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The Market as an Environment

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The Market as an Environment

Alex Viskovatoff

Abstract

More than perhaps any other major social theorist, Niklas Luhmann adopted a perspective on society at the opposite end of the atomistic-holistic spectrum to that of mainstream economics. While the position of mainstream economics is that society is nothing more than a collection of individuals, so that it can be understood simply in terms of those individuals and their interactions, Luhmann abstracts from individuals entirely, understanding social phenomena as being produced by society itself, with individuals playing a merely peripheral or “enabling” role. This radical reconceptualization of society and the relation of the individual to society allowed Luhmann to build from the ground up a highly systematic theory of society which allows one to formulate economic and social questions in new ways, freed from preconceptions that are poorly grounded or simply wrong. After providing a brief overview of Luhmann’s general social theory, this article considers two questions for which Luhmann’s theory can produce a fresh point of view. The first concerns what is the nature of markets. According to Luhmann, markets are not a kind of system (the common if tacit view), but collections of observations—the observations of market participants of other market participants. The second concerns the old question of what is the appropriate degree of intervention in the economy. Mainstream economics approaches this problem through the distinction between (free) markets and planning. According to Luhmann, this is a false dichotomy, since all economies have markets and planning. The real question is who should do the planning: private organizations or the state. The former operate on the basis of competition, that is, rivalry; the latter operates on the basis of cooperation. The problem with “socialist” or “centrally planned” economies was not that they were planned or centrally organized, since “free market” economies have planning and centralization too; it was that they relied solely on cooperation, with there being no space for competition. The paper concludes with some reflections on whether freemarket economies with minimal intervention by the state are any more sustainable than are “socialist” economies.

Niklas Luhmann, peut-être plus que les autres auteurs en théorie sociale, a adopté une approche de la société qui est à l’opposé du spectre individualisme-holisme des économistes orthodoxes. Alors que l’économie orthodoxe considère que la société n’est rien d’autre que la somme des individus et qu’elle ne peut être appréhendée qu’en termes d’individus et de leurs interactions, Luhmann fait totalement abstraction des individus et comprend les phénomènes sociaux comme étant produits par la société elle-même dans laquelle les individus jouent un rôle périphérique ou un rôle “d’habilitation”. Cette radicale reconceptualization de la société ainsi que la relation des individus à la société a permis à Luhmann de construire une théorie très méthodique de la société qui permet d’appréhender de façon différente les questions économiques et sociales, sans préreprésentations fragiles ou erronées. Après avoir donné un aperçu général de la théorie sociale

de Luhmann, l'article considère deux questions pour lesquelles la théorie de Luhmann peut apporter un nouveau point de vue. La première traite de la nature des marchés. D'après Luhmann, les marchés ne sont pas une sorte de système (comme cela est souvent considéré) mais des sommes d'observations faites par les participants au marché sur les autres participants. La seconde question concerne l'éternel problème du degré d'interventionnisme dans l'économie. Les économistes orthodoxes abordent cette question à travers la distinction entre les marchés (libres) et la planification. D'après Luhmann cette dichotomie est erronée dans la mesure où toutes les économies connaissent à la fois le marché et la planification. La véritable question est: Qui devrait planifier: les organisations privées ou l'Etat?. Les premières agissent sur la base de la concurrence, i.e de la rivalité; l'Etat agit sur la base de la coopération. Le problème avec les économies "socialistes" ou "centralement planifiées" n'est pas qu'elles sont planifiées ou qu'elles relèvent d'une organisation centralisée puisque les économies de "marché libre" connaissent aussi la planification et la centralisation. Le problème vient du fait qu'elles reposent uniquement sur la coopération et n'accordent pas de place à la concurrence. Le papier conclut en s'interrogeant sur l'idée selon laquelle les économies de libre marché avec une intervention étatique minimale sont plus viables que les économies "socialistes".

KEYWORDS: Niklas Luhmann, Theory of social systems, Economic sociology, Markets, Socialism, Sustainable growth

THE MARKET AS AN ENVIRONMENT

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1. Introduction

Although the main subject matter of mainstream economics is the market economy, it is safe to say that mainstream economics does not have a very developed concept of the market. For example, a recent book intended to explain “the market system” to laymen only spends three pages discussing markets themselves, finding it sufficient to define them simply with the observation that “Whenever people frequently pay other people to do something — sing a song or dig coal — those interchanges constitute markets”¹. What distinguishes the market system is that it “organizes or coordinates activities not through governmental planning but through the mutual interactions of buyers and sellers.” From this point of view, it seems that there is not very much more to a market than the buyers and sellers themselves, left to their own devices to conduct transactions with each other.

This should probably not be too surprising, since mainstream economics follows not merely a *methodological* individualism, but also employs an individualistic *ontology*: although all European languages have their own word for ‘society’, according to this ontology, a society is nothing more than the individuals who belong to it, together with the way in which they interact — in the case of market economies, one-on-one, with no direction from what is called the ‘state’. In this paper, I shall discuss the account of markets of that contemporary social theorist whose understanding of society is essentially the polar opposite of that of mainstream economics. According to the late German sociologist Niklas Luhmann, society is a *system*, and individuals barely appear in his account at all, since they

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¹ Lindblom-2001, p. 4.

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are not part of society and do not belong to it, but are part of its 'environment'.² For Luhmann, society is an emergent system, so that a sociologist can theorize about society without considering individuals in the same way that a cognitive scientist can theorize about cognition without considering neurons, or a chemist can study chemical reactions without constantly needing to express everything in terms of quantum mechanics. As one might expect, this approach has led to a theory that is of unparalleled complexity and conceptual richness, even if its precise empirical status is a matter which has yet to be determined. Thus in a volume devoted to various approaches to understanding markets, Luhmann's work is well worth considering.

Luhmann's theory is highly integrated, so that it is impossible to understand any portion of it without some familiarity with the theory as a whole. Before discussing markets therefore, I will briefly introduce Luhmann's theory of social systems. I will conclude by considering what one can learn from Luhmann's theory about how we should think about the proper relationship between the economy and the rest of society.

2. Luhmann's theory of social systems

Luhmann was a student of Talcott Parsons, and from the very start Luhmann believed that a sociological social theory must be a system theory. However, his theory only took its mature form when Luhmann became acquainted with the theory of *autopoietic systems* of Maturana and Varela³. Previous system theories such as Parsons' had been concerned with how systems regulate themselves or maintain boundaries with their environment; what was fundamental to systems as conceptualized in the new theory of Maturana and Varela is that systems produce themselves by producing the elements out of which they consist. The systems with which those authors were concerned were primarily biological: organisms produce themselves by continuously producing new cells, while cells produce themselves by producing various organic molecules. This theory provided Luhmann with a way of conceptualizing social systems which could analyze their 'way of being' without needing to bring individuals into the analysis; the only thing that needed to be decided was what are the elements out of which social systems consist. In his first article written after he was exposed to this theory, Luhmann used actions for this purpose (in the sense introduced by Parsons⁴ of social action), but he soon settled upon *communications*. The problem with action here

² Indeed, Luhmann thinks that 'individual' is an outmoded concept, no longer tenable given the present state of science. It represents a haphazard assembly of valid scientific concepts, namely (human) organism, cognitive system (*Bewusstseinsystem* or *psychisches System*, and person (an individual seen as a social construct) (Luhmann-1985).

³ Maturana/Varela-1980.

⁴ Parsons-1937.

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is that any action is associated with a particular person, namely the person who produces it. Communication in contrast is quintessentially social: a communication is 'emitted' by one actor, but it is directed at one or more others, and the 'reception' of the communication by those others is as important to the communication's taking place successfully as was the original emission. Furthermore, communication cannot be reduced to the activity of individual minds, since while the communication is produced by the intention of the emitter and is grasped (if successful) by the understanding of the receiver, the transmission from the one to the other is something that occurs outside of the mind of either individual.⁵

Since it is not individuals qua individuals that produce communications therefore, but individuals as they stand in certain social relations to each other, we can say that social systems produce communications; in so doing, social systems produce the elements out of which they consist. To be sure, individuals are an essential 'substrate' in this process; but, according to Luhmann, it would be as ill-conceived to bring particular individuals into the picture of how a social system produces itself over time by producing communications — which are "temporal elements" — as it would be to worry about individual neurons when one is considering how one thought produces another.

This then is the basic 'ontology' of Luhmann's theory, developed at length in the first of his two master works, *Social Systems*⁶. There are three kinds of social systems: interaction systems, which involve actors being in the direct physical presence of each other; formal organizations, like private corporations or public bureaucracies, which distinguish themselves from their environments by having particular individuals formally attached to them; and society itself. Modern society is differentiated into functional subsystems — the economy, the political system, the legal system, and science being the most noteworthy from the point of view of the theory, in that they all lend themselves to rather involved system-building, and that each has a particular *symbolically generalized communication medium* associated with it. These media are, for the subsystems just listed, respectively money, power, law, and truth.⁷ In these functional subsystems, communications take a special form, as a result of the symbolically generalized communication medium employed in

⁵ Luhmann-1988. It is precisely this characteristic of communication of having a 'being' outside any of the minds that participate in it that made Searle (Searle-1995) not include it in his social ontology, thus forcing him to introduce his notion of "collective intentionality" instead (Viskovatoff-2003b).

⁶ Luhmann-1995.

⁷ Luhmann adopted the term from Parsons, and the concept of a symbol as a signifier does not play a major role here. The idea is simply that something—for instance, metal coins—allows a whole constellation of related meanings to be developed with this 'symbol' as a kind of anchor. What Luhmann means by "symbolically generalized communication media" can be best grasped by considering what the various communication media have in common and how they serve to distinguish the operations of the various functional subsystems from each other—a market transaction from a declaration of love, for example. (Love is a symbolically generalized communication medium, according to Luhmann.)

each: thus, the economy consists of payments, which involve the exchange of money; the political system reproduces itself by producing binding decisions; the legal system reproduces itself by producing legal decisions; and the science system consists of scientific communications, publications in particular.⁸

Luhmann is quite radical in his move to make social systems autonomous of individuals, of their intentions, beliefs, and minds in general. He takes the position that meaning “has no carrier”: both cognitive systems (*i.e.*, individuals’ minds) and social systems “produce meaning”, and it would be wrong to conclude that minds are more fundamentally involved in processing meaning than social systems are. As I argue in my article⁹, this is extremely counterintuitive: there seems to be a close connection between the processing of meaning and consciousness, and even if one accepts most of Luhmann’s theoretical ontology, one would be reluctant to think of social systems as conscious. An analogy with cellular biology might be helpful here. It is sensible to talk about cells producing themselves by producing the lipids, fats, proteins, and so on out of which they consist, without considering the reactions involved in detail. One can get a basic handle on what is happening by saying that the cells produce these complex molecules under the control of their genes. But it would be to miss an essential part of how cells produce themselves to leave out the role of the genetic programs altogether, and say that the cells’ molecules produce themselves, leaving it at that. But that is essentially what Luhmann does when he says that social systems produce themselves by producing communications. So it would seem that we need an analog for social systems to the DNA of cells.

The obvious candidate here is rules. According to the accounts of philosophers from Kant to Wittgenstein, following a rule is the very essence of thought and rationality. Thus, we can follow Luhmann in saying that individuals do not make up social systems, but deviate from him by declaring that rules are an essential component of social systems, so that social systems consist of communications *and* rules. From this point of view, individuals are not more ‘fundamental’ or ‘original’ than social systems, since individuals get their rules — which they require for thought — from society.

⁸ To use Rossbach’s (1993) example, mainstream economics reproduces itself through the publication of papers containing formal models. This example gets across well the nature of modernity that Luhmann was trying to do justice to in his theory. To non-mainstream-economists, and to some mainstream economists themselves, the production of such models is not really a meaningful activity, since no one has ever been able to show these models relate to real economies (see, *e.g.*, Viskovatoff-2003a). To that social system which is mainstream economics however, meaningfulness, or the activity making sense in human terms, is a matter of complete indifference: the only thing that matters is that the system continues its process of self-production. One can thus see that what Luhmann offers is a kind of dynamized structuralism.

⁹ Viskovatoff-1999.

3. The market

Luhmann was an extremely prolific author. His books can be divided into two categories: the 'systematic' works and occasional ones. Aside from *Social Systems*, Luhmann's main masterwork is *The Society of Society*¹⁰; this lays out the final version of his social theory, with its notions of societal differentiation, symbolically generalized communication media, societal evolution, and societal self-description. But in addition to these two works of a general nature, there is a series of volumes devoted to the particular functional subsystems: *The Science of Society*, *The Law of Society*, and so forth for art, politics, religion, and the education system¹¹. The first of these specific works to appear was *The Economy of Society*.¹² In the ten chapters of this book, Luhmann progressively applies various theoretical concepts of his to the economy. In this section, I will draw on the chapter, "The market as the internal environment of the economy"¹³.

Luhmann begins by noting that from the point of view of system theory, the market can be either a system or an environment.¹⁴ We have already seen how the economy can be 'observed' from the outside as a system consisting of payments. When one considers how systems within the economy perceive or observe the economy however, we notice that such "participating systems" (mostly households and firms) see the economy "as that unity which spans the difference between the participating system and its environment which is specifically economic". (The principles that allow such participating systems to maintain

¹⁰ Luhmann-1997.

¹¹ Luhmann-1990, Luhmann-1995/2000, Luhmann-2000a, Luhmann-2000b, Luhmann-2002.

¹² One can conjecture that two reasons for Luhmann's singling out the economy to be the first to receive systematic treatment is because the economy is now the preeminent subsystem of society, and because money serves as the paradigm for a generalized communications medium, as it did for Parsons.

¹³ Luhmann-1988, pp. 91–130.

¹⁴ The concept of difference, particularly the difference between two opposed concepts, is central for Luhmann; since social systems are "meaning-processing systems", the way they build or maintain themselves is by positing a difference between themselves and their environment. A system's environment therefore is everything that is not the system. A social system has a social environment—which is all of society that is not the system itself—as well as its environment *tout court*, which consists of the physical world and individual human minds. Inherent in the notion of environment is that it is an environment *for a particular system*, and thus implies a 'perspective', although Luhmann does not use that word. Thus, there can be no environment without a system, since a given environment is in effect the rest of the world seen from the point of view of a particular system, namely the one with the environment in question. Furthermore, while systems produce themselves and have a unity, environments are "just there", without any self-production, unity, or identity of their own. That does not mean of course that a system cannot have other systems in its environment; these other systems are however opaque to the system in question, their internal operations being inaccessible to it.

themselves need not be economic, involving bureaucratic organization in the case of firms and intimacy in the case of households. Furthermore, for systems to have an economic environment, the society must have an economic subsystem which has differentiated itself from the rest of society, something that for Luhmann is an evolutionary attainment of modern society.) With this in place,

One can thus see the market as the environment of systems participating in the economy that is internal to the economy; this environment is *different for each system*, but at the same time is *the same for all*. The concept of the market thus denotes not a system, but an environment—but an environment, that can only differentiate itself out as a system, in this case the economic system. As the market, the *economic system itself* becomes the *environment of its own activities...* The “external environment” — state politics, technological developments produced by the science system, material and human resources, ecological changes — is not touched by this. But this environment can be observed differently in the market than it is when an external observer, say a sociologist or an environmental scientist observes the economy in its environment. In the market one observes only with the help of prices, that is, with a reduced, circularly closed network of mutual influences. With that one can under the proper circumstances see *far*, but in any particular case, *not be aware of appreciable complexity*¹⁵

We here come to a key aspect of Luhmann’s theory. Each functional subsystem sees its environment from a particular perspective, which is determined by the particular generalized communication medium it employs. The development of such a specialized perspective, together with specialized practices, enables it to attain a high degree of complexity, and thus be very good at solving the particular kinds of problems with which it deals. It also means that a functional system will not be sensitive to and often not even aware of factors which do not fall within its particular perspective. For example, the economy may be capable of allocating resources efficiently, but it will be indifferent to its effects on its environment, and on its physical environment — the earth’s ecology — in particular.

According to Luhmann, with the market, the economy makes itself into an environment, so that the economy can observe itself. This observation is not made by the economy taken as a whole; instead, each act of observing is done by a particular participating system. Since each such system is part of the economy however, we can say that when such a system observes the economy by observing the latter from the inside and from its particular vantage point, the economy is observing itself.

¹⁵ Luhmann-1988, p. 94; emphasis in original.

3.1. Planned economies and subsistence economies

With this conceptualization of the economy as a self-observing system in place, the very idea of a “planned economy” becomes an absurdity. As Luhmann says, “such systems cannot be planned”¹⁶. The reason for this is that since the system is self-observing, it will always notice moves to influence it, and respond accordingly, in unpredictable ways. A self-observing system for Luhmann is something very different than an automaton, whose principles of operation are fixed and can be exhaustively deduced, and which is hence predictable. As they observe themselves, systems learn, and thus their behavior changes. For Luhmann, to contrast a market economy with a planned economy is to commit a category error (although he does not use that term). He observes that to make the distinction between a market economy and a planned economy, where the latter is planned by the state, is simply to introduce a second time “the general schema of functional societal differentiation”, according to which the economy is different from the state, so that it makes as much sense to contrast a market economy with a planned economy as it would make sense to contrast a market economy with science, with the family, or with formal education. But this is not to say that there will be or should be no planning at all. The question is not whether a market economy is better than a planned economy, but “who does the planning in a market economy, and how centrally and how successfully does he do so”¹⁷. The real opposite of a market economy is a subsistence economy. In the latter, households or communities produce only for their own needs and meet their needs by doing so; this closes off the possibility of the division of labor and further forms of “system-building”.

3.2. Competition

Competition is seen as central to the market economy, both by mainstream economists and by other advocates of the “free market”. But both have relatively little to say about what competition actually amounts to, other than its being a buyer or seller finding himself in the position that he needs to make himself more attractive to participants *on the other side of the market* than he would need to do if he had no competitors. For Luhmann in contrast, the central characteristic of competition is that a competitor orients his attention around the anticipated possible actions of his *rivals*. What is special about competition compared to a conflict between rival actors is that in competition, rivals as a rule have no contact with one another, so that there is no need to spend time on interaction and communication, which means that market events can occur virtually instantaneously, and over unlimited distances. “The reaction to events is not produced over long chains linking interaction to interaction, but through an almost simultaneous reaction of many to what many anticipate as the reaction of

¹⁶ Luhmann-1988, p. 96.

¹⁷ Luhmann-1988, p. 97.

others”¹⁸. The pace of market activity becomes so quick that a “practically uncontrollable dynamic peculiar to the market” is released, with markets usually being able to react only to events and changes, as opposed to processing relatively static, structural aspects of what is being considered.

But the market does not operate through competition alone. Instead, it allows a high degree of differentiation into three kinds of ‘orientations’: competition with rivals, exchange with market participants, and cooperation between the members of a firm or household. This allows the building up of diverse structures which can be specialized according to the requirements of each orientation, thus lowering ‘social overhead’. One can ignore the feelings and interests of one’s competitors entirely, since one never sees them; and though one must keep good relations with one’s partners in exchange, one does not need at all to put the same care into such relationships as one does into one’s relationships with people one cooperates with.

It is here that Luhmann situates the difference between ‘capitalist’ and centrally planned economies. The limitation of the latter is that “it cannot take the specification of the differentiation of competition, exchange, and cooperation very far, since the whole system is organized as cooperation (or creates irrationalities for itself through the acceptance of this myth)”¹⁹. This leads to the problems well known to economists that instead of letting different competitors try their own hand at solving problems and then being able to determine what the best solution is simply by inspecting the respective results, a central authority must make a judgement without the benefit of such a comparative experiment. Furthermore, prices are not useful as sources of information about market conditions, and must also be replaced by the direct judgement of an authority. Luhmann is critical of the usual way of distinguishing these two different kinds of economies:

Our thesis that the market is the differentiated internal environment of the economic system holds for “capitalist” economies as it does for “socialist” economies. It enables their comparison and shows at the same time that characterizations such as capitalist/socialist or market economy/centrally administered economy say little. The question is, *how* a special environment for the economy becomes differentiated: through the monetary mechanism alone or also through organization. In both cases a high degree of centralization is required,²⁰ and the problem does not lie at all in the difference between centralization and decentralization. The difference emerges much more from the question, in what form the economic system disposes over its unity and its outer

¹⁸ Luhmann-1988, p. 103.

¹⁹ Luhmann-1988, p. 106.

²⁰ In capitalist economies, centralization is found in financial institutions like the central bank and financial markets, and the organization of large corporations.

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boundaries, because that determines the handicaps that a system-internal environment comes to acquire. And it is only to this environment that individual economic decisions can orient themselves.²¹

3.3. The market as a mirror

In order to answer the question of what producers observe when they observe the market, Luhmann relies upon White²². According to White, producers observe themselves and each other. The market acts as a mirror, because consumers themselves are opaque to producers. The products that already exist in a given market serve as models and reference points for new entrants into the market, preventing such entrants from needing to get into the minds of consumers: if the latter buy such products, that must be what they want. "Markets are tangible cliques of producers observing each other. Pressure from the buyer side creates a mirror in which producers see themselves"²³. Similarly, the strategy of developing a brand identity, and the usual form that advertising takes, which is simply to present the product, as opposed to addressing to consumers an argument for why it should be bought, compensate for the producers lack of knowledge of consumers.

3.4. Prices

A guiding idea for Luhmann is that systems face an environment that is so complex that they are not able to achieve a reasonably complete representation of it; therefore, a continual problem for systems is to "reduce complexity", that is, come up with strategies that will provide them with a representation of their environment which, no matter how incomplete and imperfect, will enable them to act. To put it in terms more familiar to economists, systems continuously find themselves immersed in a condition of radical uncertainty.²⁴ Therefore, the notion of 'correct', much less optimal, decisions has little significance in Luhmann's thought; what concerns him is that systems have sufficient social resources at their disposal, such as the symbolically generalized communication media, which 'frame' situations for them in such a way that the possible options for action are reduced to a manageable number, so that action is possible, and the self-production of the system can continue. For this reason, Luhmann has a rather different view of prices than a mainstream economist. For the latter, prices, in competitive markets anyway, bring markets into equilibrium, and accurately reflect

²¹ Luhmann-1988, pp. 106-7.

²² White-1981.

²³ White-1981, p. 543.

²⁴ The economic thinker with which Luhmann thus probably has the most in common is G. L. S. Shackle. On this aspect of Luhmann's thought, see Beckert-2002, ch. 4.

the relative opportunity costs of alternative uses of resources. For Luhmann on the other hand, the central feature of a price is simply that, at any given point in time, it is a determinate number. Thus, if I am shopping for a new laptop computer, for any given vendor, my choice is clear: either I pay the price he is asking for the computer, thus acquiring it, or I don't:

The identity of prices does not necessarily mean temporal stability; and it does not presuppose that the price is set by 'the market' independently of an agent's own supply or demand. One can understand prices as exploratory quantities by means of which the market is provoked and tested. But this must always happen under a specific price (or a specific range of prices).²⁵

Prices enable the differentiation of the economy from the rest of society, since only those things that have prices placed on them retain their economic relevance. As agricultural methods were improved in Europe in the sixteenth and seventeenth centuries, restrictions on selling grain on the open market, as opposed to the local nobleman keeping it as a precaution against possible poor harvests, were lifted, so that grain could be treated as any other commodity, on the basis of economic calculation. At the same time, services or privileges that belonged to other functional subsystems, such as indulgences, marriages, or administrative positions, stopped having prices put on them. Once items like these have been made off limits, more and more goods and services can be made subject to the market, and thus brought under strict economic calculation. "It was this, and not the expansion of international trade by itself, that led to the transition to industrialization"²⁶.

4. Consequences

In the context of Luhmann's theory, to say that "the market works" would be to say that the economy is able to observe itself. That is doubtless the case, since both 'capitalist' as well as centrally planned economies are able to reproduce themselves, and if they are able to do that, they are also able to observe themselves, since economies, being social systems, are also observing systems. In a capitalist economy, this observation is made by systems which participate in the economy, mostly firms and households, observing their economic environment; in centrally planned economies, this observation mostly involves central planners and other bureaucrats trying to look at the economy as a whole. It would be more reasonable however to take "the market works" to mean that what are taken to be market economies — using the word 'market' in its usual (as opposed to Luhmannian) sense — satisfy people's material needs better than do centrally

²⁵ Luhmann-1988, p. 111.

²⁶ Luhmann-1988, p. 112.

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planned economies. One can evaluate this hypothesis in Luhmann's framework. As we have seen, Luhmann takes the difference between market economies and centrally planned economies to lie in there being three different kinds of economic relation people can have to each other — competition, exchange, and cooperation — in a market economy, but only two kinds — exchange and cooperation — in a centrally planned economy. Since in the latter, prices do not contain much information about market conditions, one must compensate for this lack through organization. Because Luhmann stresses the effectiveness of prices for quickly transmitting information, as well as reflecting scarcities, while he also stresses the problematic nature of decision making, which is the principle activity of organizations, there can be no doubt for him that the former is the superior mechanism upon which to build an economy. In fact, a main principle for Luhmann is that the various functional systems of society are autonomous, which means that they should be left to function according to their own logic as much as possible without interference from other subsystems. That means for example that the state and religion should not interfere in science, also that the state should interfere as little as possible in the legal system (Luhmann is not found of statutory law), and certainly that the state should not interfere more than is necessary in the economy. Since in a centrally planned economy, the economy is not autonomous from the state, that would by itself rule central planning out as a serious model for the organization of society²⁷.

But that the market works better than central planning does not necessarily mean that the market works without qualification. Certainly, Luhmann would not leave it at that. For instance, Luhmann remarks: "Whether competition ... has the many favorable qualities which are attributed to it, and whether other qualities are not much more important and consequential, is an empirical question"²⁸. Thus, even if it has various advantages, we must consider how *sustainable* a free market economy that is not regulated in various ways is. This is especially the case since, after the fall of the Soviet Union, a consensus seems to have emerged, in the English speaking world at least, that "the market" is the answer to virtually all social problems.

There are reasons to think that the unregulated free market system is not sustainable. To see why this is the case, it is useful to turn to that other great German social theorist, Hegel, who used the term 'civil society' to refer to what we would call the economy together with other private institutions, to be distinguished from the state. As Shlomo Avineri has pointed out, Hegel was perhaps the first to recognize that it is "[n]ot the malfunction of civil society that causes poverty, but precisely its opposite, the smooth functioning of the powers of the market"²⁹.

²⁷ Curiously, Luhmann does not make this obvious point in his 1988, preferring to use irony when speaking about socialism instead. This is probably attributable to his predilection against making observations that he believes to be obvious, and also to his not wanting to give satisfaction to some of his critics, who berated him for what they viewed as his "conservatism".

²⁸ Luhmann-1988, p. 104.

While Hegel had read Adam Smith — Dickey³⁰ has even argued that it was his exposure to political economy that led Hegel to abandon his concerns as a young man centering on “applied theology” and develop his mature position — and developed his account of the “system of needs” largely on the basis of Smith’s teaching, he did not adopt Smith’s view of the economy as a successfully self-regulating system. Instead, Hegel believed that the development of the market economy was accompanied by an increasing differentiation of the population into rich and poor. The cause for this was the mechanization of work: since machines allowed a high volume of goods to be produced with a modest use of manpower, the wealthy, who owned the machinery and factories, could make high profits, thus becoming more wealthy. At the same time, the mechanization of labor meant that, unlike the case in feudal society, in which the majority of the population was engaged in agriculture, there would now be more people in the population than there were jobs available; furthermore, because of this, what jobs existed would not be very high paying. This leads to a significant portion of the population being forced out of civil society to join what Hegel called the *Pöbel* (rabble). The problem is exacerbated because civil society has a tendency to produce more goods than can be sold, since even with their desire for luxuries, the demand of the rich is bounded, while workers do not have sufficient incomes to buy all the goods which they produce³¹.

Industrialized societies were able to subdue this problem for a period of time. This appears to have occurred through two main mechanisms. The first was the development of mass markets, that is, markets for manufactured goods intended for the mass of the population and not just for the wealthy elite. Henry Ford was famously aware that if he was going to make much money selling a lot of inexpensive automobiles instead of small numbers of expensive ones, his workers would have to be able to afford the automobiles that they built. The second mechanism was regulation, primarily restrictions on imports, and legislation giving workers the right to organize. As Luhmann notes, whatever dissatisfaction still remained over the distribution of wealth and income came to be papered over with the pursuit of economic growth. The idea was that income inequality need not be a significant issue, if everyone’s income is going up.

Unfortunately, this “golden age of capitalism” appears to have been temporary. It is well known that a general growth slowdown occurred in the global economy around 1973; this was accompanied in the United States by a stagnation of wages, with almost all gains from any increase in per capita GDP that occurred going to the wealthy. As Brenner³² has argued, the principle reason for this stagnation is global overproduction. Thus, the problem about which Hegel had written seems to have returned, this time on a global level. Furthermore, the problem has been exacerbated by the aggressive policies of trade liberalization

²⁹ Avineri-1972, p. 149.

³⁰ Dickey-1987.

³¹ Hegel-1991, § 245.

³² Brenner-1998.

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that have been pursued by English-speaking countries since the end of the Cold War. Placing workers in rich countries in the position of having to compete with workers in poorer countries removes the formula for general national prosperity which had been employed by industrial societies after the initial period of “worker imiseration” which had been written about by Hegel. The response by mainstream economists as well as policy makers to the “deindustrialization” in rich countries has been to argue that manufacturing industry is not necessary, since high-paying jobs will be allegedly produced by the “new economy” to replace those jobs lost due to deindustrialization. This argument is being increasingly exposed as an empty promise however, as one finds that service sector jobs are now being exported in the same way that manufacturing jobs were exported before them.

We are thus back precisely to the situation about which Hegel wrote. When the labor force becomes globalized, workers in rich countries find themselves roughly in the position of their predecessors in the early phase of industrialization. Apparently, the attitude of mainstream economists to this problem is that it is temporary, since as newly developing countries follow in the footsteps of rich countries, a period of global prosperity will commence. This is simply a transfer to the global level of the old attitude that economic growth will eventually solve all problems of income distribution. While this strategy is workable for extended periods of time, it is irrational to think that it can be sustained indefinitely. This is because economic activity uses physical resources and produces physical waste, while physical systems such as the earth have finite capacities. Sooner or later economic growth will run into physical constraints³³. There are signs that rich societies have already started to run into such constraints. But aiming to bring up less developed countries to the standard of living of people in rich countries would far exceed those constraints.

We thus find that unregulated market economies are not sustainable. Such economies use growth as a way of temporarily ‘suppressing’ their ‘contradictions’, but perpetual growth is not a possibility. Once growth stops however, the tendency of markets to produce an increasing differentiation between rich and poor returns. And such a differentiation is not compatible with democracy. A new economics is required that will provide a solution to the problem of overproduction and will be able to assure adequate living standards for all within a developed society under conditions of ‘zero growth’. Such an economy would require a high degree of regulation. What we can learn from Luhmann’s theory is that regulation need not undermine the advantages provided by markets, since market economies already have a high degree of centralization and planning, and make an extensive use of organization, not just prices. The Luhmannian principle is “no more regulation than is necessary”. The problem with the unregulated market economy isolated by Hegel is that it leads to unacceptable differences between rich and poor. Combining these two ideas leads to the conclusion that some regulation of the economy is necessary, namely that level which results in an acceptable distribution of income (while respecting the constraints that the

³³ Daly/Cobb-1989.

physical, ecological environment places on the economy).

While Luhmann has been chastized as being “neoclassical” in his devotion to the idea that the autonomy of the economy must be preserved, his view that systems in the economy face overwhelming complexity and uncertainty leads to a rather different view as to what kinds of “interference” in the economy are unreasonable or significantly harmful from a free-market view. According to Luhmann, ineluctable human ignorance makes theorizing about economic optima, or policy prescriptions based on such theorizing, Quixotic and misplaced. What is important for Luhmann is not that systems attain optima without hindrance; it is that the self-production of systems is not interfered with. What this means is that economic agents must be left free to economize as much as possible; what it does not mean is that the state should not place constraints upon “freely economizing” agents which would not exist in a full-fledged free-market economy. Thus, taxation designed to redistribute income and other mechanisms to remedy the difficulties that the free market economy runs into as described by Hegel are perfectly acceptable from a Luhmannian perspective, so long as they are reasonably simple and transparent, so that they do not unduly raise the complexity of the decision-making problems faced by economic agents, and so long as they do not force economic agents to depart from an economic, profit-maximizing logic, by expecting corporations to use “ethical reasoning” (as opposed to taking the law into account) as well as profit-and-loss accounting in their decision making, for example. Hence, by showing the way in which the economy is properly an autonomous subsystem of society, while also being able to analyze the “tunnel vision” inherent in the logic employed by economic decision makers as well as the relationship of the economy to the rest of society, Luhmann’s theory provides a uniquely rich starting point from which to develop a conceptually adequate response to the current adulation of “the market”.

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