Lecture & Tutorial

Title
Foundations of Political Economy: What is an economy?
The social bases of economies and economic aspects of life

Abstract
This lecture provides an introduction to the field of political economy, its origins, and development over time. It explores the meaning of economy and economies and how political economy as a field of study differs from the field of economics. To concretise the subject matter, the lecture and course materials ask students to think about the subject matter in relation to their own lives and the lives of members of their families and of their friends.

Lecturer
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Preparations

Readings
Discussion questions to prepare

Based on the readings try to answer the questions below. These answers will be covered during the tutorials.

1. Drawing on the reading by Stilwell, in which ways are your lives and economic opportunities shaped by political decisions made about the economy? It may be useful to think of yourselves as students, consumers, workers, people who may wish to enter into business, speculators who may want to earn quick money.

2. To what extent does social class OR gender or ethnicity affect our life chances in the economy? Explain your views. It may be useful to think about this question in relation to the lives and life chances of yourself, your parents, grandparents, or friends.
A Genealogy of the Field from Adam Smith to the Mid-Twentieth Century

Georg Menz

DOI: 10.1093/oso/9780199579983.003.0001

Abstract and Keywords
This chapter charts the foundations of the subfield by taking the reader on a tour of key thinkers in political economy from the eighteenth century onwards. The breakaway of political economy and political science from economics is analysed, and the most central tenets of the field’s intellectual heritage are laid out in an accessible format. The twentieth century witnessed a number of non-orthodox contributions to the field, including from Max Weber, Thorstein Veblen, and Karl Polanyi. The synthetic account afforded here weaves together the important submissions made to present the trajectory Comparative Political Economy has taken. This and the following chapter offer brief summaries in textboxes and discussion questions for classroom use.

Keywords: Liberalism, Marxism, Max Weber, Thorstein Veblen, Karl Polanyi

1.1 Introduction: Why Study Comparative Political Economy?
What is comparative political economy (CPE)? This subfield of political science sits at the heart of the study of politics, as it addresses Harold Laswell’s (1936) seminal question: who gets what, when, and how?

CPE concerns itself with the comparative study of distributional outcomes across countries and thus, albeit more indirectly, among individuals. Why are some countries collectively wealthier than others? Why do some countries continue on an upward trajectory of economic growth, while others stagnate and decline?
Why do certain countries excel at high value added high quality production in high tech electronic goods or automobiles? Why do sectors characterized by fast-moving technological development flourish in some countries, but are scarce in others? How is the wealth generated, redistributed, and reinvested? What provisions are there for individuals to prosper and advance their economic fortunes? What are the implications of national economic regulation in terms of life chances and career trajectories at the micro level?

CPE concerns itself with the ‘wealth of nations’, to borrow from Adam Smith’s ([1776] 1937) most famous work, but also, albeit indirectly, the wealth of individuals. It explores how the complex domains of labour markets, industrial relations, finance, and welfare states mesh and interact. By implication, it also offers insights into individual prospects for negotiating and navigating these choices in regulation. The way in which market processes are channelled, deregulated, and reregulated has effects on corporate investment decisions and thus the creation of wealth and opportunity. Silicon Valley sprawls out to the south of San Francisco, not to the south of Tokyo or Hamburg. But likewise, the gradual incremental improvement of luxury consumer goods is more commonly associated with the dense supplier car parts and electronic networks of Japan and Germany than with Detroit.

CPE focuses on the institutional differences in the organization of modern capitalism. Different configurations in the organization of labour market regulation, education systems, finance, and welfare states lead to different outcomes in terms of levels of productivity, economic sectors of excellence, and the avenues available for individual socioeconomic advancement. At the same time, these different configurations, found across various countries, have also led to varying levels of economic growth, unemployment, and income distribution over the course of the past sixty years. It is precisely for this reason that the debate about ‘models’ or ‘varieties’ of capitalism is so central to CPE. The quest is on to identify core features and the particular nature of these abstract models in order to gain a better understanding of why certain models produce normatively desirable outcomes, or indeed why they fail to do so. But this subfield is not a mere academic exercise focusing on optimizing economic performance or improving our understanding of the complex interaction between education systems, welfare state benefits, and labour market regulation. CPE also opens our eyes to the fate of individual citizens embedded within different institutional arrangements governing the interaction between state and market. Ultimately, individual countries do not randomly embrace certain forms of regulating the way in which their labour markets function or their companies can seek out fresh injections of finance, or how much and what sort of unemployment benefits are available to displaced employees. These are conscious normative political choices. They are underpinned by political struggles between social actors. Ideological preferences may make certain ideas and proposals for policy reform more palatable than others. Policy actors can
draw on and learn from the experience of other countries, but often policy choices for economic reform are made based on ideological and ideational preference alone and constitute a leap into the dark. It is thus important to appreciate that the particular regulation of any model’s components, be they concerning finance, the labour market, or any other element, is informed by the normative and ideational glue that connects these building blocks. Elements of political culture and religious traditions and values are thus important, though sometimes understated, elements in helping account for the emergence and sustenance of institutions of political economy.

Who gets what, when, and how? Traditionally, these were political choices made by government. During the nineteenth century, late industrializer Germany rolled out basic framework provisions of its welfare state to stymie the growth of the left-wing Social Democratic Party. Meanwhile, Britain, the first country to undergo the Industrial Revolution, created a much thinner web of welfare state provisions and did so much later. The United States followed even later, even though it had industrialized around the same time as Germany, starting in the 1870s. All of these were political choices driven by domestic political and social conflict. There was nothing automatic or inevitable about them (Esping-Andersen 1985, 1990). However, they were influenced by ideological preferences, some of which need to be understood behind the backdrop of elements of political culture and religion. In Germany, Catholic social values were influential in shaping the foundational philosophy of the welfare state. In a libertarian and thinly populated settler society powerfully shaped by the Calvinist and Lutheran faith such as the US, where the distrust of excessive government power is a powerful foundational element, the development of the welfare state took a very different turn (Castles 2004). Political culture and religious traditions thus matter in the elaboration of different systems of regulating the market economy.

As long as tight regulation of international economic affairs prevailed at the global level, governments commanded more powers in taxing companies or indeed high-earning individuals. They could regulate their banks with considerable leeway. They could also operate their labour markets in whatever fashion they deemed fit. Many scholars and journalists alike noticed as early as the 1970s that the steady deregulation of international trade and finance was affecting government choices and margins for manoeuvre. Though the globalization debate is largely thought of as being the subject area of International Political Economy (IPE), it cannot be and should not be ignored by CPE scholars and students. International economic processes have a top-down impact at the national level. Businesses can threaten to outsource production processes to discipline trade unions. They can move corporate headquarters to low-tax locales to induce governments to reduce corporate tax rates (Greider 1997; Hirst and Thompson 1999). Some aspects of international economic regulation are thus relevant for the study of the political economy at the national
level. Also, in an increasingly interlinked world the distinction between the international and the domestic is no longer as easy to establish. The relevance of the international sphere has been driven home starkly by the financial crisis commencing in 2008 and the associated near collapse of the single European currency (Schmidt and Thatcher 2013; Pisani-Ferry 2014; Matthijs and Blyth 2015). Questions of redistribution, taxation, and labour market regulation lie at the heart of much of the political debate. Heated political battles and struggles emerged in the wake of a resurgent labour movement in the West in the 1970s. The 1980s witnessed the rise of new public management, neoliberal notions of limits to state intervention and ownership, and a reconfiguration of the reach of the market (Gamble 1988; Williamson 2002). All this created major political conflicts, especially in the UK and the US. The 1990s spawned the anti-globalization movement in the West and, outside the remit of this book, a major political backlash against the so-called Washington Consensus in the Global South, especially Latin America. In the 2000s, welfare state retrenchment and labour market reforms throughout Europe (Scharpf and Schmidt 2000a and b), often linked to the run-up and aftermath of the creation of European Monetary Union, incited demonstrations and political confrontations. Finally, the catastrophic fall-out of the US real estate bubble, the implosion of complex financial instruments such as derivatives (ironically originally conceived to mitigate risk), and the near collapse of the US investment banking sector send shock waves not only from Wall Street to Main Street USA, but across the globe (Lewis 2011; Blinder 2013). The ramifications of the most severe recession since the 1930s that commenced in 2008 motivated the US Occupy Movement and a number of anti-austerity movements and political parties throughout southern Europe (Blyth 2013). It also spearheaded the growth of the right-wing libertarian Tea Party movement in the US and strengthened anti-establishment right-leaning parties across Europe. CPE is not some arid academic exercise. It is the study of conflict-prone and conflict-ridden politico-economic processes that inspire, transform, and occasionally upset human lives.

What are the limits to free market capitalism? What are the political consequences of regulating market processes? If regulating markets to varying degrees constitutes an explicit normative choice, is it possible to identify optimal choices? Or will any such choice simply reflect a normative preference, for example, in favour of ‘rugged individualism’ or, conversely, low levels of income inequality? Can governments actually choose successful economic strategies or does the inherently anarchic character of markets limit what governments can hope to achieve? This book introduces, explores, and critically analyses the subfield of CPE. It helps the reader understand the building blocks of politico-economic systems of regulation. It is designed for classroom use. It systematically analyses and compares the most relevant building blocks and critically discusses them. But it also makes a novel theoretical contribution, by arguing passionately in favour of taking culture and religion seriously. The utility
of that approach is demonstrated throughout, but made explicit in the final chapter.

CPE helps us understand crucial policy choices in setting up, running, and reforming key political institutions. How generous is the welfare state? How do companies raise fresh finance and what role should banks play? Should low wage segments of the labour market be allowed to emerge? What role can the state still play in setting the rules of the game in an era of globalization? And how does all this affect individual life choices and chances? CPE is an encompassing subfield that helps us understand how economic choices have political fall-out, but also how political institutions limit or at least shape economic processes.

1.2 An Overview of the Book

The book proceeds as follows. Following this brief overview, the rest of the first chapter provides a roadmap to the field, outlining the most significant contributions made between its inception in the eighteenth century and the mid-twentieth century. In doing so, we will get a better sense of what the contours (p.5) of the subject are, but also what sort of questions are being raised and how they are being addressed. Rather than attempting to craft a coherent narrative out of a complex, sometimes contradictory, but always lively field of scholarly debate, which would be impossible to do, we will instead focus on core contributions to the field and identify the key questions they help raise. In total, twenty-five core questions will be drawn from these theoretical foundations in the first and second chapter. We will also establish the connections between the different contributions to this subfield. As we will see, the field’s roots date back to the age of classical political economy, with contributions from Adam Smith, David Ricardo, and Friedrich List, but also more recent and unorthodox contributors from the twentieth century, notably Thorstein Veblen and Karl Polanyi. This critical review of the genealogy of this field will help set the context for the rest of the book and provide a pivotal introduction to the field. We proceed in chronological fashion, commencing our tour in the late eighteenth century with Adam Smith. Scientific discovery and scholarly debates are strongly shaped by the broader historical and political backdrop, as I argue. It is for this reason that the relevant historical events shaping key thinkers will be critically exposed and reviewed.

Having acquainted ourselves with the foundations and core questions of the subfield, we continue our tour by focusing on the period since the mid-twentieth century. The second chapter thus picks up where the first left off. In this chapter, we need to chart the emphasis on models as an emerging focus of scholarly work from the publication of Shonfield’s (1965) important contribution. But the 1970s also witnessed an emerging division of labour between IPE and CPE. We will briefly clarify the boundaries, but also make clear that in some instances this dividing line can be artificial and unhelpful. In the 1970s, much of the CPE
literature was influenced by research questions that focused on comparative governance patterns, such as consociationalism and neocorporatism. In recent years, the 2008 financial crisis, what has been dubbed the ‘Great Recession’, and the near collapse of the European single currency have driven home just how dramatic the impact of international economic developments on national political economies can be.

Following our tour d’horizon, the third chapter sets out the influential ‘comparative capitalisms’ and Varieties of Capitalism (VoC) approaches that have dominated the subfield since the late 1990s. The insight underpinning the ‘models’ debate at its most basic consists of categorizing different OECD countries according to the predominant features of their politico-economic model of governance. Influential as the VoC approach is, it is not without its critics. There is a need to critically probe this contribution and, very importantly, explore the concept of ‘complementarity’, according to which certain combinations of core elements produce superior results compared to others. The chapter contains a detailed introduction to the Varieties of Capitalism framework, as it is the single most influential theoretical framework to have emerged in recent years. But it also demonstrates limits and pathologies, notably in not allotting sufficient thought to the sources of change and the cultural underpinnings of different political economies in theory and practice.

Moving on, we proceed to explore the most pivotal core elements, or ‘building blocks’, that comparative political economists study. In these more empirically oriented chapters, the following structure is adopted. We begin with a brief introduction of the main tenets of the relevant institutions that set our core six countries apart. These are the US, the UK, France, Germany, Sweden, and Japan. From there, we engage in a critical examination of sources of change, instability, and internal pathology. These are related, where appropriate, to individual countries or clearly identified as general trends. Finally, a systematic comparison between the different configurations is carried out. The question of cultural backdrop and religious traditions acting as a glue will be examined. Another recurrent theme is the probing of complementarity, in other words, to what extent certain elements go together and optimize economic performance both in theory and practice. In substance, select areas of the political economy will be explored. The selection choice is based on picking the most crucial nodes of market (re)regulation as well as an accurate reflection of the main focus areas of the scholarly literature.

How are labour markets and industrial relations regulated? What choices do individuals face in obtaining training and education? How do these institutions correspond to the overall regulation and structure of the labour market? These are some of the questions addressed in Chapter 4. How does technological change, the emergence of the service sector as a crucial source of employment, and societal developments, for example regarding the role of female labour
market participation, affect the structure of the labour market? While governments create the legal parameters for regulating employment, core operational aspects, including wages, benefits, and often also aspects of working conditions, are subject to non-state actors that vary in significance and power across countries, namely trade unions and employer associations.

Chapter 5 focuses on finance and corporate governance. How is access regulated to that crucial lubricant of economic processes, money? Just how important are shares and bonds as a source of fresh capital? How does the institutionalized regulation of savings and loans interact with and affect corporate decision-making processes? Why do bank loans predominate in some countries, but not others, and what sort of companies does this attract? The different modes of regulation finance, once a distinctly scholarly preserve, have attracted popular and journalistic interest in the wake of the 2008 financial crisis.

In Chapter 6, we explore how national systems of finance have been influenced by broader developments, including the rise of private and public debt. We will also explore the political difficulties national regulatory authorities experience when attempting to (re)regulate finance. The different models generated distinct national response strategies to this 2008 crisis. However, the events surrounding the Great Recession also drove home just how crucial the financial sector is deemed to be by policymakers, making punitive measures politically very difficult to implement.

The reregulation of labour markets and the various public, private, or para-public insurance schemes against risks of old age, illness, and invalidity have spawned a vivacious debate. This is unsurprising given how crucial the reregulation of the basic commodification of labour is in studying and understanding the state–market relationship. Chapter 7 shifts the focus to a set of questions regarding the contours and future of the welfare state. Can welfare state institutions be understood as products of the struggle between business and labour, as left-of-centre analysts would argue? Do recent reform processes reflect a mere functional need to address new risks, societal change, and demographic developments? Or are they driven by a neoliberal drive towards marketization and recommodification of labour, as is often claimed in the scholarly debates? Can welfare state provisions insure adequately against risk in a more atomized society? Do welfare state benefits create problematic incentives for individuals in charting their life courses, as right-wing critics would charge?

Having focused on private actors, market structures, and the interaction between public policy and private actors of states, in Chapter 8 the focus rests on the nature of the state, a subject which is central towards understanding the regulation of the economy and economic growth strategy. However, state institutional capacity has undergone considerable permutations throughout the
twentieth century, with ideologically driven change being important. How and when do states regulate and what actors and factors drive them? Are states still capable or, maybe more importantly, willing to reregulate market processes? It will be argued that the very nature of the state has been affected heavily by the liberalization of the international economic order, a state of affairs that can be grasped by considering the infusion of state ordering logic with central tenets of Friedrich von Hayek’s writings. An often self-imposed restraint regarding the regulation of financial service sector actors in general and banks in particular has rendered financialization another key feature of contemporary statehood. States are crucial umpires, but they are also rule-makers, arbitrators, and enforcement agencies vis-à-vis market actors. If the fundamental logic of their very actions has been subverted, however, how does this affect the kind of regulation they will produce? In this chapter we will have to explore some of the arguments developed during the 1990s debate on globalization. Though this debate and some of these questions are often categorized as belonging to the sphere of IPE, this clear dividing line is analytically limiting and seems arbitrary. For in truth, domestic systems of political economy are affected by international economic processes, and states are important nodes where the international and the national interact.

Finally, in Chapter 9 we will wrap up, revisit the call to incorporate ideational factors and cultural and religious traditions more centrally into the study of CPE, and demonstrate how this can be accomplished. In addition, we will consider a number of promising research avenues to move the debate ahead, expanding upon existing work on the role of ideology and ideas in fostering economic change. We will also consider some disruptive forces and processes that are likely to reconfigure the politico-economic landscape of the young twenty-first century, focusing predominantly on environmental factors and the pressing question of energy security.

1.3 Methodological Considerations, Case Selection, and Thematic Focus
In the broadest sense, CPE deals with the interaction of economic and political institutions, based on the changing and fluctuating composition of the economy and the nature of the rules of the game governing the economy. Markets are almost never ‘free’; they tend to be established, modified, shaped, and sometimes curtailed by government action and market forces. Regardless of whether we study labour market regulation, industrial relations, training and educational schemes, or systems of finance and banking, in CPE we are interested in what factors underpin different national economies, how they compare internationally, how they evolve, and why and how they emerge, blossom, and disappear. In that sense, we are ‘comparing’ transnationally. In order to make meaningful comparisons, CPE concentrates on the OECD countries only. Essentially, this means a focus on Western Europe, Eastern Asia, and the erstwhile British North American and Oceanian overseas settler societies. Less developed countries and the newly emerging economic giant of
China are not customarily included in the purview of this subfield, neither are the other so-called BRICS (Brazil, Russia, India, China, and South Africa) or what Goldman Sachs identified as the Next Eleven, including less obvious choices for potential developmental success stories, namely Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, South Korea, Turkey, and Vietnam (O’Neill 2001). The enormous cultural differences and the divergence of historical trajectories between these countries and the OECD membership, with attendant socioeconomic and political differences, are such that any comparison would become unwieldy and analytically flawed. Rather than attempt to cover countries that may well be on a growth trajectory, but introduce unmanageable levels of variance, it is more promising to provide in-depth coverage of a smaller selection of countries that in many ways are representative cases of larger clusters, in line with standard practice in comparative qualitative research (Ragin and Becker 1992; George and Bennett 2005; Brady and Collier 2010). These countries are Sweden, the US, the UK, Germany, Japan, and France. Pars pro toto they can regarded as representative of Scandinavia, the Anglosphere, German-speaking continental Europe, East Asia, and Mediterranean Europe. These groupings are, as we will see in Chapter 3, common clusters found in the CPE literature.

Any enterprise charting and analysing a subfield, even one as comprehensive as this one, has to entail a thematic focus, which in turn implies a cut of some sort. This book focuses on the regulation of core spheres of what constitute the most important and analytically most fruitful areas of state regulation of economic activity: labour markets and industrial relations; finance and corporate governance; welfare states; and the nature of the state. Labour markets are crucial nodes of economic exchange that drive socioeconomic advancement for the individual, determine life chances, and constitute crucial underpinnings of corporate development. Finance and corporate governance in turn determine the modalities of companies’ investment strategies. Welfare states ensure basic protection against impediments to employment; they also indirectly proffer a basic minimum wage by setting a wage floor. As we will see, detractors highlight the pathologies of creating ill-directed incentives, whilst supporters raise morally influenced arguments regarding the protection of the weak. Finally, the state and its changing nature is an important point of discussion, as it acts as rule-maker and umpire in all of these fields. There are other areas of CPE that could have been included, though many of them are much more policy-oriented and thus less institutionally based. Some of them will be covered in passing, though they did not warrant separate chapters. For example, taxation policy is an interesting domain in which different political prerogatives play out. Yet it is much less institutionalized and ultimately can be comparatively easily modified by governments according to their political preferences. Similarly, state-led economic development policy often entailed outright industrial policy, identifying promising growth sectors (‘picking winners’). But not only has industrial policy
fallen out of favour throughout the OECD, it is also very much conditioned by the politics of the specific government in charge. Any systematic comparison of some of these themes runs the risk of ageing badly, being overtaken by events, and focusing too much on policy detail, rather than more fundamental traits.

The goal is to dissect the interaction between the political and the economic and explore how political decisions, rules, norms, ideas, and institutions influence the economy and more specifically its constituent actors, and vice versa. I also argue that we need to take political culture and religious traditions much more seriously and demonstrate throughout this book how to do so. The scholarly interest in adopting a comparative angle thus lies not so much in identifying ‘what works’ or ‘best practice’, as such endeavours are not without their own methodological problems. Instead, we focus on exploring and, where possible, determining what makes different national economies and their respective political regulations ‘tick’. In so doing, the book focuses on analytical comparison and comparative political economy rather than mere political economy.

We also need to make clear what CPE is not. Confusingly, the term ‘political economy’ was historically the moniker used to describe the discipline today known as economics. In contemporary economics, however, ‘political economy’ is defined differently. It describes economic modelling of political processes, but can also include the political regulation of economic processes. Consider how the editors of the scholarly (economics) *Journal of Political Economy* define the area of enquiry: ‘monetary theory, fiscal policy, labor economics, development, micro- and macroeconomic theory, international trade and finance, industrial organization, and social economics’ (2016). Meanwhile, political economy as a standalone subfield of political science concerns itself with issue-areas on the edge between economics and political science, for example, the politics of central banks or the politics of monetary and fiscal policymaking. The definition of the term CPE comes closer to this second line of enquiry, but adds a comparative element and is more institutionalist in focus. CPE involves comparison, as the name suggests, to gain insight and deeper understanding of individual institutional arrangements by juxtaposition with other such systems.

1.4 How Contingent is CPE on Time and Place?
Place and time matter. Scholarship can be strongly shaped by the predominant concerns of an era. Given its focus on the core OECD countries, this chapter provides a comprehensive critical introduction to the most central contributions to this subfield from scholars based in continental Europe and the English-speaking world. There is no coherent narrative here to be unearthed. CPE has advanced in fits and starts. It was all but abandoned for a few years after the Second World War. It came back with a vengeance in the 1970s. During the course of its development, it also jumped disciplinary borders somewhat, while at the same time, disciplinary boundaries themselves, still somewhat fluid before
the twentieth century, became more rigid. Early CPE scholarship preceded the
division between the study of politics and economics as separate academic
disciplines. Many of the modern subdivisions between academic disciplines are
fairly artificial and of recent provenance. Before the separation into separate
disciplines of 'economics' and 'politics' or 'political science', classic economists
considered themselves political economists. Much is to be gained from the
diverse perspectives, sets of questions, normative (p.11) traditions, and lines of
reasoning these different disciplines and approaches afford. Sociologists,
political scientists, historians, and economists have all contributed to a
theoretical field which straddles the disciplinary divide between these subjects.
Yet, in the modern era, with the discipline of economics defining itself as distinct
from other social sciences and taking a distinctly mathematical turn in the early
twentieth century, comparative political economy remains dominated by
contributions from the discipline of political science and, as such, it has come to
be heavily coloured by an emphasis on institutions.

CPE is an enterprise with roots that date back to the late eighteenth century. It
is customary to treat Adam Smith as the ‘father’ of the modern discipline of
economics and, given that at the time there was no disciplinary divide between
the scientific study of politics, economics, and political economy, CPE as well.
Adam Smith’s most famous oeuvre, published in 1776, was *An Inquiry into the
regarded as the theoretical keystone of modern economics, it concerned itself
with issues and raised questions that are central to modern CPE as well. In fact,
the book’s title is an apt summary of much of the field’s research agenda! Smith
wrote just before the advent of the Industrial Revolution in England, while
French scholar François Quesnay and the Physiocrats whose assumptions
influenced his work were based in a pre-modern, largely rural, and agriculturally
driven country. Moving ahead to the late twentieth century, CPE has experienced
a strong and somewhat recent renaissance commencing in the late 1970s,
initially mainly driven by scholarship in the United States. The politically and
economically tumultuous decade of the 1970s was shaped significantly by the
end of the Bretton Woods system of fixed, yet adjustable exchange rates,
stagflation throughout most of the western world, and the end of the long
postwar boom. Politically, anxieties over the economic rise of the East Asian
tiger states, a new ‘hot’ phase in the Cold War, and, in the case of the US, the
aftermath of the divisive Vietnam War and the Watergate scandal shook the
foundations of the postwar consensus. In Europe, considerable political unrest
unfolded, driven by students protesting against the stifling conservatism of the
postwar era and workers engaging in industrial action both within and outside
of trade union channels. The rediscovery of CPE in the US was thus in part spurred
by a search for better ‘politics in hard times’ (Gourevitch 1986). Academic
interest in different capitalist politico-economic models was reignited, not least
in light of the obvious successes during the postwar era of two distinctly non-
liberal economies: Japan and West Germany. Their growth trajectory inspired significant interest amongst Anglo-American scholars (e.g. Johnson 1982; Thurow 1993), not least given the much less stable economic performance in the United Kingdom and concerns over decline in the US in the 1970s. Yet by the 1990s, the conventional wisdom du jour had changed again: now newly unified Germany (p. 12) was characterized as the ‘sick man of Europe’ (Streeck 1997a) and Japan underwent a long period of stagnation. Meanwhile, the less regulated British and American economies roared ahead (Albert 1993). There is a danger of being caught up in impressionistic sentiments and the zeitgeist. This book provides guidance to CPE that ultimately supersedes the deceptive and unhelpful attempts at picking winning models. The goal is to identify more profound patterns.

1.5 The Trajectory of CPE as a Discipline

1.5.1 Adam Smith and Classical Liberalism

Classical political economists posed many fundamental questions that remain the staple of modern CPE. They were amongst the first to claim the existence of separate political and economic spheres, a radical position for the time. In normative terms, liberals such as Adam Smith (1723–90) were concerned with autocratic governments, the vicissitudes of feudalism, and the power of entrenched interests. Smith concerned himself with the workings of a market economy on the cusp of the Industrial Revolution and, more philosophically, with the appropriate role of state regulation versus the unregulated unfolding of market forces (Smith [1776] 1937; see also Box 1.1). His second, much less well-known, principal monograph *The Theory of Moral Sentiments* (Smith 1761) makes a strong moral argument in favour of a society that is composed of shared cultural, philosophical, and religious values that will generate trust, confidence, and mutual responsibility. Market-driven processes could unfold, but their foundation had to be a society in which, to deploy a biblical adage Smith would approve of, one was one’s brother’s keeper. Smith owes an important intellectual debt to François Quesnay (1694–1774), associated with the so-called Physiocrat School. Quesnay had earlier outlined the benefits of a liberalized economy and a much more restrained state, and had hinted at the potential for market self-regulation. John Stuart Mill (1806–73) shared many of these preoccupations and continued to expand the intellectual basis of political liberalism in his comprehensive *Principles of Political Economy* ([1900] 2004).

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**Box 1.1 Adam Smith and *The Wealth of Nations***

Adam Smith’s *The Wealth of Nations* is rightly regarded as the foundation of modern economics and, by extension, CPE. It can be read both as a scientific analysis into the internal dynamics of a market-based economy and as a
A political pamphlet advocating a prominent role for market forces at the expense of state regulation.

Liberated from onerous government regulation and free from most intervention, market forces will lead to a more efficient allocation of resources. The famous metaphor used is that of an ‘invisible hand’ at the heart of such allocation. Individual egoistical motives of the individual ultimately give rise to mutually beneficial provision of goods and services, for example by the products made available for sale by a baker. The division of labour is recognized as crucial in raising productivity at the company level.

The interaction of the forces of supply and demand will drive economic processes, with the price function playing an important role in signalling scarcity or glut to producers and consumers alike.

Government ownership, planning, intervention, and steering, all commonplace at the time, are considered to create inefficiencies or, worse, be deleterious to economic growth.

However, Smith was no extremist and recognized that there was a legitimate role for the state in the provision of education, justice, defence, and general infrastructure.

Similarly, he was conscious of the tendency to conspire among industrialists and the danger of anti-competitive cartels emerging. Though strongly critical of statism and the predominant ideology of the time, mercantilism, Smith’s work is notably more tempered than that of the late twentieth-century neoliberal thinkers such as Milton Friedman and Friedrich Hayek. In the Theory of Moral Sentiments, he articulates clearly that market processes will work efficiently based on an altruistic bond between members of society. An original thinker, Smith’s work was a lot more nuanced than certain contemporary depictions might suggest that turn him into a free market radical of caricature. Nevertheless, his book is accurately read as an argument in favour of limiting the role of government interventionism and freeing up room for individual business actors to pursue actions they deem appropriate.

Another key liberal thinker following this intellectual tradition was David Ricardo (1772–1823). Principles of Political Economy and Taxation focused on the benefits of deregulated international trade, formulating the principle of comparative advantage. This concept highlights the benefits of sectoral specialization in fields with an international competitive edge, exploiting given locational advantages regarding the training of the labour force, availability of raw materials, and the state of technological development. Ricardo postulated
that international trade is beneficial for two given countries even if one
country produces two given products more cheaply and inefficiently. Even in this
scenario, the other country is better off opening itself up to trade and reducing
tariffs. Ricardo also advises letting the least efficient sectors wither and rely on
imports of these goods instead. Like Smith, Ricardo railed against heavy state
interventionism and, more specifically, protectionism as detrimental to economic
development and unnecessary.

Analytically, Smith and Ricardo argued that national wealth could be increased
through economic liberalization, the reduction of state regulation of economic
activity, international free trade, and a general ‘laissez-faire’ stance towards
economic matters. Just like modern CPE students, these eighteenth-century
scholars attempted to work towards an economically more efficient order, which
also, in their eyes, would prove to be normatively fairer. It is important to
understand that in their writing, economic liberals railed against the
predominant faith in statism in economic affairs, which was at the heart
of mercantilism. In Ricardo’s case, scholarly activity was complemented by his
political career as a member of the British parliament and his campaign against
the Corn Laws. This protectionist piece of legislation protected British farmers
against foreign corn imports through tariffs, thus indirectly raising the cost of
bread and creating artificial profit margins for large landowners, referred to as rent in classical economics. The early liberals and founders of what in modern
parlance is referred to as classical economics were thus primarily concerned
with better understanding what makes an economy tick and flourish. They were
convinced that freeing up an economy from state regulation and meddling would
unleash productive forces of competition, raising the standard of living for the
individual. In making a strong case for market self-regulation, allocation by
forces of demand and supply, and the guidance provided by the signalling effect
of prices, they also advance important normative prescriptions regarding the
ideal organization of a modern economy. Unlike more radical neoliberals in the
twentieth/twenty-first centuries, Smith and other classic liberals concede that
certain areas are best left to government provision and regulation. Smith also
acknowledges that collusion and cartels might emerge as problems, subverting
the powers of unfettered competition. Before we review the thinkers who
support the mercantilist paradigm, let us briefly consider the key general CPE
questions posed by Adam Smith (Box 1.2).

**Box 1.2 The Broader Questions Emerging from Adam Smith**

1. What is the appropriate role for the state in establishing,
overseeing, and guiding economic interchange? What and where
precisely are the limits to state regulation and intervention?
2. Which sociological and psychological elements drive economic processes?
3. How can political regulation of the economy lead to superior outcomes both regarding the promulgation of economic growth and in normative terms of fairness?
4. How central is the importance of a shared societal consensus on normative and ethical values for the efficient functioning of a market economy?

1.5.2 Friedrich List, Alexander Hamilton, and Mercantilism

Mercantilism is a paradigm that emphasized infant industry protection, strong tariff barriers, an active role for government in planning, administering, and steering economic development, and perceived international trade as a zero sum game that should only be engaged in if clear material gains can be harvested from it. It is associated with the policies pursued by the economic adviser to French king Louis XIV, Jean-Baptiste Colbert (1619–83). It is more (p.15) of a descriptive term than a theory in the strict sense, not comprising a comprehensive set of testable propositions. That said, the early nineteenth century witnessed the articulation of coherent policy prescriptions, which may not satisfy the rigorous modern definition of a theory, but prove of lasting intellectual merit nevertheless. The impassionate defence of free trade and a reduced role for state interventionism attracted criticism. Friedrich List (1789–1846) powerfully and intelligently challenged most of Smith’s ideas, including the underlying normative bias, which is unacknowledged according to List. One of his criticisms of the ‘cosmopolitanism’ he identified with Adam Smith was the implicit self-serving nature of liberal free trade arguments (List [1885] 1977). Their implementation would clearly benefit Britain as the economically most advanced country. List’s emphasis on active state interventionism and steering of economic development was, of course, not so much analysis as prescription for late industrializers, notably Germany and the United States. There is no real sustained comparative element in his writings, however. By contrast, evaluation and advice rank prominently: the goal is to counteract liberal notions of trade deregulation and in particular to advocate government initiative in the provision of infrastructure, most famously, of course, in the creation of a railway network, for which List remains renowned in his native country. Such infrastructure included high quality educational facilities, which could be financed through tariffs or taxes. Education and investment in future human resources were deemed crucial (Henderson 1983). Protective tariffs were prescribed to protect infant industries.

List was sceptical of free trade. He saw countries in the ‘temperate’ zones of the world as most likely candidates for economic development beyond mere reliance on agriculture. By contrast, ‘tropical’ countries were not particularly well suited.
Given their reliance on the export of unprocessed commodities, it was equally prudent to protect the domestic market through import tariffs. In *The National System of Political Economy*, List ([1885] 1977) moved beyond the rejection of free trade and certain tenets of economic liberalism. Smith’s emphasis on individual spontaneous economic activity as a driver of economic growth was rejected as naively underestimating the need for appropriate administrative and political guidance by the state. Smith had not claimed that the invisible hand could function in a moral and political vacuum either, but List powerfully argued that, without the state providing steering in national development, individual countries would stagnate economically and soon be dominated by the economically more advanced (see Box 1.3). That said, List took certain liberties in simplifying Smith’s argument, omitting from view the nuances that, in fairness, would preclude a simplistic caricature of Smithian free trade advocacy (Watson 2012). An important intellectual source of inspiration for List was his sojourn in the United States, especially his encounter with the work of Alexander Hamilton, whose *Report on the Subject of Manufactures* contained similarly minded advice to the (p.16) young US Congress (Hamilton 2001). Like List, Hamilton was sceptical of free trade and feared the very real prospect of perennial US economic dependence on the former colonial power, absent protective tariffs, infant industry protection, and state-led economic development. Ultimately, Hamilton’s advice proved more influential in Japan and even recently in China (Breslin 2011) than in his home country.

**Box 1.3 The Broader Questions Emerging from Friedrich List**

1. Does government have responsibility for national developmental pathways?
2. Is it sensible for latecomers in development (then and now) to ignore liberal policy prescriptions in favour of protective tariffs, nourishing infant industries, and ‘picking winners’?
3. Is liberalization of the political economy detrimental to all but the most economically advanced countries because it impedes developmental progress?
4. Are there basic public services (health, education, public transportation) that should be exempt from market forces?

Importantly for our purposes, mercantilists fundamentally reject the notion of self-governing market forces leading to benevolent outcomes for all. Instead, they advocate strategic yet robust intervention and regulation of the economy, involving strategic trade policies, nourishing of infant industries, improving the state of the infrastructure, and investing into training and education. Following this advice would have important consequences for the institutional organization
of a political economy. As we will discover in Chapter 3 and throughout this book, statist political economies, both in France and Japan, followed some of the basic prescriptions of this approach.

1.5.3 Karl Marx, Friedrich Engels, Marxism, and Neo-Marxism

Both classic liberals and mercantilists were firmly rooted in wishing to sustain a modern capitalist economy, yet they clearly differed regarding the appropriate role of government intervention and regulation. A much fiercer critique of liberal political economy was developed by Karl Marx (1818–83) and his co-author Friedrich Engels (1820–95). Despite its association with the monstrous dictatorships of the early and mid-twentieth century, Marxist political economy continues to supply a useful arsenal of tools to dissect critically the workings and machinations of capitalism. Its normative anti-capitalist bias needs to be clearly understood, however. One might also point to an inclination towards determinism and a certain tendency towards circular reasoning. Such caveats are in order. Largely because of the association with the excesses (p.17) of Stalinism and the nominally Communist dictatorships of the Soviet Union, Eastern Europe, North Korea, China, and Cuba, the ideological appeal of this school has waned dramatically since 1989. Though impossible to summarize succinctly, Marx is widely credited even by his opponents as identifying the inherent instability of capitalism and its crisis-prone character. He makes this argument explicitly in the *Manifesto of the Communist Party* (Marx and Engels 2013) and volume 3 of his main oeuvre *Capital* (Marx 1990). These economic gyrations are due to the law of underconsumption and overproduction, leading to glut, reduced production, rising unemployment, and ultimately political and economic instability and unrest. Marx claims that there is a systematically *falling rate of profit*, which will affect any given individual entrepreneur. There are systemic faults within any capitalist system that are impossible to mediate. Similarly, classical political economy neglects the implications of social class and assumes an individualistic utility-maximizing mindset (often summarized as that of an economic man or *homo oeconomicus*) that is simply unrealistic. Marx alleges that his liberal predecessors neglected the role of class in their analysis. These latter two arguments are developed in the *Theses on Feuerbach* (Engels 1941).

Another innovative element of Marx’s work is the labour theory of value, according to which the value of a given commodity is in large part determined by the amount of labour contained therein. This concept is developed in detail in volume 1 of *Capital* (Marx 1990) and builds upon Smith’s work, but relegates the market value that a given product or service can fetch to secondary importance. Instead, it highlights the plight of the working class which is dependent on selling its ability to carry out work, ‘commodifying’ its labour in this way. Their wages will only suffice to reproduce their ability to work. By contrast, the owners of the means of production will never pay the true value created by their employees as a wage. Instead, they will siphon off the so-called *surplus value*
and parasitically live off the proceeds of the work of their employees. The pressures of competition will lead individual capitalist entrepreneurs to replace workers with machinery where and if possible and attempt to push down wages. Competition, far from having the benevolent effects on prices and quality that liberals impute, will thus lead to unemployment and eventually social unrest. It also drives the falling rate of profit, an unsurmountable flaw of capitalism, developed in volume 3 of *Capital*. While the state of the labour market may, of course, improve slightly during an upturn in economic growth, the long-term fundamental logic of competition that drives individual entrepreneurs to cut labour will not be affected. As famously proclaimed in the *Manifesto* (Marx and Engels 2013), capitalism thus contains the seeds of its own destruction and creates its own gravediggers, a growing class of economically disenfranchised and politically unruly individuals that will eventually overthrow capitalism.

(p.18) The inherent flaws of capitalism, in the view of Marx and Engels a normatively unjust and exploitative order, will give rise to a new order in which the means of production are nationalized and collectively owned. Central planning will succeed the anarchic and chaotic market place in which individual entrepreneurs make decisions regarding product design and innovation, production capacity and levels, and product marketing. In the new socioeconomic order, socialism, the inequities of capitalism will be tackled by addressing the population’s basic needs, ending exploitation at work, and overcoming the inherent instability of capitalism through central planning. With the largely repressive functions of the state no longer a necessity, the state itself will wither away over time and communism will be attained. These two developments, while suggested throughout Marx’s work, are not spelled out in much detail. Box 1.4 succinctly summarizes some of Marx’s main arguments.

| Box 1.4 Karl Marx and *Capital*

Where Adam Smith was optimistic about the overall effect market competition and unregulated market forces would have on the workings of a given economy, Karl Marx highlighted the inherent instability and flaws of modern capitalism. In normative terms, classical liberals recognized that unfettered market dynamics would temporarily hurt individual businesses and employees, but regarded this as a price worth paying for the benevolent effects of market competition. Marx was less sanguine, claiming that a market economy bereft of the alleged benefits of central planning would witness glut, economic recessions, and a perennially falling rate of profit. The overall pattern of capitalist ownership according to which owners of the means of production could benefit from the mere virtue of this ownership is inherently unjust. Employees, not only members of the working class, but also salaried employees, do not and never will own any such means and are
thus confined to selling their labour power on systematically skewed terms to the capitalist owners of the means of production.

As individual capitalists compete, they replace workers with machinery and attempt to drive down wages, leading to increasing unemployment and, in the long term, social instability and political unrest. The demise of capitalism is thus inevitable because its very core mechanism—market competition—unleashes dynamics that lead to its downfall.

Capitalism is not only flawed, it is also morally corrupt and has a corrosive effect on character. Individual employees are alienated from paid labour. Every aspect of human activity and interaction will become commodified and tainted. Individual goods acquire a fetish character.

Neo-Marxist authors of the twentieth century accounted for the global spread of capitalism (Lenin 1970) or attempted to explain why capitalism failed to collapse and give way to a planned economy and socialism. These authors pointed to the powerful role of ideology in justifying political control and pacifying populations. Capitalism therefore persisted not only because of pure brute force, but because of the dominance over the ideological and ideational sphere as well. Most of these claims owed some inspiration to the work of Antonio Gramsci (1971).

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**Marx (1990)** analyses the export of the capitalist system to the North American colonies in chapter 25 of volume 1 of *Capital*. In what could be deemed an early precursor to contemporary globalization debates, Marx argues that the worldwide expansion of capitalism is driven by declining profits domestically. Thus, capital owners would be driven to invest overseas, and capitalist accumulation would by necessity spill over internationally. British colonial rule over India contributed to the erosion of Indian feudalism and the slow shift towards western-style capitalism. In that sense ‘whatever may have been the crimes of England she was the unconscious tool of history in bringing about that revolution’ (Marx 1853). The inherent drive of capitalism to worldwide expansion was further examined and developed along Marx’s line of reasoning by Vladimir Lenin in *Imperialism: The Highest Stage of Capitalism* (Lenin 1970). Box 1.5 identifies key questions that arise from Marx’s work for the study of CPE.

**Box 1.5 The Broader Questions Emerging from Karl Marx**

1. What are the socioeconomic consequences for a given polity of adopting particular patterns of ownership?
2. If we accept the proposition that capitalism creates both winners and losers, how can losers be compensated appropriately?
3. Why and how is a socioeconomic system that is ostensibly associated with creating inequality so successful in reproducing itself over space and time? What mechanisms are responsible for helping it sustain and reproduce itself?

The Communist Manifesto and its righteous denouncement of the corrosive global dissemination of capitalism can be read as a remarkably prescient analysis of contemporary globalization processes. Despite its incisive analysis of the broader logic and specific workings of capitalism, contemporary CPE debates tend to neglect Marx’s work. However, one obvious reason for this is that the practical application of socialism was pursued at an unacceptably high cost to human lives. State-centred socialism also began to fall behind the economic growth and technological innovation in the capitalist West from the 1950s onwards. Marx wrote in an era in which centre-left political parties, trade unions, welfare states, and employee-friendly labour market regulation were non-existent or nascent at best. Notwithstanding these reservations, in IPE there have been a number of important contributions to the debate broadly inspired by Marxist ideas, such as the neo-Gramscian perspective, notably Robert Cox’s *Approaches to World Order* (1996; see also Budd 2013) and Stephen Gill’s *Power and Resistance in the New World Order* (2002). These accounts helped make sense of the continued survival of capitalism throughout the twentieth century, but also pointed to persistent inconsistencies and contradictions. Political control was still exercised by the state (p.20) on behalf of the capitalist class, but the state was credited with possessing considerably more autonomy than had been previously recognized. At the same time, domination took on new forms in capitalist countries, including notably through ideological indoctrination—a subtle form of disseminating false consciousness, utilizing ‘organic intellectuals’ (Gramsci 1971), a core element identified by Italian neo-Marxist Antonio Gramsci (1891–1937). Capitalism could thus be sustained by creating an ideological superstructure that could act as a form of glue and paper over the social and political inequities. But, according to neo-Marxists, these inequities were not addressed, merely ignored.

Neo-Marxist contributions to the study of CPE remain limited. In the 1970s, there were important neo-Marxist refinements to the relationship between capital and state power. Some of these will be taken up in Chapter 7. Worth highlighting in this context are the contributions by Louis Althusser who emphasized the existence not just of a repressive, but also an ideological state apparatus (especially in his *Pour Marx*, Althusser 1965; see also 1970), extending to educational institutions, that helped create dominant mainstream ideology and quench dissent. Nicos Poulantzas (2002) similarly explored methods through which the state perpetuates capitalist economic relations despite its contradictions. In West Germany, neo-Marxist political economists
Joachim Hirsch (1995), Jürgen Habermas (1975), and Claus Offe (1973) probed the limits to which states could paper over the legitimation crisis through generous welfare benefits and an allegedly illusory sense of improvement of material standards of living. One of the most severe flaws of this literature was its inability to comprehend that these improvements were not mere figments of the imagination of a populace blinded by false consciousness, but did entail a real and measurable upward trajectory in living standards. Finally, the 1970s also witnessed the genesis of the French regulation school, shaped by scholars such as Michel Aglietta (1979) and Robert Boyer (Boyer and Saillard 2002), which emphasized state governance of economic affairs in fine-tuning economic development in advanced economies.

Marx’s radical critique of capitalism has numerous implications for the study of CPE, without necessitating importing its normative bias. It alerts us to the role of social class, ownership patterns, and systematically ingrained inequality in structuring any given political economy. Marx also correctly noted the strong political role of the wealthy and politically well-connected upper class, although it is debatable whether the state has been fully captured by such actors. In any event, the charge should alert us to the possibility of government action being biased and one-sided, which would cast doubt on its role as a neutral umpire. He identified economic recessions and correctly predicted business cycles and instability, though the prescribed solution, a planned economy, has empirically very clearly demonstrated its own pathologies. Finally, Marx also noted the crucial role that real existing material circumstances have on the individual’s mindset and preferences. Human history is not just the history of class struggle, it is also propelled forward by the materialistic basis of society and its contradictions. Neo-Marxists attempted to explain why capitalism persisted throughout the twentieth century in most parts of the world. Building on the Marxist concept of false consciousness, they turned to claims about ideology and state-led indoctrination as well as the role of religion in fabricating a societal consensus that papers over real cracks. Later CPE work disagreed with most of these claims. Max Weber accepted the role of religion and ideology as extremely important, but suggested that these could be genuine sources of inspiration for action, not tainted and false instruments deployed to placate the masses. We will turn to his work next.

1.5.4 Max Weber and Religion, Ideology, and Ideas

Ideology has made a comeback in CPE with the influence of constructivism and its emphasis on the role of ideas, a topic to which we return in Chapter 2. However, there is ultimately more focus on institutions and, less so, interests. In contemporary CPE the relative hierarchy of the ‘three Is’ is thus fairly well established, but there is no compelling rationale behind this weighting. In fact, the German sociologist Max Weber (1864–1920), another major contributor to this subfield, combined all three in his work. List (1885–1977) had already noted that the difficulty in establishing a general scientific discipline of economic
processes lay in the irregular and idiosyncratic features of individual countries. Moving beyond this insight, Weber emphasized sociocultural, political, and religious factors in moulding systems of political administration and the motives, incentives, and actions of individuals negotiating and dealing with such apparatuses. He also recognized the importance of combining the three Is in comparative social enquiry, arguing in *The Sociology of Religion* that: ‘Not ideas, but material and ideal [ideological] interests, directly govern men’s conduct. Yet very frequently the word images that have been created by ideas, like a switchman, have determined the tracks along which action has been pushed by the dynamic of interest’ (Weber [1922] 1993: 280). This insight moves the debate beyond Marx, who recognized that individuals made history within the parameters of the era in which they found themselves. As we noted earlier, the role of ideology itself, of course, attracted considerable attention from neo-Marxists and less so from Marx himself. Marxists claim that material circumstances (‘being’ or *Sein* in German) influence the intellectual realm of consciousness (*Bewußtsein*). In *The Sociology of Religion*, Weber questioned this claim and argued that ideas shape interests. In so doing, he also rejected the broader Marxist claim according to which historical materialism and economic realities shape broader societal change and political development. His work retains a contemporary quality and certainly possesses a certain iconoclastic appeal in identifying decision-making processes as being conditioned by political cultures and religion, as well as the interaction of social classes in society.

Weber’s work was informed by the realities and ethos of late nineteenth-century Prussian and later German bureaucracy. As such, it emphasized the role of the neutral and rational government bureaucracy. The modern state may hold the monopoly over the legitimate use of physical force, but the state itself is not exempt from pressures placed upon it by socioeconomic actors. Weber’s *Economy and Society* (*Wirtschaft und Gesellschaft*) comprehensively includes his focus on the socioeconomic foundations of society and the interactive effects of social, political, and economic actors. The author notes that it is possible to increase the rationality and the personal neutrality of decisions, and thus the nature of the authorities in charge can ameliorate the conditions for the existence of a rational economy. Even powerful economic actors will prefer such monocratic rational bureaucratic actors, as they understand them to be more amenable to their interests than parliaments (Weber 1980). The rationality which dominates decision-making processes could not be presupposed to exist everywhere. Where it does, however, it helps account for the specific interaction between market actors and governments.

Weber is also identified with a form of occidental rationalism, on account of crediting the Protestant work ethic for the spectacular socioeconomic success of Western Europe compared to the rest of the world, and indeed the emergence of contemporary capitalism in predominantly Protestant north western Europe. In
The Protestant Work Ethic and the Spirit of Capitalism, Weber’s ([1904] 1992) argument is not that there is a direct causal link between the Protestant ethic and the emergence of modern capitalism. However, the former is a necessary and pivotal contributing factor. Examining Calvinism (in his chapter 9) and various churches that have emerged from the Lutheran tradition, Weber argues that a particular form of asceticism combined with a robust sense of self-improvement and faith in meritocracy and earthly rewards for hard labour coalesced to promote the ideational basis for economic development. Making money has become a virtue in its own right. The western rationality Weber identifies in establishing government and its bureaucracy, but also more cultural spheres such as architecture and music, has helped properly forward this development. Modern left-wing critics might consider this a Eurocentric claim. But it is hard to contest that the developments here contributed to economic development in north western Europe and via colonialism and overseas expansion came to be extended worldwide. Though much of his oeuvre was focused on identifying social interaction, thus laying the foundation of modern sociology, Weber’s foundational work also influenced comparative political economy. Box 1.6 summarizes his main contributions, while Box 1.7 distils key questions from his work. We will revisit Weber’s claim about the role of religion and ideas throughout this book. If taken seriously, it has important consequences not only for developmental economics and growth trajectories, as recent work in that subfield would suggest (Acemoglu and Robinson 2013), it also helps us better understand how institutions could emerge and be sustained, and why they wither eventually. These are highly important suggestions for CPE analysis.

Box 1.6 Max Weber and his Economy and Society and the Protestant Work Ethic

Max Weber’s work emphasizes the importance of ideas and ideology in shaping politics. Importantly, he also considers religion to constitute one such form of ideology. Rejecting Marx’s historical materialism, he questions the extent to which economic processes drive world history and socioeconomic reality alone influences ideological developments and thus politics. To be sure, political and economic institutions are indeed some reflection of material interests held by different political actors. However, these actors themselves are driven by normative-philosophical ideologies (Weltanschauungen) which cannot simply be written off as ill-informed or an instance of false consciousness. Tenets of religion, western rationality in arranging government bureaucracies, and other elements of cultural institutions in the broad sense (comprising educational facilities and an emphasis on thorough training, but also music and architecture) have driven the development of capitalism in the West. In so doing, north-western Europe
and its overseas extensions have developed a particular constellation of capitalist institutions, influenced by a Protestant work ethic. This particular spirit of capitalism conceives of making money and being economically successful as virtuous in its own right. Weber invokes Benjamin Franklin as a powerful example embodying such spirit. By extension, one could argue that other regions have developed their institutions by similar reliance on embedded religious traditions, for example Confucianism in the case of East Asia.

Weber also rejects the Marxist conception of the state as a mere node of power concentration that enforces the interests of the owners of capital. Instead, the state, though attempting to insulate itself from societal pressures, will reflect the interests of socioeconomic actors and their political pressure to a certain extent. This influence is, however, reined in by a government bureaucracy dedicated to rationality and neutrality in its operations. This concept is strongly influenced by the ideal of Prussian bureaucracy of the late nineteenth century.

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**Box 1.7 The Broader Questions Emerging from Max Weber**

1. What role does religion play in fostering economic development in general and the emergence of a particular form of institutions governing the political economy in particular?
2. Is the state an umpire, arbitrating between competing political actors and socioeconomic actors, or will the state always be biased in favour of the economically more powerful?
3. Can political ideology exist independent of the material interests underpinning it?

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1.5.5 Alfred Marshall and Neoclassical Economics versus the Heterodox Political Economists

If Weber can be rightly credited as a pivotal contributor to CPE and the founding father of economic sociology, the same era, the late nineteenth and early twentieth century also spawned important work in economics. A number of institutional economists broke ranks with the classical economic canon and advocated two positions: (1) to shift the discipline back to its roots of political economy and thus closer to other social sciences, making up for the disciplinary division, and (2) to reconsider the already visible embrace of quantitative methodology in favour of a broader set of methodological tools and approaches. In supporting these two points, these scholars thus opposed the very direction into which the seminal contribution by Alfred Marshall (1842–1924) was pushing the ontological and methodological basis of the discipline. Marshall is commonly
credited with invigorating the classic liberal authors and founding the neoclassical approach and (successfully) advocating a methodologically more sophisticated approach, supported by (though not tantamount to) the systematic use of mathematics as well as graphic depictions of fundamental economic processes. Marshall dispensed with the labour theory of value, which both Marxists and classical economists had embraced. Instead, he focused on the aggregation of supply and its interaction with demand in the market, paving the way for modern microeconomics. Individual consumer and producer preferences, helpfully conceived of as individual choices in lieu of others, aggregate to shape the forces of both supply and demand. The supply curve is thus constructed by the interaction of individuals willing to deliver goods and services to the market based on individual considerations around opportunity cost, i.e. the cost of the foregone alternative use of time, labour, and energy. Similarly, individual demand preferences accumulate to shape the demand curve, but such preferences might be very specific to the tastes of the individual and cannot simply be assumed to rise based on rising population levels, as classical economists had suggested.

Marshall articulated a notion that had been touched upon by an earlier generation that had failed to appreciate its full analytical value. He pioneered the concept of marginal utility, pointing to the declining value attached to given goods as an increasing quantity is being obtained (Marshall [1890] 1961: 118). Marshall rejected the Marxist concept of surplus value which insinuated an exploitative siphoning off of the unearned proceeds of workers’ toils and was steeped in the labour theory of value. Profit is perceived as interest earned on investments, which is subject to severe fluctuations because of the gyrations of consumer demand. However, Marshall was not naive about the flaws of a liberal market economy, realizing that through the establishment of economies of scale and its attendant advantages in terms of reduced costs of supply, larger companies might emerge that would not be hemmed in by (p.25) the constraints weighing on smaller companies (Marshall [1890] 1961: 397). However, over time, Marshall assumed, the particularities of individual markets and the highly volatile nature of consumer tastes would see to it that such emerging giants would not become behemoths. This would also preclude abusive monopolistic behaviour: On this point, Marshall might have been slightly naive or simply overtaken by events, as the late nineteenth century witnessed the growth of companies that could very much manipulate consumer taste.

Later non-orthodox critics disagreed with Marshall. John Kenneth Galbraith ([1967] 2007) accorded significant powers to the newly emerging phenomenon of mega-corporations, alleging that they could monitor, drive, and manipulate consumer taste and preferences. If this were true, it would undermine the epistemological basis of neoclassical microeconomics. In fairness, Marshall
might have underestimated the sheer resilience larger companies would display and their increasing market powers.

While clearly rejecting Marx, Marshall was not oblivious to the gyrations of the business cycle, explaining bouts of instability by the psychological perception of the state of the economy by the business community. Unlike Marx, he did not worry about a long-term tendency of profits to decrease, as technological innovation would offset any such problem (Marshall 1923: 712), though increasing demands placed on land by business would drive up rents in the long term.

Marshall can be fairly credited with pioneering core concepts in modern microeconomics and advancing the field both methodologically and epistemologically. However, a number of non-orthodox critics disagreed fundamentally with the thrust of his work. John Commons, Adolf Berle, and later, but especially, Norwegian-American Thorstein Veblen challenged mainstream assumptions about economic processes being disembedded from societal structures. They questioned the claim of economic rationality central to (neo)classical economics. The notion that rational utility-maximizing centrally motivated individual action and could thus be relied on as a central axiom in theorizing was similarly questionable to non-orthodox scholars. These scholars did not accept Marshall’s ceteris paribus (other factors remaining equal) assumption, which was crucial in building abstract models of economic processes. This group of iconoclasts thus diverged sharply from an advocate of neoclassical economics, formal modelling, and a more quantitatively oriented approach, the author of what was to become Britain’s standard economics textbook for decades: *Principles for Economics* (Marshall [1890] 1961). But they did not only advocate a more holistic and interdisciplinary approach to the study of economic processes; some of them went one step further by denouncing the very possibility of a universally applicable science of economics that applied regardless of socio-historical and cultural context.

We need to familiarize ourselves briefly with this somewhat more sociological turn in economics. Studying different institutional configurations of the labour market, the welfare system, and institutions of finance is fruitful only if our premise is that such institutional variety will make a discernible difference. However, if the underlying laws of economics are as universal and timeless as those of physics, then such institutional and political particularities ultimately pale in significance and constitute mere harmless quirks. The heterodox writers of the late nineteenth century fundamentally disagreed with classical or, following Marshall, neoclassical economics, advocating the study of political economy through a prism that was more institutional, qualitative, and sociological in nature. In that sense, they continued an intellectual tradition of political economy that was much more in the vein of Smith, List, Marx, and Weber than what would come to be true of modern economics. Box 1.8
summarizes the main lines of argument of these non-orthodox scholars, while Box 1.9 identifies some of the key questions that can be derived from their work.

**Box 1.8 Veblen, Galbraith, Schumpeter, Polanyi: Non-Orthodox Takes on the Political Economy**

A group of heterodox scholars of political economy of the late nineteenth and early twentieth centuries rejected the quantitative turn and the genesis of neoclassical economics, embodied by Alfred Marshall. Taking issue both with methodology and core assumptions of what was to become modern economics, these scholars argue that individuals were far from being rational utility-maximizing strivers. Instead, individuals were at times easily manipulated by envy, glitter, modern advertising, and marketing techniques. Other individuals sought to defend their social status against upheaval through competition. Though far from being Marxists, thinkers such as Thorstein Veblen, Kenneth Galbraith, and Joseph Schumpeter highlighted the instability of capitalism both at the macro- and micro-level. Somewhat oddly, both Galbraith and Schumpeter assumed an eventual move towards a planned economy as inevitable throughout the advanced industrial states of the West. While their predictions might have turned out to be somewhat unrealistic, by emphasizing the importance of institutional configurations and cultural and social trends as being relevant factors, and questioning individual rationality, all authors parted way with the ambition of neoclassical economics to develop universally applicable laws. They made a crucial argument in favour of the CPE focus on the institutional configuration of political economies.

Karl Polanyi’s work stands somewhat separate as a macro-sociological work that was influenced by, though stands separate from, Marxism. Turning entities such as labour and land into market commodities is inherently flawed and creates contradictions, Polanyi argues. Market forces create major social and political upheaval and will thus always have to be reined in by political regulation in one form or another.

**Box 1.9 The Broader Questions Emerging from Veblen, Galbraith, Schumpeter, and Polanyi**

1. The perfectly competitive market place is regularly undermined by the formation of cartels and monopolies. Can such monopolies avoid regulation, resist government pressure, and undermine reregulation through lobbying, ‘capturing’ regulatory agencies, and various forms of bribery?
2. Many of the early twentieth-century non-orthodox thinkers were convinced of a drift towards a planned economy. This prediction turned out to be false, and indeed many twenty-first-century political economies are, in fact, less regulated. What accounts for the fact that state–market relations have taken the exact opposite turn of that predicted?
3. How realistic is the assumption of the rational individual? If individuals can be manipulated easily, does this make a fundamental difference to how we ought to think about market processes?

Thorstein Veblen (1857–1929) openly criticized the notion of a utility-maximizing *homo oeconomicus*. The alleged imbued rationality of such an individual simply had no reflection in reality. Humans were instead driven by responses to social circumstances and their relative position in society. In the *Theory of the Leisure Class* (Veblen 1899) Veblen coined the famous term ‘conspicuous consumption’ which he associated with a newly emergent rentier class in the US whose consumption patterns were no longer associated with rational need or requirement, but were socially constructed. These consumption patterns were then emulated by the aspiring middle classes, often finding slightly risible expressions. In no way was such consumption behaviour a form of individual rationality, rather it was a peculiar sublimated form of status envy. Not only was individual behaviour driven by external sociologically embedded factors, but socioeconomic progress itself was impossible to comprehend on the mere basis of the aggregation of individual rational decision-making. In the *Theory of the Business Enterprise* (Veblen [1904] 2010), Veblen highlighted the fundamental conflict of interests that exists in a capitalist society, though not along Marxist lines. The parasitical rentier ownership class and the associated managerial businessmen profited immensely from the status quo of an oligopolistic market structure bequeathed by two decades of American ‘robber baron capitalism’. They were sceptical of the innovations proposed by engineers, because such technological change might upset the cushy and highly profitable equilibrium they were profiting from. Economic processes, as Veblen suggests, thus cannot be adequately understood by a narrow lens of ‘economism’, but they are also impossible to analyse thoroughly and accurately without a much broader array of analytical tools, including those drawn from history, sociology, and psychology.

Kenneth Galbraith (1908–2006) similarly offered profound scepticism towards the conception of atomistic individuals, universal law-like rules governing the functioning of market processes, and, more broadly speaking, an economics discipline that was divorced from the political and socioeconomic realities of the present day, even if this came at the expense of abandoning the quest for universal timeless scientific laws akin to those in the natural sciences. In his 1958 work *The Affluent Society*, Galbraith (1958) contrasted the rise in private
wealth in the United States with public squalor, a clearly visible problem which he had attempted to address while working to advance President Roosevelt’s New Deal programme. Market forces were permanently undersupplying public goods, and excessive focus on and trust in the private sector would merely perpetuate this unbalanced state of affairs. Galbraith also criticized the neoclassical imagery of the market place. In *The New Industrial State* (Galbraith [1967] 2007) he characterizes the modern United States as being dominated by the outcomes of major corporations’ strategies. Given their market share, their marketing and planning departments, and their own entrenched interest in maintaining market stability and predictability, notably regarding finance and industrial relations, *there is no real free market* in which core assumptions of neoclassical economics regarding the interplay of supply and demand can apply. The manipulation of the modern consumer, the tight hierarchy of the mega-corporations and their elite ‘technostructure’ staff, and finally the power such actors could command all pointed to major conceptual flaws and theoretical myopia in neoclassical economics. Some of Galbraith’s assertions might appear a bit far-fetched, notably the claims that the combination of this technostructure, the market control exerted by these companies, and the amount of economic planning carried out would eventually spawn a form of socialism. However, the argument that discontent with capitalism will grow and usher in a much more centrally planned system of politico-economic governance that will address and overcome some of the fallacies and inherent instabilities of capitalism was widely shared at the same time, notably by Joseph Schumpeter.

While ultimately being situated much closer to the liberal end of the spectrum, Joseph Schumpeter (1883–1950) similarly questioned some of the received neoclassical wisdom. He remains probably best known for the term ‘creative destruction’, which was meant to describe the endogenous destructive character of capitalist innovation, but also encapsulates Schumpeter’s belief in the ultimate driving force of technological and societal progress, namely the central role played by individuals possessed by the ‘spirit of entrepreneurialism’ (or *Unternehmergeist*). In *Capitalism, Socialism, and Democracy* (Schumpeter 1950), he developed these ideas in more detail, arguing that such spirit is pivotal in reining in abusive behaviour by market participants, keeping competition strong and healthy, and thus limiting monopolistic powers. However, somewhat bewilderingly, he claims that ultimately evolution would prevail and rising discontent, especially amongst a much broader class of well-educated intellectuals, would contribute to a shift towards central planning and thus a de facto form of statist socialism.

If we pause here for a moment, we see clearly how all of these actors rejected the neoclassical assumptions of economics. They took issue not only with the methodological turn towards a more quantitatively oriented form of enquiry and formal modelling. They also rejected core assumptions about the basic
motivations and actions of the individual and thus the working of the economy at the macro-level as well. Instead, these scholars highlighted the importance of psychological and social forces: emulation; status envy; and complacency. But they were also convinced that the evolution of modern capitalism was much more chaotic and uneven than neoclassical economics allowed for, punctuated by technological innovation and social change. Far from embracing Marxism, they posited trajectories which they deemed likely avenues for future economic and political development. Even though these predictions turned out to be of mixed relevance, the general argument developed by these authors is crucial in laying the foundation and stressing the raison d’être of modern CPE. Together, they emphasize institutional factors, culturally embedded particularities that do not conform to market rationality, the growth of monopolies that rather than being subject to market forces, manipulate them, and equilibria that can be punctured by technological innovation.

Of considerable importance for the subfield, despite the somewhat marginal figure he cut out during his lifetime, was Karl Polanyi (1886–1964) and his seminal study *The Great Transformation* (Polanyi [1944] 1971). This magnum opus significantly influenced historical sociology and was rediscovered in the late 1990s as a prescient account of the ‘disembedding’ and often chaotic effects of unfettered economic liberalization. Polanyi’s account of the breakdown of pre-1914 liberal free trade, in many ways an era with striking similarities to the post-1989 era of globalization, focused on the upheaval that any attempt to ‘disembed’ market processes and forces from their social and societal context will have, leading to political and social breakdown and disorder.

Markets themselves are neither neutral entities nor in any meaningful sense natural outcomes, but rather carefully constructed. It follows that negatively affected parties may well unite to counteract such fall-out of disembedding on working conditions and living circumstances. Such collective action, taken by workers organizing in trade unions or left-wing political parties, would in time create protective institutions mitigating the impact of unrestrained market forces, such as basic social and labour protection and the welfare state. This ‘double movement’ was not only desirable, it was necessary because the unregulated market created such inegalitarian outcomes as to effectively undermine the political basis for a functioning democracy. Beyond this historical analysis, we find here a highly critical take on the theoretical assumptions of neoclassical economics and the individualistic utility-maximizing *homo oeconomicus* described earlier. Labour and land cannot be ‘naturally’ commodified; they are artificial commodities at best, which will create tensions for investors. Polanyi had honed his skills in this regard in his earlier criticism advanced towards the right-leaning libertarian Austrian School that dominated intellectual debate in Vienna in the 1920s (Dale 2010). Austrian School thinkers such as Ludwig von Mises were deeply sceptical of governmental regulation and were to profoundly shape Friedrich von Hayek. *(p.30)* Again foreshadowing
debates of the 1990s, Polanyi struggled to define guidance for an ideology that would fuse socialist and capitalist concepts, while avoiding swaying towards either end of the spectrum. One might also criticize (see Blyth 2002) that whilst he correctly anticipated the postwar era of ‘embedded liberalism’ in the West, he failed to appreciate that such an embedded state itself could come under attack from opposite social forces bent on establishing a very different equilibrium through a very differently oriented double movement. This is, of course, precisely what occurred throughout the West, commencing in the 1970s.

With the resurgence of neoclassical economics spearheaded by Marshall, and the emergence of a distinct, heavily quantitatively oriented discipline of economics as would be recognized today, these heterodox and institutional approaches did not acquire mainstream status. As important as they remain for CPE, their influence on mainstream economics remained marginal. Since the 2000s, mainstream economics has cautiously re-embraced slightly more heterogeneous approaches (Kahneman and Tversky 2000; Mirowski 2013; earlier: Simon 1978). So-called behavioural economics attempts to infuse insight from psychology into the study of economics, identifying mental quirks, psychological artefacts, and consequent irrational behaviour that is difficult to reconcile with the more conventional understanding of utility-maximizing behaviour. The award of the Nobel Memorial Prize in Economic Sciences to Elinor Ostrom in 2009, a political scientist who had explored self-governance of common resources without government intervention or the application of market forces, is an important signal worth mentioning. Similarly, Daniel Kahneman was honoured with this award in 2002 for his work on the weighing of risk and concrete decision-making. This ‘prospect theory’ demonstrates that individuals discount probable as opposed to certain outcomes, skewing their decision-making if certain loss or uncertain gains are present (Kahneman and Tversky 1979). This insight importantly tempers neoclassical argument about utility, suggesting that the framing and the understanding of the scenario faced by the individual will shape choices. Such perception cannot be regarded as ‘rational’ in the narrow sense of the term, however. Recent scholarship has once again questioned the assumption of rationality (Kahneman and Tversky 2000). However, this flourishing of orthodox approaches has not yet decisively shifted the dominant paradigmatic assumptions of the discipline.

1.5.6 The Great Debate of the Twentieth Century: Keynesianism and Friedrich Hayek’s Neoliberalism

Throughout the 1920s and beyond, heavy intellectual battles were being waged between the British economist John Maynard Keynes, commonly associated with his intellectual home, the University of Cambridge, and Friedrich Hayek (p.31) and the Austrian School. Hayek later exiled himself from Austria to London’s LSE, followed by Harvard and finally Freiburg in Germany. We will also briefly introduce the so-called Chicago School, associated principally with Milton Friedman at the eponymous university’s economics department. Both of these
major schools of political economy were convinced of their universal applicability and placed relatively little emphasis on national idiosyncrasies, nor did they attach a lot of importance to institutional characteristics. We will review them only briefly. Both coloured national (and later global) macroeconomic policy, but they are more relevant to understanding political economy as such, rather than CPE. Yet the tenets of their respective paradigms exercised profound influence on ‘real world’ macroeconomic policy design.

Though Keynes had studied the individual characteristics of national economies, notably in his work on the British colonial administration in India or the implications of the Versailles Peace Treaty for Germany, his ‘general theory’ (Keynes [1936] 2007) was always conceived to be universally applicable, provided certain basic parameters of economic development were met. To sum up his argument extremely succinctly, Keynes argued in favour of carefully circumscribed demand stimulation by government spending. Such outlay could then be recouped once the economy recovers. Stimulating the demand side will set in motion an important multiplier effect. Major government-financed programmes could even be ostensibly almost aimless—Keynes once poignantly quipped that paying men to dig up holes and to fill them up again could be sensible, as long as this created employment and extra spending power. His most outspoken critic Friedrich Hayek, at some point based only a few miles to the south of Cambridge at LSE, rejected such suggestions as analytically wrong and politically dangerous. Government intervention and regulation was insidious on philosophical grounds, as it curtailed individual liberty and strangled market forces. Analytically, any such purported demand side stimulation would simply create inflationary pressures and dissipate. In fact, Milton Friedman claimed, individuals would anticipate government spending and adjust their wage level expectations accordingly. The only sensible mechanism for manipulating economic growth, according to Friedman, was to use money supply as a strategic tool to finesse economic activity. Hayek and Friedman are commonly lumped together, although the former was ultimately more of a philosopher of economic regulation, whilst the latter was an economist more narrowly defined (Wapshott 2012). The label neoliberalism was rejected by both and is often associated with left-wing critics of this approach, but rarely adopted in the affirmative even by disciples of either of the two.

These disputes between Keynes and Hayek (Wapshott 2012) were not mere quibbling amongst sheltered academicians in ivory towers. Franklin D. Roosevelt’s New Deal programme was heavily influenced by Keynesian (p.32) thinking, as were, less salubriously, Mussolini and Hitler. To Hayek, Keynesianism was anathema, justifying excessive state meddling and interventionism. His Road to Serfdom (Hayek [1944] 1972), informed as it was by the rise of statism and political totalitarianism on the right, like in Italy, Austria, and Germany, and on the left, as with the emergence of the Soviet Union, was meant as a universal appeal against the alleged dangers of
collectivism everywhere. The dispute over the limits and possibilities of demand stimulation through public expenditure and more broadly speaking government steering of macroeconomic performance has had very real effects on public policymaking until the present day. Similarly, the Keynesianism vs. monetarism debate spawned a number of intellectual offshoots regarding the appropriate limits of government interventionism and the need for government agencies to act more like public sector companies, the latter associated with the moniker new public management. Patrick Buchanan (1967) who criticized the self-perpetuation of public sector agencies and their tendency to push for ever larger budgets and manpower was inspired by similar reasoning.

Calls to restrict state interventionism, free up economic sectors from government regulation, and pursue privatization were informed by Hayek and Friedman. Not unlike classic liberals like Adam Smith, both scholars were not just prolific in their academic work, but also attempted to engineer public policy away from what they regarded as a deleterious descent into socialism and excessive state regulation. Both were active members of the liberal think tank Mont Pelerin Society (Mirowski and Plehwe 2009). Friedman’s (1980) *Free to Choose* was targeted at a mass audience and was deliberately accessibly written. Based on a PBS TV series in the US, it was also serialized in the then widely-read US weekly *Newsweek*. Neoliberalism rallied against oppressive state regulation, inefficient, wasteful, and often badly managed government agencies and publicly owned enterprises, and pointed to aggressive trade unions abusing their powers. Whatever one makes of the normative grounding of these claims, the second half of the twentieth century had witnessed an enormous growth in the sheer size of the state throughout the West and beyond. Private taxation rates were high, government company ownership at least in Europe was extensive, the size of the public sector had mushroomed following a bastardized application of Keynesian insights, and government regulation of the economy was extensive. Meanwhile, the postwar era also witnessed the roll-out of more extensive welfare state provisions, a practice that started having real consequences once economic slowdown hit in the early 1970s. We will revisit the impact of neoliberalism as an ideology in Chapter 8, but its impact on the reform of state–market relations was enormous, especially in English-speaking countries, and eventually extending well beyond.

In the aftermath of the Bretton Woods conference of 1944, three institutions were created to project and underwrite ‘embedded liberalism’ (Ruggie 1982) throughout the western non-Communist parts of the world: the International Monetary Fund, the Bank for Reconstruction and Development (later to be renamed as the World Bank), and later the General Agreement on Tariffs and Trade (after 1995, the World Trade Organization). Within this Lockean zone of advanced industrial economies, the way in which liberalism was embedded, tamed, and regulated did differ dramatically. Similarly, the appeal of Keynesianism proved less than universal, with the United Kingdom and a
number of smaller continental European countries being the main adopters (Hall 1989). It is thus slightly misleading to speak of a universal Keynesian era, yet the appeal of Keynesian national macroeconomic management within an overall embedded yet liberal global arena was so common and applied to both the political right and centre-left that such nuance is often absent.

1.6 Conclusion: The Foundations of CPE

If we consider the period between the publication of the *Wealth of Nations* in 1776 and the feud between Keynes and Hayek in the 1930s and 1940s, we can readily discern three major trends that run through the subfield of CPE. In this final section of the first chapter, we will briefly discuss the common elements that unite what might appear to be somewhat disparate intellectual traditions and writers with very different angles. The first common trend is an engagement with the question where the *appropriate boundaries of state regulation of markets* should lie. Occasionally, political economy is misconstrued as an intellectual exercise that probes the conflict between states and markets. But this claim presupposes a questionable binary. It is more helpful to dispense with the myth of any sphere of the economy constituting an entirely unregulated free market and to think of how, to what extent, and in what shape government regulation is imprinting itself on markets. This is a question that generations of scholars have pondered. As we have seen, the analytical approaches proffered and the normative prescriptions favoured vary enormously. More recent contributions to CPE have advocated taking institutions, interests of major political actors, and ideology and culture seriously in order to understand the variety in which markets across national boundaries have developed and have been regulated. If we want to return to understanding sources of the wealth of nations, we should accept the premise that governmental regulation (or, as it were, the lack thereof) makes a discernible difference in outcome. This invites one of the major sets of questions of CPE. What sort of institutions should governments promote? How should they look? Does government interventionism into shaping sectors of the economy do more harm than good?

The answers provided to these questions vary enormously, from Marxist advocacy of nationalization to the liberal and neoliberal rejection of most forms of state interventionism, to say nothing of public ownership. In between we find mercantilists such as Hamilton and List who favoured strategic government steering and protection, especially in newly industrializing countries, such as their respective home countries. More recent contributions, starting with Weber, have emphasized cultural variables, religious traditions, and legacies as relevant factors in shaping economic development processes. Some of the heterodox political economists we discussed also cautioned about the dangers of monopolization, cartel creation, and entrenched anticompetitive interests emerging. Such forces will impede and hijack liberal government
initiatives. Government will thus likely attract significant attention by special interests seeking to influence its policy output.

The second common trend is to put the question to the reader, *cui bono*? Who benefits? Sometimes this question is posed slightly indirectly, but it is important to understand that there are questions with real relevance and political significance at the heart of CPE. The normative conviction that economic growth and prosperity are not a mere means to an end, but need have real and positive consequences for each and every individual was palpable from Smith onwards. In the mercantilist tradition, it seems to be somewhat obscured from view. Marx claimed that such ambition was fundamentally impossible to fulfil under capitalist conditions. Since then, contributions have cautioned against unrealistic assumptions about the motives of individuals, some of which can be egoistical, selfish, or even plain greedy.

CPE fundamentally concerns itself with distribution and life chances, but it does so in a somewhat indirect fashion, namely by studying the institutions that shape economic growth and development. Underlying all this somewhat abstract and highly theoretical scholarly activity, there is a normative urge to better understand the dynamics and driving forces underpinning economic development processes. It is important to remember this common theme, even if it is somewhat obscured from view at times.

Finally, the third major theme is to understand market actors’ behaviour and strategies. Notwithstanding the overt focus on public policy, the state as an actor, and governmental action and activity, CPE is interested not only in the rules of the game, but also the players. The philosophical differences in setting up different rules, in drawing varying lines of regulation, and thus manipulating the ways in which economic processes unfold have become clear in this chapter. But how do market actors respond to these different incentives made available to them? How do they bump up against the boundaries drawn? How do they play the games that regulation permits? One of the core assumptions of classical and neoclassical economics is that of the rational actor. This assumption has been touched on repeatedly throughout, as several contributors to the theoretical foundations of the discipline reject it outright. But the matter is not settled, the debate continues. As we have seen, individuals are regarded as utility-maximizing in the views of liberals such as Smith. *(p.35)* Yet Smith’s insistence on a framework of ethical cohesion underpinning the unleashing of market forces has been forgotten in recent years and considered unnecessary by neoliberals. Marxists question the agency of individuals, given how constrained they are by unjust patterns of ownership, alienation from their work, and the ideological manipulation the capitalist state subjects them to. Weber does not concur, but points to the powerful role that religion, ideology, and legacies of state regulation might play in shaping individual action beyond economic rationality in the narrow sense. Similarly, political economists such as Veblen
and Galbraith positioned themselves apart from both Smith and Marx by pointing to the influence of class and status envy, emulation, copycat behaviour, and irrational following of fashion, trend, and advertisement. For Polanyi, the disembedding of social relations caused by marketization and the rise of modern capitalism had fundamentally discombobulating consequences. Individuals struggled to cope in an unnatural and disorienting system of values. Again, there is no normative or analytical agreement between writers, and it would be unrealistic to expect any. However, the set of questions posed here will lead us to reflect not only on the prerogatives of governmental regulation, but also on the ways in which actors respond to the rules of the game they are faced with.

In the second chapter, we will turn to the chronologically next segment of the development of the subfield. Where relevant, we will comment on the historical background and world events that shaped these writers’ thinking, as we have done throughout this chapter.
What is Economy?

The word economy* has its origin in ancient Greek, where οἶκος ("eco") meant a Greek household and νόμος ("nomy") meant act, law, or principle. As years passed and the political organization of communities unfolded, "the principles of maintaining a household" became associated with the complex of the activities involving production, distribution, exchange, and consumption of goods and services, which is how we define economy. Although an economy doesn't have to be particularly large (we also speak of local and regional economies), we will use the term to refer mostly to a national economy of a particular country, such as that of the United States, and use the term international or global economy when we refer to the economic activities that encompass multiple countries or even the whole world.

Why should we care about economy? For one, it is an enormous sphere of social life, quantitatively and qualitatively. The Gross Domestic Product (GDP) in the US was over 14 trillion dollars in 2008 (Bureau of Economic Analysis 2009). For any one average full-time worker in the US, this means about fifty weeks of working from 9 a.m. to 5 p.m., with relatively little in the way of vacation. Workers in all other Western countries spend less time at work, primarily because they take more holiday and vacation days, ranging between 4 and 5 weeks, which are prescribed by the

* Terms in bold throughout the text appear in the glossary at the end of this book
state in a statutory minimum policy (Dreier 2007). The US has no such policy; thus people work more, but not as much as those in Hong Kong, Bangladesh, Singapore, or Thailand, who average an additional 200 to 300 of work hours per year.

While time at work seems to be linked most directly to economy, most activities outside work are as well. How about shopping, eating out, going to the movies or concerts, getting your car fixed or your clothes cleaned, banking, investing in the stock market, or fixing up homes? Even on vacation, from booking flights and hotels, to getting that cocktail on the beach, to tipping the guy who carries your suitcases to the taxi on the way back, it's all about economy.

Further, “the economy” does not include only paid activities in the formal sector. Non-paid work, work in the informal sector, and illegal work are all part of a nation’s economy even if it is harder to evaluate their contribution to GDP. While we will occasionally provide examples of the economy and state connection as it pertains to non-paid work or the informal and illegal economies, most of our discussion will be centered on the production, distribution, exchange, and consumption of goods and services on the legal market. Hence, it seems appropriate that we briefly discuss these other aspects of economy here.

Economic sociologists writing about care work have acknowledged that many activities that contribute importantly to the production of goods and services are not paid, such as household work or the care of children and elderly within families (Trabut and Weber 2009). Others have emphasized that pay for some activities does not adequately reflect the effort required, such as domestic work done by immigrants hired informally or work by inmates in prison. States certainly play a role in these non-paid, non-market activities. For instance, it is the courts, a part of the state apparatus, which tend to exclude prison work from the legal category of employment because they classify it as belonging to the penal rather than the economic sphere. These formal classifications have important life consequences: only employment relationships are subject to labor protection such as the minimum wage, so the legal definition of prison work as non-economic prevents inmates from challenging wages that can be less than $1 per hour (Zatz 2009).

Moreover, informal economic activities are intrinsically linked to the actions of state because, as Portes and Haller (2005) emphasize, the informal economy exists only because of the regulations enacted to create the formal economy. The expansion of the state’s capacity to intervene in economic affairs increases the opportunities for informal economic action (Lomnitz 1988). There would be no tax evasion schemes if not for the system of taxation. Thus, it is precisely the state regulation of the economy that gives rise to the opportunities to engage in informal economic activity. It could be said, then, that the informal economy exists not outside of the formal economy, but rather because of it.

There are also many activities that are considered illegal but are part of the economy because they involve production, distribution, and consumption of – albeit illicit – goods and services. The value of illegal trade is substantial. According to the Human Development Report (UNDP 1999: 103), “The illegal drug trade in 1995 was estimated at $400 billion, about 8% of world trade, more than the share of iron and steel or of motor vehicles, and roughly the same as textiles (7.5%) and gas and oil (8.6%).” A crucial point related to the economy-state discussion is the fact that whether an activity is considered illicit as opposed to licit is a result of legal regulation, not because of the intrinsically damaging nature of drugs and gambling as opposed to alcohol and stock market investing, for instance. You could go to the Netherlands and order a joint in a coffee shop in Amsterdam in the way you would coffee in Arlington, Virginia. Or you can gamble as you please in Las Vegas but would be arrested for this in Los Angeles. Thus, it is clear that the role of the federal and state government is central for what we define as the illegal economy. More generally, one of the foundational roles of the state in economy is the regulation of what can or cannot be produced as a commodity and traded on the (formal) market.

Finally, we want to say something about how we usually measure and evaluate the state of a nation's economy. Common measurements include GDP, GDP growth, national debt, interest rates,
unemployment, inflation, consumer spending, exchange rates, and balance of trade. Based on some of these indicators, scholars and practitioners classify countries as “developed” and “developing” states or as “advanced industrial nations” and “least developed countries.” The classification of individual countries in any of these categories is quite controversial. As the United Nation’s convention declares: “The designations ‘developed’ and ‘developing’ are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process” (United Nations 2010).

Precisely because of the widespread use of these categories in the collection and analysis of statistical data, the status and recognition of a country as “more or less developed” is perpetuated. To be clear, countries differ significantly in terms of their economic wealth, as measured by GDP per capita (see map 1.1). Chapter 6 on economic development discusses how countries lagging behind the rich ones are trying to catch up in terms of their economic growth. Still, simply considering the economic growth of a particular country is an imperfect measure of a country’s overall economic strength and of its citizens’ economic well-being. Other indicators include income, earnings, and wealth inequality, which measure the economic distance between different segments of the population. Poverty levels give a sense of what proportion of the population cannot afford to buy basic goods and services. Levels of unemployment show the condition of the labor market. Inflation captures the stability or fluctuation of prices. Consumers’ purchasing power indicates the value of money as measured by the quantity and quality of products and services it can buy. Trade balance shows the ratio between exports from and imports to a single country, and national debt is the amount of money owed to other governments or to the international financial organizations who lent it. Exchange rates indicate how much a nation’s currency is worth compared with that of other nations. Amid the wealth of economic indicators (no pun intended), we should realize that not one of them is absolutely more important than the other. As we argue throughout the book, desired economic goals – be they GDP growth, full employment, low inflation, or low inequality – are politically and socially defined.
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What is State?

A classical sociologist, Max Weber (1958: 78), defined a state as “a human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory.” Basically, this means that a state is an entity with sovereign authority over a specific territory, not subject to any higher authority. Although the era of transnational globalization has increased the prominence of supra-state organs such as the United Nations, as of now, these associations have no real authority and rely on each individual member state to enforce compliance with its resolutions and impose sanctions on those states that fail to comply.

The fact that states are sovereign authorities also implies that bodies such as the state bureaucracy, courts, police, and military exercise jurisdiction and force in order to maintain internal order and prevent foreign aggression. Following Weber’s distinctions between different kinds of authority, the authority of a modern state is of a rational-legal kind, meaning that it is based on impersonal rules – so-called bureaucratic structures – which constrain the power of elites. In modern Western states, elites cannot simply take action without conferring with civil society through a use of what Michael Mann (1984) calls despotic power, such as that possessed by Byzantine emperors or other oppressive “masters of the house” (which is where the word despot originates). Rather, as Mann differentiates, modern states rely mostly on infrastructural power: they can coordinate society’s activities but still remain an instrument of civil force. They do not rely on power over society but power “through society,” entailing a cooperative relationship between citizens and government. We will reference some cases where contemporary autocratic rulers use despotic power, but will focus on the infrastructural state capacities as they pertain to the economic sphere of social life. We are interested in how states penetrate the economic sphere, such as by taxing, spending, and organizing economic relations.

However, a world made up of sovereign nation-states characterized by the ability to act with infrastructural power has not always been the case. In the past, there were many different kinds of political units, from small dukedoms and principalities (such as the Principality of Wales, which existed in the northern and western parts of Wales between the thirteenth and sixteenth centuries) to large empires, such as the Roman, Ottoman, Chinese, or Austro-Hungarian Empire. Imperial powers such as France and Britain ruled colonies in Africa, North America, Asia, and Oceania. After World War II, the Union of Soviet Socialist Republics (USSR) controlled sixteen of its union republics as well as its satellite states Poland, Czechoslovakia, and Hungary, ruled by their communist parties. The rapid decolonization of the twentieth century led more than 130 colonies or dependencies to become independent states. In 1989 most of the Soviet satellite states removed communist leaders and declared political sovereignty from the Soviet Union, and in 1991 this last great empire disintegrated into fifteen states.

Today the world is composed almost entirely of sovereign nation-states. Figure 1.1 reflects the growth of the number of the world’s independent states over the past century by listing the official United Nations members for the period between 1945 and 2005.

We are concerned not only with what states are, the authority they have, or what kinds of states have existed in the world, but also with how we study and think about them. Apropos of scholarly research, the nation-state as a unit of analysis was not the point of much discussion by Western social scientists after World War II. Scholars attribute this to the fact that fascism was so closely associated with nationalism and statism as to give the state-centered phenomena a bad name. Rather, the postwar order in Western countries was organized around liberal ideas, and this also set the intellectual agenda (Hall 2003). Beginning in the 1970s, however, in light of the Vietnam War draft, the civil rights movement, the expanding welfare state, and the government management of the economy in the late 1960s and early 1970s, scholarship on the state and state-related questions experienced a comeback, or, as the title of an influential publication announced, the state was “brought back in” (Evans, Rueschemeyer, and Skocpol 1985).

Still, beginning in the late 1980s, a whole new set of circumstances arose that supposedly undermined the power of
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The collapse of state socialism delegitimized central control of the state in the economy. The signing of the Maastricht Treaty by the European Community states brought about what we now know as the European Union and led to the creation of the euro as a common supra-national currency. Emphasis by international financial institutions on freeing the financial markets across countries and the surge in global foreign investment flows boosted the power of transnational corporations to the detriment of nation-states. Or so it seemed.

The self-assertion of several new independent states following the collapse of communism made clear that nation- and state-building are very much alive and are sometimes so powerful that they result in war and ethnic cleansing, as was the case in the former Yugoslavia throughout the 1990s. The centralization of state power following the terrorist attacks of 9/11 put the US state back in focus. The failure to get the European Union Constitution ratified by individual member states in 2005 showed that the awareness of national identity within the European region was strong. The spectacular growth in China, led by an autocratic state, has provided grounds to question the importance of the "free market" for economic prosperity. The collapse of the US mortgage market in 2008 and the following financial and economic crises brought the importance of state “back in” yet again.

Not surprisingly, then, the book you are reading comes at a time when attention to the role of the state, generally, and the role of the state in the economy, specifically, is quite high. We dare to predict that it will reach its peak and then decline yet again. Yes, it seems that attention to state-centered analyses and the perceived importance of the role of the state moves in waves. What we want to argue is that this reflects political events and the prevailing Zeitgeist, the spirit of the time so to speak, more than something intrinsic in the nature of how important nation-states really are.

Finally, we want to clarify a couple of terms that we will be using when we discuss the role of the state in the economy. The first is the distinction between government and state. In common speech we use “government” more frequently than “state.” But, in its strict meaning, government refers to the body which carries out the administrative tasks of the state. If you will, the state is like a firm and the government is like its management team. When we refer to the administrative tasks of the state, we will use the term government. The second clarification we want to make is about the relationship between state and law. Throughout the book we will refer to law and legal regulation as a product of state action and analyze them as state influences on economy. Stating this, we acknowledge three caveats. For one, when they are applied, laws are interpreted, sometimes variously, by legal experts, so a link between state adoption and implementation is not necessarily straightforward. Second, courts can be more or less independent from the rest of the state, especially when judges are elected (such as in the US) as opposed to appointed as civil servants (such as in Europe).
Third, in principle, laws are subject to judicial review and can be overturned. On account of all these reasons, there is an extra layer, so to speak, between the action of state and the impact of law that complicates the immediacy of this relationship. We recognize this. Still, it is a fact that all national legal provisions need to be accepted by national governments to go in effect, and, in this sense, the state works though law to impact social life, including the economy. In the subsequent chapters, we will highlight how states do so in the governance of property relations, money, labor, and firms, and to influence economic development and internationalization.

Conceptualizing Economy–State Relations

Questions about the role of the state in the economy have generated many debates and countless pages of writing. The issue about the appropriate state involvement in economic affairs is extremely politically charged, inspiring controversies between the liberal and conservative poles. It goes to the core of the debate about the virtues of socialism vis-à-vis capitalism. Moreover, the research on the topic is voluminous because there are so many ways in which states can be involved in economies. Not surprisingly, theoretical conceptualizations of these relationships are multiple as well. Handling this controversy and complexity, at the risk of oversimplification, we will outline (only) two ways in which economy–state relations have been conceptualized. This does not allow us to specify nuances of different middle-range theories, but it does help us make core distinctions at the level of basic assumptions about the nature of the economy–state relationship. From one perspective, which we term economy–state dualism, these two spheres are conceived as separable entities operating with contrasting logics. The key question here is: To what extent should states intervene in the economic sphere? From the other perspective, which we term economy–state embeddedness, these two spheres are mutually constitutive, so that states always play a role in economies, enabling and constraining their operation in different ways. The key question from this perspective is: In what ways are states involved in the economy and with what consequences?

Economy–state dualism

A classical view on state–economy relations is characterized by an assumption that the state and the economy are two separable entities with distinct logics of orientation. The state’s preoccupation is the governance of public affairs. The economy, especially the market, is about managing resources for maximization of private interests. The public versus private orientations are in opposition. Hence, we can call this conceptualization economy–state dualism.

If we conceive of state and economy as two distinct spheres, then a state’s involvement in the economy, imposing its hand over a private sphere, is seen as an intervention, a market manipulation. Such a state is called an interventionist state, and the key question is: How much should it intervene in the economy? To what extent should governments be involved in economic affairs? The focus is on the quantity of state control over the economy. The concern is also normative: How much control is desirable? Should it be as minimal as possible, or considerable? Answering this question allows us to align societies along an analytic continuum from those with the lowest to those with the highest level of state interference. Along this continuum, as Fred Block (1994) proposed, we can distinguish five different types of state intervention in the economy: public goods state, macro-economic stabilization state, social rights state, protectionist state, and socialist state.

From a classical economic perspective dating back to the writings of Adam Smith, the father of modern economic science, states should have minimal interference in the economy. Smith’s idea of markets as guided by an invisible hand is probably one with which even those with no background in economics are familiar. This idea implies that economic activities will perform best if they are simply left to their own devices. The activities of buyers and sellers on the market will spontaneously adjust so that everyone will be best off. Prices will equilibrate where demand for goods and their supply meet. Most economists prefer this self-regulating market
idea, without state interference. To be clear, only the very few most radical of thinkers would want to get rid of state involvement in economic and social affairs altogether. Those who do so subscribe to anarchism, which considers compulsory governments as unnecessary or even harmful, and prefers anarchy or the absence of the state. Rather than promoting an anarchist stance, classical economists, including Adam Smith, subscribe to the view that the intervention of states is justified in the provision of goods, commodities, and services that markets cannot produce by themselves. These are called public goods, and such a state is referred to as a public goods state.

Following an article by a Nobel Prize winning economist, Ronald Coase (1974), a lighthouse has often been used as a classic example of a public good. It is not possible to blindfold the crew of some ships and only let others benefit from the signaling beams. That is, a characteristic of a public good is that it is difficult to exclude people from using a service, once provided. Moreover, a lighthouse’s beams do not shine less with each additional ship passing by; no one’s use detracts from the use of others. However, the provision and maintenance of public goods still requires financing. Why should we expect anyone to contribute money if they can enjoy the benefits without paying for them – that is, catch a free ride? Actually, this is called a free-rider problem. Free-riders are those who consume a resource without contributing to its upkeep. State intervention is the primary mechanism by which societies address free-rider problems – in the form of taxing citizens and then using the revenues to finance public works and infrastructure such as railroad or interstate highway systems, airports, public schools, hospitals, and water purification and sewage treatment centers. In addition to taxation, other kinds of state regulation attempt to deal with the free-rider problem for goods that do not need to be provided but require attention because of their vulnerability, such as clean air. To protect the public good of clean air, governments pass environmental degradation regulations.

The second type of intervention by the state encompasses its role in alleviating the impact of the business cycle, characterized by periods of growth and downturn, or boom and bust. This intervention is also called macro-stabilization. The stabilization state is charged with controlling economic growth and managing the downturns so that they don’t result in serious economic crises. Provision of a stable supply of money is a relatively minimal kind of such intervention. According to the influential economist Milton Friedman, government’s role should be primarily to control the money supply in the economy (Friedman and Schwartz 1963). This view espouses monetarism, a perspective which argues that excessive expansion of the money supply inherently leads to inflation and that containing inflation should be the central goal of monetary policy. Paul Volcker and Alan Greenspan, former chiefs of the Federal Reserve Bank, are both considered to have promoted policies in line with monetarism.

In its more extensive version, the role of the stabilization state is akin to the type of economic governance promoted by the British economist John Maynard Keynes. Keynesian economics advocates interventionist government policy. Government should promote monetary policy actions by the central bank beyond simply targeting the money supply, as well as fiscal policy actions, for example by using government spending in times of hardship to mitigate the adverse effects of the business cycle (Keynes 1936, 1937). We discuss this further in box 1.1.

Third, the social rights state focuses on the state’s role in the provision of protection to citizens. The British sociologist T. H. Marshall (1893–1981) provided the most influential argument along these lines in his essay entitled “Citizenship and Social Class” (1950). In this essay he introduced the concept of social rights, claiming that a citizen is only a full citizen if she or he possesses not only civil and political but also social rights, and that possession of all three rights is linked to social class. Social rights meant protection from the market forces and provision for illness, injury, and old age that should be assured by the state. States’ roles thus would be to provide working people with sources of income other than those that they can gain from their participation in the labor market. We discuss further the redistributive role of the state in providing social protection in chapter 4, suggesting how the development of the modern welfare state can be conceptualized.
Introduction

Box 1.1 John Maynard Keynes's boom and bust cycle of influence

The commonplace notion of a free market leads many to believe that the general economic view is to abhor government intervention in the economy. However, not all economists think alike on this topic. A famous individual whose theory seems to fall in and out of favor with time is the British economist John Maynard Keynes (1883-1946).

Growing up, Keynes enjoyed a privileged lifestyle. His father was an economics professor at Cambridge University and his mother was Cambridge's first woman mayor. Not surprisingly, Keynes attended the finest prep school and then proceeded to enroll at Cambridge himself. He was given the honor of representing the British government at the Versailles Peace Conference at the end of World War I, but soon afterwards became quite disenchanted with what he called the economic consequences of the peace (which he later used as the title for a book).

Keynes's experience in negotiating the postwar peace and the Stock Market Crash of 1929 were seminal events that convinced him that capitalism was inherently unstable and that this "boom and bust" cycle would continue to occur if governments did not intervene. His rejection of classical economic policies was made clear in his most famous work, *The General Theory of Employment, Interest and Money* (1936). Though some consider this book difficult to read because of its reliance on technical language and wordy prose, it is widely considered to be of immense theoretical import. In it, Keynes provides the rationale for "big government" and active intervention in the economy whenever necessary. Tariffs, protectionist measures, government spending on social programs, and unbalanced budgets were all policies that Keynes saw as appropriate ways of mitigating the excesses of the market. For Keynes, the capitalist system would not self-regulate in the interests of general prosperity. Employment and consumption would never reach the equilibrium that classical economics promised. During times of economic hardship, Keynes offered a controversial recommendation: spending. He thought that scrimping and saving, by individuals and by the government, only prolonged the problem. If consumers and the government spent, this would increase economic growth and bring an end to economic troubles. This example illustrates one of Keynes's most central contributions to economic theory: that, without government intervention, capitalism would inevitably lead to hardship and deprivation.

It is interesting to consider how Keynes's influence on popular economic thought falls in and out of favor over time, creating a sort of boom and bust cycle of its own. Keynesianism was strong after the Great Depression and all through the 1970s, which was the time of big government, social spending, and active intervention in the economy. This changed after the 1973 oil shocks, and Keynesianism was quite out of favor until the economic downturn following the 2007-8 financial crises, which stimulated its revival.

A fourth type of intervention of the state in the economy is not only by the state dualism but also by the state embeddedness perspective.

A fourth type of intervention of the state in the economy is to act in a protectionist manner. The most famous instance of a protectionist state is mercantilism of the sixteenth to eighteenth centuries, where states put in place policies such as tariffs on trade in order to encourage national economic development. The American statesman and political theorist Alexander Hamilton is known to have argued for government intervention in support of business, including imposing tariffs, building infrastructure, and providing financing to private firms (Chernow 2004). A leading German economist, Georg Friedrich List, was also influenced by Hamilton's thinking, arguing that Germany could catch up with England only through a pursuit of active policies to encourage and protect industry.

The postwar Japanese government has also been cited as
an instance of a highly protectionist state. The key role in the postwar Japanese economy was played by the Japanese Ministry of International Trade and Industry (MITI), which reacted to the Anglo-American pro-competition policies and took comprehensive and deliberate action to protect domestic industries in Japan by limiting imports, providing access to foreign technology, and offering financial help, tax breaks, protection from competition, and other services to chosen industries. Johnson (1982) and others conclude that Japan's strong interventionist state policies after World War II are part of the explanation for the economic miracle that occurred there in terms of economic growth in the 1960s through the 1980s.

Fifth, the socialist state may be thought of as an extreme example of the social rights and protectionist states. According to Marxist-Leninist ideology, the goal of society is to dominate both the economy and the state in the final stage of societal development—communism, where people will be free to work out of interest not out of need. Socialism is an intermediary stage on the way to communism where the state's role is necessary to alleviate the injustices of inequality that are involved in the capitalist mode of production, as well as the human alienation that results from subjecting people to inherently dehumanizing market transactions (Gouldner 1980). This is why socialism as experienced in the former Soviet Union and in Eastern Europe is often termed state socialism. To accomplish these goals of fairness and equality, private property needs to be abolished, economy centralized, and social protection, including full employment, assured. We discuss more about the nature of socialist states in chapter 2.

Economy-state embeddedness

The five visions of the state's role in the economy as described above are preoccupied by the question: How much state intervention in the national economy is advisable? In answering this question, studies ultimately rest on normative assumptions. They presuppose to a greater or lesser extent that states are parasitical and wasteful, and/or that markets are inherently dehumanizing and unjust (Block 1994). There is very little empirical research, however, that would substantiate these assumptions. While some state activities can be inefficient, this is not invariably the case. More likely, different kinds of state involvement contribute to different kinds of economic outcomes. This requires a focus that moves beyond the preoccupation with quantity or the extent of state intervention to asking questions such as: How does the state shape the economy? What are the different kinds of state involvement in the economy? What combination of conditions produces a state that parasitically feeds on the economy, a so-called predatory state? What combination promotes economic growth as a result of developmental state actions? What combination helps reduce poverty and ameliorate inequality, such as in a strong welfare state? Moreover, analysts working from this perspective assume that social forces shape governments' decision-making about economic affairs. They ask: What is the role of ideas, politics, and institutions for shaping economic policy-making and thus the course of economic development, domestically and globally?

The fact that economic phenomena are strongly dependent on social forces is often termed economic embeddedness. One of the most influential classical writers in economic anthropology, Karl Polanyi, is credited for this notion, writing that “economies are embedded and enmeshed in institutions economic and non-economic” (1957). You may have come across a somewhat different use of the term “embeddedness” to reflect that economic action is influenced by networks of social ties (Granovetter 1985), which is its application at the individual and firm level. We will, however, use the term in the Polanyian sense to refer to the macro-institutional environment in which economies are situated and treat the state as a key macro-institution. For this reason, we also use the term “economy-state embeddedness” for the economic sociology perspective on state and economy relations.

From the economy-state embeddedness perspective, states and economies are not two separate spheres but connected worlds. States are seen as constitutive of economy, meaning that economic activity is viewed as continuously shaped and managed by the
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state and political institutions: "State action always plays a major role in constituting economies . . . [so] it is not useful to posit states as lying outside of economic activity" (Block 1994: 696). States' role in the economy should not be understood as a mere constraint through regulation but also as something that is needed to facilitate economic processes to enable the workings of markets.

The notion of fictitious commodities, as developed by Karl Polanyi, illustrates these concurrent enabling and constraining properties of states most effectively. Polanyi argued that land, labor, and money are not commodities in the same sense as those things produced by firms to be sold on the market. We understand Polanyi's notion in two ways. On the one hand, it is a fiction that land, labor, and money are inherently produced to be supplied for sale on the market; thus, state action is needed to constitute them as commodities on the market. In another sense, it is also illusory that land, labor, and money can be easily multiplied should demand increase; in fact, state action is needed to constrain demand in preventing the destruction of these resources. Let us elaborate on both points. Land, labor, and money are not "manufactured" in order to be sold: land is not produced but given, people do not reproduce with the intention of providing more labor power, and money is an agreed-upon medium of exchange. The demand for land, labor, and money has to be regulated so as to protect the exhaustion of these resources to the point of annihilation. Just consider, if all land and natural resources were allowed to be fully privatized and the state did not retain any control over them, we would soon witness overpollution and overextraction. If human labor were to be treated as any other commodity to be sold on the market, then there would be no limit to the kinds and extent of its use by employers, resulting in inhumane exploitation and overexhaustion. In terms of money, if we could continually print it as needed, it would become worthless and no longer function as a legitimate claim on value. Economic actors would have to resort to barter trade instead of market exchange. This makes clear that, if we want economies to be sustainable, state regulation is necessary to put limits to the use of land, labor, and money. At the same time, it is undeniable that, for markets to function in the first place, it is necessary to put institutions in place that allow land, labor, and money to be bought and sold at some price – that is, to treat them as commodities. By allowing land to be privately owned, as through the enclosure movement in England in the eighteenth and nineteenth centuries (see chapter 2), and by establishing labor markets as opposed to the socialist policy of guaranteeing full employment, for example, the state enables the operation of markets. This is why we say that states are both regulatory and constitutive of market activities, and therefore cannot be placed outside markets. It is the balancing act of having simultaneously to regulate and constitute the use of natural, human, and money resources, as core market objects, that lies at the heart of the state's role in economy. States have to manage fictitious commodities, otherwise market exchange is untenable. Because natural assets, labor, and money are central objects related to all spheres of the economy, either directly or indirectly, it follows from the state embeddedness perspective that states continually manage, directly and indirectly, all spheres of the economy.

But while the involvement of state in economy from the embeddedness perspective is a given, the research focus is on the kinds of such involvement: to identify the different types of state–economy relations and their consequences, and to consider which among the multiple ways of state–economy relations induce more or less "productive synergy between states and markets," as stated by two very prominent sociologists working in this tradition, Fred Block and Peter Evans (2005).

The possibilities are more numerous than we can summarize. Instead of offering a characterization of state involvement types, as we did in the section on economy–state dualism, it is more appropriate to offer a characterization of the type of questions about economy–state embeddedness at different levels of analysis: individual, organizational, and system. These are summarized in figure 1.2. The first two sets of questions are about how states shape different economic actions, including production, distribution, exchange, and consumption, at the level of both the individual and the firm. The third set of questions is about how
states shape the whole system of economic organization, such as different kinds of capitalism or socialism. Another set of questions that motivates economy–state embeddedness research recognizes that the decision-making of states about their involvement in economic affairs is itself influenced by multiple social forces, such as politics, ideas, or institutions. These types of questions are about the role of social forces on state decisions about economy (see figure 1.3), which in turn influence economic outcomes.

In sum, the central message of the economy–state embeddedness perspective is that the state always plays an integral role in facilitating and regulating, directly and indirectly, economic outcomes. The nature of this influence, its kind and type, varies across time and space and for different political inclinations of governments, but economy and state are never conceptualized as divorced from each other. Rather, they are seen as connected worlds. This basic assumption has major consequences for thinking about the operation of markets. Remember that a well-known trope of the economy–state dualism perspective, the self-regulating market, envisions that markets operate principally without government intervention. In fact, it prefers it to be so. From the embeddedness perspective, however, markets cannot function without state provision of structures that define who can make claims over assets and what the rules of competition and cooperation are. States also create and implement rules about what can be bought or sold on the market and under what conditions. In practical terms, this elucidates why, for instance, there is no formal market in human organs and why some countries have national universal health coverage but others don’t.

Moreover, the focus on embeddedness rather than dualism in economy–state relations makes clear that a variety rather than a single (right) mix of government involvement in the economy can produce economic prosperity. That is, research on comparative development has established that the powerful role of an authoritarian state can bring about economic development, such as in China or Singapore, as can the developmentalist states of South Korea or Taiwan, or a minimalist regulatory state such as in the United Kingdom or the United States. We discuss this further in chapter 6.
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Finally, the notion of embeddedness, in particular embeddedness of state decision-making about the economy, highlights that development and prosperity need to be measured by multiple indicators, which are often untenable simultaneously, rather than by a single indicator. Different political orientations of elites, such as those of Republicans and Democrats, and different social groups or institutions, such as anti-globalization movements or international financial organizations, promote different economic and social goals. In the end, the focus on any particular desired goal, be it economic growth or economic equality, is a matter of power struggles and the ideational commitments of those groups that prevail.
The Personal is Political Economic

Who makes economic decisions?
What is the current political economic context in which those decisions are made?
What are the principal political economic challenges we face?

Many people come to the study of economics expecting that it will offer guidelines for getting rich. They are usually disappointed to find that it is about how the economic system works, rather than how the system can be worked for personal advantage. The former may help the latter, of course, because people are likely to make more astute financial decisions if they know about the economic, social, and political forces shaping the business and financial environment. Concurrently, it is also to be hoped that understanding how the economy works will stimulate more concern with strategies to achieve better social outcomes.

Generally, the study of economics should serve the needs of intelligent citizens who wish to make sense of the world around them. This is particularly important in the current era of economic uncertainty, when individuals have to cope with major changes to their material circumstances, often with little understanding of what is driving those changes and the potential to change direction.

The economic context: risk and uncertainty

We live in exciting if unsettling times. Dramatic changes in technology are transforming the way goods and services are produced and, particularly, the way information is transmitted. The barriers once imposed by the tyranny of distance and national boundaries, though still significant, are being eroded. This process has cultural and political, as well as economic, dimensions, but its most notable feature is the growing economic power of transnational corporations. Some of these companies have budgets larger than national economies. Understandably, many individuals feel dwarfed and powerless in these circumstances. The capacity of the democratic institutions within nation states to exercise control over the enormously powerful private corporations is under challenge; in many cases, governments do not even seem to have the will to exercise such control.

Meanwhile, the nature of work is also rapidly changing. A significant proportion of the potential workforce is excluded from making a direct, productive contribution, even when economic growth is taking place. Solving this problem of persistent unemployment is one of the continuing political economic challenges. For those who are in work, the emphasis is now increasingly on casual, part-time, or contract employment. In the advanced industrial nations the number of manufacturing jobs relative to service-sector jobs continues to shrink. More women are in the waged workforce, but the overall allocation of household tasks according to gender has not changed correspondingly. The proportion of older people in the population continues to grow, albeit slowly, posing the challenge of developing appropriate mechanisms for intergenerational income transfers. The capacity of governments to manage these and other processes of income redistribution is impaired by their reluctance to raise taxation to generate the necessary revenue.

Increased income inequalities, within and between nations, are a predictable feature of these circumstances. They repeatedly undermine the conditions for effective cooperation in seeking solutions. The presence of glaring economic inequalities within a nation is not conducive to the cooperative behaviour necessary for the simultaneous achievement of higher productivity and social cohesion. Similar problems exist on an international scale. Imbalances of trade and debt between rich and poor countries accentuate the long-established problem of economic inequality. Some of the poorer nations, most notably China and India, have achieved impressive economic growth rates in the past two decades, but others, especially in sub-Saharan Africa, have been slipping even further behind.

Meanwhile, in the wealthier nations the economic exuberance of the early 2000s has been replaced with a more troubled economic outlook. The capitalist system has always been prone to a cyclical pattern of boom and bust, but the global financial crisis that began in 2007–08 was a particularly harsh reminder of this systemic flaw. Even more worrying for the long term, because of the constraints imposed by the physical environment, is the increasingly unsustainable character of economic growth on a global scale. How to harmonise economy, society, and ecology most effectively is a question to which there is, as yet, no agreed answer.

It is not surprising that many individuals feel overwhelmed by these developments and problems. Therein lies the twin challenge for political economy: to analyse the underlying forces and to posit some effective solutions.
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Our day-to-day lives involve many economic decisions. Most of these are fairly small scale and short term and of no apparent significance to anyone beyond our immediate family and friends. In the aggregate, they shape the economic environment in which we live. Some such decisions, illustrating our various social and economic roles, are described below.

- **As consumers**, we make daily decisions about which of the sometimes baffling array of products we will buy with our income. We also make decisions, if only by default, about how much education we undertake and how many qualifications we acquire are likely to have a bearing on our future economic opportunities.
- **As workers**, we are faced with constrained choices about the jobs we seek and the hours we work. We also have to make periodic decisions, individually or collectively, about the strategic stances to take in negotiations with our employers about wages and conditions of work.
- **Meanwhile, business decision-makers** make their own strategic decisions about employment and wages payments. They also periodically review the methods they use for producing goods and services, how much they will invest in new production facilities, the prices they will charge for their products, and their sales promotion practices.
- **Speculators** continually review their portfolio of assets, deciding what to buy and sell according to their judgments about future price movements and the possibility of capital gains. When media commentators refer to how 'the markets' respond to economic news or government policy initiatives, it is the behaviour of these speculators to which they are referring.
- **Banks** decide about making loans to their clients, usually according to set guidelines. They also make decisions about the interest rates offered to depositors and charged to borrowers. The margins between these borrowing and lending rates are a principal source of banks' profits, and so they are kept under continual review.
- **Government ministers**, especially those in key departments such as Treasury and Finance, also make frequent adjustments to economic policies. They do so in response to changing economic conditions in national and global markets, and to political pressures (including the speculative sentiments of the markets). These public policy positions are also significantly influenced by prevailing economic theories.

Micro decisions: macro outcomes

There is a link between micro personal choices and macro societal choices. Individuals' economic decisions affect and are affected by broader political economic forces. Indeed, it is reasonable, as a first approximation, to see what is happening in the economy at the outcome of the sum of individual decisions. So, whether the economy is functioning well or not—whether the overall economic conditions are buoyant or stagnant, for example—is the result of whether the numerous interdependent decisions mesh effectively. There is, of course, much scope for inconsistency, conflicts of interest, and contradictory elements.

As political economists, we can step back from the individual choices and short-term decisions to see the bigger picture. This can help us understand the political economic structures that shape and constrain our options. It can also help to reveal the forces that change the context within which individual economic decisions are made.

Three trilogies

A simple device for considering some basic political economic principles is shown in Figure 2.1 (overleaf).

The first diagram depicts the relationship between market, state, and community. It shows the three different ways in which economic activity can be organized: market, state, and community. Goods and services may be produced for exchange in the market. Many are. Alternatively, the production and distribution of goods and services may be organized by a central coordinating agency such as the state. The state may be responsive to the wishes of the society through democratic processes, or it may be authoritarian in character. The third possibility is that the production and distribution of goods and services results directly from community provision. People produce goods and services for themselves and their neighbours, and benefit from reciprocal relationships. The community may be quite small—perhaps just a household—or it may comprise a larger group of people whose voluntary cooperation results in purposeful economic activity without the need for markets or a state.

These three different ways of providing for our material needs and wants normally coexist in any society, but their relative importance varies, and there are recurrent tensions between them. The same diagram illustrates the boundary tensions in terms of the balance between public and private sectors of the economy, the choice between voluntary and government welfare provision, and the extent to which social life is structured by market processes.

The second diagram in Figure 2.1 shows the spatial scales at which economic activities can be organized and coordinated: local, national and global. Local production can be for local consumption. Much is. National coordination of productive activity is also commonly attempted. The markets for some products are nationwide, and governments usually try, more or less successfully, to manage national economies. The global dimension is becoming increasingly important, however, as global markets, and even some embryonic forms of a global state, have developed. The articulation of these three spatial scales and the balance between them are key issues. As suggested in the second diagram in Figure 2.1, tensions may occur in relation to national sovereignty, the development of global cities, and regional development. Here is a gentle reminder of the importance of the spatial dimension in political economy. All economic activity—indeed, all of life—takes place in both time and
Part I: Current Economic Processes and Problems

There is a link between micro personal choices and macro societal choices. Individuals' economic decisions affect and are affected by broader political economic forces. Indeed, it is short term and of no apparent significance to anyone beyond our immediate family and friends. Such personal choices, illustrating our various social and economic roles, are described below.

As students, we are investing in our economic future as well as hopefully pursuing personal development. How much education we undertake and how many qualifications we acquire are likely to have a bearing on our future economic opportunities.

As consumers, we make daily decisions about which of the sometimes baffling array of products we will buy with our income. We also make decisions, if only by default, about how much we are prepared to forgo the immediate gratification of consumption in order to accumulate personal savings.

As workers, we are faced with constrained choices about the jobs we seek and the hours we work. We also have to make periodic decisions, individually or collectively, about the strategic stances to take in negotiations with our employers about wages and conditions of work.

Meanwhile, business decision-makers make their own strategic decisions about employment and wages payments. They also periodically review the methods they use for producing goods and services, how much they will invest in new production facilities, the prices they will charge for their products, and their sales promotion practices.

Speculators continually review their portfolio of assets, deciding what to buy and sell according to their judgments about future price movements and the possibility of capital gains. When media commentators refer to how 'the markets' respond to economic news or government policy initiatives, it is the behaviour of these speculators to which they are referring.

Banks decide about making loans to their clients, usually according to set guidelines. They also make decisions about the interest rates offered to depositors and charged to borrowers. The margins between these borrowing and lending rates are a principal source of banks' profits, and so they are kept under continual review.

Government ministers, especially those in key departments such as Treasury and Finance, also make frequent adjustments to economic policies. They do so in response to changing economic conditions in national and global markets, and to political pressures (including the speculative sentiments of the market). These public policy positions are also significantly influenced by prevailing economic theories.

Micro decisions: macro outcomes

Three trilogies

A simple device for considering some basic political economic principles is shown in Figure 2.1 (overleaf). The first diagram depicts the relationship between market, state, and community. It shows the three different ways in which economic activity can be organised: market, state, and community. Goods and services may be produced for exchange in the market. Many are. Alternatively, the production and distribution of goods and services may be organised by a central coordinating agency such as the state. The state may be responsive to the wishes of the society through democratic processes, or it may be authoritarian in character. The third possibility is that the production and distribution of goods and services results directly from community provision. People produce goods and services for themselves and their neighbours, and benefit from reciprocal relationships. The community may be quite small—perhaps just a household—or it may comprise a larger group of people whose voluntary cooperation results in purposeful economic activity without the need for markets or a state.

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PART I: CURRENT ECONOMIC PROCESSES AND PROBLEMS

CHAPTER 2: THE PERSONAL IS POLITICAL ECONOMIC

FIGURE 2.1 THREE TRILOGIES: INSTITUTIONS, SPATIAL SCALES, AND SYSTEMS

The third trilogy shown in Figure 2.1 depicts the relationship between economy, society, and ecology. Economic activities always depend on certain social and ecological preconditions—the availability of labour and natural resources, for example—and they have major social and environmental consequences. Political economy necessarily focuses on these connections. It looks at how the balance between economic, social, and ecological concerns is affected by the relationships between market, state, and community, and between local, national, and global scales of economic organisation. In practice, balance is seldom achieved, and the resulting contradictions are manifest in ongoing concerns about distributational equity, ecological sustainability, and the quality of life.

These three trilogies shown in Figure 2.1 draw attention to social choices. Do we want our economic arrangements to be mainly market orientated, increasingly global in character, and prioritising the pursuit of economic growth? Would it be better to have a greater role for the state, and more emphasis on planned national economic development and the pursuit of social and/or environmental goals? Or would we prefer more focus on the role of the community and localised forms of political economic organisation? What combination of these arrangements would be best? How can we seek to achieve that outcome? These are fundamental questions facing us all as citizens. They are issues that political economy seeks to illuminate.

Conclusion

As individuals, we all participate in the political economic drama. The personal is political economic. However, our roles in the drama are not predetermined. As actors, we can improvise, even tear up the script. It helps to know what is going on and what our options are, individually and collectively. We need an understanding of the political economic processes and possibilities. We have to identify what can be done to produce political economic futures consistent with our individual and collective needs and aspirations.

We need, therefore, to understand the capabilities and limitations of markets as means of organising and integrating economic activities. We need to explore appropriate economic roles for community and government that are desirable and feasible in an increasingly global political economic context. We need to develop the most effective means for securing economic progress, and balancing concerns about economic efficiency with social justice and ecological sustainability. And we need to evaluate alternative strategies for the pursuit of greater economic security, stability, and equity.

To address these concerns we must look beyond the short-term, day-to-day economic decisions we make as consumers, workers, investors, or business managers. We need to deepen our understanding of the political economic forces shaping our lives.
FIGURE 2.1 THREE TRILOGIES: INSTITUTIONS, SPATIAL SCALES, AND SYSTEMS

CHAPTER 2: THE PERSONAL IS POLITICAL ECONOMIC

space, so we need analytical structures that pay due attention to these coordinates of our behaviour.

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