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# Chapter 1

## Political Economy The Revival of an 'Interdiscipline'

Michael R. Krätke and Geoffrey R.D. Underhill

### Political Economy: What's in a Name?

Political economy is a venerable intellectual tradition that has undergone a recent revival. It was the name given to a version of social science prevailing in Europe until late in the nineteenth century, closely linked to its progenitor, moral (meaning social and political) philosophy. Its roots lie deep in the liberal Enlightenment that emerged across Europe in the seventeenth and eighteenth centuries, but it was given particular vigour through such figures of the 'Scottish Enlightenment' as David Hume, James Steuart, and Adam Smith in the latter half of the eighteenth century.

In the 1870s, political economy informed every budding civil servant or member of the political and economic elites how to run the affairs of state. The social movements of the French Revolution and in Britain during the 1820s brought forth a wave of radical or 'popular' political economy upon which Marx built his 'critique', challenging the very bases of modern civil society (private property, capital, market exchange, money). Legislation in Britain and elsewhere was subject to heated debates (the 'general glut' debate concerning the possibility of general crisis; the banking-currency school controversy about the nature of money and credit; the debate on free trade; the debate on the freedom of the labour 'market'). All were fought in public as well as in academic publications, and because many of the leading political economists were politicians as well (famously, the free-trade advocate David Ricardo), there was no clear-cut divide between 'academic' and 'political' debates.

Drawing attention to the potential social conflicts that would result from underlying socio-economic relationships dividing society into classes, political economy was designated the 'dismal science'. Long before Marx, political economists were accused of inciting class struggle. From the 1870s on, several political economists provided the core of what was to become—and was immediately proclaimed as—a 'pure theory' of political economy comparable to a social physics or mechanics, focusing on the analysis of market exchange under the hypothetical conditions of 'absolute [perfect] competition'. The idea was to develop a more optimistic and 'pure' science of economics free of its roots in social and political analysis. This emergence of modern 'neo-classical' economics as orthodoxy marked a divide between analysis of (conflictual) political and social relationships, on the one hand, and the analysis of (harmonious) market exchange, on the other, but true political economists rebelled against this division in a series of revivals in the twentieth century, preferring to see the patterns of market exchange as an integral part of broader social and political phenomena.

At the same time, the analytical techniques of 'utilitarian calculus' and marginal utility theory based on the utility or 'pleasure'-maximizing behaviour of self-interested 'rational economic man', which came to be employed in economic 'science', have also heavily influenced the emergence of other social sciences, especially sociology, political science, and international relations. The so-called 'rational choice' approach is very much an offspring of neo-classical economics, analyzing politics and political interactions as 'markets'. These

approaches are at odds with broader institutional or historically based approaches to these disciplines, which maintain their (often tenuous) links with classical political economy. However, given that political economy was itself a compromise between these various modes of analysis, there is no reason why they cannot complement each other if the intention to do so is present.

On the other hand, political economy is back in economics as well. Since the 1970s there is an ongoing revolt uniting all sorts of dissidents—Keynesians, institutionalists, Marxists, Ricardians—against the mainstream. History, evolution, time, space, and various social relationships in economic theorizing have returned to the agenda of critical economists, symbolized by the student protests in 2000 against the 'autism' of established neo-classical economics.<sup>1</sup>

Political economy today has come to have at least four meanings, and students should be careful to identify the version with which they are dealing because mainstream economists, critical economists, and political scientists mean quite different things when they use the same term 'political economy'. First, many economists still use the term to denote the study of economic policy issues *within* economics. Political economy in this sense is the application of neo-classical analysis to specific policy issues, wherein analysts attempt to identify optimal policy solutions for key variables such as inflation or unemployment. Second, what is called the 'economic theory of politics' is little more than the strict application of the concepts and analytical methods of neo-classical economics to the realm of political interactions and bargaining, which are consequently transformed into something looking very much like a 'market'. Neo-classical techniques are employed to determine how policy decisions are taken, given stylized conflicts among identifiable actors. Third, the name 'political economy' is used as a rallying cry by heterodox economists, indicating a more or less radical critique of the allegedly 'unpolitical' mainstream economics. Various strands of heterodox economics may be lumped together under this heading, including post-Keynesian, neo-Ricardian, Marxian and neo-

Marxian, Austrian school (von Hayek), and institutionalist and neo-institutionalist traditions. In specific, the term 'political economy' is used to denote 'radical economics', a potential amalgam of Marxian economics plus some feminism, ecology or postmodernism. Finally, political economy indicates the recent rediscovery by political scientists of the importance of economic issues and, in particular, of the political nature allegedly of 'economic facts, structures, and processes. This has led to a series of efforts to reoccupy what was once a man's land between the realms of economics and political science. In this respect, the term also indicates the revivalist move *across* disciplinary boundaries—and the venture into a new 'interdiscipline'—which is the subject of this chapter.

This chapter will develop several key points concerning political economy and its revival. It will begin by reviewing the origin of political economy in the 'classical' period of Enlightenment, then follow the progress of debate through the emergence of radical or 'critical' political economy and the eventual emergence of the separate disciplines of economics and political science/international relations. The chapter then turns to the contemporary revival of political economy as a study with domestic (comparative and international aspects focused on the relationship of national political economies to the global political process of global economic integration). The chapter will conclude by examining the crucial question of the relationship between political authority and markets, and how the political institutions of the state are embedded in the market as a thoroughly social phenomenon.

The overall argument of the chapter is that political economy should remain in touch with its classical and radical roots. Successful approaches to political economy do not embrace a series of 'sub-fields' but rather constitute an interdiscipline, however difficult a project that might be emphasized in the Introduction to this volume. Political economy consists of analyzing a set of socio-political relationships that can be summarized as follows: (1) there is a systematic reciprocal relationship between the political

economic domains; (2) as the ways in which societies produce and distribute their means of subsistence and surpluses changes, so the nature and structure of the societies themselves will evolve over time; (3) there is a dynamic and systematic relationship between the changing structures of production and exchange, on the one hand, and the forms that political authority and governance will take over time, on the other. Therefore the political institutions we call states are embedded in the social relationships around which production and exchange are organized, and the state and the market, as in the classical period, should be conceptualized as forming a single, integrated ensemble of governance.

### The Life and Times of Classical and Radical Political Economy

Political economy preceded the social sciences as we know them today. When it emerged in the seventeenth century, social science research had to be disentangled from philosophical and, especially, pre-scientific theological thinking. Political economy was both a science and a practice based on a new sort of knowledge and inquiry, but it lacked all the features of the 'disciplinary' social sciences we know today. To this pre-disciplinary stage we nonetheless owe a number of innovations crucial to contemporary social science, such as statistics ('Political Arithmetick') or the invention of macro-economic models depicting the interdependencies among producers, workers, taxation, and demand and supply, beginning with the *Tableaux économiques* of the French physiocrats in the eighteenth century. Last and certainly not least, the classical political economists were the first to envisage 'economic laws' or dynamics and a long-run evolution of human societies during which the basic features of economic, social, and political life changed in relation to each other.

Classical political economy was also very political from its beginnings. Building on Aristotle and the Greek philosophers, classical political economists initially thought in terms of 'art'—the art of running a large (family) household or estate, and

the various rights and obligations within/between a family and its (bonded) labourers. Political economy, as the classics conceived it, also had to deal with a series of *new* phenomena—the rise of the modern state, the development of 'national economies', and the rapid expansion of a world economy that had not previously existed. The pre-eminent scholars of classical political economy—from William Petty at the end of the seventeenth century to Karl Marx in the second half of the nineteenth century—were well aware of the radical changes in the economy and society of their own time. The medieval world had come to an end and there were commercial, financial, and industrial revolutions of an unforeseen scale and scope.

Political economists therefore variously investigated, propagated, and criticized the new social and economic order of modern (mercantile and later industrial) capitalism as it emerged. Its virtues and associated ideas of political and economic freedoms had to be propagated and defended against the prevailing ideas of the *ancien régime* and absolute monarchy, and its prerequisites had to be created. These consisted of private property rights for all (not just for the landowning Church, aristocracy, or monarch), including the patents associated with intellectual property rights; market systems as opposed to religious or monarchical edict; national and international monetary systems directed to the needs of commerce; a credit and banking system free of religious restraints on 'usury'; and new forms of private enterprise, e.g., 'limited liability' and joint-stock ownership. All had to be constructed, institutionalized, and enforced together with the basic institutions of the modern state that associated itself with emerging capitalism through new forms of taxation, public money, and, not least, the public debt. Deeply involved as they were in this historical process of transition towards modern capitalism, classical political economists shared an overtly political conception of their science.

The movement may be regarded as beginning with the mid-eighteenth-century physiocrats in France, including Antoine Mirabeau and their inspiration, François Quesnay.<sup>2</sup> They regarded agricultural *production* (as opposed to commercial

*transactions*) and the land as the foundation of value creation. Production was in turn tied to a series of interdependent relationships in society: they were the first to see a political economy as a circular flow of production, employment, and consumption oiled by money as a medium, with manufactures and luxury goods as incidental 'sterile' extras. Interdependence in economic terms meant social and political interdependence, though not necessarily on equal terms. This idea of circular flow governed by a series of natural laws (the *Tableaux économiques*) remains central to all contemporary economic thought, although industry and service production have long supplanted agriculture in theory and practice as the focus of analysis. The physiocrats also gave birth to the idea that the best prices were likely to emerge if individuals were allowed to compete freely, revealing a self-regulating natural order.

The central place of manufactures and commerce in the political economy was a crucial development of later political economists, particularly those of the Scottish Enlightenment. James Steuart maintained the ancient notion of 'oeconomy' as the 'art of providing for all the wants of a family, with prudence and frugality', and asserted the analogy—'what oeconomy is in a family, political oeconomy is in a state'—and thus distinguished the private from the 'publick'.<sup>3</sup> David Hume made a central contribution concerning the role of money in the circular economic flow of commerce and price levels (the quantity theory of money), and its international payments dimensions (the price-specie flow mechanism of the gold standard), both central planks in our understanding of the relationship between prices, money, and (domestic/international) economic activity.<sup>4</sup>

Adam Smith, just a few years later, saw it as 'a branch of the science of a statesman or legislator'—the science that should teach how to enlarge the 'wealth of nations' and how 'to enrich both the people and the sovereign'.<sup>5</sup> Smith deserves further mention as the key figure in the movement, recognized as such by Hume in his praiseworthy preface to *Wealth of Nations* (1776). Smith's seminal contribution was in understanding that the sophisticated

development of the division of labour in industry lay at the root of greater economic efficiency: therefore, greater levels of wealth and prosperity for all.<sup>6</sup> High levels of specialization could increase productivity and the surpluses a society could produce—thus disputing the physiocrats' claim concerning agriculture in political economy—implying that a deep, mature economy based on highly developed manufactures and elaborate commercial interaction was to be encouraged.

Furthermore, Smith developed a number of important arguments in favour of enforcing market mechanisms as promoting a better pattern of distribution and greater levels of wealth than the seventeenth- and eighteenth-century mercantilist system dominated by monarch, Church, and state-sponsored merchant oligopoly. Deliberate change in the functioning and structures of economic interdependencies presaged more harmonious social and political relationships and greater benefits for all, employing human greed as a route to collective improvement. As he famously argued, we do not owe our good meals to the charity of the butcher but to his desire for self-enrichment.<sup>7</sup> As individuals pursue their own best interests motivated by greed, they unwittingly realize an important public good—a more productive society with a broader division of labour and more for all. In this way, argued against the restrictive practices in the labour market of the craft guilds, who (often through inherited membership) controlled for their members' benefit the quantity and price of labour crucial activities, and the prerogatives of royal and other commercial monopolies set by political authority which institutionalized the privileges of the powerful and impaired adjustment to economic change. Competition would lower prices and free resources for investment.

Furthermore, he was underpinning some of the crucial liberal Enlightenment arguments about personal *political* freedoms. Freedom of private property, unencumbered by fear of arbitrary seizure, was associated with freedom to choose one's occupation and enjoy the fruit of one's labour. Doing so would enhance both wealth and equality. Labour, capital, and their skilful employment were

the source of wealth in society, not inherited riches and privilege. This implied that ordinary people had a worth of their own, associating economic and political freedoms or 'natural rights' as one. Despite this optimistic doctrine, Smith remained sceptical about the power of commercial interests and argued that intervention was needed to ensure that restrictive practices and self-interested behaviour of the commercial classes were curbed and regulated to ensure market-based outcomes and benefits.

David Ricardo took Smith's work in a systematic and coherent direction and developed now familiar techniques of deductive economic reasoning under strict and highly abstract assumptions. His aim was to demonstrate the advantages of government policies promoting the new market principles, for example, in taxation and international trade. Societies at the time were deeply divided along class lines—and political economists were searching for 'laws' governing their conflicts of interest and betterment of the situation. At the same time, Jean-Baptiste Say attempted to demonstrate systematically his law that 'supply creates its own demand' (Say's Law), by which he meant that the wages from employment for a given level of production would result in sufficient purchasing power to see that it was sold—an early demonstration of the principle of economic equilibrium.

This turn towards abstract reasoning proved influential and linked up with Jeremy Bentham's 'utilitarian calculus' in moral philosophy: people are assumed to be rational and to pursue a self-interested agenda of 'utility maximization' ('utility' standing variously for pleasure, wealth, happiness, profit) in interaction with others. The question, as Smith had seen, was how this pursuit of self-interest might add up to a beneficial outcome for the social whole (or not). Liberal ideas concerning harmony of interests and economic equilibrium combined with the new 'science' in a heady idealism that often conflicted with observable realities. John Stuart Mill, writing as the Ricardian consensus concerning the 'basic principles' and 'true laws' was collapsing, explicitly made the distinction between

production, ruled by 'natural and universal laws' (like the 'law of diminishing returns'), and distribution, ruled by custom and hence subject to change and political strife.

Finally, there was Marx, who coined the term 'classical political economy'. He clearly belongs to the classical tradition, but as its greatest critic he also goes far beyond it. The critical or radical political economy tradition he founded aimed to debunk liberal idealism and expound the real, inner mechanisms of capitalism as well as its intrinsic tendencies (or 'laws of motion'). Marx's critique was not just political and ethical—demonstrating, he hoped, the historical limits of modern capitalism—but also 'economic'. He extended Mill's arguments concerning strife associated with distribution to the functioning of capitalist production and exchange itself. Capitalism was a contested and complex system of social relations involving fundamental power relationships between the 'economic classes' of modern society. Without the modern state and modern law, without politics, the highly artificial institutions of modern capitalism could not last a day.

Marx represented a turning point. His revolutionary critique stimulated many to intensify the search for 'pure science' removed from the complexities of history and socio-political interaction, generating 'Economics' as opposed to the older and discredited term, 'Political Economy'. The utilitarian calculus fostered the 'marginal revolution' based on (often highly algebraic) marginal utility analysis as a sort of anatomy of market transactions. This generated Leon Walras's mathematical 'general equilibrium model' demonstrating in the abstract that the interdependent economic flows could result in a long-run balance between demand and supply factors. Alfred Marshall's *Principles of Economics*, first published in 1890, replaced Mill's 1848 *Principles of Political Economy* as the leading and standard textbook and for over 50 years retained this position in the English-speaking world. Political economy was 'purified' and professional economists forgot about history, politics, and conflicts of social life. Their concern was to analyze

'universal' patterns of market exchange proper as applied to both economic and social life, and to demonstrate the attainability of equilibrium yielding 'Pareto optimal' levels of general welfare, where no one person can be better off without someone else being worse off.<sup>9</sup> The new orthodoxy also implied the emergence of a *separate* study of society (sociology) and of politics (political science and international relations). These separate disciplinary tracks have been maintained to this day.

How is the tradition of classical political economy relevant today? The heritage appears split between those who claim eternal 'laws' of economics as natural or, in a flight of modesty, laws of 'rational behaviour'. Others—like Sismondi, Jones, Mill, and Marx—focus more on the historical, transient, contested, and hence *political* nature of all economic processes. Smith was no true believer in the liberal Utopia of a market unbound: the furies of private interests would always disturb the markets, which had to be regulated to make them work. Political economy informs us not to take 'economic man' for granted, but to study the social relationships behind the division between private interests and the public or 'common' good. Individuals and economic relationships, thus 'laws', are in fact highly contestable, generated by society through social and political interaction, not as assumed by mainstream economics. Political economists like Karl Polanyi and Albert Hirschman do not take any 'universal' market behaviour for granted, and they take issue with the notion of the 'neutrality' of money. Money and credit involve exchange and power relationships (different classes do different things with it) anchored in social practices and beliefs (confidence), which can be a source of instability and even crisis: money is only stable as long as collective human behaviour makes it so. In stark contrast to mainstream economics, political economists study market competition in time and space: economic agents (e.g., firms) have a history and their interaction is often cyclical and uncertain.

Last but not least, political economists in the classical tradition are preoccupied with the study of

the interaction between political and economic processes. The tradition understood that system production changed symbiotically with pattern classes in society and patterns of governance requiring a theory of history. Adam Smith realized that a better relationship between private pursuit of self-interest and collectively acceptable outcomes in terms of state and market required carefully crafted conditions enforced by political authority not beholden to the whims of the rich and powerful. The interaction between states and markets misleading formula if each represents a competing logic: power on the one side, rational exchange behaviour on the other. Private property and market exchange also involve power structures underpinned by the political and social arrangements maintained through our institutions of governance. Understanding how and why markets politically made and determined, as well as how and why states are made up of and determined peculiar economic institutions of their own making, allows political economists to overcome the oversimplified state-market divide. In this respect, Karl Polanyi's seminal study on the Great Transformation has been a source of inspiration cherished by many political economists ever since its first publication in 1944.<sup>9</sup>

### A Tale of Two Revivals: International and Comparative Political Economy

This section<sup>10</sup> traces the revival of political economy within the broad discipline of political science. In the post-war period social science began a rapid and rather exaggerated process of specialization, and much concerning the international relationships and shared heritage of these subjects was lost. The re-emergence of political economy refers to a process of reintegration what had been somewhat arbitrarily split. Though specialization resulted from the laudable pursuit of better expertise, it had important opportunity costs for our understanding of the world around us. Furthermore, as the global economy became increasingly integrated,

traditional distinction between the study of things international and things domestic began to break down. As the political and economic domains stubbornly revealed themselves to be closely interdependent, there was a re-examination of disciplinary specialization.

Classical political economy had always been preoccupied with the domestic and world economies. Although only fragments, such as Ricardo's theory of comparative advantage, survive in orthodox economics, classical political economists had been very much concerned with the contrast between the wealth of some nations and the poverty of others. The decline of the Spanish empire, the Dutch miracle of the seventeenth century, the rise of Britain to industrial and commercial supremacy, the capitalist development of backward countries like Russia were all topics of heated debate among political economists. So the beginning of a revival of political economy had two dimensions or sources in the literature: comparative political economy (CPE), which seeks to analyze and explain the similarities and/or differences among national and/or regional variants of political economy, and international political economy (IPE), which analyzes the relationships among the various national/regional components of the global system. Each of these dimensions began to approach the other within political science/international relations.

One might begin with the work of Richard Cooper, an economist,<sup>11</sup> who was particularly influential in inducing political science/international relations scholars, including comparative foreign policy analysts, to consider the observable fact of *interdependence* and what it meant for our understanding of the world around us. Increasingly, foreign affairs would be understood in relation to the tensions between domestic considerations and relations with other states and their own domestic dynamics. This blurred the levels-of-analysis distinction through the work of a range of scholars (for example, James Rosenau).<sup>12</sup>

A further step was the emergence in the late 1960s of the debate about 'transnational relations', wherein *international* was placed in opposition to the

more sophisticated concept of *transnational* relationships (see also the Introduction to Part I). Interdependence among states and their societies<sup>13</sup> was central to this debate, highlighting the role of both *non-state* and *sub-state* actors of a private or public nature. Such concepts greatly expanded the empirical terrain on which the nascent IPE/CPE would operate.

There were disputes about basic assumptions of agency and method. Cooper's article was an early application of methodologically individualist rational choice to IPE, an application that became particularly influential when applied to game theory and the transaction cost economics of Nobel Prize-winner Ronald Coase<sup>14</sup> and others. Axelrod's innovative use of game theory and Keohane's use of transaction cost logic were particularly useful examples, as was Mancur Olson's application of his own 'public goods' approach in his *Rise and Decline of Nations*.<sup>15</sup> These more formal and quantitative rational choice contributions under the 'positive political economy' label represent a growing direct overlap of neo-classical economics and IPE.<sup>16</sup>

Meanwhile, 1970s monetary turbulence, the rise of the Euromarkets, and the expansion of international trade signalled a transformation at domestic and international levels. Trade and financial policies had always been highly charged politically, both *within* and *among* states in the system, proving fertile ground for interdisciplinary sectoral research projects, e.g., the team under Andrew Shonfield at the Royal Institute for International Affairs (Chatham House) that included Susan Strange, perhaps the most renowned of all the IPE 'revival' generation.<sup>17</sup> B.J. Cohen represents one of the rare cases of an economist who came in from the cold of the dismal science—producing his seminal *Organizing the World's Money* (1977).<sup>18</sup> A healthy literature developed in various issue-areas on emerging co-operative 'international regimes'.<sup>19</sup>

Comparative and international political economy began increasingly to overlap. The economic historian Charles Kindleberger developed his explanation of the collapse of the international monetary system in the 1930s in terms of domestic policy failures and the need for a political stabilizer for international markets, spawning the often

misunderstood 'hegemonic stability' hypothesis,<sup>20</sup> which was further pursued by Robert Gilpin, who started as a specialist in French public policy.<sup>21</sup> Further contributions from comparative political economists followed, including Peter Katzenstein's *Between Power and Plenty*<sup>22</sup> on diverse national responses to the 1970s oil shocks, and the work of Peter Gourevitch and John Zysman.<sup>23</sup> Comparative specialists recognized that the phenomenon of deepening European and global integration forced them to reassess their approach to their subject, linking the crisis of welfare states variously to systemic or national-level developments: it was increasingly difficult to remain a country specialist without absorbing the impact of structural changes in the global economy—the debates about corporatism and the role of organized interests were forced to 'go global'.<sup>24</sup> Comparativists (the 'developmental state' debate) were also busy analyzing the difficulties of developing political economies at the domestic level as global integration pressures mounted.<sup>25</sup> While some IPE specialists had always anchored global generalizations in specific sectoral and, indeed, country cases, IPE and CPE needed each other as much as ever, coming together in a synthesis through the work of scholars such as Philip Cerny.<sup>26</sup>

The radical tradition in international political economy must not be neglected, especially as it kept alive assumptions about the interdependent nature of the political and economic domains. Indeed, over time the radical and the 'orthodox' have moved closer together.<sup>27</sup> Radical contributions stemming from Marx and Lenin can be split a number of ways, with the work of Sutcliffe and Owen or Kubalkova and Cruickshank standing out as sound texts.<sup>28</sup> Considerable innovation occurred with the emergence of the 'French Regulation' school led by Michel Aglietta and including well-known scholars such as Robert Boyer and Alain Lipietz,<sup>29</sup> and the revival of empirical work in the Marxist school.<sup>30</sup> Perhaps the most obvious of the long-standing radical contributions to IPE is that of dependency theorists, with variants ranging from world systems theory developed by Immanuel Wallerstein and others<sup>31</sup> to explanations emphasizing

ing domestic factors.<sup>32</sup> The insights of dependency theorists concerning uneven development inequality have been difficult to ignore, and the ongoing discomfort the mainstream has increasingly accepted some of the basic observations of dependency theorists. Finally, Robert Cox was author of an important innovation bridging international relations/international political economy and the domestic level of analysis in important respect. His 'neo-Gramscian' approach,<sup>33</sup> resolutely post-structuralist in its theory, has been embraced whole or in part by a sizable proportion of IPE specialists. Cox also served as a reminder to link political economy to its historical roots as he drew heavily on Marx, Gramsci, and Karl Polanyi, and himself as represented by Fernand Braudel. His conceptual devices cross levels of analysis and admit the relevance of a wide range of public and private actors and, crucially, the relationships among them in the pattern of global governance. The emphasis on transnationalization of class and (related) corporate power was also developed by the 'Amsterdam School',<sup>34</sup> as well as by scholars such as Stephen at York University in Canada.<sup>35</sup>

The emergence of IPE has paralleled wider developments in the social sciences. In this sense 'new' issues have made their way onto the agenda prompting renewed consideration of conceptual approaches as well. Of particular note is the rise of feminist scholarship and work on the environment—heralding feminist and 'green' approaches to IPE. Both have moved rapidly from arguing the need to find a place in CPE/IPE scholarship to showing how these approaches might be included on the agenda through theory and empirical case research (see especially Chapters 5, 6, and 18 in this volume). IPE and CPE scholarship is now rich and varied. Different perspectives and scholars emphasize different aspects of the normative agenda, a much of the underlying debate is ultimately about values, not simply analysis and research tools.<sup>36</sup> The mainstream (international) economics and (international) political economy remain in mutual neglect or even denial. Hardly anyone, perhaps with the remarkable exception of the pioneer Susan Strange, has ever complained.<sup>37</sup>

## Whither Political Economy?

The emerging political economy approaches were increasingly resisting disciplinary straitjackets and reaching across boundaries towards economics and, in particular, the classical roots. Research into social and economic interdependence across political boundaries threw into question the levels-of-analysis assumptions of comparative politics and international relations. It brought to the fore the question of which actors and what issues are of central importance. By examining the constraints of economic structure and the impact of political interaction on the changing economic scene, it highlighted the role of structure versus agency in this process of transformation (for an account of these theoretical issues, see the Introduction to this volume). In time, inquiry settled on a move away from a focus on 'government' towards a focus on the looser concept of 'governance'.<sup>38</sup> This once again expanded the range of issues on the table.

In other words, emergence of political economy was a reawakening and relinking with the broad if not always coherent tradition of social science scholarship from the French physiocrats onward, via Smith, Marx, Keynes, Polanyi, and the pioneers of the contemporary period. This welcome ecumenism has become characterized by a concern with how the pieces of the global puzzle fit together: the social, the normative, the formal and institutionalized, the public and the private, the local and the global. This requires specialized research employing diverse techniques but based on a broad understanding of the nature of political authority and underlying socio-economic structures in a variety of settings.

It is arguable that despite this welcome diversity in *approach*, political economy has come to settle around a set of core questions and empirically verifiable assumptions concerning the nature of the social whole. Given arguments about roots, a useful starting point is Adam Smith himself,<sup>39</sup> who was strongly aware that, historically, evolving ways in which who gets what, when, and how lend form and substance (sometimes rather unpleasant) to society and to its more formal institutions of gover-

nance, and who has power over whom. In this he shared much with his eventual critic, Marx. Smith observed an ongoing tension between the private interests of individuals and the needs of the wider community—a tension between the pursuit of self-interest and the public good. This leads to the first core issue: how has this tension been resolved in particular periods of history? One might disagree with Smith's market-based proposal, but his core question remains relevant in our increasingly transnational political economy, with the lines of institutionalized authority becoming more blurred all the time.

This leads to a crucial second core assumption—that there is a systematic and reciprocal relationship between the political and the economic domains. Systems of production and exchange are deeply embedded and indeed underpin the evolving characteristics of our societies. Building on the concern with history within both classical and radical political economy, a third assumption is that, over time, a systematic but not always linear relationship exists between the changing ways in which societies organize production and exchange, on the one hand, and emerging patterns of governance, on the other.

These core issues can be formulated in contemporary terms. We now have a market-based social system, indeed, an increasingly global one, but not always the carefully contrived conditions Smith recommended. The market has furthermore proved less stable, less equal, and less harmonious in operation than he and many of his successors thought would be the case; hence, radical critique. Power is clearly not the sole preserve of the formal institutions that pretend to monopolize it, particularly states—private market power is very much part of the pattern of governance we experience. The core issues noted above all focus on the reciprocal relationship between economic structures of the market and political authority (loosely defined) in the ongoing and accelerating process of global change,<sup>40</sup> and political authority is today largely represented by the state. This means we should focus on the *contemporary state-market relationship* in this period of global economic integration and

changing forms of governance: what we think a state is, what we think a market is, and how, if at all, they are or should be related. The central focus on the contemporary state-market relationship leaves ample room for normative concerns such as who should get what and how, the appropriate nature of governance, and guidance as to how we might improve the global order.

If the relationship between political authority and markets is the core question, the argument here is that the discipline must move beyond mere invocation in terms of dealing with it. For too long, scholars have either merely invoked the interrelationship in terms of mutual effects (i.e., economic liberal or realist approaches) or assumed it. Either way, the relationship has not been adequately conceptualized. Politics and markets, as most IPE/CPE literature insists, are interdependent, but their interdependency is usually depicted as a simple dichotomy: states *versus* markets, each following contrasting and antagonistic logic (political power *versus* rational, self-interested action) and always pulling in opposite directions. In the conventional view, states and markets are ruled by contrasting values, and the processes in each domain remain distinct. This state-market tug-of-war is deeply rooted in the nineteenth-century disciplinary split between economics and political science. Accordingly, the dichotomy view, still prevailing in contemporary political economy, does not overcome the conceptual divide between politics and economics. In fact, it reproduces their unhappy divorce.

This dichotomy view has a number of disadvantages. First, it is based on formulas that lack explanatory accuracy because of empirically inaccurate analytical differentiation. To invoke 'markets' as an abbreviation for the structure and logic of development of contemporary economies is wide of the mark. Modern capitalist economies are structured by firms, which internally are not markets but power hierarchies.<sup>41</sup> Furthermore, modern economies comprise a variety of markets, among them the markets for the 'fictitious commodities' such as human labour, land or natural resources, money and capital. These are also essentially social

power structures that yield a range of potential conflicts requiring political resolution between employers and employees, landowners and land users, creditors and debtors, investors and capital users). These are not 'markets' in abstract but distinct or specific markets and systems as social entities. States, on the other hand, as political economists should see them, are economic *organizations* of a peculiar, political kind of origin. They have acquired a series of 'monopolies' that are either directly economic (power of taxation, monopoly of money) or central to economic life, like the 'monopoly of legitimate violence' and the 'monopoly of law'. States are in this sense the institutions that act as a forum to resolve the political conflicts generated in the social domain of the market.

Second, the state-market dichotomy explains a number of phenomena rather poorly. For instance, why do successful and ostensibly mobile market agents not *consistently* take the 'exit option' but by many instances, choose to remain wedded to enduring state-market configurations (viz. Japan)? Or why have persistent predictions of a 'retreat of the state'<sup>42</sup> and race-to-the-bottom regulatory competition failed to materialize under the pressure of global market integration? Or again, why do some economies display an outstanding adaptive capacity to external pressures at one time, but demonstrate continuity in institutional structure and even personnel, demonstrate incapacity at another time? What is more, the state-market dichotomy presents a distorted view of business strategies and the process of competition as consisting solely of deployment of firms' relative capacities in terms of organization, innovation, and capital. Thus, *political* resources deployed in the policy processes—ability to shape the terms of competition in line with the preferences of private actors—are counted as an add-on extra, good if one can manage it, instead of seen as integral to the very nature of inter-firm competition itself.

So how might we transform political economy into a true inter-discipline in touch with its classical roots, overcoming the states *versus* markets dichotomy and bringing together political sci-

tists and heterodox economists who still remain in a tacit state of mutual negligence and ignorance? A lead is provided by the literature on institutional economics. Douglass North argued that the ways in which markets are structured, the sorts of values embedded in the prevailing regulatory systems, and which actors/organizations are able to develop within the prevailing incentives make all the difference to outcomes.<sup>11</sup> In this view, the institutions of the market and the institutions of the policy process are integrated into the notion of what a market is. Markets cannot thrive without the reduction of transaction costs that governance provides. But it is insufficient to import techniques of economics (in this case, the transaction cost approach) into political science or vice versa. We must fully recognize the implications of such formulations and think of the market setting as part of a wider process that includes the crucial functions that states and firms, as institutions, both perform, along with the functions and actions of other social constituents.

Let us take one recent proposal to replace the dichotomy with a broader concept<sup>12</sup> linking state and market in the process of governance. Remembering the classical economists, we can conceive of states and their political conflicts as active constituents of the marketplace, and of market actors and their constituencies as participants in the wider process of governance. Rethinking the state-market relationship, we focus on the process of regulation taking place on markets, within firms, and in interactions between firms, as well as among other, compound market actors. Apparently, the regulatory processes at the (trans)national level are as much a part of business strategies as the game of investment and marketing. Firms simultaneously deploy their political and competitive resources to achieve the outcomes they seek. The preferences of powerful coalitions of market agents are integrated into the policy process. States and markets can be regarded as parts of an integrated ensemble of governance, the *state-market condominium* wherein the identifiable parts of the whole cannot be conceptualized or analyzed in isolation from each other.

Change occurs simultaneously through the process of economic competition among firms, on the one hand, and the policy and regulatory processes mediated by the institutions of the state, on the other. Market agents enhance or protect their position and prosperity by making simultaneous calculations through their business strategies, deploying in parallel their competitive (investment, technology, productivity, organization, labour skills) and political (in the policy processes of the state and in less formal institutional settings) resources. This is clearly visible in corporatist systems in Western Europe, where even labour is integrated into both state policy processes and the strategic decision-making of firms, and in the close integration of private firms/associations into the system of bureaucratic management that characterizes the economic development process in Japan and other parts of Asia. The point is less obvious to observers of Anglo-Saxon political economies, where the independence of the private sector appears more marked than in other societies. But the considerable evidence of 'regulatory capture' of the agencies of governance in the US economy should indicate the need to avoid the stereotypes developed, particularly in the economics literature.

Of course, this conceptualization of states and markets appears counter-intuitive in the present global era increasingly dominated by private-sector market processes. The case also appears difficult to support in view of the existence of multiple sovereignties in the global economy, which firms are supposedly trying to circumvent. Our contemporary experience of modern capitalism and the prevalence of economic modes of analysis engrave on our intellects the idea of the state-market dichotomy. Yet it is precisely against this sort of orthodoxy that political economy teaches us to rebel. There is nothing surprising in the idea that a transnational market structure, or indeed any market, should have multiple institutional nodes exercising authority in different ways and even with different functions. The analogy of a federal system or of the European Union is useful here: different layers of political institutions can fulfill the 'state' function over time and we should not mis-

conceive the identifiable institutional/organizational structures of the state as a phenomenon external to the dynamics of the market.

The state-market condominium model facilitates understanding of the role of 'non-state' private interests, integrated into the complex institutional fabric of the state, in driving the process of global integration. As the pattern of material interests in national political economies has become more transnational, so the state has changed. Over the past three decades, the state has become far more a facilitator of global market processes than a protector of domestic market structures and interests (see Chapter 26 by Cerny). The pattern of political authority becomes more transnational in symbiosis with the transformation of the market. The state has progressively delegated a number of tasks either to private bodies or to institutions of international co-operation, though it maintains its functions in terms of domestic political legitimacy and all the tensions that entails. In this sense what we have seen is not so much a retreat of the state in the face of market forces, but a transformation of the state in symbiosis with the transformation of economic structures. This argument also implies that the state could claw back (at a cost!) its authority should political and market circumstances make this a desirable policy option. Political agency, depending on the balance of social forces and their organizational and institutional capacities, can be deployed to liberalize or indeed to invoke closure, as has happened many times in history—humankind does have free will where the market is concerned. It should be clear that the form and functions of the state will continue to evolve, as they have in the past. The question, then, is not why the state is in retreat, but how long the current form of state-market condominium is sustainable in the face of the increased volatility of the global markets.

## Conclusion

This chapter has demonstrated that, in addition to flourishing, comparative and international political economy have come of age in an emerging synthesis. Forms of academic specialization were

failing to address, let alone answer, important questions. This synthesis was as much a revival of older traditions as a new development, but it is no less welcome for that.

Yet the political economy revival initially failed to grapple successfully with the conceptual puzzle of the state-market relationship. We have arrived here for a conceptual leap that would generate a genuine political economy approach: the adoption of the state-market condominium model. We all political and economic agents at one and the same time, whatever the historical context. The argument is important because it re-establishes the role of agency, the capacity to make normatively informed policy choices concerning the nature and direction of the current global transformation. The need to focus on determining the political and economic situations that need to be challenged in order to correct the balance of costs and benefits of global economic integration, particularly the problem of inequality and poverty.

The state-market condominium model then operationalizes political economy and infuses the global economic development process with agency. There is room for discretionary policy and action, even for the relatively vulnerable. We can, at least to a limited degree, affect the norms and values underpinning global order. As long as we see only a tug-of-war between the state and the market, then the benefits of one will be overshadowed by the costs of the other. The point is that they exist in symbiosis. The argument also demonstrates the real importance of Strange's insistence that we should focus not on the state and markets as such, but on the interaction of *political authority* and the *market*. Political authority is just vested in the formal institutions of states and their offshoots of governance, such as international regimes, but is also present in the agents of the market as part of the state-market condominium. The market is governance, even as it appears to be in mysterious, private ways.

## Notes

1. See E. Fullbrook, ed., *The Crisis in Economics* (London: Routledge, 2003).
2. See H. Landreth, *History of Economic Thought* (Boston: Houghton Mifflin, 1976), 24–9.
3. See J. Steuart, *An Inquiry into the Principles of Political Economy* (New York: Augustus M. Kelley, 1967 [1767]), 1–2.
4. See David Hume, *Of Interest, Of Money and Of the Balance of Trade*, in E. Rotwein, ed., *David Hume: Writings on Economics* (Madison: University of Wisconsin Press, 1970 [1752]).
5. See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1937 [1776]), 375.
6. *Ibid.*, Book I, chs 1–3.
7. Robert Heilbroner, ed., *The Essential Adam Smith* (Oxford: Oxford University Press, 1986), 168–71.
8. Landreth, *History of Economic Thought*, 408–11.
9. K. Polanyi, *The Great Transformation* (Boston: Beacon Press, 1957 [1944]).
10. This and the following section of this chapter draw heavily on Underhill, 'State, Market, and Global Political Economy: Genealogy of an (Inter-?)discipline', *International Affairs* 76, 4 (Oct. 2000): 805–24.
11. Richard N. Cooper, *The Economics of Interdependence* (New York: McGraw-Hill, 1968).
12. James N. Rosenau, ed., *Domestic Sources of Foreign Policy* (New York: Free Press, 1967).
13. Robert O. Keohane and Joseph Nye, *Power and Interdependence: World Politics in Transition* (Boston: Little, Brown, 1977), 8–11.
14. Ronald Coase, 'The Problem of Social Cost', *Journal of Law and Economics* 3 (1960): 1–44.
15. Robert Axelrod, *The Evolution of Co-operation* (New York: Basic Books, 1984); Robert O. Keohane, *After Hegemony: Co-operation and Discord in the World Political Economy* (Princeton, NJ: Princeton University Press, 1984); M. Olson, *The Rise and Decline of Nations* (New Haven: Yale University Press, 1982).
16. J. Alt and K. Schepsle, *Perspectives on Positive Political Economy* (Cambridge: Cambridge University Press, 1990); Dani Rodrik, *Has Globalization Gone Too Far?* (Washington: Institute for International Economics, 1997).
17. A. Shonfield, V. Curzon, et al., *Politics and Trade*, vol. 1, and Susan Strange, *International Monetary Relations*, vol. 2, of *International Economic Relations of the Western World 1959–1971*, ed. A. Shonfield (Oxford: Oxford University Press, 1976). For a critical assessment and further development of the work of Susan Strange, see A. Verdun and T. Lawton, eds., *Strange Power* (Aldershot: Ashgate, 2000).
18. Benjamin J. Cohen, *Organizing the World's Money* (New York: Basic Books, 1977).
19. Starting with, among others, Keohane and Nye, *Power and Interdependence*, and S. Krasner, ed., *International Regimes* (Ithaca, NY: Cornell University Press, 1983).
20. Charles Kindleberger, *The World in Depression 1929–39* (Berkeley: University of California Press, 1973).
21. Robert Gilpin, *US Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment* (New York: Basic Books, 1975).
22. Peter J. Katzenstein, ed., *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Madison: University of Wisconsin Press, 1978).
23. See Peter Gourevitch, *Politics in Hard Times* (Ithaca, NY: Cornell University Press, 1986); J. Zysman, *Governments, Markets, and Growth* (Ithaca, NY: Cornell University Press, 1983).
24. See Justin Greenwood and Henry Jacek, eds., *Organized Business and the New Global Order* (London: Routledge, 2000).
25. See P. Evans and J.D. Stephens, 'Studying Development Since the Sixties: The Emergence of a New Comparative Political Economy', *Theory and Society* 17 (1988): 713–45.
26. On the state in the global economy, see P. Cerny, *The Changing Architecture of Politics: Structure, Agency, and the Future of the State* (London: Sage, 1990); on finance, see Cerny, ed., *Finance and World Politics: Markets, Regimes, and States in the Post-Hegemonic Era* (Aldershot: Edward Elgar, 1993).
27. The influence of radical political economy on Cerny's work is a good example of the ways in which radical insights have affected a range of scholars.
28. Bob Sutcliffe and Roger Owen, eds., *Studies in the Theory of Imperialism* (London: Longman, 1972); V. Kubalkova and A. Cruickshank, *Marxism and International Relations* (Oxford: Clarendon Press, 1985).
29. M. Aghetta, *A Theory of Capitalist Regulation* (London: New Left Books, 1979). The school is covered well in the review article by Alain Noël, 'Accumulation, Regulation, and Social Change: An Essay on French Political Economy', *International Organization* 41, 2 (Spring 1987): 303–33.
30. See Peter Burnham, 'Open Marxism and Vulgar International Political Economy', *Review of International Political Economy* 1, 2 (Summer 1994): 221–31.
31. See Christopher Chase-Dunn, *Global Formation: Structures of the World Economy* (Oxford: Blackwell, 1989).
32. Henrique Cardoso and Enzo Falletto, *Dependency and Development in Latin America* (Berkeley: University of California Press, 1979).
33. See Robert W. Cox, with T. Sinclair, *Approaches to World Order* (Cambridge: Cambridge University Press, 1996); Cox, *Production, Power, and World Order* (New York: Columbia University Press, 1987).
34. See the widely cited Kees van der Pijl, *The Making of the Atlantic Ruling Class* (London: Verso, 1984), and, more recently, van der Pijl, *Transnational Classes and International Relations* (London: Routledge, 1998).
35. Stephen Gill, ed., *Gramsci, Historical Material and International Relations* (Cambridge: Cambridge University Press, 1993).
36. See Susan Strange, *States and Markets* (Oxford: Blackwell, 1988), ch. 1.
37. See Susan Strange, *Authority and Markets: Six Strange's Writings on International Political Economy* (London: Palgrave Macmillan, 2002), and especially her classic article, 'International Economic and International Relations: A Case of Mutual Neglect', *International Affairs* 46, 2 (Apr. 1970): 304–15.
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39. See Andrew Skinner, 'Introduction' to A. Smith, *The Wealth of Nations* (London: Penguin, 1970 [1776]); Heilbroner, ed., *The Essential Adam Smith*.
40. The point Susan Strange made so long ago in 'Study of Transnational Relations', *International Affairs* 52, 3 (July 1976): 333–45.
41. See Oliver Williamson, *Markets and Hierarchies* (New York: Free Press, 1975). Williamson recognizes the point but does not bring it alive politically and in social terms.
42. Such as that propounded by Susan Strange in *Retreat of the State* (Cambridge: Cambridge University Press, 1996).
43. D.C. North, *Institutions, Institutional Change, Economic Performance* (Cambridge: Cambridge University Press, 1990), 109.
44. See Geoffrey R.D. Underhill, 'States, Markets, Governance for Emerging Market Economies', *International Affairs* 79, 4 (July 2003): 755–8.

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## Chapter 2

# Problems of Power and Knowledge in a Changing World Order

Robert W. Cox

Theory concerning human affairs is not cumulative and progressive. Theory follows history, so that when the structures and problems of one era give place to emerging new structures and new problems there is a challenge for theory to respond. This is most notably the case with regard to world politics. The concepts and categories that became conventional following World War II are now widely challenged by recent history.

Established bodies of knowledge have their own inertia. They represent a considerable investment of time and effort—not to be cast away lightly. Furthermore, even while recognizing that the circumstances that validated established knowledge have changed, ingenious thinkers may adapt accustomed mental frameworks to new circumstances and new perceptions of threats to security without basically changing them. One form of 'realism' maintains that the basic structure of world order is unchanged since Thucydides wrote about the Peloponnesian War. Even though certain theorems of power relations may be abstracted from the flow of history, they can never be more than explanatory hypotheses, possibly helpful in interpreting specific situations but not to be represented as the universal truth of power politics. The flow of history is constantly producing power structures that shape and constrain actions and outcomes in different historical epochs.

It takes the shock of awareness that global power relations have significantly altered to call into question the conventional thinking and to stimulate the development of alternative forms of knowledge. Old realities remain. The state may retreat<sup>1</sup> with respect to some of its erstwhile functions, but it

assumes new functions. Economic globalization does not bring about the disappearance of the state any more than *real socialism* brought about its 'withering away'. States make the framework for globalization. But states can also become agencies for bringing the global economy under social control. The state remains a site of struggle for those who would challenge the social consequences of globalization. History does not end with globalization—the economy and liberal political structures.

For three decades and more, knowledge in the sphere of world politics was built predominantly with reference to the Cold War. 'Neo-realism', the influential theoretical construct of that period, was a problem-solving form of knowledge applicable to the rivalry of two superpowers.<sup>2</sup> It was general and adequate to that specific purpose. Its limitation was that anything not pertaining to the superpower struggle tended to be ignored.

Of course, for the great mass of humankind other considerations were paramount: physical survival in conditions of hunger, disease, violent conflicts, and, at a more spiritual level, the denial of cultural identity. These were subordinated to the global power struggle, or, insofar as they became disruptive, were linked instrumentally to the interests of the two superpowers. Two competing forms of homogenization—world capitalism and world communism, respectively picturing themselves as the free world and national liberation—were the only games admitted. Once the overarching control of the Cold War was lifted, the underlying but obscured diversity of the human situation became apparent. Neo-realism lost its monopoly of explaining the world and of proposing action.<sup>3</sup>