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"Still Disenchanted?
The Modernity of Postindustrial Capitalism"

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STILL DISENCHANTED? THE MODERNITY OF POSTINDUSTRIAL CAPITALISM

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Modern sociology is built on an interlocking series of assumptions about the nature of modernity, and in particular about the capitalist economic system on which it is based. In Maine's (1875) view, "status" relationships built around personal loyalties would be replaced by impersonal "contract," developing Marx's observation that modern capitalism turned wage labor into a commodity; Tönnies (1887/1955) argued that the intimate norms of *Gemeinschaft* (community) would be replaced by a broad *Gesellschaft* (society) characterized by formal law; Durkheim (1893/1933) described the shift from mechanical or organic solidarity; while Weber (1904/1930) held that modernity would see an increasing rationalization of all aspects of life, and the steady displacement of religion, magic, and other non-rational perspectives with that of modern science. This latter point was crystallized in Weber's famous observation at the end of *The Protestant Ethic and the Spirit of Capitalism* about the "disenchantment" of modern world: while there were still "ghosts of dead religious beliefs" haunting late capitalism in the form of social habits like thrift and work, modern man had nonetheless built for himself an "iron cage" of rationalism from which there was no escape.

The classical sociologists were aware, however, that the rationalization of modern economic life had to contend with powerful non-rational sources of behavior. Durkheim wrote about anomie and

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suicide as byproducts of the shift into industrial society, and Weber foresaw the return of charismatic authority precisely as a response to the iron cage of modern capitalism. The same has not generally been true of contemporary neoclassical economics, which takes assumptions of rationality even further and tends to have a more optimistic view of human history. Not only is human behavior instrumentally rational, but the "embedded norms" of classical sociology that define community and often establish the ends of human activity can themselves be decomposed into individual preferences that are the object of rational pursuit. For modern economics, the most important forms of agency are individual rather than collective: group norms concerning behaviors like reciprocity and honesty are the product of game-theoretic interactions between rational individuals who enter into "society" to satisfy their purely individual preferences.

In the world of neoclassical economics, informality, religion, magic, custom, and other non-rational sources of behavior—the sphere of culture—have relatively weak explanatory power. Indeed, certain neoclassical economists like Becker (1993) argue that not just modern capitalism but the whole of human behavior can be understood as the outcome of rational optimization. In the law and economics literature, there is often an overt hypothesis that there will be an evolution towards economic efficiency over time as firms and institutions compete with one another (Roe 1996).

It is hard to doubt that modern science, rationalism, and secularism have all made great strides over the past several centuries, and that a social science predicated like modern economics on an assumption about the rationality of human behavior will in fact successfully describe much of today's economic world. But such explanations ultimately confront the problem that important areas of

economic behavior remain non-rational in origin,[2] e.g., based on religious belief, inherited social habit, or what Weber labeled charismatic authority. Social norms and values whose origins and staying power cannot be explained as the result of any functional or game-theoretic interaction among rational individuals continue to shape the economies around the globe, including those of the postindustrial world. Religion and other deeply embedded cultural values have not disappeared and affect the way traders and investors operate in the global economy.

But it is not simply a matter that the ghosts of dead religious beliefs have not yet been fully exorcised. Capitalism itself does not fully dictate a single, optimal set of institutions on which all societies will necessarily converge as a result of ever-more ruthless competition. There is a degree of variance among functionally efficient institutions, and the choice that any given society makes among them is often the result of norms or path-dependencies that economics as a science cannot explain. Indeed, it is possible to argue with Platteau (1994 I and II) that the *most* efficient forms of contemporary capitalism rest on prior social givens like the existence of a generalized system of morality that are ultimately non-economic in origin. Whether or not the latter assertion is true, it appears that Weber's iron cage is actually made of a somewhat more flexible material.

CULTURAL EXPLANATIONS IN HISTORICAL PERSPECTIVE

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[2]By non-rational, I mean not rational in the sense that economists use the term rationality, i.e., consciously optimizing behavior. Non-rational behavior can in fact serve rational economic aims (e.g., the Protestant work ethic or the Asian emphasis on education), and is not the same as irrational behavior.

The view that economic behavior needs to be explained by reference to religion and other historically-determined non-economic sources of behavior—i.e., that it has cultural determinants—has traced a complex trajectory since the publication of Weber's *Protestant Ethic*, the *locus classicus* of this genre. Through the middle of the twentieth century, such explanations were quite common, with analysts like Parsons (1951), Lewis (1955), McClellan (1961), and Hagen (1962), arguing that modernization required the adoption of certain enabling cultural values distinct from those found in "traditional" societies.

This view came under sharp attack in the 1960s and 70s from two sources. The first came from the political Left. Some were neo-Marxists like the *dependencia* theorists (Cardoso and Faletto 1969) who argued that poverty was the result not of poor cultural values, but of structural biases in the global economy. Others were postmodernists who argued that modernization theory was ethnocentric and privileged Western over non-Western values.

But a second source of criticism of culturalist explanations came from the political Right, in the form of neoclassical economists arguing that their growth models were sufficient to explain all but a small residual in observed economic behavior (Solow 1956). This group maintained that the outcomes typically ascribed to cultural factors were actually better explained by political or economic factors within the scope of those models, and accused those promoting them of methodological sloppiness (Becker 1993).

In the last two decades of the twentieth century, cultural explanations of economic behavior have made a comeback of sorts and, if not fully established within the mainstream of the discipline of economics, has found a more secure niche in the social sciences more broadly. One of the sources for this change came with the rise of a

new subdiscipline within economics labeled the "new institutionalism," associated with economic historian Douglass North (North 1990, 1994).

North does not contest the foundations of neoclassical economics as far as they relate to microeconomic theory. He argues, however, that models like price theory fail when scaled up to the level of the macroeconomy, because the latter introduces a host of non-economic variables like political institutions and path-dependent cognitive structures that inhibit the adoption of optimal economic policies (North and Denzau 1994). Institutions, for North, are formal or informal rules that regularize and make predictable economic behavior, thereby reducing transaction costs. Many institutions are thus efficient, and economists have developed a huge body of game theory to explain how they arise. But North would be the first to admit that societies can get trapped in suboptimal equilibria where the rationality of individual actors provides no obvious way out. That societies ever do overcome such obstacles is thus often a matter of historical accident, culture, luck, leadership, or other factors that economists with less of an institutionalist bent generally tend to disregard.

Further impetus for thinking about non-rational sources of economic behavior outside the standard neoclassical model came from the real world. The East Asian "miracle" was seen by many to reflect not simply good economic policies and sound institutions—"getting the fundamentals right" in the words of the World Bank (1993)—but also some culturally distinctive micro institutions like the Japanese seniority wage system, lifetime employment, and the *keiretsu* system of business networks, the South Korean *chaebol*, or the bank-financed Chinese family business. The force of these arguments diminished considerably after the 1997-1998 Asian economic crisis, when these same culturally

distinctive institutions were seen as one of the sources of the crisis, and were in the process of being dismantled as part of post-crisis reform (Lanyi and Lee 1999).

But closer examination of the East Asian case reveals that culture and values remained an important component of the "miracle." It is widely conceded that one of the reasons why Asia grew faster economically than other parts of the world in the postwar period was the fact that many countries there had superior institutions and quality of governance for economic policymaking (World Bank 1997, Haggard 2000, Fukuyama and Marwah 2000). Those countries with the strongest institutions like Japan, South Korea, and Taiwan, ran ambitious and relatively successful industrial policies for several decades; those with weaker institutions like China, Malaysia, Indonesia, and Thailand, intervened less heavily. To assert that good governance was important is not necessarily to provide an explanation falling within the domain of traditional economics, however, but rather to beg the question of how certain societies develop superior institutions, since it is clear that they cannot be imported like technology or physical capital. There was, in other words, something in these country's cultural backgrounds and historical experiences that permitted them to create effective governance institutions when historical conditions were right. Conversely, Argentina's persistent failure to manage macroeconomic policy properly over a period of several generations suggests that poor policy and weak institutions reflects a deeper cultural problem.

A similar observation can be made about the former socialist world, which tried to develop both democratic political institutions and market economies in the post-1989 period. There was a huge variance in post-communist transition outcomes, a variance that is very

difficult to explain using the normal tools of neoclassical economics. The standard neoclassical growth models led to predictions that countries like Ukraine and Russia should have done best after communism, since they had the largest stocks of physical and human capital at the time of communism's collapse. In fact, the best predictor of post-communist transition outcomes was the cultural distance between the country in question and Western Europe, with Protestant Estonia coming out on top, followed by Catholic Poland and Hungary, followed by Orthodox Russia, Ukraine, or Bulgaria, followed in turn by Muslim Central Asia. Here as in East Asia, the speed with which societies were able to rebuild post-communist institutions correlated with success in economic and political transition, but the former was clearly a dependent and not an independent variable.

The idea that shared cultural values and embedded social relationships could have a significant impact on economic development and growth has been most intensively discussed in recent years under the rubric of social capital. Social capital is defined as a form of capital that arises out of the ability of people to cooperate in groups (Coleman 1988, Putnam 2000, Woolcock 1998). The concept of social capital has been around at least since the time of Tocqueville's observations that American democracy rested on an American "art of association" that inclined citizens to work together in a broad variety of voluntary associations. The economic impact of social capital was most evident in countries like Italy that shared a common system of formal law but which experienced wide variation in economic and political outcomes (Putnam 1993). The origin of these interregional differences was held to be cultural factors like Banfield's (1958) "amoral familism" which discouraged trust and cooperation outside the boundaries of the nuclear family.

The concept of social capital remains controversial among economists (see for example Arrow 2000, Solow 2000), perhaps understandably in light of the fact that there is still no generally agreed definition as to what it is and particularly how it is to be measured. Most would not deny, however, that institutions (understood in North's sense) were critical for economic growth, and that the cooperative norms that characterize social capital are also important.

There is, however, a substantial gulf separating economists from other social scientists concerning the origins of norms. A great deal of economic theory has been developed to address the problems of collective action (Olson 1965, Hardin 1968) and the spontaneous generation of cooperative norms (Sugden 1989, Ellickson 1991). Since Axelrod and Hamilton's (1981) pioneering work, it has been clear that norms of reciprocity and honesty will emerge spontaneously out of an iterated prisoner's dilemma game. Ostrom (1990) has documented a number of empirical examples of the emergence of cooperative norms providing solutions to problems of shared common-pool resources like fisheries and forests, that earlier economic theory suggests should have led either to a "tragedy of the commons" outcome or state regulation. More recent analysts (Posner 2000) have tried to use a rational-choice framework to explain how social norms are generated more broadly, in what at times appears to be a sophisticated updating of functionalist theories of culture.

The problem with this approach, however, is that while some norms do indeed arise out of a strategic interaction between individual rational agents, a great many others do not (Fukuyama 1999). Sociologists have tried to give functional explanations for norms like the Muslim limit of four wives per husband or the Hindu ban on eating cows, but neither the origin nor the survival of these practices has a

fully convincing economic explanation. While social capital is generated daily in modern postindustrial societies through the kinds of rational, game-theoretic processes described by economists, in other cases it arises as an externality or byproduct of activities with completely different purposes. Religion and religious belief, for example, are sources of shared values and social capital that have always resisted functional or rational-choice explanations (or have been incorporated into such interpretations at the cost of a trivializing reductionism). It is not true, as Hirsch (1977) has suggested, that modern societies are living off of the social capital generated during bygone eras of religious enchantment, and will inevitably collapse of their own internal contradictions. But it is also not the case that a society's full stock of social capital is generated or renewed automatically as a result of the everyday economic activity. The realm of values and culture remains to an important degree autonomous from the realm of the economy.

SOCIAL VALUES AND POSTINDUSTRIAL CAPITALISM: THREE CASES

While many people would grant that cultural values are important in explaining economic behavior in historical preindustrial or contemporary developing countries, most assume with the social theorists cited at the beginning of this article that the importance of such factors declines with modernization. Cultural norms that value leisure at the expense of work, or that attach social status to rentiers rather than industrialists, or that dictate that clerics rather than markets should set interest rates, are seen as cultural obstacles to modernization which need to be overcome if growth is to occur. The modern economic world that results once these barriers are

surpassed is one in which rational optimization is sufficient to account for most behavior.

This view is problematic because there are still several key areas where rational optimization, and therefore the analytical tools based on the assumption of rational optimization, are insufficient to explain economic behavior. Certain preexisting cultural norms are necessary to the successful functioning not just of premodern economic societies, but of postindustrial ones as well. The two most important areas in which this is evident is in firms and organization, and in the question of how societies control political corruption.

The Black Box of the Firm

One of the areas in which neoclassical economics seems the least satisfying is organizational theory, that is, the microeconomic theory of what goes on inside individual firms and how the latter are optimally organized. There is, of course, a highly developed neoclassical theory of the firm that explains the existence of firms in terms of transaction costs and the difficulties of monitoring and rewarding joint output (Coase 1937, Williamson 1981, 1985), as well as a critique of that approach that argues that firms can be seen as certain specialized kinds of markets (Alchian and Demsetz 1972). The fact of the matter is that models that see firms as no more than bundles of labor contracts or that try to extend the individualistic premises of markets into the inside of the "black box" of organizations almost always miss an important part of what is actually going on. Miller (1992) shows that neither hierarchies nor decentralized authority constitute optimal forms of decision-making under all circumstances, which means that managers have considerable latitude in designing organizations.

The limits of traditional economic theory in explaining how firms and organizations operate is evident when one considers the role of information in them. Economists have long understood that information is a peculiar commodity insofar as the first copy is often very costly or difficult to produce, while subsequent copies are essentially free. A firm owns the property rights to all the information generated within it, in theory, and therefore should be able to move that information costlessly from wherever it is generated to wherever it is potentially useful. But this never happens in any real-world organization: information owned by the firm is distorted, delayed, or otherwise used strategically by employees whose individual interests are never fully aligned with those of their fellows or of the organization as a whole. A great deal of economic theorizing about organizations has sought to solve such principal-agent problems by aligning the interests of individuals better with the organization through changing the incentive structure that they face.

These principal-agent problems can never be fully solved, however, if the agents behave like *homo economicus* pursuing narrowly-defined individual interests. A survey of the management literature over the past generation shows an emphasis not so much on structuring individual incentives, but rather on factors like leadership (Schein 1988), the building of corporate and organizational cultures (Wilson 1989), and motivating workers through loyalty and norms (Malone and Davidow, 1992). Successful organizations build social capital by bolstering worker loyalty, either to the firm as a whole or to fellow workers, and having the workers internalize group goals as their own. The extensive literature on the Japanese firm emphasizes the important of norms and social bonding to their success (Rohlen 1974; Abegglen and Stalk 1985; Dore and Aoki 1994). Organizations that build a high

degree of internal cohesion and mutual trust are able to achieve certain cooperative outcomes far more easily than those that are riven by individualistic internal competition. This is most obvious in military organizations that live or die by the amount of unit cohesion they are able to achieve (Marshall 1947), but it is also evident in modern economic organizations.

Many recent productivity-enhancing managerial innovations have exploited the informational advantages and incentive structures accruing to group-oriented, high-trust workplaces. The flattening of formerly hierarchical organizations in effect substitutes informal social capital for formal organization (Fukuyama 1999). Another example is just-in-time or lean manufacturing, which has replaced Taylorite forms of factory organization throughout much of the North American automobile industry (Womack, Jones et. al. 1991). Taylorism, or scientific management, was a real-life embodiment of Weberian bureaucratic rationality, in which complex production was organized hierarchically and incentives were purely individual economic ones. Lean manufacturing by contrast rests on the delegation of responsibility to groups of workers who build horizontal relationships and learn to trust one another. This type of organization produces huge gains in worker productivity because it makes use of social capital.

There are, of course, drawbacks to organizations that are too tightly bonded internally, from nepotism, inbreeding, and corruption, to resistance to innovation (Granovetter 1973). But social capital in the form of shared norms is a critical element that is necessary to the proper functioning of modern capitalism's micro-level institutions.

Reciprocity, Regions, and High-Tech Research and Development

Informal norms of reciprocity turn out to be critical not just inside the black box of the firm, but outside it as well, in regions and industrial districts. The fact that certain regions like the British Midlands in the nineteenth century, or central Italy and Silicon Valley in the twentieth, have been the loci of particularly intensive economic development has been a subject of interest to economists from at least the time of Alfred Marshall (1890/1920) to the present (Porter 1998). Most of these studies tend to focus on externalities like education or complementarities in skill sets to explain this phenomenon. But social capital and informal norms of reciprocity are also a critical part of the story.

Saxenian (1994) for example points out that, despite the apparent competitiveness and atomization of the information technology industry, there are a large number of social networks linking engineers and managers in Silicon Valley. These networks facilitate the informal sharing of valuable intellectual property between ostensibly competing firms. There is of course a great deal of sharing of intellectual property through formal mechanisms like cross-licensing and other types of contracting. But most accounts of the way that the Valley does business stress the importance of informal ties, which economize on transaction costs and greatly facilitate the movement of new ideas and practices within the broader R&D community. It is also the case that contracts between IT firms in Silicon Valley tend to be thinner than those negotiated between similar firms in other parts of the United States, because the parties tend to trust one another more and therefore feel that there is less of a necessity insure themselves against different contingencies involving opportunism and cheating.

In most cases the ties on which such trust relationships are based are modern and voluntary rather than ascriptive, such as common

educational background (e.g., attending the same electrical engineering department), common past employment (many leaders of the US semiconductor industry in the 1980s and 90s once worked for Fairchild Semiconductor in the 1950s and 60s), or in other cases participation in the Bay Area counterculture of the 1960s. In other cases, however, the moral bonds are more traditional. Shared religion (Mormonism) has played a role in the development of the software industry around Provo, Utah, and shared ethnicity has promoted a high volume of trade and investment between Silicon Valley and regions in both Taiwan and India (Saxenian 1999). Regions remain important despite the "death of distance" said to be brought about by the information revolution (Cairncross 1997) because networks of reciprocity are strongest when there is physical contact and contiguity. If two engineers who are friends but work for competing companies don't have the opportunity to meet at a bar or attend the same workshops or health clubs, they are much less likely to share information.

In other cases, however, technology has facilitated the growth of so-called "communities of practice" that transcend geographical limits (Brown and Daguid 1991). These communities are built around individual technologies, and involve informal sharing of intellectual property based on reciprocity. The open-source software movement is based on an explicit norm of reciprocity and the rejection of individual property rights, and has led to among other things the development of the Linux operating system, a product whose market value is measured in the billions of dollars.

Corruption and the Rule of Law

The 1990s saw a great increase in the awareness of the development policy community of the importance of political corruption

as an obstacle to economic development. A decade that began with the so-called "Washington consensus" neoliberal approach to development emphasizing markets ended with a realization that in the absence of effective state institutions, no development would be possible. This new consensus on the importance of what came to be called "governance" was reflected in the World Bank's 1997 and 2001 *World Development* reports (World Bank 1997, 2001).

The new emphasis on institutions simply begs the question, however, of how effective institutions are created. A great deal of thought has been put in recent years into the question of institutional design, and of the proper sequencing of institutional reform. As Klitgaard (1988) notes, controlling corruption is often a question of shifting the incentive structure facing bureaucrats so that there is a better chance they will be rewarded for doing their jobs honestly and a greater likelihood of being monitored and held accountable if they do not.

Most studies of political corruption conclude, however, that institutional reforms like professionalism in training, higher pay for public sector workers, and monitoring by outside agencies, goes only so far in controlling official wrongdoing. In particular, if leaders at the top of the government's various hierarchies (and especially the judicial hierarchy) are themselves corrupt, then no amount of institutional rejiggering will be sufficient to solve the problem. Controlling corruption, in other words, has a moral component was well: if the entire political and/or business elite in a country shares norms that tolerate bribery and nepotism, then even the best-designed institutions won't work.

As noted earlier, the iterated prisoner's dilemma game suggests that honesty and reciprocity (or at least, the *appearance* of honesty

and reciprocity) are not exogenous to a market-based economic system, since repeatedly interacting agents will develop a stake in good reputations. Adam Smith made a similar point when he talked about the civilizing effects of *doux commerce* (Smith 1776/1981, Hirschman 1982). But while some forms of honesty and reciprocity will arise spontaneously in a commercial society, what cannot be taken for granted is the existence of a generalized system of morality that will extend trustworthy behavior to public officials more generally. There are plenty of equilibrium outcomes in which public officials maximize their individual payoffs by accepting bribes or otherwise shortchanging the public interest. That one should want to exercise public office impartially, that a bureaucratic position is not an opportunity to steal on behalf of one's family, that politics is not simply a game for redistributing wealth, are all moral and political ideas that do not necessarily arise spontaneously.

The rule of law has traditionally been understood to act as a bridge between strangers, one that allows them to engage in market transactions. But how does one implement a rule of law if those responsible for creating it themselves do not trust one another, or behave opportunistically? There is a chicken-and-egg problem here that many developing and transitional countries face today: they need clean and transparent legal institutions in order to create a generalized system of trust that extends beyond a narrow circle of family and friends, and yet cannot create those institutions because of their inability to cooperate. Historically, modernizing societies in Europe and North America overcame this problem only as a result of cultural factors exogenous to the economic system. Whether such modernized, rule-of-law systems become self-sustaining once created is another question. Platteau (1994 II) argues that they are not; as evidence one

might point to the fact that even within the modernized European Union there remains a gradient of levels of corruption from north to south that correlates strongly with religion.

CONCLUSIONS

A century after Max Weber's gloomy conclusion that modern societies would be trapped within an iron cage of bureaucratic rationalism, we find that postindustrial economies have evolved in a rather different direction. He was proven the most wrong with regard to his view about the importance of centralized bureaucracy: decentralized markets and individuals within those markets have proven to be much more efficient allocators of resources than rational bureaucrats, a fact that has helped to keep bureaucracy in check in the latter decades of the twentieth century.

But Weber's predictions about the disenchantment of modern economic society have also not proven correct either. The contemporary global economy has its share of discontents, from inequality and insecurity to environmental and social damage. But the particular nightmare of Weber's age, that modern workers would be trapped as voiceless cogs in a gigantic, heartless Taylorite machine, has not materialized. A postindustrial economy's dependence on education and skills, and the difficulties of coordination in a high-tech, knowledge-intensive environment, have guaranteed the need for human judgment and creativity in the workplace, as well as the survival informal norms of reciprocity, trust, and shared values among workers. The latter are not just anachronistic holdovers from a bygone age of enchantment, but necessary to the efficient functioning of an information economy.

There is a further methodological implication. Modern neoclassical economics, with its focus on rational optimization, will

never be able to fully explicate the functioning of a modern economy. Embedded social norms, path dependencies, and moral commitments that come not from rational calculations of individual self-interest but from received authority, religion, history, and tradition, will be important to a full understanding of the economy, and yet remain outside of the scope of the science of economics as currently understood. These necessary aspects of modern economic life are accessible only through an economic sociology.

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