22

Markets and States

Colin Crouch

The state and the market can be distinguished from other social institutions by the clarity and abstract nature of what actors within them are trying to maximize: power and material wealth respectively. Political science and economics have therefore become very distinct disciplines; unlike sociology, which is the residual social science. Historically, the development of capitalism depended on a separation of state and market in which the state guaranteed the rules and freedoms necessary for the market. This separation was compromised in the nineteenth century insofar as working-class mobilization involved the attempt to use the state to gain protection from the market, which was to be suppressed in communism, or more closely regulated in social democracy. In the late twentieth century there were two major changes: the growth of neo-liberalism with its demands for a strict separation of state and market; and increased freedom for the world market which undermined the power of organized groups in the economy and severely challenged their involvement in economic governance. However, the way in which the rise of neo-liberalism has taken place paradoxically intensifies state-market entanglement insofar as it recommends the extension of market principles of exchange to the state itself. The neo-liberal state is far from the anonymous guardian of the level playing field advocated by both classical and neo-liberal theory.

The state and the market can be distinguished from other social institutions by the clarity and abstract character of what actors within them are trying to maximize: in the former, power; in the latter, material wealth.

While those within the state, or struggling to have access to the state, have a diversity of substantive goals, they can function effectively only if they can gain control over the capacity to give orders on the assumption that they will be obeyed. Following Max Weber's (1922: Part I, ch. 1, sec. 17) famous formulation, it is the distinctive feature of the state that in the last resort it commands a monopoly of the legitimate use of violence to support its authority. Politics, the name of the activity that focuses on access to the state, is therefore always action focused on the maximization of outcomes through command, through the attainment of power. Similarly, while actors within the market seek diversity of substantive goods and services, they can do this effectively only if they possess the means of exchange.

Economic behavior, as market action is termed, is therefore always focused on the maximization of the means of exchange – in modern economies, wealth.

Power and wealth are distinctive as goals of human activity in that they give their possessors a generalized capacity. While one is holding either power or wealth one can potentially use them for a number of different substantive ends. Once they become focused on the pursuit of a substantive objective in this way, they become limited. The pursuits of pure power and pure wealth therefore have a singular rationality, one which is compromised every time that they are converted into something specific.

The state is the primary locus for political, power-seeking behavior, and the market the primary locus for economic, wealth-seeking behavior. However, both the political and the economic can be extended by analogy to other spheres. Wherever there is power-seeking behavior we can speak of a political situation. There is for example a politics of the family: the situation where one or other family members are maneuvring against or manipulating others in order to attain their goals. Wherever there is exchange we can speak of an economic relationship. There is therefore an economics of the family, where the relations among family members are seen as a series of markets (see particularly the work of Gary Becker 1981).

It is difficult to find fundamental goals of similar abstract type in other social institutions. (The only exception is possibly religion, where action is focused on the overwhelming general need to appease powerful figures in a world beyond this one – achieving a state of grace with God in Christian terms.) It is this characteristic which early on enabled study of the state and the market to become distinct disciplines – political science and economics respectively (theology too if it is a social science) – rather than remain part of a general science of society, or sociology, and to develop their bodies of theory more strongly than that discipline.

This pattern within the structure of the social sciences is also found in many actual social representations. In formally structured societies the *virtuosi* of state and market, and those of religion, are picked out as privileged social classes: in European history these were the orders of, respectively, aristocrats, bourgeoisie, and priests; a similar pattern existed in the core caste order of Mogul India, though with the priestly caste accorded pride of place. Stratification in the rest of the population was far less systematic and clear; they were just a residuum, even though a vast majority. Similarly, the classic Greek and Roman city embodied a seat of government, a market, and a temple as the most important buildings, normally located formally in relationship to each other in the most prominent part of the city. The medieval European city followed the same pattern, with town hall, market place, and church similarly located. Other parts were less distinct and prominent; society in general was literally the poorly differentiated residuum which simply filled up the rest of available space.

Today sociology remains the residual social science. Attempts, such as that by Talcott Parsons (especially in Parsons and Smelser 1956), to claim that it was the most general, and therefore central, social science, of which political science and economics were subdisciplines, have never succeeded. One reason for this, as Carlo Trigilia (1998) has argued, is that, in conceding them their autonomy, Parsons did not go on to show how they could be reintegrated within a general social science. Another reason is this lack of a core motivational principle of action and consequent lack of institutional clarity within the residuum.

There remains the question whether either power or wealth, command or exchange, can be absorbed by the other. Can economics be reduced to political science, or *vice versa*? In practice it works only one way round. It is frequently, and today increasingly, claimed by economics that all exercises of power, as well as all other social actions, can be reduced to instances of exchange, of markets (see Dowding, chapter 3, in this volume). To obey the law, for example, can be seen as a decision to accept the constraint on behavior of obedience in exchange for the avoidance of punishment. To take a very specific example: should one see a fine for parking a car on a double yellow line as just a form of car-parking fee – distinguished from normal ones only by the fact that it is less reliably levied though particularly heavy if it is levied? Or is it an expression of the coercive power of the state to make our behavior conform to certain norms?

This approach can be extremely illuminating in requiring very precise consideration of the logic of action of groups and individuals, challenging implicit and unquestioned assumptions behind theories. In the forms of public choice and rational choice theories it has in recent years made a distinctive contribution to the study of politics and more general social action too (Russell 1979; Lewin and Vedung 1980; Elster 1986; Lane 1987; McLean 1987; Rowley 1987, 1997; Coleman and Fararo 1992; Friedman, J. 1996; Downs 1998). The main problem with this economic reductionism is that redefining all exercises of power and authority as exchanges sometimes requires either an over-elaborate re-description and analysis of what is taking place in a power relation, or a stripping out from the analysis of any elements which cannot be reduced to exchange.

There is no space here to analyse these claims of economic theory in detail (for useful critiques, see Dunleavy 1991; Dowding and King 1995; Udehn 1996). We should, however, take note of the attempt, since it is very relevant to changes taking place in the relations between states and markets, with which we shall be occupied. Arguments that economic theory can provide an adequate account of political behavior have developed alongside beliefs that the state should behave as though it were a market actor. Even within the economy itself there has been a tendency for firms to deconstruct themselves as institutions embodying authority relations between employers and employees, rejecting the insights of the Coasian theory of the firm (Coase 1937) and returning to a more purely exchanged model of the work relationship. This involves firms giving many of their employees the status of self-employed contractors and therefore declaring that their relationship with them is one of exchange, not command.

Within the political world itself, established relations between state and market have been challenged by a number of developments: moves to contractualize relations within and between government departments, making officials relate to each other as though they were in a market for each other's services; in many cases functions previously seen as part of the state have been contracted out to firms, market actors. Activities of public services are increasingly subject to the imposition of quantitative targets, which seek to reduce their activities to a number of numerical symbols – resembling a price and therefore becoming a market item. States increasingly turn to actors from the market sector to show them how to run governments as though they were businesses (see Palumbo, chapter 12, in this volume). The ideology of neo-liberalism, which has stimulated these changes, starts from the assumption that market and state should be strictly separated. That it has led to a new form of their mutual entanglement is paradoxical. To understand what has been happening it is necessary to step back and consider very briefly the historical development of relations between state and market.

AN HISTORICAL PERSPECTIVE

In medieval Europe, control over armed force gradually transformed into control over legal processes, and the set of organizations that came to be called the state became the property of relatively closed networks of families. These assigned privileges to themselves and excluded most other social groups from participation in state work. They became the European aristocracies; the most successful became monarchical dynasties. Although struggle among them was frequent and often murderous, they united in the need to restrict access to control over the emerging state to their number. Among the great majority of the population excluded from these ranks, some became able to accumulate property through buying and selling activities which grew in scope as technology advanced, increasing the range of goods and services that could be bought and sold. While the aristocracy presided over the large acres of the countryside, merchants were essentially urban people, and established their bases in the growing towns, often winning special rights and privileges for these. In this way the bourgeoisie became a separate social order, its world of exchange rivalling that of aristocratic command.

These worlds could not be kept apart. Bourgeois property and markets needed favorable law if they were to be protected from robbery and develop the complex rules and enforcements required for commerce to grow. The courts of kings and nobles were the only sources of such law. Meanwhile, these latter needed money to fight their wars and sustain their courts. While they could often get this by taking or taxing it, they also needed the cooperation of those who were able to make wealth grow – often the urban bourgeoisie. In this way the two great classes, one with its position rooted in the state, the other in the market, developed their uneasy symbiosis. They needed each other, though the power base of each threatened the other. The essential emerging demand of the bourgeoisie was that if the new capitalist economy they were developing was to thrive, it needed a very specific role from the polity: the state had to guarantee the freedoms and rules necessary for the conduct of the market, but beyond that it should not interfere (North 1990). The state should be sufficiently favorable to market interests to be willing to erect the highly elaborate institutions required: laws of property ownership and transfer, which make owners of capital responsible for their activities (otherwise they would waste resources and let down their creditors), but not so responsible that they are afraid to take initiatives. It requires a concept of bankruptcy, otherwise badly performing firms simply stay around, hoarding resources which they use inefficiently and never paying their debts; but not a bankruptcy law so severe that fear of it inhibits risk taking.

It wants capacities to share risk, so that entrepreneurship thrives; but not so extensive that agents can act irresponsibly. It wants employment contracts which make labor free and mobile; but which leave firms with scope to tie employees down with loyalty incentives.

The progress of the market certainly did not require a suppression of the state. What was essential was separation of state and market: partly and most obviously to avoid state interference in market processes. But *pari passu* it was also necessary to protect the state from special pleading by particular groups of capitalists. Ideally it ceased to be the private possession of a class, and instead became the public guarantor of the market as a level playing field. However, while this might be the interests of the market as a whole, it was not necessarily that of any one capitalist, who might seek advantages for his enterprise through political favors. Even if the maximizing principles of state and market are different, they can be converted into each other. Political power can be used to lay hands on resources that can then be used in the market, while wealth acquired in exchange can be used to buy influence in the state.

The ideal capitalist state is not a dictatorship – which will be unlikely to permit so much autonomy to the market – but a liberal polity in which political power is limited to a broad class of property owners (North 1990). Ideally none of these should be sufficiently powerful to be able to impose individual pressure on the state. Conditions approximating to this existed in a number of countries, but particularly England and the Netherlands, in the 200 years or so prior to the advance of democracy, though in neither country was the condition of an absence of privileged individual capitalists fully met.

In practice this simplified story had many vicissitudes, as it played itself out in different ways and at different speeds across Europe and, eventually, the Americas and elsewhere from the sixteenth century onwards. Here there is space to mention only one of these. In some places, by the late nineteenth century the growth of industrialization had made possible the social and political organization of some of the other groups in the largely undifferentiated, non-citizen masses, particularly skilled manual workers in industry. Many of these came to perceive that, because their numbers were so great, if they could attain political rights, they might be able to wield or at least influence state power so that state resources might offset the weaknesses they experienced in the market because of their generally low incomes. In some versions of the strategy which emerged from working-class mobilization the market was to be suppressed altogether; this became the hallmark of communist movements. In other versions it would survive, but regulated and controlled in the interests of those lacking market power; the political philosophy of social democracy. In general, the struggle between state and market changed from being that between aristocracy and bourgeoisie to that between capitalism and socialism. Briefly, was the state to limit its actions to guarantee property rights, or should it intervene to protect various classes from the operation of those markets?: the core political question of the twentieth century.

Resolution of these tensions was not easy. Sometimes (as during the fascist or Nazi periods in several countries) those thriving in the market became so afraid of the hostility of socialist forces toward it that they supported authoritarian control of the state, even though dictatorship would bring transgression of the separation of state and market so important to market capitalism. In Russia and other parts of Eastern Europe, movements acting in the name of socialism came close to destroying market processes altogether.

Generalizing very broadly, by the middle of the twentieth century the rise of the working class and its relations with established socioeconomic interests resulted in a complex web of compromises, stand-offs and mutual advantages. Outside the Soviet bloc, states in the industrial world continued to guarantee the market order, but intervened in the economy at a number of points. Some of these followed a socialist logic of protecting the working class from the market; others responded to the demand of capitalist interests themselves for protection from the instabilities of the market process. The state became a highly extended institution, carrying out a mass of economic activities as well as purely political ones, while representatives of various market interests, mainly in the form of trade unions and employers' organizations, were in turn deeply embedded in the polity.

A series of inflationary shocks in the 1970s initially produced even more complexity. Levels of taxation and of state intervention in the economy grew as governments sought restabilization, while they also tried to engage organizations of market actors in sharing the state function of economic governance with them. This compromised even further than in the preceding period the relative autonomies of state and market.

However, an underlying shift in social interests was at hand. Economic change weakened the organized manual workers who had led the challenge to the bourgeois state. The task of advocating the activist state passed increasingly to public service employees who carried out its extended functions, and whose position as creatures of that state was vulnerable. Economic globalization was about to have its impact in giving capital choices to move away from state forms that it did not like. Finally, a growth in the importance of financial as opposed to industrial capital was taking place. Financial capital possesses far greater geographical mobility, far fewer sunk costs, and can therefore escape the state, which is territory-bound. The autonomy of the market from the state was being strengthened just at the point where it had seemed to be fatally compromised. At the same time, the attempt at a total triumph of state over market in the Soviet-controlled part of Europe was collapsing. The neo-liberal ideas which had been developing in economic and political theory began to match changes in the relationships of social forces.

States and Markets at the End of the Twentieth Century

Subsequent developments can be examined at two levels. First, there was a straightforward neo-liberal call for the market to be left alone from state interference. In practical terms this meant reduced taxation, less public spending, and less pressure of the state on the economy in general. At the same time, increased freedom for the market would reduce the role of organized groups in the economy, leading to an end to their involvement in economic governance. The growing claims of economic theory to be able to provide better analyses of public policy than political science became very relevant at this point. It was primarily a claim in favor of clarity in objectives, in exchanges, and in means-end relationships.

As already noted, the capitalist economy is never truly free from the state, and ideally needs a particular liberal regime of property owners. Reintroducing conditions like these in the 1980s, about half a century after the spread of democracy throughout much of the advanced capitalist world and the consequent need for states to respond to the interests of the non-propertied, was a difficult task requiring political management. Parts of the population had to be persuaded that they did not want state protection from the market, while those who still did had to be politically out-maneuvred. At the same time two centuries of freedom for property-owners themselves to organize politically had produced a mass of lobbies and privileged interest groups on the side of capitalism itself. Reasserting a true separation of market and state would require a very strong and autonomous state, and indeed one almost impossible to achieve. If the state was both strong and autonomous, it would be unlikely to accept the full autonomy of the market; if it was not truly autonomous but mainly responsive to pro-market interests, it might, given the oligopolistic character of late twentieth-century capitalism, be also likely to privilege particular corporations rather than provide the true level playing field.

In fact, the most perfect reassertion of the free market came, not from one of the democracies, but from a brutal dictatorship: the military regime of General Auguste Pinochetin Chile (Drago 1998). That such a government should repress anti-capitalist, labor, and pro-welfare interests was to be expected. What was surprising was that the regime was also independent of the propertied lobbies which had long been powerful in Chilean politics. General Pinochet and his supporters were closely associated with economists from the University of Chicago, who had been the intellectual backbone of the whole neo-liberal movement (most notably, Milton Friedman – see Friedman 1962 for a political rather than technical statement). Chicago policies were implemented rigorously in Chile so that, contrary to the usual logic of state-market relations, it was a military dictatorship which clarified the market from state involvement more thoroughly than anywhere else.

The UK and the USA became the prime democratic sites for similar experiments, particularly during the governments of Margaret Thatcher and Ronald Reagan respectively – Thatcher becoming a close friend of Pinochet. The thriving condition of democracy in these two countries forced compromises with the reforms – though for the distinctive combination of a "free economy and a strong state," see Gamble 1994. Nevertheless, following the neo-liberal program of first these governments and later those of Western Europe (especially following the institution of a neo-liberal monetary regime as part of the introduction of a single European currency in most countries of the European Union), the balance between the market and the state now corresponds more closely to the preferences of actors in the former than at any time since the Second World War – in some countries more than ever (see Tonkiss, chapter 23, in this volume).

But there were more paradoxes. As noted, the general class of property owners has an interest in sustaining a market regime as a level playing field; not in special privileges being won by individuals of its number. In economic and political theory alike this condition is fulfilled by the anonymity criterion. This requires not only that actors act anonymously in the market, but that they do so in the political process too. They have votes, and they may dispute in the law courts; and that is all.

This is however an unrealistic model. The notion of anonymity within the market itself is a fiction. Individual firms must always be trying to overcome the state of anonymity, which for them is a problem. They want customers and suppliers to know them by reputation, and they want to use that reputation as a form of power, for example, in purchaser–supplier relationships.

Economic theory has found ways of coping with this, of showing how oligopolistic competition may have wider benefits, and how it does not necessarily exclude often quite fierce competition over price or quality. However, the political problem raised does not disappear so easily. If some firms stand out by their giant size, become well-known institutions within their society, and accumulate large wealth, what is to prevent them using these advantages as political leverage? At least they will be able to lobby government for policies favorable to their market interests. At most they may engage complex and implicit exchanges of funds to political parties and either favorable state action for their interests or even the award of government contracts. In some countries and in some circumstances such exchanges may be illegal, but this is usually the case only when an exchange is very specific. One form of the relationship between states and markets is therefore a set of special relationships between politicians and state officials on one side, and firms and entrepreneurs on the other.

All politico-economic systems are vulnerable to this. Neo-liberal theorists would argue that, by disengaging state and market from the entanglements brought about by the postwar compromise between capitalism and socialism, their reforms should reduce the possibilities. However, the manner in which the rise of neo-liberalism has taken place paradoxically intensifies this particular form of state-market entanglement. The neo-liberal state defers to business interests; it believes that its own internal processes have been discredited by the years of social democratic compromise, and wishes to clean itself out by borrowing as many practices and procedures as possible from private firms. This was less true during the original, nineteenth-century capitalist period, when the state still carried something of monarchical (or in France, early republican) aura about it, and the public official was seen as a special kind of functionary, following a different professional ethic from that appropriate to the private firm. During the course of the latter twentieth century this concept of the distinctive character of public service was partially transmuted into the special role of the welfare state.

Neo-liberal theory challenges this. The ranks of state employment having swollen to include, not just a hierarchy of high-status officials, but a mass of public employees, many of whom are organized into special interest lobbies of their own, the concept of the specificity of public service is rejected. If it is "special" it is merely because it does not follow rules of profit maximization, and is therefore inefficient. Whereas, according to the neo-classical economic theory on which neo-liberalism draws, successful market actors perfectly and rationally anticipate all consequences of their actions, the state, not being a market actor, is unable to do this. Its interventions in the market are therefore virtually certain to reduce the level of rationality. This should partly be remedied by keeping the state out of the market; but for its important remaining residual functions, it must improve its rational capacity by becoming more like a firm, a market actor (Osborne and Gaebler 1992; Fay 1997).

Ideally, state agencies should be relocated in the market; that is, privatized. Either the state privatizes an activity entirely, leaving the sector alone with its customers; or it contracts out its functions to private firms, like a large customer firm. Finally, parts of the public service which at least temporarily remain within the state must learn to act as though they were in the market – units are made either to compete with each other or to trade with each other on a purchaser–provider basis.

This logical conclusion of neo-liberal thinking breaks with the fundamental liberal principle with which it started: mutual recognition of the separate spheres of state and market, their different logics and their respective goals. Not only is the state seen as having no goals or *modi operandi* different from those of market actors, but it is seen to gain by subordinating its activities as much as possible to such actors.

Elements of state sovereignty are preserved through the practice of regulation, though even here there are paradoxes. Although much neo-liberal rhetoric is about deregulation of the economy, the growth of regulation and considerable innovation in its forms have been hallmarks of the period. This is because most former publicly-owned industries were in sectors in which it is difficult to have anything resembling perfect markets, mainly because the large scale of investment required to operate the primarily infrastructural industries concerned acts as an entry barrier to new firms.

Privatized industries therefore usually need to be regulated, where regulation results from recognition that markets cannot be shaped perfectly to assert the needs of customers, employees or public interests. In addition to monopoly characteristics, this might occur because of externalities – where economic action has either negative or positive consequences for third parties which cannot easily take a market form (pollution is the main example of a negative externality). It might be because it is considered that certain moral or other standards have to be maintained even if the free market would not guarantee this (as in regulation of the display of sex and violence on television). Alternatively there might be a strong belief in public policy that people should have access to certain goods even if they cannot afford or (more contentiously) would not choose to buy them (education, health services, retirement pensions). In many instances strict neo-liberals try either to deny that such problems matter (for example, adopting a libertarian position on television viewing) or to find market means of solving them (for example tackling pollution by fiscal means of making the polluter pay). However, very often the political salience of some of these issues is such that a state-governed regulatory system is established even if the service concerned is removed from direct public provision. Here, regulation continues to follow a logic of state engagement with markets typical of the postwar period.

There is however a second, more purely neo-liberal case for regulation. This is the need for a regulatory regime to assure market actors that competition will remain fair and free and not vulnerable to arbitrary interference by the state

(Majone 1994, 1997). The regulator is there to protect the competitive order against the state as much as against abuse from within the market. Although this residually recognizes the public interest role of the state as the body most likely to install such an institution, since the state is a suspect actor from the point of view of neo-liberalism, it is unlikely to be trusted with the regulatory role itself. This logic leads to the interesting phenomenon of the private regulation of public actors. The ultimate example is the financial markets; whereas during the post-war period governments and central banks regulated the conduct of the financial markets, under conditions of deregulation and globalization it is the other way round (Boyer 2000). The markets, through their buying and selling of different currencies, pass continuous judgments on the conduct of governments, who have to obey their indications or see their currencies collapse. In the case of the European Central Bank, which has been founded by a treaty between states and therefore requires particular explicitness in its constitution, sensitivity to the priorities of the markets has been built in as the only criterion to which the Bank should respond. More formally, two particular US financial corporations, Moodys and Standard and Poor, provide rankings of the creditworthiness of governments throughout the world; effectively therefore a duopoly private enterprise is regulating a fundamental characteristic of states.

Within individual countries the privatization or contracting out of regulation as part of the general process of neo-liberal public-service reform can have similar consequences. For example, in the United Kingdom the inspection of local government departments and schools is contracted out to private firms, who are empowered to make judgments that will be supported by public authority. In some cases the enterprises providing these inspection services are also competing with local government departments to take over their functions as part of a privatization process. Here government remains the ultimate arbiter of the process, but it is a state which seeks tutelage from market actors.

These actions by the state of privatization, contracting out, sharing regulation with firms, deferring to firms on how to conduct its own business, continuously erode even further the boundaries between the state and the market, the reinforcement of which had been one of the starting points of the whole paradoxical neo-liberal exercise. This in turn increases the scope for increased transactions and contracts between politicians and individual business people – a role of the state very remote from the autonomous guardian of the level playing field of an anonymous market that was the starting point of both classical liberal and neo-liberal theory. Separation of state and market therefore appears to be a *chimera* in complex modern societies.

Further Reading

Gamble, A. 1994: *The Free Economy and the Strong State: The Politics of Thatcherism*, second edition. London: Macmillan.

Osborne, D. and Gaebler, T. 1992: *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector.* Reading, MA: Addison-Wesley-Longman.

Udehn, L. 1996: *The Limits of Public Choice: A Sociological Critique of the Economic Theory of Politics*. London: Routledge.