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Opportunity out of Crisis: Economic Sociology and the Analysis of Risk, Regulation and Security

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The role of the social sciences in the current financial crisis is no doubt very far from the minds of regulators, politicians and policy makers as they grapple with each daily twist and turn of events. And yet it ought to be apparent that, even allowing for bad behaviour, this crisis raises questions about the forms of knowledge which inform management, especially risk management, and regulation. Academics have been very quick into print on the causes and consequences of the crisis, but slower to reflect on the role of the social sciences themselves. Fortunately, the emerging exchanges and alliances between economic sociology, social studies of science and accounting in its broadest sense, provide the best possible platform for exploring this issue.

Important work on the instruments that constitute and perform markets has been done by MacKenzie (2006), Preda (2006) and others. But a larger task awaits, namely a renewed understanding of how the discipline of financial economics, and its various elements, has come to be the pre-eminent *performative*, and now perhaps non-performative, social science. Work by Richard Whitley (1986) and others has drawn attention to the rise of financial economics and its role in the financialization of enterprises, but the centrality of financial economics to what Peter Miller (2009) calls the *anatomy* of failure remains to be analyzed. Of course, there are clues for this analysis spread throughout the history of economic sociology and there has never been a better or more exciting opportunity for the varied forms of critique of *rational choice* theories of agents, organizations and markets to find a new synthesis in this anatomy.

This work could supply key concepts and frames for the analysis of specific practices of risk management and regulation. Some of this work is underway, but there are considerable opportunities for alliances between regulation

studies and economic sociology to explore the conditions under which these practices have *performed* a certain style of security as the foundation for economic exchange. Indeed, as STS scholars know, the conditions of failure are ideal for revealing the logic of these practices, and their promises of assurance. Older studies of *legalization* processes in organizations (Sitkin and Bies 1994) deserve to be revisited, not least because it seems that the regulatory obsession with compliance and due process, which reaches its pinnacle in Basel 2 and the Sarbanes-Oxley legislation, may well have the character of a man-made disaster (Turner and Pidgeon 1997).

Contemporary circumstances also offer an opportunity to develop a sociology of transparency, clues for which are widely dispersed in the social sciences (Prat 2005; Strathern 2000). There is a regulatory instinct that more transparency is better but this ideal overlooks how transparency is contingent on material systems of representation, like accounting, laden with biases and interests. Understanding how these technologies of representation provide the visibility of economic action for analysts and policy makers is hardly a new theme, but this could be a useful point of re-engagement between sociology and accounting. Financial economics is itself a technology of representing and intervening which is deeply implicated in this analysis. For example, the *fair value* debate in accounting may seem too specialised for general consumption by an economic sociology audience, yet nothing less is at stake in this debate than the transformation of accounting into a sub-branch of financial economics, with consequences for who has authority in accounting matters (Power 2009).

The fair value accounting debate also provides a case for revisiting some traditional issues in economic sociology, such as the price formation process and its dynamics, and for opening up new areas such as a sociology of liquidity. Such studies would, I expect, reveal the dense inter-relations and co-dependencies between risk management, accounting, credit rating bodies and other institutions. These relations are invisible in good times and give the appearance of being discrete, autonomous elements of the financial system. Yet bad times reveal the complex social interdependencies which are highly vulnerable to a failure

of one element. Financial regulators have always been concerned about the systemic risks of a single financial institution collapsing, but perhaps we have also seen a collapse of the forms of knowledge which contribute to financial stability.

Today, states are still figuring out how to fix things. But attention will turn to diagnosis and, inevitably, blame at some time in the future. In particular, the discrediting and subsequent reconstruction of practices of risk management will be interesting to observe during 2009. There appears to be a policy resolve that cultural and behavioural factors must be at the heart of any reform process, and a new kind of practice called *oversight*, is being demanded. It remains to be seen how these demands for change make inroads into the more technical domains of risk analysis, but economic sociologists have much to contribute, with an extensive understanding of the ethical foundations of market behaviour. Throughout the 1990s there were demands for risk management to be *embedded*, without any clear understanding of what that meant. Again, this is a theme on which economic sociology has much to say.

As economic sociologists, we should probably be cautious about taking the label of *financial crisis* too much at face value – although the temptation to be thoroughly realist about this is very great, such is the reach of its effects. So we should be mindful of the mechanisms by which the crisis is represented by regulators and others since this will reveal the diagnostic biases of any reform process. It is no bad thing to be reminded of a philosophical truth, namely that events are always events under a particular description and we should be wary of those descriptions which have most popular currency. A critical anatomy of this crisis may lead, most uncomfortably for regulators, to the very practices which were supposed to underwrite the collective financial security and stability of developed economies. The vested interests against such a conclusion are very great, but it may be, as ecologically minded sociologists would no doubt agree, that the forms of standardization and legalization which have characterised the rise of the regulatory state in the last two decades, have only served to render the financial system less diverse and therefore less resilient. Or to put it another way, if organizational and epistemic isomorphism is one of the root causes of what has happened the solution is some form of what Monique Girard and David Stark (2003) call *regulatory heterarchy*.

The complex social foundations of markets, the subject of so much good work over the years, and which are normally invisible, are now exposed for all to see. The self understanding of market actors as entrepreneurial, risk-taking disconnected individuals which gained pre-eminence for over two decades and which has been exported by business schools, is now simply incredible. It is tempting for economic sociology simply to say *we told you so* but it is also a great opportunity both for engagement in public policy for those that wish to do so, and also for the invigoration of existing agendas of enquiry.

Academic disciplines often pretend to have a certain kind of autonomy, but we know that they are subject to numerous influences from the social, economic and political environment. Perhaps at no time in the history of economic sociology as a discipline has the time been more opportune for a wider dissemination of its insights. With the social reproduction of security and trust now in doubt, we can safely predict the widespread creation of new institutions and oversight bodies, populated by the same experts, educated at the same business schools, in the same core subjects, and promulgating the same logics of practice. For this reason I greatly welcome the focus of this issue of the *Economic Sociology Newsletter*, and believe its theme to be rather urgent. I also hope that the current crisis provides economic sociology, and its many co-travellers in adjacent fields, with the opportunity to consolidate a powerful intellectual coalition in academy. If not now, when?

Michael Power is Professor of Accounting and Research Theme Director of the ESRC Centre for the Analysis of Risk and Regulation (CARR) at the London School of Economics and Political Science. His research focuses on the role of internal and external auditing in corporate governance; internal control systems, operational risk management, errors and risk reporting; auditability, transparency and accountability; organizations, regulation and standardization. He is author of the books *Organized Uncertainty: Designing a World of Risk Management* (Oxford University Press, 2007) and *The Audit Society: Rituals of Verification* (Oxford University Press, 1997; second paperback edition 1999).

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