Architecture of Markets

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Abstract

Markets are socially constructed arenas where repeated exchanges occur between buyers and sellers under a set of formal and informal rules governing relations among competitors, suppliers, and customers. These arenas operate according to local understandings and rules that guide interaction, facilitate trade, define what products are produced, indeed constitute the products themselves, and provide stability for buyers, sellers, and producers. Marketplaces are also dependent on governments, laws, and cultural understandings supporting market activity. Our essay provides a brief exposition of this perspective. Then, it considers cutting-edge work on three topics: (i) the formation of markets and prices, (ii) the organization of capitalism in different societies, and (iii) financialization and globalization. We suggest that in the future, path breaking research will: (i) explore the sociology of consumption, (ii) combine insights from the sociology of markets and from studies of the role of economic thought in constructing markets, and (iii) investigate national and transnational regulations.

INTRODUCTION

The sociology of markets has been one of sociology's most vibrant fields over the past 25 years. At its core is the attempt to insert social theory and sociological perspectives into analyses of firms, markets, and industries. Mark Granovetter's declaration that economic action is always embedded in social life has been an intellectual rallying cry, opening a floodgate of research and bringing scholars armed with sociological ideas into the study of market activity. These scholars have deployed an impressive array of theoretical concepts to push forward this agenda.

It is useful to begin with some definitions. Markets are socially constructed arenas where repeated exchanges occur between buyers and sellers under a set of formal rules and informal understandings governing relations among competitors, suppliers, and customers. These rules and understandings guide interactions, facilitate trade, define what products are produced, sometimes constitute the products themselves, and provide stability for

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buyers, sellers, and producers. In modern capitalism, markets also depend on governments, laws, and larger cultural understandings.

One way to conceive of this is that participants in a market form *reproducible role structures*—that is, sets of recognizable participants who occupy certain positions (such as incumbent market leader or upstart challenger) and interact routinely over time. This view opens up the questions at the crux of the sociology of markets. What general problems must be solved for markets to emerge? How do role structures stabilize? How do markets evolve? How do they die or transform into other markets? Moreover, what is the role of states in the construction and maintenance of markets?

THEORETICAL FOUNDATIONS

THINKING ABOUT THE BASIC QUESTIONS

Markets defined as self-reproducing role structures can sometimes emerge without state intervention. Before the modern era, extensive relationships between market actors made this possible—relationships that often depended on common kinship, ethnicity, or religion. These commonalities created trust, allowed actors to monitor one another, and offered ways to settle grievances.

However, state oversight is crucial for the operation of markets today, especially given the complex division of labor that characterizes modern life. Formal laws granting property rights, safeguarding exchange and competition, and enforcing contracts make exchange more predictable and conflicts among market participants easier to resolve. State bureaucracies, such as regulatory agencies and ministries of trade and commerce, have also helped oversee and promote markets. These various forms of state intervention have emerged and evolved in response to economic crises (such as the economic depressions of the late nineteenth and early twentieth centuries) and to the demands of market participants through history. It is worth noting that state involvement has been necessary even for the establishment and management of markets often considered "free."

Informal rules and formal laws provide templates that make it easier for new actors to create new markets. This is not to say that such rules are neutral. On the contrary, most of the literature considers existing market rules to be the outcome of political processes. Government officials, workers, and employers engage in struggles to structure these rules to their advantage. Once in place, these rules tend to have big effects on economic development. Therefore, examining variations in these rules, and the implications for economic growth, has generated a great deal of scholarly interest.

For stable markets to emerge and distribute goods successfully, market actors must solve a range of problems. Their solutions then become regularized patterns of behavior, or sometimes formal rules, which make a particular product market, industry, national economy, or regional economy distinctive. For example, in the early stage of a market's development, a product's qualities need to be defined. Governments, firms, and even customers have input into the question of what count as safe food products, useful telecommunications standards, or tradable financial securities. Firms must also develop the competency and capacity to produce these goods. They need to be able to trust their suppliers, employees, and customers in order to secure inputs, labor, and capital. Thus, social relationships help firms stabilize their environments and guarantee access to scarce resources. Firms must even be able to forecast the activities and responses of their competitors in order to position themselves in the ongoing struggle for market share, and therefore need access to information on their competitors. Finally, by responding to directives from the government and trying to co-opt government agencies, firms can also secure their futures.

The sociology of markets also investigates the way social structures facilitate price-setting. While neoclassical economics traditionally treats price-setting as a "natural" and inevitable phenomenon—the intersection of supply curves and demand curves—the sociology-of-markets literature has shown that social relationships and common understandings about a product evolve over time to produce stable prices.

Scholars have also shown how the social structuring of markets shapes the behavior and organization of firms. For example, they have shown how social networks affect the birth and death of small and large firms. They have observed the development and spread of new products and financial innovations. They have investigated how and why firms change their organizational structure and their approaches to competition, explaining strategies such as product diversification, geographic expansion, vertical integration, and the allocation of leadership of the firm to one subunit or another. They have examined how firms are owned—such as by a wide range of public shareholders, by families, by banks, or by the state. They have studied the linkages among boards of directors of different firms. Moreover, they have investigated how firms raise capital: whether they turn to stock markets, bond markets, or bank lending, for example.

Theoretical Approaches: Network Analysis, Institutional Theory, and Political Economy

The sociology of markets draws heavily on three theoretical approaches: network analysis, institutional theory in organizational studies, and political economy. These three schools of thought offer different conceptual tools to make sense of what happens in markets. At the same time, there are overlaps in what each school stresses. For example, institutional theory and political economy both emphasize the state's role in constructing markets. Moreover, network analysis and institutional theory both explore how social structures transmit market information, define standard operating procedures, and generate trust.

Network analysis is a metaphor, a set of techniques to display data, and a way of studying the social mechanisms by which key market problems get resolved. If the sociology of markets' key insight is that market actors are embedded in social relationships that define who they are and what they do, then network analysis is the starting point for mapping those relationships. Formal network-analysis techniques have demonstrated how the relationships among actors help explain what they will do: whom they will hire, with whom they will trade goods and exchange capital, how often they will repeat such transactions, and so on. Networks also serve as conduits for information, operate to mitigate problems of trust, and control resource dependencies. It is now firmly established that the connections among actors can affect prices, increase the probability that well-connected firms will survive, and help market participants compete better and find customers and suppliers.

On the one hand, institutional theory emphasizes informal understandings and cognitive frames that shape the social structure of markets. Institutional theorists often conceptualize markets as fields where firms watch one another, imitate one another, and build niches to reproduce their positions. The observant and reflexive character of firm behavior can often mitigate competition and stabilize markets.

On the other hand, institutional theory also stresses how the formal laws, regulations, and actions of states and courts have profound effects on market structure. It argues that states and markets are joined at the hip. Moreover, firms can appeal to states for help. When incumbent firms successfully shape the rules governing their industry, they can reproduce their leading positions over time. Institutional theory also stresses not only how states set rules and enforce sanctions, but how they define what types of products are appropriate for exchange. Meanwhile, institutional theory also examines how the internal dynamics of states affect the way they intervene in markets. The structure of courts, ministries, and regulatory agencies, as well as struggles among parties and political factions, all affect state intervention.

Political economy has pioneered thinking about the linkages between states, law, and markets and the historical emergence of systems of governance. The political-economy literature on "comparative capitalisms"—the comparative study of capitalist arrangements and their effects on various outcomes, including economic development—is a fundamental part of the sociology of markets. This literature has revealed that the relationships among governments, workers, and capitalists have varied dramatically over time and geography, and that economic trajectories are often culturally and nationally specific. Markets are not "brought" by outsiders, but instead are social and political constructions reflecting a country's culture, its history of class relations, and the various interventions its governments have carried out through history. In this view, each national system of capitalism forms an integrated whole: an enmeshed set of institutions such as systems of labor relations, modes of capital allocation and corporate control via securities markets and bank lending, systems of education and training, tax systems, and state involvement and ownership in key industries.

The political-economy literature has been the most forthright about trying to understand which such systems produce the most sustained economic growth. Scholars have documented that different national systems of capitalism exist and have debated how to fit them into categories, such as on the basis of national protectionism, levels of state intervention, and modes of capital allocation to firms. Yet beginning with the collapse of communism in the late 1980s, a whole series of studies began to appear asserting that differences among national capitalist systems would soon disappear. These studies predicted that as global capitalism spread and barriers to international trade and capital flows crumbled, production and consumption would shift to those countries with the most efficient market institutions, bringing governments to their knees and forcing rapid convergence to a generic liberal model of capitalism. However, this prediction proved false. Research suggests that national systems of capitalism are resilient, even in the face of political and economic crises. This has led other scholars to conclude that key features of these systems must allow firms, states, and workers to adapt efficiently to new challenges.

In spite of the differences among these three theoretical perspectives, all three can advance the sociology of markets. Their concepts, language, and data-analysis techniques form a toolbox that could plausibly be used to analyze a particular market. One of the dangers in the sociology of markets is that scholars often focus on their favorite mechanism at the expense of other possible ways to understand what is happening in their market of interest. At the end of the essay, we discuss how to solve this problem.

CUTTING-EDGE RESEARCH

Recent scholarship has offered critiques of these perspectives and has thereby advanced innovative research agendas. We focus here on three streams of work, going from micro to macro. First, we consider recent work on the creation of "market devices." Then, we consider research on comparative capitalisms and development, particularly in China and Latin America. Finally, we return to the issue of globalization and the potential for convergence among market forms by considering the literature on financialization and globalization.

Market Devices

The literature on market devices focuses on a problem that neither network analysis nor political economy is very good at treating (but that institutional theory arguably is). For markets actually to work, products need to be created, evaluated, and priced. The institutions that do this are "market devices." The literature includes at least two approaches to thinking about them. One originates with the idea that we need conventions to make judgments of price and quality simpler. For example, if a bank wants to loan money, it must judge each customer's creditworthiness. Over time, ratings agencies have developed different quantitative yardsticks that allow banks to judge the riskiness of loans. In commercial lending, these ratings involve putting letters from AAA to D on borrowers' credit. On the consumer side of the market, agencies' credit scores rank people on a numerical scale.

The problem of price-setting is a very general one with far-reaching implications for firm behavior. Deciding how much to pay someone, whether or not a bottle of wine is worth $50, and how we would make such judgments require a whole infrastructure in markets to justify these kinds of social comparisons. Many of these comparisons involve rankings and other quantitative indices. Once in place, such market devices take on a life of their own. Actors in markets use them not just to decide what to buy or sell, but to measure themselves and their performance against others. Rankings can push firms to reevaluate their strategies and tactics in order to improve their standing.

This brings us to a second way in which market devices get constructed: via the "performativity" of economics. One area of work that has been particularly productive has examined how principles and quantitative models from economics can structure financial markets. For example, there is a body of theory in economics that discusses how different types of auctions work. Not surprisingly, sellers deploy this knowledge to auction hard-to-value objects. Thus, the science of economics actually makes the market for such objects possible. In the case of futures contracts traded on exchanges, derivatives traders' use of the Black–Scholes–Merton (BSM) theory for pricing derivatives actually caused prices to approach the values that BSM predicted. *Scholars* term the implementation of economic ideas to structure markets "performativity." This label implies that we self-consciously take an idea and put it into practice: literally, we perform it. Once in place, performed market devices can take on a life of their own as well.

Comparative Capitalisms

The literature comparing national capitalisms and their trajectories spans not just sociology, but also political science and economics. Scholars have made several advances here. First, national models of property rights, labor markets, training systems, and competition differ greatly around the world—and yet appear to be relatively stable within each country. There have been efforts to categorize these models across countries. Yet classification efforts often stumble, since economies sharing features of one type of institution (e.g., education, labor, corporate control, and tax rates) may differ in another. Nonetheless, there is evidence that liberal systems such as the United States and Great Britain form a type. "Coordinated" systems appear to be more heterogeneous. Moreover, regardless, there is no evidence that all national systems are converging to a single form.

Scholars have also sought to understand economic transformation in the post-socialist world and other developing economies. They have documented the collapse of institutions in Eastern Europe and Russia and have analyzed the features of the systems that have taken their place. China has also been the focus of sustained study. The main issues in this literature involve the role of the state in the market. Research shows that states with disorganized bureaucracies and poorly paid, incompetent bureaucrats are more prone to use their position to gain financial advantage by helping their friends and family or taking bribes and payoffs. This makes it harder for firms to do business and slows economic growth. Scholars also agree that defining property rights clearly and assuring the rule of law are important to development. However, establishing such institutions is difficult to do from above; they usually arise dynamically from the demands of firms and citizens. Also controversial is the relationship between economic development and state investment in particular firms and industries. States have done this successfully in some cases, but failed miserably and wasted scarce resources in others.

Financialization and Globalization

Financialization is a set of related phenomena. It comprises the growing dominance of finance tools in the management of firms, the ability of financial markets to dictate what firms and governments do, and the growth and importance of the international financial system in the distribution of capital around the world.

The growing dominance of finance tools corresponds with the rise since the 1980s of the shareholder-value view of the firm, particularly in the United States. These tools allow managers who view the firm through the lens of the balance sheet, such as chief financial officers (CFOs), to maximize shareholder value. The basic idea of the shareholder-value view is that firms exist to provide returns to shareholders. Shareholders of publicly held corporations care primarily about two metrics: (i) share price and (ii) the ratio of profits to assets. With this in mind, managers use a range of tools to increase these metrics, including financial engineering of balance sheets, outsourcing, downsizing, investing in technology, cutting salaries and benefits, and increasing the working hours of the employees who remain. Upper-level managers frequently receive shares and bonuses for meeting financial targets.

The rise of the shareholder-value view, and the concomitant ascendance in power of finance-oriented managers (such as CFOs) and the rise in importance of financial devices, originated in firms' changing relationship with the financial markets. Scholars have documented that during the 1980s' merger movement, institutional investors pushed management teams to increase their profitability. When managers resisted, their firms became takeover targets. Since then, the relationship between the financial markets and the largest corporations has been symbiotic.

Corporations' re-orientation toward shareholder value and the financial markets is not the only manifestation of financialization, however. Financial markets themselves have also grown enormously and integrated globally. Net transnational flows of bonds, bank capital, investment capital, and derivatives each dwarf the revenues of major corporations and even many states. The globalization of finance may mean that governments are increasingly hemmed in by financial markets, and that firms have no resort but to do what financial markets reward.

FRONTIER ISSUES IN THE SOCIOLOGY OF MARKETS

The frontier issues we consider here are areas where interesting work is beginning to appear and where future work should go. They are, nonetheless, linked to the cutting-edge issues discussed above. We consider the sociology of consumption, the link between arguments about performativity and market devices on the one hand and the sociology of markets on the other, and the survival of national models and the problems of national and international regulations in an era of globalization. While these topics seem disparate, they link with the existing base of knowledge and extend that base in fruitful directions both theoretically and empirically.

Most of the sociology of markets ignores consumption, focusing instead on production (something that happens in economics as well). However, there are links worth exploring between the study of consumption and existing questions in the sociology of markets. One such matter that already has a literature is the question of what goods can and cannot be bought and sold. How is that some products once thought impossible to "marketize" have become commonplace in markets? The rise of Islamic finance provides a striking example. Many Muslims (though not all) consider the charging and collection of interest to be religiously unacceptable, sometimes leading them to keep their savings out of the banking system. However, in the 1970s, driven by the rising price of oil and a growing pious bourgeoisie in the Islamic world, Islamic banks emerged. These institutions conduct financial operations by employing asset sales between the bank and the customer to replace interest with profit markups. Today, Islamic financial institutions offer a wide range of products including Islamic credit cards, Islamic bonds, and even Islamic derivatives—products that many Muslims once considered un-Islamic.

Life insurance also offers examples of the marketization of new goods. Over the course of the nineteenth century, life insurance went from being viewed by many Americans as a macabre commoditization of death to being considered a prudent way to provide for one's family. More recently, during the 1980s and 1990s, selling one's life-insurance policy to a third party went from being widely considered morally abhorrent—because it gave someone else an incentive to wish for one's early death—to being the basis for a new market in "viaticals." The AIDS epidemic moved forward this transformation in markets: as AIDS patients faced rising health-care bills and poverty, they sought to sell their own life-insurance policies. Here, the moral discourse in favor of a dignified death came to trump the moral discourse against betting on death, producing a new market.

More generally, the sociology of consumption has stressed that consumption is often an attempt to secure social status and "produce a lifestyle." Historians and historical sociologists have documented how this process occurred in early modern Europe, when the newly rich bourgeoisie tried to mimic the nobility. This led the nobility to shift the markers of high social status continuously in order to retain their edge over the rising bourgeoisie. In more recent times, such status hierarchies are dynamic and continuously shifting. One important place to observe such processes is in the race for positional goods such as cars, good schools, fashion, and houses. As income inequality has increased in America, the price of positional goods has increased. In order to keep up, working-class Americans have taken on debt to finance their consumption and "keep up."

In the sociology of markets, research into financialization connects the study of consumption with the study of production. As firms are increasingly pushed by stock markets to judge their performance by financial criteria, households too have been pushed to become more financially savvy. Americans must pay more and more attention to managing the current and future costs of health care, education, declining pensions, and mortgage debt. As some scholars have noted, households must now learn to learn to manage their assets and debt much like firms do. Going into debt to keep up with the Joneses, or leveraging home equity to finance one's children's education, are viewed as reasonable life decisions.

This raises the issue of morality again, albeit in a different context. While many Americans used to consider taking on debt immoral, accumulating debt is becoming normative as they increasingly apply a financial calculus to their spending, and as low interest rates and financial deregulation encourage firms to offer cheap credit to consumers. Research connecting increasing social inequality, interest rates and deregulation, and changes in the way households think about consumption patterns and their "financial balance sheets" has barely begun.

The creation of market devices generally, and the more specific problems of the creation of complex financial products and the globalization of finance, have produced an important new literature in economic sociology. However, so far, there have been few attempts to bridge the gap between approaches that focus on the *instruments* allowing markets to function (i.e., market devices) and those that emphasize the *social structuring* of markets themselves. This is the deepest epistemological gap in the sociology of markets today. Scholars focusing on instruments tend to be grounded theoretically in science and technology studies (STS) and the social studies of science in general, in actor-network theory, and in a strong appreciation for the technical details of the machines that make markets work. This scholarly tradition is strongest in Europe (including the United Kingdom). On the other hand, scholars focusing on social structuring are grounded theoretically in the "embeddedness" version of the sociology of markets, which emphasizes institutions and social networks in explaining the behavior of firms and consumers. The embeddedness approach is dominant in the United States.

Each side of this epistemological divide has received thoughtful critiques. Scholars focusing on market devices have been criticized for fetishizing technical detail, for underemphasizing human agency as opposed to the "agency" of machines, and for not always making clear how markets change through history.

However, the embeddedness version of the sociology of markets has come in for criticism as well. Research into performativity has shown that the economics profession provides tools to make markets possible. This means that neoclassical theory is not just an attempt to describe what markets do, but also a set of prescriptions for how to set markets up in the first place. This suggests in turn that studies of market processes focusing on firms, their interactions, and their strategies miss the point: without focusing on the principles and technical detail that the economics profession offers, we cannot understand the construction of markets. The most fruitful site for this perspective has been the sociology of finance. Here, there is clear evidence for a dialectical relationship between the financial-economics profession and the evolution of markets.

Another critique of the embeddedness perspective arises from the observation that financial markets, once constructed, take on a logic of their own. This overwhelms the efforts of firms to shape them or governments to regulate them. According to this critique, the "actors" we should focus on are not firms and governments, which are rendered less powerful by financialization, but rather the interlinked computer systems that sit in the main international centers of finance and structure global capital flows.

While the aforementioned critiques of both epistemological positions in the sociology of markets have generated important research, there are ways future studies can bridge the divide. One approach would be to focus on the role of government, which helps shape both market devices (such as the electronic infrastructure of commodities markets and financial markets) and market institutions that build trust and enforce contracts (such as laws and regulations).

A second approach would be to focus on the links between firms and the instruments they use. For example, in the markets for most financial securities, the main players are a relatively small number of large global banks. The trading floors for financial products are integrated into these banks themselves, and the banks have a presence in international financial hubs such as London, New York, Tokyo, and offshore banking centers in Switzerland, the Bahamas, and Luxembourg. Sudden changes in the stability and survival of certain financial markets offer opportunities to explore linkages between the internal organization and strategies of the largest banks and the complex financial instruments. In one such case, the financial crisis that began in 2008, these banks held and traded collateralized debt obligations and credit-default swaps at ever-higher volumes, leading to the near-collapse of the international financial system. Research that integrates the technical study of financial instruments with a holistic understanding of the institutions and social structures in which markets for these instruments are embedded is an important way to prevent such crises from happening again.

Moving away from the epistemological divide, this brings us to one more frontier for future research: the study of national capitalisms and systems of regulations in light of financialization and globalization. Scholars have struggled for years to understand how national systems of governance respond to global pressures. Many consider it inevitable that global economic pressures, including the whim of sovereign-bond markets, will limit national governments' degrees of freedom. This will force governments not only to deregulate product markets, but to cut back on welfare expenditures and labor protections. However, evidence for this "race-to-the-bottom" proposition is mixed at best. While there have been some changes in the way that governments regulate, tax, and spend in the past two decades, there is no consistent trajectory across countries. Many of the national capitalisms have changed in response to global challenges, but most have retained their core features.

This implies several interesting research agendas. First, states and national firms may not really be feeling the pressures posited by globalization theorists. Indeed, these national structures may be capable of adjusting to, and even taking advantage of, global economic pressures. Second, it could be that government officials themselves are in fact the principal drivers of the globalization agenda, as they seek to stimulate economic growth in their own economies. States are the principal parties to most international agreements such as the North American Free Trade Area (NAFTA) and the European Union (EU). Not surprisingly, these large agreements have stimulated trade within their bailiwicks.

Global treaties to govern the flow of capital, trade, and now global warming have proven difficult to secure. A small army of scholars is looking into these problems—and the sociology of markets should offer them some clues. Today, firms from many countries participate in the global organization of production and consumption. According to the sociology of markets, one force that either pushes forward agreements or keeps them from happening is the degree to which global competitors have formed a stable market where they can achieve consensus. One institution in which firms seem to have achieved stability and consensus is the Basel Accords, which govern international banking and set standards for reserve requirements and forms of prudential regulation. While the Basel Accords have faced some difficulties, their content and very existence reflects a general consensus that banks should operate on a level playing field. Banks themselves have generally supported the Basel Accords (while simultaneously seeking influence over their own national systems of banking regulation). Studying the achievement of international consensus among firms and states in banking, and applying the lessons learned to other industries and arenas, would be worthwhile.

In conclusion, the sociology of markets has laid down a tapestry of compelling theoretical perspectives and empirical work. We strongly suggest that scholars active in one branch of the sociology of markets search the broader literature for useful tools. Instead of ensconcing ourselves in theory camps or narrow research paradigms, we should step back and realize that we have created a rich toolbox of concepts—a toolbox ready to produce deeper and more nuanced understandings of markets.

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