THE ROLE OF EMBEDDEDNESS IN THE RECONSTRUCTION OF THE MARKET PARADIGM: A NETWORK APPROACH

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Abstract

In order to be able to address some significant criticisms aimed at the academic discipline of economics, it is necessary for economists to elaborate the fundamental structures on which the economic system is based. These fundamentals structures consisting of rules and norms – in other words, institutions – structure the transactions forming the basis for the study of economics. Thus we consider economics as consisting of an instituted system: in Polanyi's terms, as an institutional process. However, in order to be able to speak about features characterising an institutional process, it is necessary to refer to the term that encompasses all these features: we shall do so by referring to their "embeddedness".

This conception can be applied to studying the market as a comprehensive and complex structure that is formed according to the following conditions: 1) the existence of actors carrying out mutual activities and forming multilateral links; 2) the embeddedness of actors' interrelations within diverse areas (e.g. cultural, cognitive, social etc.). In other words, the market emerges from a network of embedded actions. The paper attempts to establish a theoretical framework for investigation of the phenomenon of the market and to lay the foundation for apprehending the market paradigm within a network approach.

Key words: institutional process, embeddedness, network approach, market paradigm.

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Introduction

The idea for writing this paper occurred in terms of a response to accusations levelled against the contemporary economic market paradigm from politicians, businesspeople and members of the general public, which have taken place as part of a reaction on the part of a broadly representative sector of the community against perceived faults within the discipline of economics. The paper attempts to explain the current market paradigm applying in terms of the phenomenon of embeddedness and in this way to contribute to an increased understanding of concepts within the context of the market and commerce. Inspired by the work carried out by Karl Polanyi and presented in “The Economy as Instituted Process”, this paper consists in a further investigation and apprehension of Polanyi’s research programme.

In order to be able to address some rather salient objections addressed to economics, it seems to be indispensable to elaborate the fundamentals upon which any attempt to fix the economic system must be based. These fundamentals are rules and norms; in other words, institutions that structure economic transactions. Thus, we consider economics as an instituted system: in Polanyi’s terms, as an instituted process.

Any institutional process consists of actions accomplished in terms of the functionality of institutions and corresponding with an institutional environment. In the conception of Williamson and Hodgson, these are interwoven with law, order and human relationships; in other words, they are integrated into a social landscape. Institutional processes are derived from institutional design, i.e. from the planning, restoration, moderation and fulfilment of routines. The design of all the above-mentioned stages of institutional processes corresponds with specific cultural and social circumstances and proceeds according to legislation, traditions and ingrained patterns of behaviour. Thus institutional processes are not standardised actions, but are rather uniquely originated and elaborated within each discrete system. In order to speak about distinctive cultural features characterising institutional process we require a term that can encompass all these factors: this term will be referred to as “embeddedness”. This comprehensive term identifies the core topic of institutional processes; therefore, if we are to attempt to define the essence of processes defined as institutional, it is sufficient and necessary to say that they ought to be embedded.

First mentioned by Karl Polanyi in “The Great Transformation” – and subsequently revised by Mark Granovetter, the concept of “embeddedness” has been widely adopted, although acquiring different and often controversial glosses and commentaries. Therefore, in order to distinguish between these various definitions and establish guidelines that can help us to select an appropriate direction within our discussion, it will be necessary to analyse the genesis of this term.

The term “embeddedness” is indeed ascribed to Karl Polanyi; while this is an established fact, it is worth noting that embeddedness was not a central point within his seminal work “The Great Transformation”. It was referred to in the chapter “Evolution of the Market Patterns”, in which the market economy is opposed to reciprocity and the redistribution economy. "In the vast ancient systems of redistribution, acts of barter as well as local markets were a usual but not more than a subordinate trait. The same is true where reciprocity rules: acts of barter are here usually embedded in long-range relations implying trust and confidence, a situation which tends to obliterate the bilateral character of the transaction" (Polanyi, 1944).

The idea of distinguishing and contrasting three economic models or patterns of integration with each other was presented in his later thesis "The Economy as Instituted Process", in which he excludes the term "market" from the triad "market, reciprocity and redistributions" and replaces the first one with the term "exchange". Thus Polanyi extends the term "market" to refer to a form of economic organisation, encompassing all economic modes: i.e. exchange, reciprocity and redistribution. To inform our further examinations, we will note that 1) contrary to general belief, the market is beyond and not equal to exchange; 2) market and redistributive economies are not alternative management approaches: the former encompasses the latter; 3) the market is a domestic and internal form of organisation. In Polanyi's terms, the market is primarily constrained by the institutional framework, which should regulate interactions between actors; moreover, it is embedded in a larger social and political system. Thus, embeddedness is seen not only as an analytical tool for investigating the economic reality but also as the collection of political, historical, cultural, structural and other forces that guide the formation of the economy.

The concept of embeddedness was rethought and revitalised by Mark Granovetter in his now-classic paper "Economic Action and Social Structure: The Problem of Embeddedness", giving rise to a discipline referred to as "the new economic sociology". In this paradigm the focus shifts from larger social systems into which economics is inserted to instead consider actual social relations, i.e. to interactions between two or more actors. Granovetter`s conception shapes methodological fundamentals of economic action, economic outcomes and institutions. According to his idea, embeddedness refers to an economic action included in bilateral relations; as such, it should be studied in correspondence with such relations. This type of embeddedness was named "relational embeddedness". Since bilateral relations are involved in multilateral relationships, the former tends to be analysed within the structured relational networks that give rise to structural embeddedness.

In Granovetter's interpretation, embeddedness was opposed to two competing conceptions in research debates: an "oversocialised" paradigm of action accepted in modern sociology and "undersocialised" paradigm assigned to neoclassical economists. Since the former characterises individual behaviour as determined by a system of norms and values, where history, origins, membership and modes of grouping behaviour impact individuals, the latter tends to neglect the role of social relations and structures, instead deriving from the notion of anonymous and atomised actors taking decisions according to market signals in the search for personal profit.

For Granovetter, both approaches towards action are unsatisfactory in terms of answering the question of how market actors can avoid breaking agreements, resulting in fraud and malfeasance. The author presents an alternative view, proposing the idea that economic action is “embedded in concrete, ongoing systems of social relations”; in other words, in *social networks*. Without rejecting the significant role of the fulfilment of generalised moral obligations, he refers to a trust-conception that underlies relational and structural linkages. Trust itself can be considered as a source of credible information leading to fair transacting. But how does trust occur and develop? Granovetter argues that personal trust-setting interactions underpin general, “universal” morality. This implies an actor’s instability in behaving in accordance with a unified moral system of regulations that depends on relational-structural context and self-non-self-discrimination. Thus, being based on trust, which produces loyalty and cooperation, networks constitute their own internal rules of the game, or institutions, contrasting from external common institutes. In other words, Granovetter argues that networks are subject to institutional processes.

A discussion of the genesis of the conception of “embeddedness” would be incomplete without mentioning other uses of this term. For instance, in their broad study “Structures of Capital: The Social Organization of the Economy”, Sharon Zukin and Paul DiMaggio distinguish between cognitive, cultural, structural and political embeddedness. Cognitive embeddedness refers to “the ways in which the structured regularities of mental processes limit the exercise of economic reasoning.” Cultural embeddedness refers to “the role of shared collective understandings in shaping economic strategies and goals”. Structural embeddedness is defined in Granovetter’s terms as “the contextualisation of economic exchange in patterns of ongoing interpersonal relations”. Finally, by political embeddedness they refer to “the manner in which economic institutions and decisions are shaped by a struggle for power that involves economic actors and nonmarket institutions,” such as the legal framework of the state.[1]

For the purposes of the present paper it seems reasonable to highlight the role of cultural embeddedness for economic action. Sharon Zukin and Paul DiMaggio describe it as

[1] Dequech, D. (2003). Cognitive and Cultural Embeddedness: Combining Institutional Economics and Economic Sociology. Journal of Economic Issues. Vol. 37, no.2. p. 466

follows: “Culture, in the form of beliefs and ideologies, taken for granted assumptions, or formal rule systems, also prescribes strategies of self-interested action […] and defines the actors who may legitimately engage in them. […] Culture provides scripts for applying different strategies to different classes of exchange. Finally, norms and constitutive understandings regulate market exchange”.[2] The most notable point here is the use of such words like “norms”, “formal rule system”, “constitutive understandings” for describing culture as a phenomenon that implies the relatedness of the term “culture” to the concept of the “institution”; in its Northean interpretation, the “rules of the game”. Boyd and Richerson (1985) suggest a similar pattern, according to which culture is identified as “decision-making heuristics or rules of thumb that have evolved to serve our need to make decisions in complex and uncertain environments”.

The interconnection and proximity of culture and institutions were illustrated by Allan Gruchy (1987), who used “homo culturalis” and “homo institutionalis” as alternative definitions to the neoclassical “homo economicus”. That fact proves the idea about culture as not only “a historically transmitted pattern of meanings embodied in symbols, a system of inherited conceptions expressed in symbolic forms by means of which men communicate, perpetuate and develop their knowledge about and their attitudes toward life” (Geertz, 1973), but as “the sum of and the interrelationships among institutions.” (Neale, 1994). This strong cohesion of culture and institutions was studied in (Alberto Alesina, Paola Giuliano, 2013), who rethought the Northean approach to culture as a source of informal rules (North, 1990), positing culture as prior to informal rules. Such a broad and multiplied interpretation of culture demonstrates its sufficient role in the institutionalising of an economic action.

Given structural embeddedness based upon trustworthiness and a wider conception of a culture, let us move towards an assumption about the embedded character of all economic actions that take place in an existing social environment. Being influenced by multiple factors, economics is to be considered as the sum of economic actions, spatially located but spread far beyond its physical boundaries. Taking into account ideas concerning the specific pattern of economic development depending on various comprehensive actions, it is necessary to address this question from an institutional perspective.

The institutional perspective consists of a point from which cultural and relational approaches are seen to converge (Scott, 2001). Culture, which traditionally defines norms and

[2] Dequech, D. (2003). Cognitive and Cultural Embeddedness: Combining Institutional Economics and Economic Sociology. Journal of Economic Issues. Vol. 37, no.2. p. 463

values, arrangements and prohibitions, generates trust and behavioural expectations (Fukuyma, 1995), does not exist on its own, but is constituted by human interactions. In other words, culture implies beliefs about the consequences of one's actions, but includes the possibility that these beliefs can be manipulated by earlier generations or by experimentation (Alesina, Giuliano, 2013). Thus beliefs, expectations, convictions and trustworthiness are transmitted from one group of people to another, from elder generations to younger; are assimilated and gradually updated through new activities and experience (Guiso, Sapienza, Zingales, 2008b). In its most concentrated form, this interwovenness of cultural-relational elements is presented in terms of networks. Such a conceptualisation of networks as institutionally embedded interactions leads us back to Granovetter.

In his now-classic paper "Economic Action and Social Structures: The Problem of Embeddedness", Granovetter overcomes an under- and oversocialised dichotomy and proposes the idea that economic action is embedded in networks of interpersonal relationships. In presenting a critique of Oliver Williamson`s work "Markets and Hierarchies" (1975), Granovetter proposes a concrete example of embeddedness in economic reality. According to Williamson, the decision to perform within the boundaries of hierarchy- or "boundary-free" markets depends on the frequency and cost of transactions between firms. If transactions are rare and require no specific investment, firms will operate across the market; if transactions are frequent and expensive in terms of investment, hierarchical relationships between firms will form. Coming from a sociological perspective, Granovetter points out that both relations – whether market or hierarchical – are "embedded in broader system of relations", arguing that "the anonymous market of neoclassical models is virtually nonexistent in economic life and that transactions of all kind are rife with the social connection" (Granovetter, 1985). The other point of his critique is connected with Williamson's overestimation of the efficiency of hierarchical power. Whereas Williamson underlines the independent role of the internal auditor, who "has greater freedom of action", Granovetter, in referring to Dalton`s work, argues the contrary, pointing towards a specific type of relationship between department and enterprise.

In other words, the "undersocialised" perspective of market relationships and the "oversocialised" perspective of hierarchical relationships presented in Williamson`s interpretation were rethought by Granovetter thus becoming reconciled with an embeddedness-conception, i.e. in a network approach.

The broader view of interfirm relationships, which allows us to include "markets" and "hierarchies" as specific types of embedded relationships, presents an opportunity to examine a number of other economic interactions from a network approach. Granovetter considers business interrelations to be closely interwoven with social ones; this position was not alien to Polanyi's theories.

The latter, as mentioned above, defined the market in broad terms, not as an alternative means of describing exchange. Although Polanyi defined the market as the "locus of exchange", noting the co-extensive character of both terms, exchange is described as an economic relationship, whereas market is an economic institution. If the latter definition seems clear, the former must be further elaborated. What are the essential features of exchange? We can identify the following: 1) exchange is a movement of goods between actors; 2) exchange proceeds at an established or bargained rate. The second statement supports the idea that exchange, despite its resemblance to the definition of "market", is not the only form of market relation. Polanyi points out that "… although market institutions, therefore, are exchange institutions, market and exchange are not coterminous. Exchange at set rates occurs under reciprocal and redistributive forms of integration; exchange at bargained rates [...] is limited to price-making markets".[3] In other words, exchange can be carried out in various ways – at established or bargained rates and in the form of reciprocity, redistribution or exchange itself.

We now turn our attention to the three previously referred to forms of exchange. Polanyi calls them "forms of integration", indicating mutual dependence of these economic patterns. Reciprocity identifies movements between points of symmetrically chosen groupings, redistribution signifies movements towards a centre and backwards, exchange denotes counter movements between "hands". At the first glance, it may seem that frequent movements of goods can support reciprocity, redistribution and exchange itself. This argument is fully consistent if we take all these forms as atomised and unrelated economic patterns. However, in describing all these forms in integrated terms, it is necessary to consider institutional arrangements that support the functioning of the whole market system. Here it is important to highlight that repeated but unrelated actions in terms of barter or any other forms of exchange do not in themselves generate such market-like structures, but simply comprise the mutual and interdependent linkages of actors. Thus, in order to examine forms of exchange that are considered as having been integrated into a market system, it is necessary to take a network approach.

[3] Polanyi, Karl.(1957) "The Economy as Instituted Process". New York: Free Press. p.267

Since exchange, redistribution and reciprocity are expressed in movements from one point to another, we can propose that all of them proceed under market conditions, i.e. are shaped by the market as an institution. Since all of these economic actions taking place according to market conditions are interdependent both as the sum of acts within any form of integration and as the sum of all three forms within the market structure, we can point to the embedded character of these economic relationships, despite their being conducted by otherwise interrelated actors. Thus, in order for a market to be formed, two necessary prior conditions are: 1) actors who fulfil mutual actions and form multilateral relations); 2) the embeddedness of the actors' interrelations into many areas (e.g. cultural, cognitive, social etc.). In other words, the market arises from a network of embedded actions.

From that perspective, the market seems to be a comprehensive and complex structure, which is fundamentally based on *embedded*, multilateral, repeated economic actions that form relatively stable social frames. This point has become especially crucial in recent times, since it is clear that the market system takes place within the current economic paradigm (with any market failure being attributed to failures of that paradigm). Thus, while the "market" was formerly considered from a global international perspective, as a common and a universal means of supporting economic interactions within a worldwide space, as an open and flexible model for economic performance, in reality the model referred to as "the market" nowadays is not related to the original classical sense of market. Rather, it is the phenomenon of international *world trade*, encompassing the majority of countries, which provides a unified order of exchange for all actors. Nevertheless, in spite of the repeated actions of trade partners forming multilateral links between each other in accordance with the codified rules of the game, these can hardly originate a market. The reason for that hypothetical failure lies in the absence of embeddedness.

Conclusion

Embeddedness, being a complex phenomenon, is always "charged" – culturally, relationally, structurally and cognitively. In cases where rules and arrangements are in place, we can speak about institutionally "charged" embeddedness. In general terms, the market is institutionally embedded, i.e. involved in a unified institutional area through the repeated, interrelated transactions of actors. Trade, on the other hand is discrete, based on repeated exchange transactions that are not integrated into cultural or institutional frameworks. Karl Polanyi pointed to specific features of trade in such terms: "The decision to acquire some kinds of goods from a definite distance and place of origin will be taken under circumstances different from those under which other kinds of goods would have to be acquired from somewhere else. Trading ventures are, for this reason, a discontinuous affair. They are restricted to concrete undertakings, which are liquidated one by one and do not tend to develop into a continuous enterprise." This indicates that trade transactions comprise actions out of "multilateral interrelations", lacking a "continuous history", i.e. they represent a non-embedded process.

Thus we can consider embeddedness as the key factor that differentiates market and world trade relationships. This idea can contribute to an understanding of economic history and economic events that take place within the current "market paradigm".

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