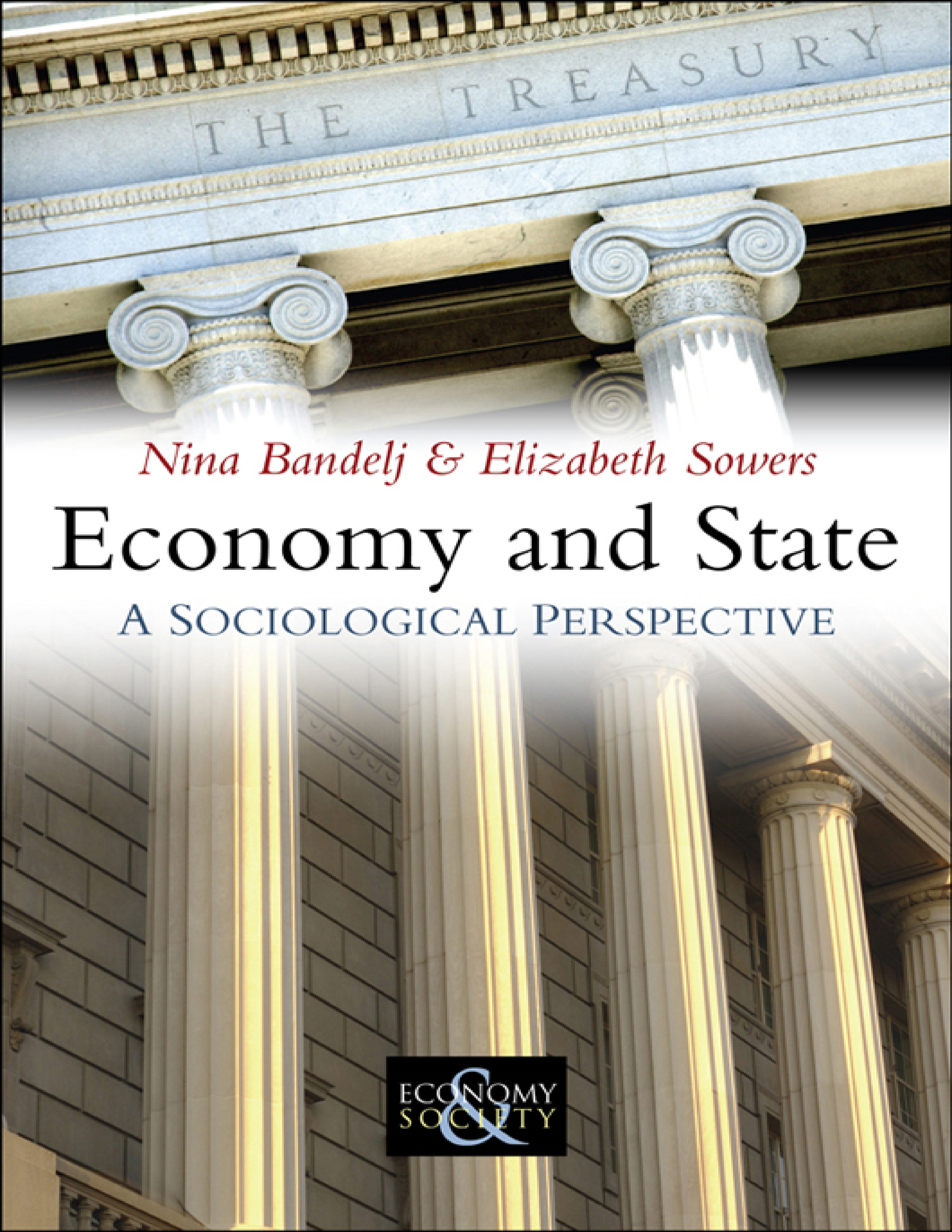

Nina Bandelj & Elizabeth Sowers

Economy and State

A Sociological Perspective

ECONOMY & SOCIETY

Economy and State

Economy and Society series

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polity

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Introduction

On November 4, 2008, the people of the United States of America made history by electing Barack Hussein Obama the country's forty-fourth president, the country's first black chief executive. Three months into his presidency, to aid the crisis-wrought American – and global – economy, Mr Obama's government put in place a stimulus bill of nearly $800 billion, mortgage relief, a huge capital injection into the banking system by the Federal Reserve to lower interest rates and expand credit, and a public– private program for buying up toxic assets. Should President Obama do all this? More generally, to what extent should governments be involved in economic affairs? After all, one of the most familiar economic tropes is that of a "free-market" – free of government intervention.

The connection between the state and the economy has been a perennial issue of social theory and policy, though not always with equal verve. A very basic comparison of the number of news articles on this topic in different time periods is illuminating. For instance, there were about 500 articles mentioning economy and state published in *USA Today* over the twelve months of 2006, or approximately forty per month, compared with the almost 140 articles on that topic that appeared in each of the first three months of 2009. The content varies remarkably as well, from "Inflation reports rev up stocks; Fed's latest stance gains credibility" (August 17, 2006, p. 1B) to "Another big drop: Dow down 508; Fed efforts, rate hint fail to stem massive losses" (October 8, 2008, p. 1B). Why such differences in quantity and content? We suggest that this is because the relationship between economy and state is not of *one kind*, whereby, in the *laissez-faire* spirit, the goal is to strive to maintain as little governmental intervention in economic affairs as possible. Instead, we argue that economy and state intertwine and forge *multiple kinds* of relationships with varied consequences. Our aim is to elucidate the different ways in which state action influences economy, and therefore all of us, in our roles as students, employees, employers, entrepreneurs, homemakers, retirees, consumers, and tax payers. Why does this generation have more trouble finding jobs than did their parents? Are taxes too high? Who is really right about the economy, the Republicans or the Democrats? Should governments do something to reduce social inequality? Why are some nations more prosper ous than others? These issues all relate to the role of the state in economy, and we hope to address them in this book.

We adopt a broadly comparative approach and aim to integrate our knowledge of capitalist, socialist, and postsocialist economies, discuss the experiences of the developed as well as the developing world, and tackle the challenges brought by the most recent wave of economic globalization. Across these diverse topics, we pay special attention to how different social forces influence policy decision-making about economic affairs, which, in turn, influences the economy.

This is a short book and we don't claim to exhaust scholarly research on the topic (and you are probably thankful to us for not using up more pages than we do). Specifically, we want to acknowledge three limitations. First, we will place our inquiry primarily in the work of economic sociologists, although references will be made to more general sociological literature and comparisons drawn to work in political science and economics on economy–state nexus. Second, we will focus on the interplay between economy and *modern* nation-states, going back to the past no more than a couple of hundred years. Third, our point of departure is the functioning and organization of the economy rather than state. Hence, we discuss the state governance of two central economic objects (i.e. property and money), two crucial economic subjects (i.e. labor and firms), and two consequential macro-economic processes (i.e. economic development and economic internationalization/globalization). This also provides the rationale for the chapter organization that follows this introduction, where we lay out the theoretical perspectives on economy–state relations. However, before turning to theory, we want to define more precisely what we mean by "economy" and what we mean by "state."

What is Economy?

The word **economy**[*] has its origin in ancient Greek, where *oikos* ("eco") meant a Greek household and *nomos* ("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 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.

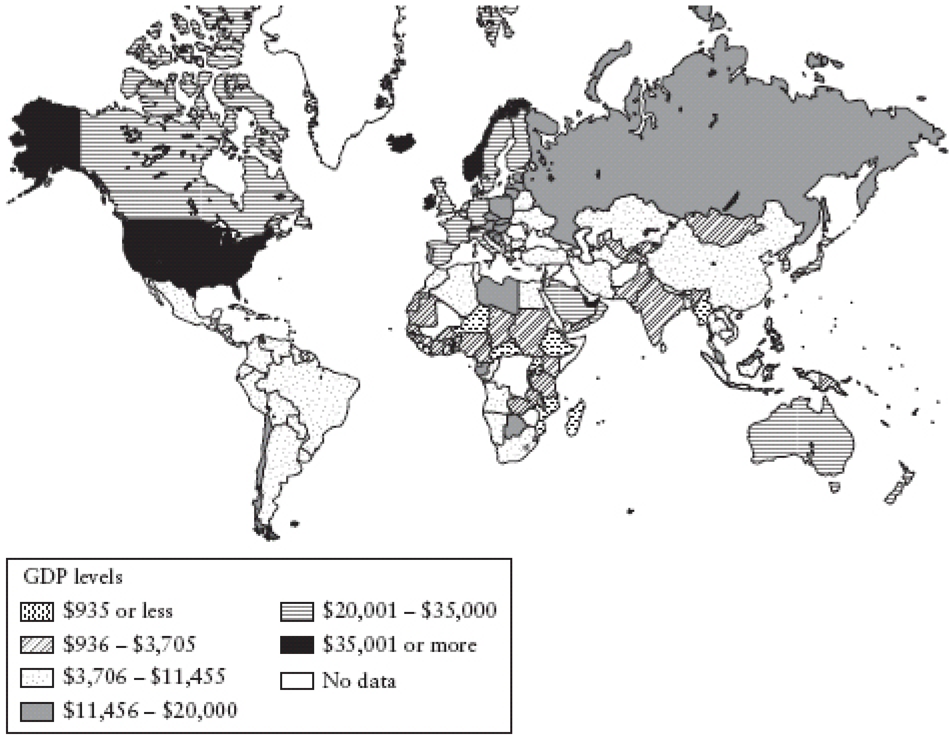
Economic sociologists writing about care work have acknowledged that many activities that contribute importantly to the production of goods and services are not paid, such as household work or the care of children and elderly within families (Trabut and Weber 2009). Others have emphasized that pay for 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.



Source: World Development Indicators, 2005.

Map 1.1 Size of world economies, GDP per capita in PPP

What is State?

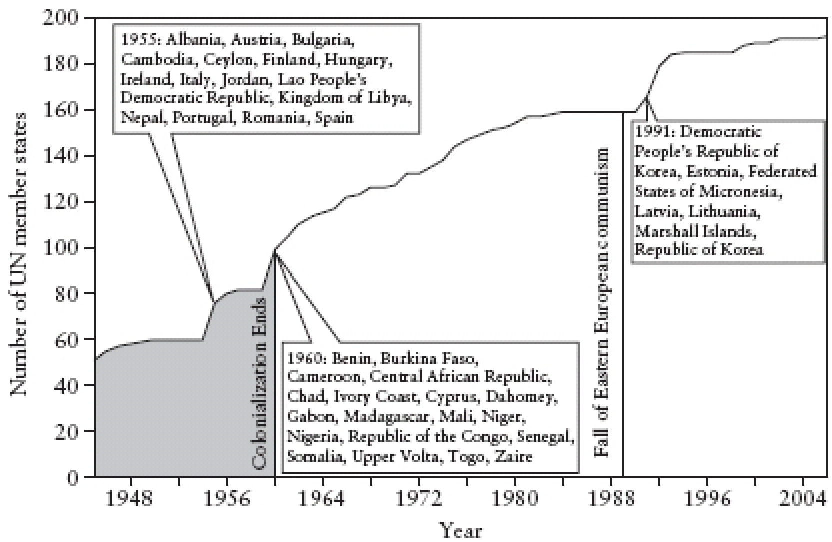
A classical sociologist, Max Weber (1958: 78), defined a state as “a human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory.” Basically, this means that a state is an entity with sovereign authority over a specific territory, not subject 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 AustroHungarian 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 state-centered views. 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.



*Initial Members (1945): Argentina, Australia, Belgium, Bolivia, Brazil, Byelorussian Soviet Socialist Republic, Canada, Chile, China, Colombia, Costa Rica, Cuba, Czechoslovakia, Denmark, Dominican Republic, Ecuador, Egypt, El Salvador, Ethiopia, France, Greece, Guatemala, Haiti, Honduras, India, Iran, Iraq, Lebanon, Liberia, Luxembourg, Mexico, Netherlands, New Zealand, Nicaragua, Norway, Panama, Paraguay, Peru, Philippines, Poland, Saudi Arabia, South Africa, Syrian Arab Republic, Turkey, Ukraine, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, Venezuela, Yugoslavia

Source: United Nations (2009).

Figure 1.1 Membership in the United Nations over time

The self-assertion of several new independent states following the collapse of communism made clear that nation and statebuilding 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 not only by the state dualism but also by the state embeddedness perspective.

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