistic and more complete by observing that exchange is driven not just by its own inner laws but by social-cultural factors, as stressed by economic sociology. Such an approach is predicated on the sociologics (i.e., social-cultural nature and structure) of exchange rather than on the natural economic logic of them (catallaxy) and even of non-economic phenomena (social exchange theory). By applying such laws from the economy to pseudo- or non-economic realms (viz., economically

invaluable goods), social exchange theory in rational choice sociology seems *prima facie* even more dubious than compromised orthodox catalactics. The latter at least does not claim that its principles are valid for non-economic phenomena, as does social exchange theory, which thus, just as rational choice generally, becomes a universal model aiming at simultaneously explaining all social phenomena and thus perhaps none (Smelser 1992:403).

In theoretical terms, the general assumption of a neo-Weberian approach to economic exchange has been that this is subject to a process of social-cultural structuration, which endows it with a sociologic and imbeds it in society and culture. Such an assumption has contradicted the argument implied in the pure economic theory of exchange, which posits that this is disembedded and isolated from society and is governed by an intrinsic asocial, non-cultural, and ahistorical logic. This assumption also has collided with the overarching paradigm of rational choice models of social exchange, which extends the principle of economic exchange to all social action and thus to the underlying null hypothesis that such a principle is self-sufficient and unaffected by other social variables. The alternative assumption has radically inverted such a paradigm by instead treating this principle of exchange as one of the possible principles or modes of social action. Whereas the rational choice paradigm engages in grounding social exchange and generally human action on economic principles, the neo-Weberian approach has grounded exchange in social-cultural postulates. This, in a nutshell, is the difference between a neo-Weberian sociocultural approach to exchange (economic sociology), in relation to an economic-utilitarian model of social life (rational choice theory), and a purely economic analysis of markets (catalaxy).

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