

# Making the invisible hand visible: evaluating the social-constructivist perspective on FDI in postsocialist Europe

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*From Communists to Foreign Capitalists* is an appealing read for anyone interested in deeper knowledge about how market economies with large shares of foreign ownership of domestic assets emerged in Central and Eastern European (CEE) countries after the fall of state socialism. The book delves into the construction and functioning of the market economy through incoming FDI in order to empirically examine 'claims about spontaneous market emergence and the asocial nature of market exchanges' (p. 3). The book's empirical scope is impressive, covering 11 postsocialist countries: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The author addresses the integration of these countries into transnational FDI flows and the determinants that structure these flows on the side of investors as well as that of host countries. The main argument rests on the premise that FDI is a relational social process in which the economic action of investors and host country actors is embedded in institutions, networks, power resources, politics and culture. Markets in CEE countries thus did not emerge through asocial economic transactions and 'the invisible hand', but through active roles played by postsocialist states in institutionalizing and legitimizing FDI and through the interplay of investors' and hosts' ties, political considerations and cultural perceptions of economic action.

The assertion that social forces do not merely constrain, but rather constitute the economic action of investors and hosts in inherently uncertain conditions lies at the centre of the social-constructivist framework on action, which Bandelj elaborates. This framework is applied in order to explain the three main questions of the book. The first question concerns the creation of FDI markets in postsocialist countries; in particular, the reasons why particular CEE states opted for particular routes towards FDI institutionalization and legitimation. The book's second question is why different countries received different amounts of FDI, and why particular investors invest in particular host countries. The final question departs from macro-level determinants of FDI and asks how FDI

attempts are realized at the level of individual investor firms, and which factors constitute the realization of these organizational attempts.

Addressing the first research question, the author argues that markets in post-socialist countries are socially created institutions. Her analysis shows that 'economic prosperity and stabilization of a country do not exert a significant influence on the initial phases of FDI penetration' (p. 101). Rather, it is the active role played by the visible hand of postsocialist governments, coupled with political choices and the influence of peer states and the European Union, which most significantly shaped the legitimization of FDI as the appropriate strategy in these newly emerged market economies.

In response to the other research questions, Bandelj argues that the economic action of investors and hosts is not geared toward the single goal of profit maximization through stable and *a priori* known rational means–end logic, as expected by instrumentalist economic explanations of action. The author reinforces a social-constructivist perspective on economic action with the practical-actor model and argues that 'depending on the context, [...] actors will hold both economic and non-economic motives for action, and their attempts at instrumental calculations will be mixed with, or even replaced by, affect, value judgments and routine, which *may or may not* lead to efficiency maximization' (p. 6, emphasis in the original). Quantitative empirical evidence that FDI unfolds between countries that have political, migration, trade and historical–cultural relations illustrates the general argument. The actions of investors and hosts are thus not instrumental and do not follow a rational profit motive, but rather are constituted through social, structural, political and cultural influences. In consequence, host countries' economic characteristics signalling risk and return to atomized investors fail to explain cross-country FDI patterns, because foreign investors and hosts are situated in a variety of relational settings that determine the actual FDI flows. In conditions of high uncertainty, which undoubtedly characterizes the early postsocialist conditions, social forces then 'help actors to transform the uncertain, complex mess into a manageable transaction' (p. 169).

In addition, Bandelj maintains that social forces not only constitute actors' preferences, but also affect their stability, because 'means, ends or both means and ends can change during the action process' (p. 182). How exactly social forces structure economic behaviour, if the only thing that is certain is uncertainty, is illustrated through a few qualitative case studies of investor strategies. Whereas some investors have opted for commitment-based action and have purposefully subordinated the profit maximization to social concerns when choosing the host country and location, the action of other investors is better described as muddling through situational contingencies, or even improvising action after the logic of social interaction with host country actors has become familiar to

the investor. Bandelj argues that in the uncertain conditions of postsocialist transition, selecting investment locations based merely on the invisible hand of the market, or, in other words, on *ex ante* rational calculations of risk and return, would most often prevent investors from investing in CEE countries.

I do find the book highly interesting, clearly structured and well written. However, the continuous reiteration of the argument for practical rather than rational actors leads me to question the general explanatory power of the social-constructivist perspective and the practical-actor model vis-à-vis the instrumentalist perspective with a rational-actor model. Although Bandelj presents the two models as *alternatives* and substantiates the appropriateness of the social-constructivist perspective, the questions that remain open are whether and to what extent rational action and practical action are mutually exclusive and thus can be really treated as analytical alternatives. Bandelj does not explicitly discuss their mutual exclusivity. At the same time, she admits that practical action is not irrational action. In my view, the author in fact deals with two understandings of rationality rather than with rationality and its alternative. The first one is a narrow instrumentalist perspective on rational actors which sees them as striving for profits as their only goal and engaging in means–ends calculations of appropriate strategies. In this case, the actors' *universally rational behaviour* indicates that they strive for isolation from the social context. The second perspective presents economic action as pragmatic social action, which I would refer to as *embedded rational behaviour* constructed through social forces. In this latter case, actors make embedded rational decisions that are dynamically responsive to concrete situations and informed by social forces. Based on this reasoning, I perceive the practical-actor model as an operationalization of the functioning of a broadly understood rationality in real social worlds, rather than an alternative to rationality itself. Given this shortcoming, I believe that Bandelj's social-constructivist perspective on economic action can be enhanced by a greater analytical openness to the concept of rationality and its operationalization, referring to the variability of actors' substantive goals as well as to the variability of rational procedural logics of economic action. Such an enquiry could strengthen the interdisciplinary debate and mutual learning between economists and economic sociologists and thus enhance the theoretical foundations of the discipline of economic sociology.

My other point of criticism also relates to the generalization of the practical actor model, in particular with reference to investors' choices of where to invest. Bandelj argues that 'contrary to the general equilibrium theory and race-to-the-bottom thesis, [the] analyses show that individual host country characteristics, such as economic potential and growth, political stability and the policy environment, explain relatively little of the variation in flows between pairs of [investor and host] countries' (pp. 122–125). This argument

supports the general social-constructivist perspective on investors choosing their investment locations through social forces rather than through market signals and risk calculations. However, the empirical underpinning of this argument rests on a group of postsocialist countries, which in my view do not capture the genuine variation of world-wide economic contexts for investments. Although Bandelj presents a number of differences that put each postsocialist country on a different path-dependent trajectory of reforming the political and economic system, it is questionable whether these countries vary that substantively in terms of their economic development, market signals and efforts in joining the European Union; and whether, on the basis of their limited variation, one can convincingly argue that FDI flows are largely unaffected by the economic characteristics of the host countries.

This is not to say that social forces do not guide investors' actions in the search for a host country. However, to provide an empirical underpinning of the argument of always-embedded action of practical actors, as opposed to the instrumental action of narrowly defined rational actors, the empirical selection of host countries should be modified to capture a broader variation in economic and political conditions. Empirical analysis of FDI flows and investor decisions in genuinely diverse conditions is necessary to corroborate the general validity of the social-constructivist perspective. Bandelj makes a good start in this endeavour, even if her empirical line of reasoning refers to countries whose economic and political conditions are not that different from one another on the global scale. This task of future research is now relevant more than ever because of the current global financial crisis and the potential economic recession, a time when many of the host countries which had, until recently, been attractive are at risk of stagnation of new FDI or even an exodus of foreign investors.

Despite the points of criticism raised above, the author's elaboration of the social-constructivist perspective on the economy, coupled with original empirical illustrations of FDI in postsocialist countries, makes the book a valuable contribution to economic sociology. In particular, the book makes a two-fold contribution. First, its attempt to elaborate, operationalize, measure and document embedded behaviour directly addresses the renowned concept of embeddedness, which Granovetter (1985, 1992) borrowed from Polanyi (1944). Bandelj succeeds in expanding the vitality of the concept by operationalizing and substantiating the social foundations of economic institutions and behaviour through an innovative combination of qualitative and quantitative research methods. The book's second contribution is the author's concurrent scrutiny of the constellations and interrelations of several social forces. A case study of a realized and a failed FDI attempt in Slovenia shows that social forces operate as a constellation of structure, power and culture, rather than one social force dominating others. I agree with Bandelj that a focus on a multiplicity of social forces

and attention to their mutual relations is a viable response to possibly counter-productive debates in economic sociology, which underscore one or the other favoured explanatory factor (i.e. networks, institutions, power or culture).

In summary, *From Communists to Foreign Capitalists* offers a great source of inspiration for further elaborating the social-constructivist perspective on the economy and economic behaviour, as well as empirically testing the practical-actor model in other contexts, other places and other times. I believe such steps are essential in order to the general robustness of Bandelj's comprehensive explanatory framework.

## References

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# The new economic sociology of FDI—still much to be done

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Nina Bandelj's *From Communists to Foreign Capitalist* exemplifies the work of the new cohort of sociologists that was trained and influenced by the leaders of the New Economic Sociology: DiMaggio, Fligstein, Granovetter, Block and Evans, among others. It provides a valuable exercise in the study of the vitally important subject of FDI in post-communist countries. It is distinguished by its clear argumentation, rigorous statistical analysis and an appreciation of the importance of culture, networks and power in shaping economic action. It is carefully and thoughtfully written, full of compelling quantitative and qualitative data.

The comparative sociology of capitalism in Central and Eastern Europe has recognized the overwhelming importance of FDI in the transition (Eyal *et al.*,