How to Restore Confidence in the Economy in Times of Financial Crisis?

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Source
Abstract

Based on the observation that the current financial crisis affects the grounds of confidence of consumers in a pervasive manner, the following essay deals with the question why it is now the state that can only restore confidence in the economy? The paper argues that the financial crisis is mainly considered as being caused by cumulative effects and so called “systematic dangers” rather than being reflected as a result of one’s own risks and decisions. Given this functional approach I argue that it is confidence (in contrast to trust as being attributed to risks) which is affected and which can only be restored symbolically. In modern societies which are communicatively divided in different subsystems each following specific functions, collectively binding decisions can only be made by the state via politics.
1 Introduction

Although political responses to the financial crisis have seen new and intensified efforts to strengthen international cooperation, including through the G20 and related initiatives, the willingness to commit to legally binding measures seems neither in the short term nor in the long term likely to build a global order of financial regulation. Rather than establishing efficient international commitments, national governments took actions on their own. But why is it that only politics are likely to restore in the financial system?

The sociological concept of functional differentiation relates to the fact that the economy – as a social subsystem – can mostly be steered by its own operations, hence by financial transactions. Similarly, liberal economic theory considers a free market without political constraints (excluding contract law and property rights) as efficient in order to allocate goods and services pareto optimal (Kolb 2004: 51-71).

Based on the observation that the current financial crisis affects the grounds of confidence in a very pervasive manner, the following essay deals with the question why it is the state that can only restore this sort of confidence within the economic system? The paper argues that the financial crisis is mainly considered as being caused by cumulative effects and so called “systematic dangers” rather than being reflected as a result of personal decisions. In the face of systemic dangers, “confidence” (in contrast to “trust” being attributed to risks) is affected and can only be restored symbolically. In modern societies – communicatively divided in different subsystems following specific functions – collectively binding decisions can only be made by the state via politics.

Given this starting point, this paper firstly analyses the emergence of a modern economy by classic sociological theorists. Taking those approaches as a basic framework, I try to elaborate on the process of social differentiation by means of a functional analysis, which focuses on the shift from personal trust to confidence in social subsystems. I argue that whereas trust is attributed as a risk of taking a decision, system confidence relates to dangers expressing being subject to the external decisions. Having combined these two distinctions, the current financial crisis will be analysed upon the initial question of how the state can restore confidence in the economy. Throughout the analysis, a special emphasis will be put on relating and contrasting the main thesis with arguments discussed in the texts read during the course.

2. Social Differentiation and Capitalist Economy

Before modern economy evolved as a functional system with its own rationality the exchange of goods was spiritually related to distribute gifts. In his essay of the same
name, Marcel Mauss (1925) explained the origin of a commodity economy by the so-called “potlatch” as the place where previous market relations occurred. Given the fact that no legal system was established to preserve property rights, the act of making and accepting a gift created a social bond with an obligation to reciprocate. According to Mauss, not to return entailed the loss of honour and status. Following Emile Durkheim’s notion of social cohesion Mauss's argument was that solidarity is achieved through the social ties consolidated by gift exchange (Mauss [1923-24] 2002; Durkheim [1893] 1986).

Switching from pre-modern forms of exchange to modernity, Durkheim described capitalism as the paradigm change from mechanic to organic solidarity establishing the basis of the division of labour. In a higher differentiated society where human beings follow special roles, economic exchange demands higher coordination of actions. At the meantime it implies higher dependency since equality as principle of cohesion was replaced by functionality. Hence the division of labour represents not only a threat to social order and social solidarity but also the solution to problems of social order and reproduction. Hence, modernity is inescapably linked with the notion of anatomy and integrity as conflicting forces (Durkheim [1983] 1986; Schimank 2000: 26-44).

Providing a less ontological and more functional approach (“formal sociology”) rather than focusing on given facts (“faits sociaux”), Georg Simmel described the emergence of modern capitalism by the so-called metropolis life representing the seats of the proceeded division of labour and economic exchange (Simmel [1903] 1950; Rammstedt 1988). As a result of the higher degree of external stimuli and the limited mental capacity to absorb complexity, man in urban areas developed a rational, averse, indifferent and intellectual character in order not to get paralysed. Given those impersonal interactions as prevailing forms of “sociation” in bigger cities, modern individuality can only be guaranteed by presenting oneself as “being different”, for instance by associating in groups. Taking on differentiated roles in different areas of life, interactions in money economies are more likely to form parts of different social circles and possibly conflicting combinations of such roles. As a matter of fact, individuals know each other by fragments – only with reference to those actions taken within a special role (Simmel [1903] 1950, Coser 1977).

Later, Max Weber traces the special rationality of money economy back to the innovation of different so-called “value spheres”. Besides economy he distinguishes religion and politics, each following their own absolute logic and provoking together certain tensions. Contrary to social interactions which are universally, Weber declares bureaucratic organisations as the most dominant evolutionary acquisition of modernity. Hence, Durkheim, Simmel and Weber consider social differentiation as an ambivalent
process: Being liberated opponent historical and religious bonds man gained autonomy and individuality. Meanwhile, dependency increased since man find themselves in different, conflicting roles, circles and organisations (Weber [1917, 1919] 1999; Schimank 2000: 53-69). Thus, their approaches imply or can be read as descriptions of the appearance of an economic system in which personal face-to-face interactions were replaced by anonymous, averse and rational relationships.

The German sociologist Niklas Luhmann – more than 60 years later – traced this qualitative and quantitative change back to the distinction between personal trust and confidence (1979; 2000). First of all, according to Luhmann, trust occurs within a framework of interaction which is influenced by both personality and social systems. It cannot be exclusively associated with either. This is why I have to apply a theoretical language, where concepts such as system, environment or complexity are formulated at such a high level of abstraction in order to lend themselves to psychological and sociological interpretation alike. The features and consequences of his approach to analyse modern, differentiated societies will be introduced subsequently.

3. Trust and Confidence from a Functional Perspective

Luhmann takes social complexity as a fundamental point of departure in order to describe trust as a social relationship subject as such to its own special system of rules. Though distinguishing personal trust from confidence in functional systems, he refers both to the function of reducing social complexity. Trust, in this broadest sense of confidence in one’s expectations, is a basic fact of social life. Without trust anything would be likely to happen that would prevent man from acting at all.

3.1 Social Complexity

Before looking at the function of trust, I have to attend to the basic features of this functional approach. In contrast to normative or ontological sciences, functional analysis is not a matter of establishing connections between given data or reliable knowledge through which it gains further knowledge. It is rather concerned ultimately with problems and solutions which depend on observers and on time and thus, on the contingent attribution between social systems to their environment(s).¹ From this perspective, problems as well as their solutions take on their meaning not from assumed invariable,

¹ In this sense Luhmann refers back to Simmel’s definition according to which trust is related to a blending of knowledge and ignorance in order to enable acting pragmatically (Simmel 1922: 263; in: Luhmann 1979: 26; 31 (footnote 6)).
essential property but from particular positions in a framework of alternative possibilities. Hence, a social action can be attributed to several systems, so that systems may be interconnected in a very complex way. Thus, the "nature" of identity is defined by the conditions under which it might be replaced by another. Given this approach, the potential for envisaging complexity appears boundless – a capacity not to be found in the everyday and traditional understanding.

In this view, Luhmann defines complexity in very abstract terms. However, his concept relates to draw a distinction between system and environment and with regard to a system’s potential for actualisation. Over and above the plenitude or real objects of various kinds and the amplification of their variety in the course of time, the complexity of the world enhanced through this social dimension which appears in man’ consciousness not simply as something objective, but as an alter ego. This concept then signifies a number of possibilities which are opened up through system formation. It implies that the conditions (and hence boundaries) of possibility can be specified, that the world becomes constituted and also that the world contains more possibilities than can be realized via system formation.

On the one hand, this relationship between world and system can be seen as a problem of overload and of constantly threatened instability. On the other hand, the same situation appears as a higher order, constructed by reducing complexity through system building, which renders the problem of selection. Thus, selectivity enables self-stabilisation of systems. Consequently, where there is trust there are enlarged possibilities for experience and action. Hence, there is an increase in the complexity of the social system since trust constitutes a mechanism to reduce it and to tolerate uncertainty (Luhmann 1979: 4-10).

How does this reduction happen? First of all, to show trust means to anticipate the future. It is to behave as if the future were certain. In this regard, a theory of trust requires a theory of time. The constitution of objective time, the interpretation of the subjectively experienced opposition between duration and change through the objective opposition between identical states and events, opens up an area of variance. From the perspective of events, states are set in motion along with the present. From the perspective of states, events are set up in motion along with the future and the past, which means they are opened up for alternative possibilities. Thus, the duality of the mutually exclusive perspectives guarantees this completeness and delivers man from the idea that everything could vary simultaneously with everything else. To conclude, this discussion helped throwing the function of trust into sharper relief: Trust strengthens the capacity of the present for understanding and reducing complexity. It tightens states
– as opposed to events – and thus makes it possible to live and to act with greater complexity in relations to events (Luhmann 1979: 10-17).

3.2 Personal Trust

Since you cannot trust chaos, where nothing connects with each other and therefore expectations cannot be generalised, trust presumes a structured environment, such as the existence of other systems in the environment. Hence, through human beings, as a special kind of systems, an enlargement of complexity is possible on which trust is focused. Trust, then, is generalised expectation that the other will handle his freedom of action, in holding up his personality which he has presented and made socially visible. Hence, personal trust is considered as the integration of external expectations by face-to-face interactions and experiences – trust in one’s own self-presentation and in other people’s interpretation of it, so to speak. Thus, the possibilities for action increase proportionately to the rise of trust. However, trust is not merely understood in terms of personal strategies, as it is by Erving Goffman (1990). The foundations of trust in a society are also adjusted to the prospects and conditions for self-presentations and the tactical problems and dangers involved in it (Luhmann 1979: 39).

Not every action is considered a being part of own’s self-presentation. An action will not be reckoned as an attribution to the personality if it recognised as the result of a direct instruction from a superior. Hence, trustworthiness requires using freedom of action as a kind of “social investment”, such as being different. For instance, in market exchange, where deals can be concluded immediately because of the guarantees afforded by financial and credit systems which bridge differences in time, it is true that personal interests are reflected in the choice of goods, but such deals do not apply to presents and favours, which call for expressions of thanks. With reference to Mauss ([1923-24] 2002): Those transactions run the risk of not being reciprocated. Thus, trust demands a mutual commitment.

Once mutual trust has been safely established, it would be blatantly tactless or even disastrous if one of the participants wanted to return to the learning stage between unknowns persons: In a deepened personal relationship on the basis of favours, trust is expressed when it can sustain a long-drawn-out imbalance since at this level, immediate and exactly gauged reciprocation becomes a sign of mistrust. In this sense, that external uncertainty is internalized through a process of learning trust in general corresponds to four main aspects: Since reality is too complex to be controlled, taking

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2 In this context Luhmann quotes Simmel on learning trust in secret societies where renewing trust becomes a strong social binding force (Simmel 1922: 282, in: Luhmann 1979: 44; 47 (footnote17)).
the “risk” of trust enables to overdraw, simplify and to generalise certain information about the environment in order to preserve certain, selected expectations of the future.

In completely risk-free role relationships (for example, if the participants are shielded from all personal consequences by their membership of an organisation) there are hardly any available starting points for the development and stabilisation of trust. Although the reduction of social complexity is even then an inescapable basis for the conduct of existence, it is not primarily in the form of personal trust via face-to-face interactions (Luhmann 1979: 45).³ It seems that personal trust is only formed where it is needed – if the individual personality acquires significance for the social structure and if it indispensable for the mediation of complex interactions that they have to be rearranged when that personality ceases to be involved – as strong as now and ever in all areas of social life where repeated contacts take place.⁴ However, there is no doubt that modern differentiated social orders are too complex to be created only by this type of orientations towards persons (Luhmann 1979: 38-47).

### 3.3 Trust, Familiarity and Confidence⁵

Aiming at defining confidence, we have to avoid confusion between familiarity and trust. Whereas familiarity is an unavoidable fact of life, trust is a solution for specific problems of risk. But trust has to be achieved within a familiar world, and changes may occur in the familiar features of the world which will have an impact on the possibility of developing trust in human relations. Hence, we cannot neglect the conditions of familiarity and its limits when we set out to explore the conditions of trust. Though trust is only possible in a familiar world, it is inescapably linked with a future orientation while familiarity is linked with the past.

Similarly, confidence needs to be distinguished from trust. Both concepts refer to expectations which may lapse into disappointments. The normal case is that of confidence. You are confident that your expectations will not be disappointed: that politicians will try to avoid war, that cars will not break down or that remedies will be

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³ Given this background, Granovetter (1995) discovered that job seeking was more likely to be achieved through “weak” acquaintances than through “strong” friends grounding on the variety of connection via “weak ties”. Though trust, as Luhmanns concept suggests, requires adapting external expectations which are more likely to converge after having experienced common events, even friendships remain gamble. Thus, the concept of role and the distinction between interactive social relation and organisation-based contacts in form of members seems to have a higher explanatory value.

⁴ Distopian visions of a mass society of overwhelming anonymity must then be refused. Simmel's essay on metropolis and mental life ([1903] 1950) can be interpreted as an example that personal trust as the dominant form in simple societies even perpetuates until modern times in order to preserve one's individuality.

⁵ In his previous publication “Trust and Power” Luhmann named the former “system trust” (1965) by “confidence”. Throughout this paper, this shift will be followed.
explored when diseases emerge. You cannot live without forming expectations with respect to contingent events and you have to neglect, more or less, the possibility of disappointment. You neglect this because it is a rare possibility and because you do not know what to do else. The alternative is to live in a state of permanent uncertainty and to withdraw expectations without having anything with which to replace them.

In contrast, as indicated above, trust requires a previous engagement on your part as a decision-maker. It presupposes a situation of risk. For instance, you may or may not buy a used car which turns out to be a “lemon” (Akerlof 1970). You can avoid taking the risk, but only if you are willing to waive the associated advantages. You do not depend on trusting relations in the same way you depend on confidence, but trust too can be a matter of routine and normal behaviour. In this sense you define a situation as trust, if you will have to consider an internal attribution, such as one’s own decisions, and eventually regret your trusting choice. Contrary, in the case of confidence you will react to disappointment by external attribution and is therefore related to dangers. Thus, the distinction between confidence and trust depends on our ability to distinguish between dangers and risks – they are not ontologically given. This distinction does not refer to questions of probability or improbability since all actions can be associating with both sides – but not simultaneously: Though the risk to invest in mortgage assets had promised advantage, months later it can turn into failure due to the cumulative effects of global transactions. Thus, from a functional perspective, the decision and the loss depend on the observer and on time (Luhmann 1990; Luhmann 2000).

To conclude, familiarity, confidence and trust are different modes of asserting expectations – different types of self-assurance or self-reference. Thus, confidence and eventually trust are the decisive issues, and familiarity survives as a purely private milieu without function for society as a whole. Differences in familiar milieus may explain cultural and national differentiation, or the diverging results of socialization; they do no longer describe the human condition (Luhmann 1979: 18-38; 2000: 94-99).

### 3.4 Confidence in Functional Subsystems

However, the question is not simply to assign expectations to types and to sort them according to whether they are based respectively on confidence or on trust. A relation of confidence may turn into one of trust if it becomes possible (or is seen to be possible) to

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6 Otherwise what we have is a simple hope. While trust reflects contingency, hope ignores other possibilities (Luhmann 1979: 24-25).

7 This discovery of ‘risk’ as a general feature of modern and individualised life – roughly replacing what had previously been known as “fortuna” – does not facilitate the task of religion, but it adds another dimension to human experience. It becomes ever more typical and understandable that decisions cannot avoid risk (Short 1984; in: Luhmann 2000: 98).
avoid that relation. Contrary, as a participant in the economy you necessarily must have confidence in money. Otherwise you would not accept it as part of everyday life without deciding whether or not to accept it. In this sense money has always been said to be based on ‘social contract’. But you also need trust to keep and not spend your money, or to invest it in one way and not in others (Luhmann 2000: 99-100).

In simple societies which only constitutes upon personal face-to-face interaction rather than role contacts within modern organisations and differentiated social subsystems, such as economy or politics, trust nearly replaces a legal system since no sanction mechanism had been established to stabilise norms and to release the risk of trust. In more sharply differentiated social orders, on the contrary, it is inevitable for law and trust to become separate and in that way it is rather observed as confidence in subsystems. Risks are individualised, showing trust is no longer socially required and controlled on the level of functional subsystem. In addition, trust and confidence in law stand apart from one another also in their motivational bases. Conformity with law can be motivated by society only indirectly and impersonally, and can be guaranteed via powerful threats provided by an established political system or finally with the aid of an “ultimate means”, namely the application of power via physical forces or violence (Luhmann 1979: 34; Luhmann 1999).

Contrary, political and economic liberalism attempts to shift expectations from confidence to trust by focusing on the individual responsibility for deciding between trust and distrust. In this sense, it neglects the problems of attribution and the large amount of confidence required for participation in political, legal or economic subsystems. But what does this imply, if people do not perceive a condition of trust or distrust but a condition of unavoidable confidence? To put it in a nutshell: They will not save and invest if they lack trust; they will feel alienated if they lack confidence. Hence, confidence serves as a prerequisite of participation while trust as a condition of the best utilization of chances and opportunities. Confidence in the system and trust in partners are different attitudes with respect to alternatives, but they may influence each other; and in particular, a decline in confidence or an increasing difficulty in finding situations and partners which warrant trust may unleash deteriorating effects which diminish the range of activities available to the subsystem. Thus, the lack of confidence and the need for trust may form a vicious circle. A system – economic, legal, or political – requires trust as an input condition. Without trust it cannot stimulate supportive activities in situations of uncertainty or risk. At the same time, the structural and operational properties of such a system may erode confidence and thereby undermine one of the essential conditions of trust. The inclusion of persons in important social systems is thus neither a matter of nature, nor a matter of trusting, risk-taking, or rational decision. There is neither the need
nor even the occasion to decide about confidence in the system (Luhmann 2000: 99-102).

To describe more concretely the different consequences: the lack of confidence will lead to feelings of alienation, and eventually to retreat into smaller worlds of purely local importance to new forms of ‘ethnogenesis’ or to fundamentalist attitudes. The lack of trust, on the other hand, simply withdraws activities. It reduces the range of possibilities for rational action. It prevents, above all, capital investment under conditions of uncertainty and risk. It may reduce public interest in innovative branches which is not yet recognized and confirmed by the establishment of experts. Through lack of trust a system may lose size (Luhmann 2000: 102-107).

This shift from simple trust-based societies to large functional subsystems on the grounds of confidence is also linked to the emergence of organisations: Within organisations reciprocity is replaced by complementary. While former societies were characterised by the dominant forms of mutual expectations on the level of social interactions, the membership in organisations is only guaranteed by a general participation motivation which is paid. Positive actions cannot be attributed personally to express thankfulness. Inverse, negative behaviour cannot be considered as pure satisfaction of revenge. Thus, man are only part of organisations through taking decisions in different organisational roles and are not being viewed as whole persons. Among members a certain degree of contact stability is self-explanatory (“law of seeing again”). However, the participation motivation of members in organisations and the contact between unknown persons base rather on superficial grounds and are independent from interactions upon sympathy between friends. Consequently, in organisations information about roles serve more than information about persons, even if the former opens up occasions for informal behaviour. From this perspective, organisations destroy the correspondence of contact density, confidence and solidarity as it was predominant in lower social differentiated societies (Luhmann 1999; Kieserling 1999: 335-385).

Thus, the coming-up of confidence is intrinsically tied to the process of differentiation and in particular of the internal differentiation of interactive, organisational and functional social systems. Hence, Luhmann is offering an approach that takes more into account the limited rationality, social complexity and the dependency on different forms of trust. In order to evaluate the current financial crisis in terms of the distinction between trust and confidence respectively in terms of the distinction between concepts of risk and danger, I have to indicate its background and its mainly associated triggers. These will be discussed in the following chapter.
4. How to Restore Confidence in the Economy?

Economists from diverse theoretical perspectives, such as Jayati Ghosh (2008) and Dani Rodrik (2009), both trace the historical pervasiveness of the current financial crisis back to the preceded emergence of three simultaneous imbalances: The first imbalance describes the high independencies between the financial and the real economy. By the increasing extent of financialisation of hardly all kinds of economic activities, financial transactions decoupled from the real production. The second, macroeconomic disequilibrium refers to the boosted current account deficits. In particular, the US debt burden served as a “liquidity engine” of the demand boom resulting in unequal trade relations between so called the “developed North” and the “developing South”. In addition, coordinated expansion provided not only the bases for fiscal, but also for the waste of natural resources causing the third ecological imbalance: Though the Club of Rome declared the “Limits to Growth” years ago, pollution, congestion and degradation remain unsolved (Meadows 1972; Ghosh 2008).

As a matter of fact, all three indicated imbalances have been known, discussed and criticised for years – and not only by finance economists – whereas no decisive actions had been taken in order to diminish or even to prevent the well predicted scenario. This observation leads to the question: “Why remained the world so impressively stagnant while watching the titanic encountering the iceberg?”

Given the functional and constructivist perspective developed in the previous chapters, the argument of this work is that these imbalances and therefore the lack of counteractions can be explained by the concepts of the distinctions between trust and confidence and between risk and danger. The paper argues that the emergence of these imbalances was mainly attributed with external decisions since all three describe so called “unintended”, negative spill-over and self-multiplier effects (Merton 1936). Thus, due to these cumulative impacts, attributions got diffused and were less viewed or respectively reflected with one’s own decisions and risks but rather as a global danger.

In this sense, the financial crisis, first of all, affected the confidence in the subsystem rather than the interpersonal trustworthy relationships – even though the lack of confidence in a second step damaged trust between bankers and consumers initiating the mentioned vicious circle and collapsing in an overall crisis.

How did states tried to manage this financial crisis and the lack of confidence? The general response was a political one: In order to avoid uncontrollable side-effects of not taking the counterparty risks, states nationalised banking. However, according to Ghosh (2008) and Rodrik (2009), there were no alternatives to reduce current account deficits. Nevertheless, this socialisation of losses can only be considered as transitional solution, because it increases again the second, macroeconomic disequilibrium of unbalanced
trade deficits. Implicitly referring to the notion of “creative destruction” popularised by Joseph Schumpeter (Kolb 2004: 156-166), especially Ghosh suggested turning the crisis into the opportunity of changing the hitherto unequal and unsustainable economy by political decisions. Nevertheless, the diagnosis that a system is more likely to absorb variety in a state of crisis than in a state of stability has already been explored by Karl Weick (1995).

In modern and functional differentiated societies, it is only the state which can set collectively binding decisions within the political subsystem. Hence, the state is considered as an organisational address endowed with financial assertiveness and authority. Collective decisions presume a certain level of division of labour. Thus, the process of formalisation and differentiation of positions and competencies enables to address expectations specifically. However, the application of such formal rules is not limited to the exercising positions but to all members, namely all citizens of the state (Luhmann 2002: 189-273).

The state seen as “lender of last resort” as well as consumer serves as the only address (in the sense of an organised system) to get the “ball rolling again” in order to make other follow it. Though these “bailouts” (such as sureties or share holdings of so called “bad banks”) take huge financial burdens and are likely to be carried and balanced for generations, confidence is restored virtually since it cannot simply be bought back by money – transactions based on personal trust. Hence, confidence functions even as meritorious good. Thus, the lack of confidence in the financial economy is replaced by political confidence due to its thereby expressed capacity to act collectively. First of all, this replacement is considered as a symbolic action in order to initiate a kind of “self-purifying catharsis”.

Indirectly referring back to Goffmans notion of a „confidence game“([1959] 1990), we can assume that collective learning is more likely and easier than carrying the burden simple on oneself. This is also the reason why protests always need to attribute negative impacts with external dangers (of politicians, entrepreneurs etc.). If they reflect negative effects as risks of own decisions, this would only motivate to change oneself. Contrary, the danger perspective enables to express being subject of external, uncontrollable decisions. Though both, danger and risk, are related to an uncertain future, reflecting dangers enables to mobilise collective protest and actions in order to gain recompenses for negative outcomes – plain spoken: A problem shared is a problem halved (Luhmann 1993).8

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8 For instance, the rhetoric and programmatic “individualisation” of modern risks, such as unemployment or diseases as smoker’s cancer, is used by politicians to avoid civil counter-movements, namely and successfully via the so called ”workfare programmes”. Inversely, civil
However, given the diversity of national economies the therapy of establishing a
democratically “global financial governance” by political summits or civil pressure groups
seems neither feasible nor desirable: Due to functional differentiation and the complexity
of modern societies, the economy can simply be managed by its own operations. Thus,
*risk* need to be incorporated into financial decisions, namely by creating new financial
instruments such as swaps (Nollman 1997), for instance. The price of these products
reflects as much payment expectations as needed and can be interpreted by
consumers. Thus, *risk* incorporating instruments provide equal information to the whole
system rather than establishing monopolistic relations of “adverse selection” which are
likely to waste more time and money and are therefore regarded as less efficient (Akerlof
1970). 9 Similarly, sustainable solutions have to be rewarded by consumers, for example
by affording higher prices. Nevertheless, incorporating imbalances leaves global finance
as unsafe as ever, but it enables to attribute financial *risks* to own decisions – and is
therefore affecting trust in interactive relationships (Baecker 2008a; Backer 2008b).

Hence, in order to analyse the re-setup of confidence, it can be again useful to
distinguish between the mentioned internal differentiation of interactive, organisational
and societal system: While the trust in personal relationships between bankers as well
as between principal and agent is a matter of socialisation and personal experiences,
the confidence between banking organisations might be more a question of transparent
information and the setting of new legal rules and creating new financial risk-
incorporating products. Then, confidence cannot easily be restored by performing
structural change via firing former leaders. However, by replacing its so considered
“scapegoats”, the organisation expresses visually for its environment a kind of formal
modernisation and restructuring (Luhmann 2007: 181-202; Ahlemeier 2008).

To conclude, the distinction between confidence and trust throws light on the fact that a
withdrawal of trust is not an immediate and necessary result of lacking confidence.
Customers who regard their investments as *risks* and therefore would have lost trust in
their relations with banks, are possibly more likely to reflect their limited cognitive attitude
and their perhaps too little understanding of financial investments. The potential of
research about special conditions in particular systems which may interrupt such a
vicious circle of losing trust by losing confidence by losing *trust* and so on seems to be
even today not adequately tapped. The economy, for example, may enjoy periods in
which it is possible to have reasonable trust in investment, and stable political conditions

rights associations can attribute these political decisions to “dangers”. Consequently, they can
demonstrate their point of observation publicly or formally by signing petitions.
9 With respect to the current financial crisis, the innovation of so called “credit default swaps” as a
market-driven instrument – in contrast to hitherto business model of monopolistic credit rating
agencies – are discussed as an alternative to assess creditworthiness more sensitively (Baecker
2008b; Brabänder 2008).
may assist in this. Results may then strengthen confidence in monetary stability – that is, in the system. The law may protect civil rights, freedom, and property even in the face of political opportunity. Thereby, it may create a confidence in the legal system and in positions of security which then makes it easier to place trust in interactive relations. Moreover, we know from many empirical studies that a negative stereotype of the system, the bureaucracy, “capitalistic” enterprises, and international corporations is not incompatible with positive experiences in individual cases: Your bank gives you good service, your doctor or your teacher has proven to be very careful, professional or considerate. Hence, it may be possible to build up trust on the micro-level and protect systems against loss of confidence on the macro-level. This case seems to be true for the ongoing spiral of buying and selling bad mortgage, credits and other high-risky products though by that time problematic, cumulative and spill-over effects had been evaluated and predicted previously with the result of leading into the perhaps biggest financial crisis (Luhmann 2000: 104-107).

5. Conclusion

Despite of the explanatory value of the distinction between trust and confidence, Luhmann (2000) suggests avoiding the overestimation of a single device in order to approach of social relations sociologically. The concept of trust cannot replace the concept of “Gemeinschaft” or of “solidarity”. Trust or distrust: this is certainly not the distinction we should use to characterize modern society. Contrary, it may be more important to accept two interdependent structural changes: firstly, the increasing diversification and particularization of familiarities and unfamiliarities; and secondly, the increasing replacement of danger by risk, that is by the possibility of future damages which we will have to consider as a consequence of our own action or omission. If this is true our rationalities will, as a matter of course, require risk-taking. And risk-taking will as far as others are involved, require trust. Consequently, we are likely to enter sooner or later into the vicious circle of not risking trust, losing possibilities of rational action, losing confidence in the system, and so on being that much less prepared to risk trust at all.

We may then continue to live with a new type of anxiety about the future outcome of present decisions, and with a general suspicion of dishonest dealings. Nevertheless, taking one’s own decisions into account is the only way to learn from the past. In terms of the financial system and its evolution, the innovation of new financial instruments incorporating systemic risks always marked a new step on the path to higher differentiation which at the end goes along with higher confidence.
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