

Sociological explanations in economic fields

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Abstract:

The spectacular revival of economic sociology since the 1980s is viewed as part of a wider paradigm shift in sociological theorizing about the question of how to link action and structure when explaining the social. By doing so, the failures of classical functionalist sociology as well as those of the neo-classical equilibrium theory should be avoided. But economic sociology which postulates improving economic analysis by using sociological concepts and factors as social relations and networks usually only pays little attention to issues related to theory building.

*Because of this, I am proposing to outline the relevance of **institutions** in the sense of social expectations for social and economic actions by focusing special interdependencies on the basis of an action theory. The existence and the functions of **social institutions are** then be explained and systemized within a framework of macro-micro-explanations. I will begin with a reconstruction of “The Protestant Ethic and the Spirit of Capitalism” - a masterpiece of institution-analysis - and highlight the heuristic as well as some problems of micro-macro-transitions using an institution concept. Based on this, I will demonstrate that action based, multi-level explanations can broaden the approach offered by Max Weber by providing precise theoretical arguments about **when and why** social institutions get relevant for individual actions and what effects – intended and unintended – are to be expected on the macro-level.*

0. What I am doing

The spectacular revival of economic sociology in the US in the 1980s and in Europe at the very beginning of the 21st century is seen as **part of a paradigm shift** in sociological theory. Whereas classical sociology almost always dealt with normatively defined situations in which individual decisions and interests disappear neo-classical economic theory focused the rational autonomous individual trying to maximize private utility in market structures lost institutions.

Because of this **New Institutionalism** as well as **New Economic Sociology** claim to explain and analyze **economic actions and structures** better than mainstream economic theory by using sociological concepts and focusing social aspects. For this New Economic Sociology

particularly regards **social interactions** and **networks** as frame of economic actions either market transactions or organizational behavior or entrepreneurship.

But because of the imperfections of the sociological tradition and the meanwhile dominant multi-perspective sociologists were not well-prepared in improving and systemizing theories alongside different social aspects when economic sociology came back.

Whereas **New Economic Institutionalism** has started successful to integrate “social institutions” like hierarchies, trust, social capital in the very well-developed action-based economic approach the two ‘**new-comers**’ in Sociology couldn’t do this so easy. Today there is a strong demand to bring **individuals** together with **social structure** particular in **economic fields**.

This can be done by building up a sociological approach that provides arguments about **why particular social facts** get explanatory relevance for economic actions and structures so they help to improve economic explanations and analyses. For me the classical sociological concept of institutions is such an instrument because it claims that individual actions framed by institutions get structural effects. This means the task for economic sociology would be **to explain** mainly **when** and **how** institutions work in social and economic life. Then explanations would be ‘**better**’ by regarding institutions than that of standard **economic theory and that of functionalistic sociology** by showing that these are only special cases of a general social issue .

1. Where is Economic sociology all about?

In my opinion **economic sociology** can learn much for this by a *critical view* of the work of **Max Weber** – whose rich work isn’t fully discovered till now as Richard Swedberg always claims. But Weber is still important for economic sociology because of two reasons: First of his **methodological premise** to start explaining social regularities from an individual view, second for his well-known historical analyses of rationalization where he also focused the need and functioning of institutions with regard to both individual actions and social change especially for the analyses of the **modern rational capitalism** as a particular institutional setting.

Furthermore Weber dealt a lot with economic theorists and gave economic action and economic facts a central place in his own work. For him (1985/1922):

“economic action’ is any peaceful exercise of an actor’s control over resources which is in its main impulse oriented toward economic ends.” (ES 63)

Weber also complained that economists didn’t view institutions as a social fact having functions in economic life.

For Weber economic actions are defined as **mean-end-oriented actions** in order to **produce, consume or distribute scarce goods and services**. For sociology important is that they result in specific forms of production, consumption or distribution in different societies. The central characteristic of modern social and economic structures is rationalization and the wide distribution of **formal institutions** or **organizations** like the **business firm**.

The modern economic institutions and organizations can be therefore regarded as much as a **topic** for sociologists as for economists.

In the 1960s and 1970s **Neil Smelser** asked with regard to Max Weber for an economic sociology which analyses the **causal relations** between economic and social facts in everyday life (Smelser 1963/1968).

More precisely Neil Smelser and Richard Swedberg defined in their very influencing “Handbook of Economic Sociology” published first in 1994 and in a second edition in 2005 that economic sociology should be

„the application of the frames of reference, variables, and explanatory models of sociology to that complex of activities which is concerned with the production, distribution, exchange, and consumption of scarce goods and services“ (Smelser, Swedberg 1994, 2005: 3; see also Smelser 1968: 45 ff.).

Challenges of economic sociology

- For this I like to sum up main challenge for current **economic sociology** is to find ways of **explaining economic structures** or **processes** by taking **social factors** into account.

This responds in two ways on the **New Economic Sociology** outlined in the US in the 1980s esp. by Mark Granovetter who claims in contrary to economic theory **social relations and networks** as important for economic action. But this is not all of sociology so critical remarks have been done focusing the lack of **institutional** and **structural components**. Such critics are given especially by Pierre Bourdieu, Neil Fligstein, Victor Nee and others who try to focus more structural components of social life.

- But to prevent the failures of both neo-classical economics and classical sociology and for adopting the claim of economic sociology to focus **social factors** it seems to me most important to regard **institutions** first in accordance to the **individuals** because so we can see **why** such social facts get relevant and second what social effects – intended and unintended – they produce.

The good message is that economic sociology can do this in the *framework of multi-level explanations* that are also developed since the 1980s to bridge micro- and macro-theories and connect both levels of analyses in all social sciences. Such explanations are founded by an action theory that can focus the relevance of **particular social factors** from the **individual point of view** and showing how to transform these actions into **social** effects.

- On the one hand social institutions can be used to describe a social setting and then asking when and how they frame individual actions and transform them into social effects and on the other hand sociology has to explain why and how social institutions come into being and are maintained by the individuals. Whereas the first question is more relevant to economic sociology the second one is it for new sociological institutionalism. But both get together within this approach that tries to link **individual actions** and **social structures** via explaining and analyzing **social institutions** in the sense of social expectations.

2. What to learn from the Protestant Ethic?

In the work of Max Weber we can find first of all the problem of social order explored as general need of **social expectations when individuals act in regard to one another**.

2.1 Action and social order

As always known Max Weber claimed to start sociological explanations by regarding individuals and their intentions and then he asked how individuals could be able to build up social relationships in a complex world. Because of the complexity of the world and the mutual motives of individuals **social actions** and **social relationships** need to be grounded in stable **reciprocal expectations**.

But such reciprocal expectations get an **objective chance** for Weber only **when** they are **framed** by **general rules** which are **accepted as legitimate by the individuals** because then everybody will orient on them and can normally expect that the other do the same.

For Weber an order can be legitimate because of three ideal-type beliefs. **First**, legitimacy can occur due to a belief in the **formal correctness** of an order or the **process of defining** it. **Second**, it can occur due to the belief in the **holiness of tradition**. **Third**, it can occur due to the belief in the **extraordinary skills of the ruler** (Weber 1985, page 124ff; 1973). What is important to see is that Weber didn't explain the objective chance with direct account to individual interests although it is assumed that a legitimate order responds to general interests.

The very important point to Weber was that a legitimate end-oriented order especially when guaranteed by a bureaucratic staff **enables groups of individuals** to act coordinated and moreover to build up stable organizations (Verbände) as a formal institution of coordination.

The assumption of a collective principle of legitimacy implies that the **ruled** as much as the **stuff normally** follow the order without reference to individual interests and social interdependencies. In fact only this allows to interpret hierarchies or organizations as a **formal institution** providing coordination in every social field and every social interaction free of negative or unintended by-products.

The well-known thesis of Max Weber that **bureaucratic organizations** like the **modern business firm** are the **most rational form of coordination** and **therefore unavoidable** in modern life is due to the assumption of a given collective **validation**. Without the tendency of threatening individual capacities Weber didn't say only less about problems of functioning and maintaining hierarchical institutions and organizations in social and economic fields.

2.2 Protestant Ethic

The religious studies of ascetic Protestantism can be seen as adaptation of the general argument of an overall **rationalization** of ideas and institutions. Especially the "Protestant Ethic and the spirit of Capitalism" can be interpreted as an institution analyses.

In "*The Protestant Ethic*" Weber argues that especially some protestant sects believe that they can not be sure to be elected by god so they follow the rational rules set by ascetic protestantism in order to find signs god's blessing in the real world. In other words: Weber explained the behaviour of a particular group of actors in a specific historical situation by elaborating a religious interest and the normative power of the Protestant Ethic.

While a group of person follows the systematic, rational and world-oriented **rules** of Protestantism **typical patterns of behavior can be deduced**. More precisely Weber out-lined that

- a systematic way of life,
- systematic work behavior (calling),
- and especially a very good feeling by profit maximization

get powerful social institutions that change former traditional behavior in economic life.

Regarding Weber's argument within a framework of multi-level explanations differentiation assumptions on the individual and the macro-level it is to say that he explains patterns of actions for a group of people with regard to individual interests and the collective ideas of Protestantism and deducing from this social structural elements. This explanatory strategy implies first that because of the institutionalized patterns actions get structural effects of the same art and second it disregards unintended consequences due to social interdependencies in the group of Protestants as well as to other groups.

So the rational structures and elements of modern capitalism: big business firms, rational organizations, rational calculation and the systematic profit-maximization, are explained as the direct but unintended result of the institutionalized actions of Protestants or more over of collective ideas.

But Weber also argued that once established and successful in every day economic life these institutions are self-stabilizing and can miss their former basis: the religious background.

Whereas the **institutionalization** of **rationalized** and **economically relevant** patterns of behaviour is explained due to individual interests the functioning and maintaining is not. It seems like that Weber described the functions and maintains of institutions when established without any regard to individual interests and social interdependencies for example reactions from Non-Protestants.

2.3 Some critical remarks summing up

Let me sum up what we have seen and what we are missing.

First of all it can be said that Weber focused the need of institutions by regarding individuals in a complex world and outlining the question how to orient once action on the others. But the

validity of social institutions is explained on the assumption of given collective ideas: principles of legitimacy or religious ethics. In both cases the institutionalized social expectations are founded in collective ideas and not in individual interests or problems of social action. Furthermore we have to say that Max Weber's solution of social order or social relationships always depends on the normative framing of individual interests in the concrete situation by general rules. This is due to the missing action theory in the work of Weber who as always known Weber operated on the basis of a typology of action and the empirical evidence of motives. For the Protestants Weber argued that the normative rules determine in their actions in a social relevant degree. But Weber has no general argument why individuals sometimes orient on rules and misregarding interests or vice versa.

And second the reconstruction shows that he used a very simple argument for transforming individual actions into structural effects: he deduced the macro-effects directly from the institutionalized patterns without any regard to social interdependencies.

Last but not least we can see that institutions matter if they are founded by collective ideas about what is right or wrong and if they focus every day life behaviour. Especially institutions which are founded by a legal order and guaranteed by officials are relevant for modern economies because they are for Weber the main basis of coordinated, rational collective actions. The modern business firm is for Weber therefore the main institution of capitalism but only working on the basis of legal orders.

3. Action-based multi-level explanations

The missing links by Weber can be figured out in the framework of an action-based, multi-level model of explanation founded by an action theory.

The claim is to give place to individuals intentions and beliefs but also to situational aspects or macro assumptions.

Institutions can then be first explained as result of intentional actions in specific social situations and second be regarded as a situational factor which causes structures by framing individual actions. Therefore we need a model that shows how institutions work.

Approach

1. It is mostly suggested to use an action theory which assumes that all individuals act because of intentions and to combine this assumption with model of social situations.
2. The main variable in the action theory picks up relevant aspects of the situation. They inspire so bridge-hypotheses about possible actions and their value for the individuals. So it is highly recommended to start with a simple action theory for example the assumptions that individuals act in regard to private interests and by being able to evaluate the results of actions and situations in response to their intentions. But the action theory should and can be broaden by taking common interests or belief systems as intentions into account or by specifying the individual's capacities.
3. A rational action theory provides a selection rule for example individuals choose the action providing maximum utility or the one best fitting their values or minimizing fear.
4. In a third step then the explained individual actions have to be transformed into collective effects like the allocation of power, norms or private goods. Such transformation can be made by formal rules but also with response to institution theories.

Use for Sociology

The sociological quality or perspective lays in describing various **social interdependencies**. Such interdependencies are mainly to be defined by constellations of individual intentions or interests when using a rational choice theory because this focuses individual interests.

But situations can also be described by regarding social institutions, networks, hierarchical organizations from the point of individual interests then we have to show when and why such social factors work on individual actions and what structural effects they will cause. As mentioned above also situational models should be very simple but might be broaden by additional assumptions.

Use for Economic Sociology

The **heuristic** of an action-based explanation for **economic sociology** and **institution theories** lays in figuring out **social interdependences making particular mutual expectations** advantageous for individuals and therefore exploring their need.

In response to general types of social interdependency or problems of social acting the need of social institutions is shown for social as well as economic life.

The most exciting problem focussing the need of social expectations discussed in economic sociology is the trust problem. Or in other words: in contrast to the assumption of neo-classic it is assumed that also voluntary transactions need credible commitments. I'm trying to give now precise arguments about when and why social expectations are useful and therefore rational for individuals and what consequences they might have.

Therefore I'm not starting with Weber's assumption of a collective basis but by reconstructing social interdependencies by focusing interest constellations. And in the second step I'm analysing the functioning of informal and formal institutions and asking for social effects caused by them.

This can be seen as starting point for an integrated approach focussing and systemizing social situations which make institutions in the sense of social expectations rational for individual actors but also looking for their intended and unintended consequences.

4 Institutions matter! But why and to what effects?

With regard to Max Weber we can now argue that **"institutions matter in economic life"** when collective ideas frame individual actions because then mutual expectations and coordination effects are to be expected without regard to situational interests and social interdependencies. This might be an important case but not all of economic life.

So I'm arguing now on the basis of a theory of intentional actions that more precise theses can be formulated about institutions when we do not start with such a strong assumption on the macro-level about the foundation of institutions. Instead of this I suggest to start with simple assumptions about individuals trying to act with regard to their own intentions in social fields and therefore dealing with the problem of social expectation. This allows to explain establishing and maintaining social institutions with regard to individual intentions and therefore important social constellations.

If we start with the very simple assumption that individuals act in order to seek private interests we can argue that with regard to this three situations can be differentiated.

1. Common interests
2. Complementary interests

The mostly discussed **trust-problem** in new economic sociology as well as the problem of mutual expectation in the work of Max Weber can be discussed now more precisely and with response to different solutions and social effects.

1. Complementary interests

If we start with complementary interests it is to argue that the easiest case will be two or more actors who only need to know what the other(s) will do in order to act intentionally. This case is described for example by Thomas Schelling as a pure coordination game in the art of 'strangers' will meet in New York and haven't made an appointment about where and when. Then simple common knowledge can help and can build up to institutions by using private or common knowledge. For example to meet at 'the most famous building, empire state building or to drive on the left side in UK or on the right side in the US.

James Coleman used this situation-model by making an additional assumption that this might motivate actors to exchange not private but social goods like the rights to determine and control actions. If one or more actors can 'use' such rights' in order to gain own interests and pay the other for selling them the first actor will get a principal who needs expectations about the others: their abilities, their motivations and their real actions. But such expectations need additional guarantees: either hierarchical control and loan systems (Anreizsysteme) or social norms.

Because of the interest structure such institutions have they aren't to be regarded as a convention but can be explained as the **intended approach** of principals to enforce control. Institutions that are engaged and maintained by self-interested principals mostly have the unintended by-product to hire officials and set up hierarchical structures which tend to seek own authority interests on the cost of all by building up power monopolies, consuming resources, and so on. Although formal control- institutions can be explained as rational from the view of the principal they need to be structured and also controlled – and so on.

Another adaptation of this situation which can be seen as useful for economic sociology is provided in the work of Oliver Williamson. He discussed the problem that exchange relations often have costs because the underlying contracts can not specify all details. Especially when asset specificity works what means that one partner has to invest specifically in the exchange relation social expectations can help to run these exchange and therefore improving efficiency. Because of the explored control problem what is a strong form of a trust problem formal and hierarchical enforced institutions are rational and build up but must be regard again as the source of further institutions. For example managers who have in large companies the task to control the workers as well as financiers cause also control problems but on a much higher level because of their authority and power.

The chance for economic sociology is to figure out situations which make social interaction or exchange useful for the individuals but cause need for stable mutual institutions so by analyzing the structure of interests we can describe the problem and ask what sort of institution might be necessary and possible. If formal institutions guaranteed by hierarchies are to be explained we can say that there are unintended by-products to be expected caused by the interest structure and enforced by the power structure of control-systems.

Second we can now say that firms are a major institution in modern economies that can be explained as a rational, institutionalized answer for controlling and determining actions of others. And we can now postulate that the maintenance of firms has to be explained by analysing new incentives given in and by hierarchical structures.

2. Common interests

Whereas sociologists take common interests serious when discussing collective actions they don't ask what problems this has because of individual interests. This is because they argue like Weber or assuming that common interests enforce collective actions themselves.

One of the major insights of using a rational choice theory is now that also common interests do not automatically lead to collective actions but also need social institutions guaranteed by social mechanisms like hierarchies or social reputation.

Such institutions and their functioning might be more important for new Institutionalism and sociology in general than for economic sociology that has its main focus on exchange

relations. Nevertheless an interesting case for economic sociology to deal with under the perspective of common interests

- are consumer or producer associations
- and pressure groups esp. trade unions.

In contrast to classical sociology as well as neo-classic such forms of coordinated collective behaviour is to be discussed as a problem of public good. This means to ask how rational actors are able to find or create institutions that allow them to solve different kinds of free-riding. Because free-riding is a dominant strategy when common interests are enforced by others such expectations need to be enforced either inside the group by social mechanisms or by establishing authority and control structures what's also a public good.

Economic sociology can use and broaden the concept of public goods to discuss why producer or consumer associations are so seldom in modern economies or what social institutions are possible and necessary to establish and maintain such associations. An economically interesting variation of this general problem is discussed by Russell Hardin and Elinor Ostrom as 'Tragedy of Commons'. Especially Ostrom showed that the economically using of scarce common goods like water or fishes can be governed within small groups successfully.

5 A very short summary

Let me sum up:

1. Institutions matter! in economic life because they provide mutual expectations and thereby solving various problems of social actions.
2. Within an action-based multi-level framework we can figure out typical situations which make institutions useful especially for rational actors seeking their own interests but taking others into account. By doing so we can also analyse the functioning and maintenance of institutions and their by-products. I have shown here that formal institutions which are framed by control mechanisms and hierarchies generate further problems of control.

3. The integrative perspective of this approach is to elaborate variations of the named two main situations and showing when institutions are established to solve them and what social effects they can have. Intended coordination effects as well as the unintended enforcement of hierarchies with all the following problems.

4. Last but not least some work has to be done to widen the action theory so that interests as well as duties can be integrated in the sense that we can give theoretical arguments about economic actions governed by normatively founded institutions and by interest-based.

3. Business firms as well as producer associations should now be explained as formal institutions established by rational actors to coordinate their actions but also generating further problems and un-intended by-products.

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