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## **Globalization and Governance of Uncertainty**

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# Abstract

Recent developments, most notably concerning environmental changes, challenge our so central idea that by accumulating knowledge we will gain better control over our surroundings. In fact, a number of prominent theorists have pointed to an increasing complexity and *uncertainty* understood as an *inability to predict outcomes* as a central feature of the “widening, deepening and speeding up of global interconnectedness” we understand as globalization (Held et al, 1999:14, Beck et al, 2003, Giddens, 1995, 1999, 2000, Lash, 2003, North, 2005). The argument of this paper is that by focusing on *how we cope with uncertainty* the connection between the need for governance and the current transformations will be the centre of attention.

The complexity of the social and economic world due to unintended consequences prevents the anticipation of outcomes; the resulting uncertainty complicates decision-making when actors have insufficient structure to base their decisions on. Correspondingly, *institutions are the outcomes of individuals’ need, or demand, for order and coherence in the face of change and uncertainty.*

Uncertainty and change are linked through the accelerating change and incremental complexity characterising globalization. Growing trade and internationalization of production exemplifies a *new cycle of market expansion* (Polanyi, 2001 [1944], Hettne, 2001). Globalization can be seen as an “instituted process” where market expansion on a global scale unintentionally leads to *new uncertainties* which in turn generate new institutional arrangements (Polanyi, 1968 [1957]). If the quintessential idea of the Enlightenment project is the possibility of an increased mastery of the world, then the globalized situation is fundamentally characterized by an intensified awareness that mastery is impossible (Beck et al, 2003:20). The key point is that this process is evolving but not in a cumulative way; as it unfolds *the essential structure underlying it also changes.* Heighten

If there is high uncertainty regarding citizens’ political and economic rights, ‘rent-seeking’ behaviour often results because the greater the uncertainty over citizen rights, the greater the potential advantages to be gained from devoting oneself to competition for them (North et al, 2000). With uncertainty about citizens’ rights there is *politically much at stake.* This implies that there are socially highly destructive incentives for individuals to compete for those rights through ‘rent-seeking’ behaviour which carries a tendency to undermine the prevailing order. It also means that those in power are less likely to give up the power because they have much to lose, and that those out of power are more likely to resort to methods which are outside of the law. Uncertainty about basic rights also has another consequence of major importance. When the state fails to provide and guard these rights through sovereignty, *individuals’ incentives to invest in economically productive activities are also undermined* and rationality for investing in protection against actions of others, including the state, is produced (Rodrik, 1999, North et al, 2000). *As a result of globalization and the increased uncertainty it brings, development has become increasingly about governance and about providing order.*

Recent developments, most notably concerning environmental changes, challenge our so central idea that by accumulating knowledge we will gain better control over our surroundings. In fact, a number of prominent theorists have pointed to an increasing complexity and *uncertainty* understood as an *inability to predict outcomes* as a central feature of the “widening, deepening and speeding up of global interconnectedness” we understand as globalization (Held et al, 1999:14, Beck et al, 2003, Giddens, 1995, 1999, 2000, Lash, 2003, North, 2005). The argument of this paper is that by focusing on *how we cope with uncertainty* the connection between the need for governance and the current transformations will be the centre of attention. The paper begins with a section on the relationship between institutions and uncertainty. The following section discusses the mechanisms characterising the historical transformations. Subsequent sections spell out globalization in terms of increased uncertainty, followed by a section on implication of increasing uncertainty of development processes.

### ***Institutions and uncertainty***

To start with, a clarification of the concept of uncertainty and why it is so central is needed. Uncertainty implies a fundamental inability to quantify and predict. The classic definition of uncertainty comes from Frank H. Knight (1921) who distinguished between risk and uncertainty, where risk is a condition in which it is possible to assign probabilities to outcomes and where uncertainty is a condition under which no such probability distribution exists. In situations of uncertainty actors must *form expectations* concerning the likely outcome<sup>1</sup>.

As the rich literature on institutions shows, institutions exist for actors to be able to cope with uncertainty. The most basic tension in society is between the changing nature of the social world and the ‘frozen structures’ or *institutions* needed to function socially, to interact, in the highly complex, continually changing, and thus uncertain world we live in. This argument presupposes a tension in society but it should be pointed out that this tension is not to be understood as a “state of nature” or as tension between people. Rather, it is a tension between change and the devices with which people confront it. It is therefore not to be understood in a deterministic sense as

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<sup>1</sup>Although it of course is far beyond the scope of this paper to show it, I would still like to point out that the concept of uncertainty and how to cope with it is a central theme in institutionalist theory whether with a sociological, economic, political science or historical perspective. See for example Knight (1921), Alchian (1950), Meyer & Rowan (1977), Myrdal (1978), Williamson (1975), Granovetter (1985), DiMaggio & Powell (1983, 1991), Simon (1978, 1997), Lawson (1985), Beckert, (1996, 2002), Hall & Taylor (1996), North (1990, 1991, 2005). Parsons (2006:1111) argues that Weber “differentiated between economic and sociological perspectives on the economy by incorporating uncertainty in to the latter”.

something which is inherent to and unalterable in human relations. What is implied is a meta-theoretical, ontological, understanding in which “agents cannot learn all the relevant future inter-temporal contingencies through time because the past does not provide a reliable guide to the future” and where” [h]uman institutions such as money and firms have evolved to cope with uncertainty but have unintended been a further source of uncertainty” (Dunn, 2000:431, see also North 2005). The implication of this is that *the underlying structures of society also change with the effect that cumulative learning does not necessarily diminish uncertainty.*

The complexity of causal relations arises from the unintended consequences of our actions (Giddens, 1984). The relationship between structure and action is therefore reflected in how actors, through their actions, produce and reproduce the structures they experience as conditions of action without having the ability to control intentionally their concrete content (Giddens, 1984). The complexity of the social world due to unintended consequences prevents the anticipation of outcomes; the resulting uncertainty complicates decision-making when actors have insufficient structure to base their decisions on. Correspondingly, *institutions are the outcomes of individuals’ need and demand for order and coherence in the face of change and uncertainty.* They provide a capacity to *stabilize expectations.* They create reciprocal expectations which limit the choice set of actors, and thereby reduce uncertainty as they enable actors to “secure expectations” (Commons, 1934:705, Knight, 1992). Importantly though, institutions are themselves *continuous and contestable socio-political processes* and not merely outcomes of efficient and self-enforcing processes (Polanyi, 2001 [1944], Harriss, 2003, Knight, 1992, Fligstein, 1996). Institutions and conventions emerge both as responses and as definitions of uncertainty (Heiner, 1983, Storper & Salais, 1997, Knight, 1992).

Governing uncertainty can therefore be understood as attempts to produce ‘closed systems’. In market contexts this is most clearly reflected in the need and quest for predictability in economic terms (Weber, 1978, Parsons, 2006, Swedberg, 1998). Needless to say, to be able to aptly predict behaviour is central to economizing (Weber, 1978, see also Collins, 1980), and the most competitive economies are ones which best cope with uncertainty (Hayek, 1945). By ‘closing’ in, or restricting the choices into a smaller set of actions, institutions improve agents’ abilities to control their environment (Weber, 1978, Polanyi, 1957, Meyer & Rowan, 1977, Simon, 1978, Heiner, 1983, DiMaggio & Powell, 1983, North, 1990, 1991, 2005). These, so produced ‘rules’ and

the rule-governed behaviour accompanying them – shaped into institutions – cultivate increasingly predictable behaviour based on which other actors can predict, optimize their use of means, and economize (Heiner, 1983). *This ‘instituted process’ provides contexts within which predictability, order and rationality can prevail* (Meyer & Rowan, 1977, Simon, 1978, Heiner, 1983). A consequence of uncertainty is, however, that rationality remains indeterminate (Beck, 1992). This therefore also implies what Max Weber pointed out when discussing ‘open’ and ‘closed’ relationships, that “[i]n the case of many relationships [...] there is a tendency to shift from a phase of expansion to one of exclusiveness” (Weber, 1978:45, see also Fligstein, 1996). Perhaps equally important therefore – *when alternatives are suppressed the prospects for reliable reproduction and provision of stability and order is enhanced* (Clemens & Cook, 1999). Closing a relationship off from the outside gives opportunities for regulation from the inside (Swedberg, 1998).

### ***Transformation and ‘disembedding’ processes***

Societal transformation can be understood as a process of change driven by increasing dependence on market mechanisms. This implies understanding transformation as a process of greater inclusion and integration in the larger transformational direction of society where a ‘growing differentiation of needs’ can be satisfied through impersonal exchange (Weber 1978:638). Such a ‘Great Transformation’ (Polanyi 2001[1944]) is a process of ‘*disembedding*’ (Polanyi 2001[1944]; Beck 1992; Giddens 1990) of the economy from traditional social relations resulting in greater *complexity* in the period of transition, where; “[i]nstead of economy being embedded in social relations, social relations are embedded in the economic system” (Polanyi 2001[1944]:60).

The resulting uncertainty for actors generates a desire for a re-introduction of social devices to reduce the uncertainty faced (Polanyi 2001[1944]; Beckert 1996). Polanyi’s (2001[1944]) argument was of an inherent ‘countermovement’ necessary to create stability after movement toward a *laissez-faire* economy. For Polanyi, the important point was that both processes are *politically* engineered and that the ‘disembedding’ is a necessarily abortive process. This is also something which Beckert reasserts, namely that; ‘on theoretical grounds, the claim of modernization theory that economic processes are increasingly removed from their social embeddedness with the development of market economies can be rejected’ (Beckert 2002:293). It is a

transformation away from pre-modern society in which economic relations are distinguished by a minimal need for trust (Giddens 1990; Bourdieu 1977)<sup>2</sup>, a change from ‘custom to contract’. We can distinguish four ways in which the integration of action in pre-modern society is organised. Kinship, geographical context, religion and tradition all structure interaction through their historicity, lending them stability (Weber 1978; Giddens 1990). As they are based on particularistic bonds they are ‘taken for granted’ and are not questioned. These are disembedded from the local community in the process of transformation<sup>3</sup>. In such a ‘prestige economy’ it is necessary to build and nurture personal bonds to not only secure ones existence but also to gain social status. This is dependent upon the community’s acceptance and acknowledgment not only of one’s personal actions but, more importantly, those of other family members as well. It is of course also in the interest of the community as a whole that individuals and families conform to the proscriptions of the community. Such a ‘capital of rights and duties built up in the course of successive generations’ provides ‘an additional source of strength which can be called upon when extra-ordinary situations break in upon the daily routine’ (Bourdieu 1977:178). This ‘capital of honour and prestige’ is ‘readily convertible’ (Bourdieu 1977:179) into economic capital with the family name as the means. However, even though ‘social honour, or prestige, may be the basis of economic power, and very frequently has been’, it becomes ‘disembedded’ during the process of transformation since the market is impersonal (Weber 1978:926). Thus, the *disembedding process* intrinsic to societal transformation entails a shift from structured forms of life as the provider of meaning to that of the individual as an agent who *chooses* to give loyalty to structures and institutions with and more and more alternatives to choose from (Beck 1992).

Increased division of labour itself leads to higher complexity. The process of transformation ‘disembeds’ social and economic exchange from traditional forms of trust as they prevent the spread of division of labour from which novel cooperation and exchange relations emerge (Weber 1978). Cooperation and exchange become possible without having to rely on traditional mechanisms because disembedding mechanisms ‘remove social relations from the immediacies of context’ (Giddens 1990:28). However, when the structuring influences of kinship, tradition, and religious cosmologies on

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<sup>2</sup> In Bourdieu’s terms this would entail a shift in importance from symbolic capital to economic capital.

<sup>3</sup> I deliberately use the term ‘transformation’ as opposed to ‘modernisation’. The intention is to thereby avoid a perception of change as a linear process as is easily the case when the concepts ‘traditional’ and ‘modern’ are used in a polarising fashion (Gusfield 1967).

actions are disembedded, the basis for cooperative relations is replaced by a situation in which their necessary stabilisation can only be achieved through the active inter-subjective communication of actors. Alternatives multiply. Trust is built up gradually through the process of exchange itself. The trust achieved through such communicative processes of reproduction, with *increasing alternatives of how to interact*, is thus distinguished from the traditional forms of trust by its *contingency*. The increasing contingency in expectations of what others will do gives rise to *uncertainty* and a growing need to shape stable contexts of trust (Beckert 2002). The discussion thus leads to a focus on the relationship between change and the structures used to confront it. When the sources of uncertainty change the preconditions for institutional reproduction also do so.

### ***Globalization and increasing uncertainty***

Uncertainty and change are linked through the accelerating change and the incremental complexity which characterises globalization. Growing trade and internationalization of production is evidence of a new cycle of market expansion (Polanyi, 2001 [1944], Hettne, 2001). At the same time development of global *economic* institutions from GATT to WTO as well as the extensive legal frameworks drawn up for regional markets such as the Single European market or NAFTA show that the global markets which are evolving can do so because common rules to govern them have been established (Held et al, 1999). Globalization can thus be seen to represent a change in the way the economy is instituted, and can fruitfully be understood as an “instituted process” where market expansion on a global scale unintentionally leads to new uncertainties which in turn generate new institutional arrangements throughout society (Polanyi, 1968 [1957]).

The process of globalization entails a new phase in the historical development of modern society. The increased mobility of capital, technology and people over the globe results in a restructuring of industrial production and in an increased differentiation. Increased interconnectedness through globalization means new challenges for cooperation. The greater the number of actors to cooperate and the less information they have of each other, and the less they share understandings and cultural beliefs with each other, together with often less long term interactions, the more uncertainty will result. The more distanced interaction or exchange becomes, the more it is likely to be characterised by uncertainty. With market expansion beyond national borders, the nation-state which at one time supported modernization has come to be restraining and

in the process of institutionalisation of a global market economy (Held et al, 1999), the very premises of modernization are being called into question (Beck et al, 2003). If the quintessential idea of the Enlightenment project is the possibility of an increased mastery of the world, then the globalized situation is fundamentally characterized by an intensified awareness that mastery is impossible (Beck et al, 2003:20). At centre of this change is thus a developing awareness of uncertainty as a fundamental feature of society. It is an awareness of a *change from a dominance of the past to the dominance of the future* (Koselleck, 1998). In contrast to the linear understanding of change inherent to modernity a *non-linear perception of change is growing* because complex institutional structures are no longer simply reproducing: they are changing (Lash, 2003). The important point is therefore that this process is evolving but not in a cumulative way, because as it unfolds the essential structure underlying it also changes. Globalization therefore also means an *increased uncertainty about institutions and social structures themselves*.

As an effect of the cycle of market expansion on a global level (Hettne, 2001), traditional social relationships and groupings change and become obsolete. In other words, globalization uproots the very roots of what earlier produced certainty and predictability. It was the mission of the Enlightenment thinkers to replace tradition with behaviour based on reason, but when reason replaces traditional behaviour, the ‘framework for action’ that tradition provides, a framework which does not need to be questioned every time, is replaced by a situation where action receives its necessary framework in the interaction itself. However, this does not entail a loss of tradition in society (Giddens, 1995, Beck et al, 1994). Instead, it is now a question of beliefs and habits as means being routinely called into question by people living their life more as a conscious negotiation of the effects of modern society. The *increased interconnectedness and intersubjectivity introduces a multiplicity of alternative institutional structures*. This ‘reflexive’ situation is therefore more uncertain as modern societies are experiencing a disruption of the previous governance structures. Humans increased attempts to alter history has changed the sources of, and increased, uncertainty. While earlier stemming mainly from our attempts to gain control over nature, it now stems directly coming from our involvement in trying to shape our destinies (Giddens, 1995, 2002). This new uncertainty is epitomized in globalization and the logical unfolding of modernity. The difference is that we now no longer are able to calculate risk, something which characterised early modernity.

### ***Institutionalising tendencies and coping mechanisms***

One important way of overcoming uncertainty used by market economy organizations is by being exclusive in their selection of exchange partners (Podolny, 1994). By restricting the set of exchange partners to actors with whom they have had interactions before, organizations choose the best exchange partner from a set of actors on which they have the greatest knowledge (Geertz, 1978, Podolny, 1994). One example of a coping mechanism is how industrial organizations have typically been structured in a way in which the ‘productive core’ has been shielded off from the uncertainties of the environment and the market by separation of such functions as – in firms at least – sales, purchasing and marketing, from it. The sole purpose of this, whether in times of Tayloristic ‘scientific management’ or in so called ‘lean management’ of our outsourcing age, has been to create a core free from uncertainty in which rationality in terms of economic optimisation of given means to given ends can be pursued (Kühl, 2000). This is the way in which the “instituted process” of the economy works in the micro perspective. Organization has been a central coping mechanism.

Indeed, this same argument can also be found in Ronald Coase’s seminal explanation of the existence of firms as “supersession of the price mechanism” (Coase, 1937:389). Coase pointed out that “it is profitable to establish a firm” because “there is a cost of using the price mechanism” (Coase, 1937:390)<sup>4</sup>. Such cost, later termed ‘transaction cost’ arises because uncertainty about other actors behaviour makes it necessary to plan, adapt and monitor that transactions are carried through, all of which is costly (Williamson, 1981). From this point of view, institutions – in this case firms – which help “secure expectations” lower transaction and production costs and thus also provide competitive advantages (North, 1991). However, structuring interaction to bring competitive advantages through institutions and a mechanism of exclusion include mechanisms that bring distributive asymmetries and inequalities (Knight, 1992). Not only do ‘institutions matter’ (North, 1991, 2005), but what sociological understandings of institutions emphasize is that also ‘power matters’ (DiMaggio & Powell, 1991, Hurrel, 2003:35, March & Olsen, 1998). This implies that narrowing down the choice set through exclusivity embodied in institutions as a way to meet demands for efficiency and competition not only makes uncertainty manageable. An important side-effect or

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<sup>4</sup> From the perspective of neo-classical economics and its assumptions of fully rational and informed actors, the existence of firms is unexplainable because it *abstracts from uncertainty*.

unintended consequence of the ‘principle of exclusion’ is the structured and unequal distributional effects it brings. Such a ‘suppression of the price mechanism’ through exclusivity is done by way of power<sup>5</sup>. Thus, unequal distribution results both within and between institutions. To sum up therefore, social change and hence also order, disorder and development is fundamentally about coping with uncertainty through providing order in the form of institutional arrangements.

### ***Order and the reproduction of institutional structure***

Order is achieved through institutional structures providing stable, regular and predictable patterns of behaviour (Elster, 1989). Indeed, institutions can be seen as building-blocks of social order (Streeck & Thelen, 2005). In a political sense then order rests on clear rights of citizens, whether personal, religious, political or economic. Order concerns the guaranteeing and governance of these rights by a political entity in turn governed by those rights of citizens which all imply limits to the behaviour of political officials (Hurrell, 2003). The specific institutional configuration reduces uncertainty about citizen’s rights by imposing constraints on political actors’ intent on improving their positions, and thus provides order (Elster, 1989, North et al, 2000). The legitimacy of the political order is based on the degree it coincides with shared understandings and belief systems concerning the ends of government and the extent of citizen’s rights (North et al, 2000, DiMaggio & Powell, 1991, March & Olsen, 1998). Disorder on the other hand thus implies an inability to cope with uncertainty regarding rights because of which both coordination and cooperation becomes increasingly difficult. With the changes in sources of uncertainty that increased integration into the transforming globalization process entails, *increasing demands for reproduction of institutional structures to provide order arise* (Thelen, 1999).

Both order and development, and disorder and conflict are related to how uncertainty is ‘institutionalised’. If there is high uncertainty regarding citizens’ political and economic rights, ‘rent-seeking’ behaviour often results because the greater the uncertainty over citizen rights, the greater the potential advantages to be gained from devoting oneself to competition for them (North et al, 2000). Rent-seeking – typically arising in countries in transition – concerns efforts to acquire rights which bring income that does not require productive investments. In other words, rents are “pure profit” by

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<sup>5</sup> This represents the ideal typical dichotomy between ‘market’ and ‘hierarchy’ as organizing principles of transaction originating in organization theory, where markets through prices maximizes efforts but implicitly induces cheating, and hierarchy provides control through constraining behaviour and thus produces incentives to minimize efforts (Williamson, 1975, Hennart, 1993).

virtue of the right possessed<sup>6</sup>. Resources spent on rent-seeking are socially unproductive and bring nothing to the good of the public (North et al, 2000). *When there is uncertainty about citizens' rights there is politically much at stake*<sup>7</sup>. This implies that there are socially highly destructive incentives for individuals to compete for those rights, i.e. through 'rent-seeking' behaviour, which carries a tendency to undermine the prevailing order. It also means that those in power are less likely to give up the power because they have much to lose, and that those out of power are more likely to resort to methods which are outside of the law. Such uncertainty about basic rights also has another consequence of major importance. When the state fails to provide and guard these rights through sovereignty, individuals' incentives to invest in economically productive activities are also undermined and investing in protection against actions of others, including the state, instead becomes rational (Rodrik, 1999, North et al, 2000). This in turn threatens to lead to a vicious circle of "downward (from the state) movement of authority" (Hettne, 2001:32, Greif, 2006) to more localized providers of order, stability and predictability, something which in turn further undermines the legitimacy of the government. Social resources are invested in negative peace instead of positive peace.

Development which excludes, results in diverse experiences of members of society. When understandings, beliefs, and mental models are not shared, means to coordinate often lack in legitimacy (Denzau & North, 1994, DiMaggio & Powell, 1991, March & Olsen, 1998). Inequalities lead to heterogeneity which disrupts reliable reproduction of institutional structures (Clemens & Cook, 1999). There need to be a common understanding of what the rights of citizens should be and what the legitimate ends of the state are (DiMaggio, 1997, Greif, 1994, Sewell, 1992). If not, leaders can manipulate what for some members of society are fundamental rights without losing support of others. In effect, without agreement on rights of citizens there are no clear boundaries on government – leaders are not sufficiently governed by the people – and authoritarian rule may be the result (Heiner, 1980, North et al, 2000). This thus implies a relation between inclusive development and social or political order, or, for that matter, between peace and development.

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<sup>6</sup> One definition of rent is as "resources that provide advantages for incumbents of social positions that are independent of the characteristics of the incumbents" (Sørensen, 1996:1333). A definition of rent-seeking is as "attempts to intervene in the marketplace in order to capture monopoly profits" (Tullock, 1991).

<sup>7</sup> The fate of many transition countries bear witness of this, where the transition from one type of system of rights (collective) to another (individual) often gives rise to rent-seeking behaviour (Svejnar, 2002, Liechtenstein, 1996).

## **Conclusion**

The accelerating change and interconnectedness of the world through globalization entails a non-linear process with changing sources of uncertainty and an increasing multiplicity in alternative institutional structures as providers of orders. New challenges need to be met continuously. Integration into different sources of uncertainty affects the local order. As such it is also not a 'self-reproducing' (Polanyi, 1957), but a highly contested process which has been, and is, in need of political regulation at all levels (Held et al, 1999). It is one thing to establish order but another altogether to maintain order in the process of economic and political change (North et al, 2000:1). Higher demands for organizational efforts on societies and economies which are struggling to develop precisely through improvements of this very kind have been the result. With globalization, uncertainty and increased demands on reproduction of governance mechanisms has become a distinguishing feature. *As a result of globalization and the increased uncertainty it brings, development has become increasingly about governance and about providing order.*

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