

States, markets and governance for emerging market economies: private interests, the public good and the legitimacy of the development process

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The words 'states, markets and governance' surely draw together the great issues of our times in this apparently 'global' era. Despite the unprecedented prosperity of a range of developed economies and the considerable success of some emerging market countries, a recurrent *frisson* of doubt regularly shakes the collective consciousness when the issue of governance and the global market is raised. Frequent financial crises in the developing world are not the only reason, nor is the growing inequality which has accompanied the market integration process. Corporate scandals in the US and the threat of global recession have hardly helped the situation. Unease is perhaps particularly prevalent when one invokes the issue of democratic accountability and observes the tension between global market integration and the resolutely national forms of governance which, for the most part, prevail. The rioters of Genoa, Stockholm, Quebec, Prague and Seattle (the list will no doubt become longer) are no longer needed to keep the issue on the public agenda. The past 20 years of liberal market reforms across a range of societies have wrought changes which make many nostalgic for past certainties which probably never were.

This article is based on the premise that how 'we' as a society think about states, markets and governance affects what we believe 'we' can do about or with them. The clear implication is that, if much thinking about states and markets is flawed, as here I argue that it is, then it is highly likely that policy-makers (among others) will make mistakes in their responses to the undoubted pressures of change. In this sense, if we intend to change the way things work for us, we must also change the way we think about them. We need to think about the market, in particular, in ways which empower and help to realize our normative preferences about the sort of world in which we wish to live. We should retreat from understandings of the market and governance which involve spontaneous order and the inevitability of market forces. We need to rethink what the market actually is, and I would argue this means rethinking politics and governance as well. More specifically, it requires rethinking our understanding of the state-market relationship, which has considerable implications for how we distinguish between the public and the private. This is particularly

important for the world's poor, who live mainly in developing societies.

My argument begins with an observation about our everyday manner of discussing states and markets. We find it quite natural to speak of them as if they were two fundamentally different things. Our common way of talking about states and markets leads us to make assumptions about the 'governance' of, or ways in which we deal with, each. Typically, we discuss each of states and markets with an assumed clarity of distinction between them. Markets and market forces are all about what business, labour and consumers do. Markets are part of a private domain wherein individuals and companies interact so as to determine prices through the interaction of production, supply, demand and other allocative decisions. The market is based on a private right of actual or corporate individuals to enjoy the principal benefits of private property and the 'fruits of one's labour'. What one does in the market is no one else's business, as long as whatever is done commands a reasonable price and does not break the law or grossly offend a general sense of decency.

States, on the other hand, are about politics, domestic and international. Politics is about what governments, political parties and (in a democratic context) electorates do in a complex pattern of interaction. Politics, too, is based on rights defined by law and constitution, but few other than the arbitrary dictator would argue that politics is a private affair. Politics is, particularly in a democracy, about inherently public interaction; it is about the way a society settles its fundamental and not-so-fundamental conflicts of interest about how government and governance should and shall work. Politics is, then, at the heart of the public domain;¹ and, at its best, the political process aims at ensuring that politicians serve the 'public good'. So, underpinning our clear understanding of the difference between the state and the market is a distinction of corresponding clarity between the public and the private. Hence in the 'Washington consensus' version of development policy, success is often equated with firmly establishing this public-private distinction; hence the term 'emerging market'.

At this point, political economists might quite rightly point out that there is a continuous relationship between states and markets. Political decisions on taxation levels, for example, may of course affect market conditions, as the Brazilian, Argentine, Turkish (or other) governments could no doubt witness in their latest financial crises. My argument in this article is that we need to take a radical step beyond insistence on the *interaction* or *interdependence* of states and markets in the process of governance. In our world at least, they are only found together and they are *both* very much about governance: about the way in which society is ordered and structured, the way in which authority is patterned. While one might make a case for maintaining the analytical distinction for the sake of a better understanding, I would argue that they should be seen as embedded together in the wider social whole. In this sense, we should not view them as *separate* things, but as part of the same dynamic of governance: a state-market

¹ See the wide-ranging discussion of the 'public domain' in Daniel Drache, ed., *The market or the public domain? Global governance and the asymmetry of power* (London and New York: Routledge, 2001).

‘ensemble’ or *condominium*. After all, if politics is *not* about who gets what, when and how, I am not at all sure what it is about. Of course, in a market system, ‘who gets what, when and how’ is largely decided by the market; but let us remind ourselves that there are other ways of determining the outcome and contemporary market systems in fact contain a mix of these. In this sense, the core question in political economy today remains as it always has been: What is the relationship between the market (and the private interests and prerogatives it includes) and political authority at various levels of governance (and the notions of the public interest which we like to presume are inherent in politics)? If there is more than one way successfully to construct a market, then there is clearly more than one successful path to development. The varied economic and social history of advanced economies should have taught this lesson some time ago.

I will begin the body of this article by outlining the conceptual case for the state–market condominium as a model for better understanding the substance and process of governance. I will then use concrete examples from my own research to illustrate the point. I will go on to outline what I consider to be some of the more important practical and, in particular, policy implications of the model in a situation of what scholars refer to as increasingly ‘multilevel governance’, placing this discussion in the context of policy issues relevant to North–South relations. I will conclude by linking the model to broader issues of the balance between private interests and the public good, which suggests a discussion of political legitimacy and the democratic process.

Models of state and market

The state–market dichotomy

The distinction between the state and the market is a commonplace in everyday discussion. The intelligent media reveal just how common it is. Newscasts and newspapers are divided into sections on politics, business (which really ought to be labelled ‘economy’),² culture, media, sport and so on. At the edges, these worlds meet in important ways in day-to-day terms. Politics can interfere with the Olympics, which is ‘sport’; governments might interfere in merger and takeover business decisions, something which they should or should not do, depending on one’s standpoint. Yet we all, in contemporary society, understand the clear distinction between the state and the market.

The distinction is applied to the extent of anthropomorphizing ‘the market’: treating markets as if they were agents with the actions, intentions and consciousness of human beings or individual corporations. One may read daily in the newspapers about how ‘the market reacted vigorously to the announcement by the minister,’ or ‘the market did not react to the announcement by the

² The Anglo-Saxon press is particularly guilty of this, as if ‘economy’ were only about what business does, and not about labour, consumers and regulators too.

European Central Bank,' or 'the market has succeeded in getting around government policy.' Policy-makers ask themselves how the market will react to a measure proposed to the legislature. The potential reaction of the market is often invoked as a reason why a particular solution would not work. In this way, we assign agency to markets, and the capacity to circumvent regulations and tax laws, or to be fruitful and multiply their kind. We all know that this is a sort of shorthand for the reactions, or lack thereof, of a range of different economic agents interacting in complex circumstances. Yet we live and breathe this shorthand as if it were real, as if markets really did do these things. The concept of markets as 'things' goes very deep; many societies are organized in large part around successful market mechanisms for production and exchange, so this is not surprising. Yet if the concept implicit in this discourse is inaccurate, as I claim it is, then we are prisoners of our own rhetoric to the extent that we act as if it were true.

Where does this clear distinction come from? I would argue that we can find its intellectual and ideological roots in the nineteenth century and the rise of both industrialization and the emergence of democratic forms of governance. The arguments of Karl Polanyi, to whom we shall return later, are useful here and have important implications for understanding the development process.³ In the first place, industrialization could not have taken place without the process of 'commodification' of the vital factors of production, land, labour and capital, beginning in Britain. By commodification, Polanyi literally meant the creation of new legal devices whereby these factors of production could be exchanged freely and privately on the market. Common land and ancient occupancy rights of ordinary rural dwellers were thus revoked through the 'acts of enclosure'. Some landlords opposed this, but others saw it as an opportunity to release themselves from a paternalistic burden and improve agricultural productivity, or even to sell up in order to repay debt born of aristocratic extravagance. Over time, money as capital entirely replaced land as the store of value and became common throughout the economy as a medium of exchange for commodities, while money itself came to be bought and sold on financial markets. Finally, labour had to be 'set free' in the sense that without a certain mobility of labour, enabling its transfer from the land to industrial employment, the industrial market economy was unlikely to function effectively. Correspondingly, 'poor laws' restricting the poor to their parish of origin and the common-law rights of tenants to occupy their dwellings were superseded, sending the dispossessed in search of employment, usually in the new industrial towns. Industry could draw on the new mobility of labour, and agriculture emerged as a business employing new machinery, just like industry. This sort of story was repeated in different ways and circumstances across Europe.

Once the market began to function as the core organizing principle of industrial society, it was not long before individuals and social constituencies

³ Karl Polanyi, *The great transformation* (Boston: Beacon, 1944).

forgot that things had ever been different. A private realm of exchange of commodities (including labour) and finance, emerged to replace the world of mercantilism and the residue of the middle ages. The private business affairs of individuals interacting in the market were largely separate from the concerns of the state, especially as states in the nineteenth century did relatively little in terms of today's expectations. At the risk of considerable simplification, states worried about other things, especially security and empire-building. The state-market distinction was born and entered the collective consciousness as part of an inalienable reality, except to radicals (for example, Marx), who questioned the very basis and justice of the system itself, and continue to do so. The distinction lies at the core of current discussions concerning 'good governance' in emerging market economies.

The public-private, state-market distinction is mirrored in scholarly debate. Alongside these historical developments emerged a science of economics which focused on explaining the pattern of market interactions, in terms of both how it worked and how it might work better. It was a science which was relatively unconcerned with how the transformation to the market had taken place, or whether it might be in turn superseded. Debates *within* economics were varied and complex enough, and remain so today, to maintain intellectual momentum.

Meanwhile, developments in what is more readily acknowledged as the realm of the public domain, government, helped to reinforce the state-market, public-private distinction. Democratic movements sought to wrest private power over government from the monarchs and their cronies and to place it in the hands of elected representatives. Limiting the private, arbitrary power of the monarch meant creating a public domain of interest to everyone, the sphere of government in the public interest and for the public good. This movement was accompanied by ideas of individual rights, constitutionally and legally enforced, which would limit the capacity of government to intrude in the day-to-day affairs of citizens, as people came to be known. The roots of this democratic constitutionalism were deep in the Enlightenment which had its beginnings in the late seventeenth century, ironically at the very moment that absolute monarchy was perfected by Louis the Sun King.

Not surprisingly, the liberal ideas behind this political movement had links to the ideas which had produced the private domain of property and the market—as a bulwark against the arbitrary exercise of power by authoritarian landlords and monarchs. Political philosophers such as Rousseau, Montesquieu, Locke and Kant shared much with the classical political economists of the Scottish Enlightenment: David Hume, Adam Smith, David Ricardo. The public-private distinction became part and parcel of the cry which echoed across Europe and the Americas for rights and freedom in the context of representative government based on democratic practices. Not surprisingly, private 'economic' freedoms, the right of ordinary entrepreneurs and labourers to pursue legitimate economic activities free from the restrictions of the mercantilist oligopolies maintained by the monarch and his political allies, figured among the movement's aims. The

result was, first, the eventual emergence of the market mechanism as a powerful organizing principle promoting industrialization and commerce. This was followed, on the whole much later, by the emergence of limited and eventually largely democratic forms of representative government. Democracy was in many cases as much a response to the misery of industrialism as it was to the arbitrariness of absolute monarchy.

So there came to be a realm of private, democratically and constitutionally guaranteed rights of individuals to participate in the very public business of selecting the government. At the same time there was a private domain of economic freedoms which constituted the market, from which some, as always, did better than others. It was a short step towards an intellectual system which not only justified and reinforced this state–market dichotomy, but also quite rightly recognized the historical interdependence of market and constitutional freedoms. It is worth noting that democratic practice never succeeded in penetrating the private domain of the market, and indeed it was often part of the argument that it should not.

In this regard we can now take a moment to observe how contemporary scholarly disciplines continue to reinforce the very strong popular perception of a state–market dichotomy. We can do this through a brief examination of what remain the two most prevalent strains of political and economic thought in western European societies, the liberal and realist schools. Liberal and realist scholars represent more or less polar opposites in the debate on the state–market relationship in the global economy, but each in its own way maintains a clear distinction between the two.

Liberal scholars, particularly in neoclassical economics, have strongly advocated the market as an organizing principle for our developing world political economy. In a long tradition of liberal idealism, advocates of the global market view it as an escape from the disabilities of politics,⁴ and a march towards the natural and spontaneous order of the Austrian School,⁵ underpinned by the harmony of interests which Adam Smith was convinced could be allowed to flourish under certain carefully nurtured conditions.⁶ While Smith himself was ultimately sceptical about the possibility of preventing the eventual corruption of a market economy into a series of rent-seeking arrangements sponsored by

⁴ Walter Wriston, in *The twilight of sovereignty* (New York: Scribner, 1992), argues that the global integration processes driven by the rapid growth of information technology spell, if not the end of the nation-state as such, a rapid and beneficial dilution of state power over space and peoples: see esp. ch. 8, 'Borders are not boundaries'. Kenichi Ohmae argues from a more conventional standpoint, contending that contemporary business strategies and the rise of consumer choice have produced an increasingly interlinked economy bypassing traditional state functions, a process once again characterized as fundamentally liberating: see *The borderless world* (London: Collins, 1990) and *The end of the nation-state: the rise of regional economies*, (London: HarperCollins, 1995).

⁵ See F. A. Hayek, *The constitution of liberty* (London: Routledge & Kegan Paul, 1960), and *Individualism and economic order* (London: Routledge & Kegan Paul, 1949); K. R. Leube and A. H. Zlabinger, eds, *The political economy of freedom: essays in honour of F. A. Hayek* (Vienna: Philosophia, 1985).

⁶ Claudio Napoleoni, *Smith, Ricardo, Marx* (Oxford: Blackwell, 1975), p. 30. See also Adam Smith, *An inquiry into the nature and causes of the wealth of nations*, ed. Edwin Cannan (New York: Modern Library, 1937), e.g. pp. 99, 118–43.

the market actors themselves, others have rushed in where Smith was very careful to tread.⁷

Despite the caution of Smith and others,⁸ transnational integration dominated by market processes is often seen as an ideal state of affairs,⁹ in which there would be an end to the interference of the sectional interests which characterize most forms of political interaction, and the states of the international system in particular. This view is, of course, underpinned by the usually implicit assumption that states and markets are antithetical organizing principles, representing hierarchy, power and coercion versus decentralization, spontaneous interaction and even liberty.

The other side of the debate most typically starts from realist principles in international relations, underpinned by a corresponding (but more often explicit) assumption that the economic and political domains are again separate entities. As Hans Morgenthau put it in the sixth of his six principles of political realism: 'Intellectually the political realist maintains the autonomy of the political sphere, as the economist, the lawyer, and moralist maintain theirs.'¹⁰ Here the argument is that politics will, in the nature of things, dominate economic processes, particularly in the international domain.¹¹ It is not surprising that a lively debate exists which pits the tradition of political realism against the 'globalizers' of liberal-idealist heritage. It is a continuation of the realist-idealist controversy which goes back to the interwar period and beyond.

In sum, the intellectual apparatus of scholarship provides considerable reinforcement to the commonly held view that states and markets, public versus private domain, are distinct entities, and that indeed they *should* be so. This is very much the case in current development policy debates within international financial institutions and bilateral aid agencies. However, political economists, comparative or international, will be apt to protest at this point that there are other ways of looking at the question which focus on the *relationship* between states and markets. This point provides an appropriate bridge to the next section, in which I offer a critique of the state-market dichotomy and develop the state-market condominium model.

The state-market condominium

Can one really claim a meaningful and empirically verifiable distinction between political authority and the market? If so, where does one place authoritative

⁷ Smith was particularly wary of the role of vested interests in policy-making; see quotation on p.?? below.

⁸ Such as the renowned interwar realist E. H. Carr: see *The twenty years crisis 1919-1939: an introduction to the study of international relations* (London: Macmillan, 1946), esp. ch. 14 (Conclusion).

⁹ P. G. Cerny discusses globalization as an ideal-typical discourse in 'Globalisation and other stories: the search for a new paradigm for international relations', *International Journal* 60: 4, Autumn 1996, p. 625.

¹⁰ Hans J. Morgenthau, *Politics among nations* (New York: Knopf: 1956), p. 10.

¹¹ Ethan B. Kapstein, in *Governing the global economy: international finance and the state* (Cambridge, MA: Harvard University Press, 1994), has argued that states are still very much in control of the process of global financial integration, working through the cooperative regulatory and supervisory processes of the Basle Committee on Banking Supervision, among others.

political decisions on environmental regulation, trade law or competition law, or state support for investment, all of which have huge implications for transaction costs in market-based economic competition, both within and across borders? Do these very political matters fall within the public domain of politics and states, or the private domain of the market (and one should note that these policies are heavily influenced by the interests they affect)? How would one answer such a question? I would argue that one cannot, if one attempts to maintain a distinction between states and markets for other than occasional analytical purposes.

If one were to go back in time, one would discover that the distinction between political and economic interaction was not perceived as clearly as it is today. Perhaps that is simply because we are now so much more sophisticated, and one mark of sophistication is a greater degree of analytical specialization. Yet the way in which the production and distribution of wealth was accomplished, the way in which society produced and distributed benefits (or lack thereof) across social constituencies, was historically tied in an intimate fashion to the way in which the powerful chose to organize it for the rest of us. A medieval landlord saw little difference between control of the land and food production on the one hand, and the broader pattern of governance of the world around him on the other. Peasants laboured to produce food and gave most as taxes in exchange for the use of common land and for security in a turbulent world. Peasants also represented expendable bodies for use in defence. The landlord and the church on whom the system rested used a mixture of accepted spiritual doctrine and naked power to ensure that this continued to be the case. In turn, Louis XIV of France, a rather successful ruler, saw little difference between his personal interests and fortunes as monarch and the centralized economic organization of the realm which he initiated: 'l'état, c'est moi,' as he put it, and that included control over the production and trade of many key commodities in the economy. In both cases, the system of production was intimately and consciously linked to the broader sociopolitical order. One might observe that especially in non-democratic developing states, elites manifest similar attitudes even today, much to the detriment of the common weal.

Political economy focuses precisely on the reciprocal relationship between political authority and the private pursuits of economic agents in the market. Adam Smith himself put this question at the core of political economy. Smith lived in a period of rapid change in eighteenth-century Scotland and northern England (similar to circumstances in many contemporary developing countries) and was therefore strongly aware of history, and how the different ways in which societies provided for their sustenance and surpluses (and the distribution thereof) affected the patterns of social structure and political authority over time. The changing ways in which who gets what, when and how lend form and substance—in sometimes rather unpleasant ways—to society and to its more formal institutions of governance, to the rules by which it lives, and by which it shapes who has power over whom. In this Smith shared much with his eventual critic, Marx.

Critically, Smith observed that there was a continuing tension between the private passions and interests of individuals, and the collective needs of the wider community—a tension between the pursuit of self-interest and the fulfilment of the public good. His core question was: How might this tension be resolved?¹² Are we permanently faced with iniquity and compulsion to order the affairs of humankind? Must the powerful always abscond with the lion's share of the benefits of human endeavour, making the world miserable for the rest? What forms of governance might help us to curb the exclusionary excesses of rulers and the rich, usually one and the same, and permit the innovative capacity of human beings to come to bear on the process of economic development? These questions are, of course, central to issues of development and governance in emerging market economies.

He argued that, under certain conditions carefully contrived and enforced by political authorities, decentralized markets characterized by competition might help us to turn the pursuit of private gain towards achieving the important common aim of producing and distributing wealth in the most optimal fashion possible. One might disagree with his prescription,¹³ but the problem he posed remains central to political economy and governance, whether in developed or developing countries, or in the international or domestic context. Smith's core question can also be reformulated in more contemporary terms. We have the market—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 the radical critiques that have been mounted. Power is clearly not the preserve of the formal institutions which pretend to monopolize it, particularly states. Private market power is very much part of the pattern of governance we experience.

Seen in this light, Smith's core question can help us re-evaluate the state–market dichotomy and its relevance to our understanding of the contemporary global economy and the development process. He gets us back to the nature of the reciprocal relationship between political authority and private pursuits in the market: What ought to be the public good in terms of the wider process of economic development and governance? Whose interests do and should prevail in the various tiers of institutions and less formal arrangements which constitute global governance and development policy? What is the relationship between market structures and political authority (loosely defined) in the ongoing and accelerating process of global change in which developing societies are embedded?¹⁴

These questions encapsulate what the study of political economy is about, despite all its diversity. What do we think a state is? What do we think a market

¹² See Napoleoni, *Smith, Ricardo, Marx*.

¹³ I would argue the verdict should depend on the case at hand. For instance, one could hardly argue with credibility that former centrally planned economies need more, not less, state intervention.

¹⁴ A point made by Susan Strange some time ago in 'The study of transnational relations', *International Affairs* 52: 3, July 1976, pp. 333–45.

is? How, if at all, are they/should they be related? This 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 global order. Yet, if the *relationship* between political authority and markets is the core question, I argue that the discipline must move beyond mere invocation in terms of dealing with it. For too long, scholars have either merely *invoked* the inter-relationship in terms of mutual effects, or *assumed* it. Either way, the relationship has not been adequately conceptualized. This is important, because, as stated at the outset, how we think about political authority, the market and their relationship affects how we respond to them, what we believe we can do with them in terms of policy both within and beyond the context of state decision-making. It affects how we can change global order, and for what purposes.

The problem is as follows. If most scholars of political economy insist that political authority and markets are interdependent, the relationship is usually portrayed as one of interdependent antagonism. Political logic, particularly the logic of states, pulls in one direction; economic logic, the logic of the markets, pulls in another. Political expediency or legitimacy may be invoked to override market forces, or market forces may defeat attempts at political definition of outcome, but either way, states and markets exist in antipathy to each other. Thus a discipline trying to get away from the state–market dichotomy characterizes the interaction of states and markets as a sort of tug-of-war between market forces and state attempts to control or direct them.¹⁵ At most, development policy might be seen as ‘taming’ or ‘supplementing’ the market with a view to compensating for market failure.

If we really do have a *political economy*, we must demonstrate, empirically and conceptually, how the whole is greater than the sum of its parts; *how* states and markets are integral to each other in the process of governance. If we do not, it is impossible to resolve the argument about whether states or markets are really in control, and to explain why both states and markets appear so different today from how they did three decades ago.

Perhaps the best known and most insistent commentator on the point was Susan Strange; she was a ‘states and markets’ scholar, as I have argued elsewhere.¹⁶ Yet even Strange was strong on invocation of the state–market relationship, and relatively short on theoretical elaboration. She too invoked the epic struggle between states and markets, arguing that ‘markets’ were winning in the contemporary period of transnational integration. This yielded a retreat of the state

¹⁵ See e.g. Robert Gilpin, *The political economy of international relations* (Princeton: Princeton University Press, 1986); Herman M. Schwarz, *States versus markets: the emergence of a global economy*, 2nd edn (Basingstoke: Macmillan, 2000), which is particularly useful for putting contemporary developments in historical perspective; and Robert Boyer and Daniel Drache, eds, *States against markets: the limits of globalization* (London: Routledge, 1996). It is in fact a small step from some of the contributions in the Boyer and Drache volume to the position argued in this article, particularly where they draw on the works of Harold Innis and Karl Polanyi.

¹⁶ Geoffrey R. D. Underhill, ‘Global money and the decline of state power’, in A. Verdun, T. Lawton and J. Rosenau, eds, *Strange power: shaping the parameters of international relations and international political economy* (Aldershot: Ashgate, 2000), p. 126.

in the face of market ascendancy,¹⁷ largely self-induced, with grave dangers for the legitimacy and functioning of the global system. The implications for the developing countries she regarded as particularly serious.

Yet we need to take our Polanyi and the notion of political economy seriously: as I outlined earlier in this article, he argues that the market makes no sense without the state, that indeed the market system was created and enforced by the state.¹⁸ The idea of a separate economic domain without politics was to him a stark utopia which failed, resulting in surely the greatest human tragedy of the modern period: the Depression, fascism and the Second World War. In other words, where concepts based on a state–market dichotomy prevail, this is likely to lead to tragedy in terms of development policy.

Somehow we need to conceptualize how states are embedded in wider, increasingly transnational social structures; how key socioeconomic constituencies of non-state (usually business) actors are integrated into the institutional processes of states and government; how the agency of these actors, through state policy institutions, are central to the process of global economic transformation and to the terms of competition among market agents. The claim is, then, that the political economy is something greater than the sum of the state–market parts.

This means that there is still one more and crucial conceptual step to take in order to move beyond the tug-of-war position of state–market dichotomy. The concept of states and markets as separate (if interacting) entities is often a useful abstraction, but we need to remind ourselves that states and markets are not discrete *things* as such. They are never, in fact, found alone, and so are not *things* at all. Many of the most important political decisions a community can take concern the way in which markets should and shall work. In this sense, states and markets are part of the same integrated ensemble of governance, a state–market *condominium*, and should be thought of as such. The regulatory and policy-making institutions of the state are one element of the market, one set of institutions, through which the overall process of governance operates. The structures of the market are constituted as much and simultaneously by the political processes of the state—and the political resources of the various private or public actors involved in a specific policy process—as by the process of economic competition itself. Likewise, the political and regulatory process is as much part of business strategies as the game of investment and marketing.¹⁹ The preferences of market agents and other constituencies of market society are integrated into the institutions of the state through policy and regulatory processes at domestic and international levels of analysis, depending on their individual organizational capacities/coherence, and of course power. The

¹⁷ Susan Strange, *The retreat of the state: the diffusion of power in the world economy* (Cambridge: Cambridge University Press, 1996).

¹⁸ Polanyi, *The great transformation*.

¹⁹ See Geoffrey R. D. Underhill, *Industrial crisis and the open economy: politics, global trade and the textile industry in the advanced economies* (Basingstoke: Macmillan, 1998), pp. 18–25 and *passim*.

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incentives and constraints of state policy and regulation are in turn part of the landscape of decision-making by businesses as they compete with each other. Policy and regulation, just like the competitive strategies of firms, confer advantages on some and costs on others. At the same time, some are more capable of affecting the policy outcome than others.

In creating a market, then, we take a political decision to *delegate* to private individuals the very public responsibility of organizing the creation and distribution of wealth. This implies a certain accountability of private economic agents to the public domain, especially in an emerging market democracy. We can argue about the terms of that accountability and the extent and character of the freedoms, and the purposes to which these should be applied. But the idea that the private sector somehow exists in a separate world of 'free' enterprise is sustainable in neither empirical nor normative terms. Echoing Polanyi, there is nothing spontaneous or natural about a market as the primary organizing principle for economic activity; it is an act of public policy. For good or ill, political economies have been different in the past (which includes Soviet-style central planning), and may well be so in the future. Furthermore, markets work in very different ways depending on the economic activity in question, the sector, and the historical and cultural setting across the global economy. If these arguments can be sustained, then there are considerable implications for global governance and development policy in particular.

Applying the model

I have not arrived at this intellectual conclusion through idle, armchair reflection. Purely abstract theoretical enquiry, for all its undoubted intellectual satisfaction, is too often the source of serious misunderstanding of concrete phenomena around us. It thus runs the risk of becoming the source of potentially ruinous policy recommendations or programmes. Elegant argument in itself does not constitute understanding. There are some very elegant arguments around as to why the world is flat, but they just happen to be wrong. The same can apply to many theories of the economy or politics. The state–market condominium model results from primary research, and as such can be demonstrated through case material. I will develop two examples, one concerning international trade, and the other concerning the global integration of financial markets.

States, markets and international trade

The first case concerns the development of the global trade regime in the textile and clothing sector over the past 40–odd years.²⁰ In this case, states and a coalition of market agents in Europe and North America used their combined power to shape the market for textile and clothing products largely to their own private

²⁰ See *ibid.*

advantage. Developing country producers were deliberately forced off one of the few playing fields where they could readily compete. Thus the private interests of the market did not compete with new producers in the developing world on textbook economic terms. Far from it. Private interests appropriated the mantle of national policy, of the *public* good, for their own purposes. They systematically got the better of both European and North American consumers, and of developing country producers in a range of often fragile emerging market economies. The established producers successfully defended their competitive position not through innovation, or through investments in technology, or through better management. Instead, they captured the policy process at national and international levels and employed their political resources, through state policies, to maintain terms of competition advantageous to themselves. Never mind that developing country firms succeeded in producing equal or better products for a better price—this ‘economic’ factor was not allowed to come to bear.

The outline of the case is as follows. From the 1950s onwards, European and United States textile and clothing producers began to face a moderately liberal trading environment. They also enjoyed rapidly growing domestic markets. On the strength of rising consumption, the future looked golden. There was little incentive to do other than expand capacity to meet the growing demand. Over time however, new developing country producers also began to enter the market. Their meddlesome competition was usually in cotton production and mass-market clothing assembly. The first such producer was 1950s Japan, and access to the American market was initially easy. Japanese producers, with lower wage costs, competed successfully in a quite limited range of straightforward products. The expansion of demand made domestic adjustment for US producers relatively painless. According to trade theory, everyone would have been better off with steady liberalization of the global market, with price and product competition allowed to prevail among different national producers. ‘All the liberalization that the traffic would bear’ was in fact the trade policy of the United States government, both generally and towards the textile sector.

This was not to be. National producers were unhappy with even the most minor intrusions into their home turf. We should recall that textile producers represent the original wave of industrialization in the older industrial economies. One result of their established nature is that they became well entrenched politically, in the United States in relation both to Congress and to government departments in the form of the Department of Commerce and what became in time the Office of the United States Trade Representative (USTR). Historically, textile and clothing producers in the United States had prospered behind protective tariff walls, well sheltered from competition from older (read: British and European) producers. Though European producers were no longer a worry, these protective walls were under threat. Textile and clothing producers used their political connections and began to complain of ‘unfair’ Japanese competition, which became a familiar refrain.

Government policy-makers became hostage to senators in Congress who supported the textile sector industrial alliance.²¹ As Japan was by the 1960s a member of GATT, overt protectionism through tariffs or formal quotas was impossible. Instead, so-called 'Voluntary Export Restraints' or VERs were invented, whereby Japan not-very-voluntarily restricted its exports in cotton textile products for five years from 1956. Over time, Japan became less important as an alleged source of 'unfair' competition. Poorer countries with yet lower wages tried to climb the economic ladder through textile-based industrialization. The advanced countries continually sought to put obstacles in their way. The 'voluntary' quotas became formalized in the multilateral Short-Term Arrangement (STA, 1961–2) and the Long-Term Arrangement in Cotton Textile Trade (LTA, 1962–73), aimed at most developing countries.

Meanwhile, in Europe similar developments were taking place in a different way. Markets grew as consumption increased, but companies did not appreciate adjusting to the challenges that did arise. Some European textile and clothing industries (particularly in the UK) faced competition from colonial, soon to become ex-colonial, producers, which paid lower wages. For others, particularly France, historically protected access to colonial markets was closed off as a result of decolonization. European countries also faced more intense competition from other GATT members. Most important was the intensified competition which resulted, after 1968, from the removal of internal tariffs within the Common Market partnership. Suddenly, national industries faced intra-EU competition, which was intense for the ill-prepared. It is also worth noting that competition from artificial fibres (nylon and rayon) played a significant role in reducing what should have been the good fortunes of traditional textile and clothing producers in Europe. Firms began to react to the 'market disruption', the adopted euphemism for competition. They joined the US firms in the STA and LTA trade agreements aimed at an ever wider range of developing countries.

The industries of the two dominant economic zones of the world economy thus became a transatlantic state–market alliance, often including trade unions as part of the coalition, which consistently resisted competition by invoking 'voluntary' quotas. Furthermore, this alliance accomplished its objectives *against* the clearly expressed liberal trade policy objectives of *both* major economies involved, the United States and the European Community.

It has been robustly established that the lion's share of competitive challenges to firms in difficulty came from fellow European, US and high-wage producer firms. Developing country producers made relatively few inroads in a limited number of product ranges, mostly mass-produced cotton clothing, as in the United States. Italy was probably the biggest source of competitive pressure on other industrialized countries, particularly in Europe.²² It was, in any case, politically difficult to challenge full GATT or Common Market trading partners in

²¹ H. Richard Friman, *Patchwork protectionism: textile trade policy in the United States, Japan, and West Germany* (Ithaca, NY: Cornell University Press, 1990), p. 95.

²² Underhill, *Industrial crisis*, ch. 1.

the industrialized world. But the developing countries were politically weak and an easy target; their exports did grow rapidly, even if they were not proportionately very significant. Middle-income countries such as Spain or Portugal were also responsible for a degree of competition, and they too became subject to quotas until their entry into the EC. Eventually the LTA hardened into the Multi-Fibre Arrangement (MFA), signed in 1973 and renewed consistently with ever broader country and product coverage until 1994; indeed, though in its death throes following the Uruguay Round, it is still with us. A wide range of Mediterranean and other middle-income countries also faced quota restrictions in this period. The European Community/Union and the United States were effectively protected from competition from all newly industrializing and developing economies for well over 40 years on an ever-widening range of products: not the best way to help international development prospects.

How does one interpret this story? The traditional Ricardian explanation, based on factor endowments and perfect competition, should have been one of a steady shift in the division of labour in the sector, with more labour-intensive activities moving to countries with lower wages. To an extent this happened; but developing country products, as mentioned, in fact made relatively few serious inroads into developed country markets. A 'market competition/international division of labour' story in fact does little for our understanding. Relatively open competition did not prevail, and the strategies of firms did not engage on 'economic' turf alone.

In the first place, rigorous analysis of optimal available cost structures and available new technologies demonstrates that labour costs were far from crucial for most textile sector products, the exception being clothing manufacture. Dynamic firms in the advanced economies preserved their competitive advantages in most segments of the sector. For those that did not, this was largely due to their own failure to take advantage of opportunities through investment in technology or marketing/management skills. Many firms simply did not want to change their ways and engage in the more open competition which international trade liberalization implied. Investment levels were often chronically low, and product innovation did not keep up with the market and the changing patterns of consumption as society changed in the late twentieth century. If the firms could not compete, it was their own fault for not taking advantage of viable alternative strategies. They turned to protection as the way out.

Thus we cannot understand the evolution of the sector without simultaneous reference to *both* the (failed) competitive strategies of many firms in the advanced countries *and* the political bargains they were able to strike through their capture of the global trade regime. So, instead of firms responding to competition through adjustment, or paying the ultimate price in a Darwinian economic universe, they responded by shaping the terms of competition in their own favour. A transnational policy process emerged in symbiosis with the pressures of global market competition, successfully erecting a complex rent-seeking operation and thwarting the development aspirations of poorer

countries in the process. There was a clear integration of the political dynamics of the trade regime and the market game of competitive advantage as played by firms.

There is a further irony to the story. Over time, the more innovative firms in the advanced countries did find responses to the competitive challenges of liberalization within the European Union and across the advanced economies. For many this was through investment in new technologies, product innovation, marketing strategies and better management. In clothing production it also involved outsourcing labour-intensive production to neighbouring low-wage countries. States began to respond to the demands of firms in this regard by setting up favourable tax and finance regimes for the re-import of the finished clothing products, for both domestic and export markets. The United States Caribbean Basin Initiative and EU agreements with Mediterranean countries included such measures. The problem was that this outsourcing and re-importation of production grew rapidly, and the quota system slowly became an obstacle. The producer firms of the advanced economies were *themselves* increasingly responsible for the rapid growth of imports from low-wage economies. Industries found themselves requesting that quotas be exceeded so that outsourcing activities could grow. Policy preferences once more began to shift, this time in a more liberal direction. The Uruguay Round trade accord saw the industries of the advanced economies eventually agree to phase out the MFA over ten years from 1994. By this time, well over a third of US and EU imports from low-wage producers were initiated through outsourcing by American and European firms themselves. They had mastered the terms of competition and no longer needed protectionist devices. In fact, the more outsourcing spread, the more liberalization would be the order of the day. As long as they could control the terms of competition one way or another, they were happy rent-seekers—but they were a far cry from the textbook version of entrepreneurs. The idea that the end of the MFA in 2005 ushers in an era of free market competition is false. States and firms have stopped fixing the market together, because the firms are now able to do it themselves.

In the end, the scope of competition was adjusted to the limits of the *politically possible* rather than the strategies of firms being adjusted to the limits of the *competitively successful*. A model based on state–market dichotomy could not help us to understand this situation, and why firms did not adjust to ‘economic’ pressures. An explanation based on the state–market condominium model allows us to appreciate the dynamics of the sector’s political economy. States, and international regulatory processes such as the trade regime, are at the heart of operationalizing markets as broader systems of governance in the global political economy. Private interests successfully used the cloak of state legitimacy to institutionalize their preferences in shaping the game of competition at the level of national governments and international agreements. The consequences for the development prospects of poorer countries cannot have gone unnoticed. It is my contention that all markets operate in this fashion, which is very far from

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the spontaneity of the Austrian School. Indeed, similar anti-development coalitions are often at work inside developing countries themselves.

The liberalization and global integration of financial services markets

Perhaps one can understand relatively easily how an essentially *protectionist* story is appropriate to the state–market condominium model. A case of *liberalization*, however, fits more easily with traditional notions of markets as natural phenomena which, if left to their own devices, will multiply spontaneously. Even though the emergence of global banking and securities markets is commonly viewed as the archetypal market process beyond the reach of states, I would contend that the case of contemporary global financial services sector development is more adequately explained by the state–market condominium than by more traditional approaches based on a state–market dichotomy. The process was far from spontaneous: the creation of global financial markets was a political strategy by a state–market alliance of interests which became transnational in nature. Once again, private interests converted themselves into public and legitimated purposes through their successful integration into key policy processes across the G-10 economies. Private preferences were converted, through state policy, into the evolving structure of the global market. This has not always served the interests of developing countries with fragile, infant financial sectors. This story, especially the corresponding emergence of persistent financial crisis, thus has implications for the development process.²³

Financial regulation, supervision and market development has always involved private interests. In fact, self-regulation through private authorities is historically speaking the dominant historical mode of financial sector governance, often led by privately owned institutions which eventually (through nationalization) became our contemporary central banks. This legacy lingers on in important ways, but the rise of democracy coupled with the tragedy of the Great Depression and Second World War fundamentally altered the relationship of state authorities to financial institutions. The financial and monetary system is rightly viewed as being so central to wider social and political stability that a strong sense of public interest has developed around the issues of supervision and regulation. As I have argued elsewhere, the financial and monetary system is, or at least *should be*, squarely at the centre of the public domain.²⁴ Many developing country governments think so too; but this is not a popular view among elite financial policy-making circles.

State agencies thus became involved in defining the scope and nature of financial market activity. The Bretton Woods conference famously attempted to subordinate private financial markets and firms to national public policy goals

²³ See Geoffrey R. D. Underhill and Xiaoke Zhang, eds, *International financial governance under stress: global structures versus national imperatives* (Cambridge: Cambridge University Press, 2003).

²⁴ See Geoffrey R. D. Underhill, 'The public good versus private interests in the global monetary and financial system', *International and Comparative Corporate Law Journal* 2: 3, 2000, pp. 335–59.

of long-term economic development and stability. This restrictive financial regime was introduced much to the dissatisfaction of the New York banking community.²⁵ The purpose was ‘to drive the usurious money-lenders from the temple of international finance’, in the words of the US Secretary of the Treasury of the time, Henry Morgenthau.²⁶ One cannot imagine a similar declaration from the present or indeed any recent occupant of that office. In this way, it was hoped that the pressures of adjustment to international monetary and financial flows would be rendered compatible with the imperatives of domestic social stability and democratic political legitimacy. The aim was to serve emerging ex-colonies and war-damaged developed economies alike.

The postwar growth miracle sustained this vision for some time. Despite the appearance of state dominance, a closely knit policy community around financial supervisory and regulatory issues, including monetary policy and other questions of macroeconomic governance, represented a public–private sector condominium defining the nature and structure of financial markets.²⁷ Finance ministries and central banks worked closely with private and state-owned financial institutions in the implementation and design of policies in this crucial domain. Practices of ‘financial repression’ in most European countries, not to mention Japan, legitimated the idea for developing countries.

By the 1960s, however, particularly in the United States, private financial institutions began to outgrow their local context and to seek a more liberal regulatory regime from their governments. This was politically difficult on the US domestic front, given the recent experience of the Depression and the war. But cracks appeared in the Bretton Woods compromise, and it collapsed in 1973 with the advent of floating exchange rates and increased private capital mobility. Private coalitions, in close alliance with public institutions like central banks and financial supervisors (sometimes one and the same), began to negotiate deregulation at the same time as states themselves had to adjust to the pressures of the brave new financial world. Many states needed high levels of credit in the harsher economic climate where expensive welfare states were committed to vast expenditure in order to soften the blow, and the liberalization of global capital markets served this purpose. A state–market condominium aimed at the construction of globally integrated capital markets became increasingly successful.

These political pressures translated into the worldwide movement for liberal financial reform, making the condominium transnational in nature, though the policy was not universally accepted. Many states reformed their financial systems

²⁵ Marcello de Cecco, ‘Origins of the postwar payments system’, *Cambridge Journal of Economics* 3, 1979, pp. 49–61, and ‘International financial markets and US policy since 1945’, *International Affairs* 52: 3, July 1986, pp. 381–99; Fred Block, *The origins of international economic disorder* (Berkeley: University of California Press, 1977), ch. 3.

²⁶ Henry Morgenthau, as cited in Richard Gardner, *Sterling–dollar diplomacy in current perspective* (New York: Columbia University Press, 1981), p. 76.

²⁷ See Geoffrey R. D. Underhill, ‘Private markets and public responsibility in a global system: conflict and co-operation in transnational banking and securities regulation’, in Geoffrey R. D. Underhill, ed., *The new world order in international finance* (Basingstoke: Macmillan, 1997), pp. 17–49.

in a liberal direction, starting with the United States in the 1970s and through into the 1990s. The UK implemented perhaps one of the best-known reform programmes in 1986, the Big Bang, after a long-drawn-out political battle to overcome overly comfortable vested interests in the City, especially the monopolistic brokerage community.²⁸ In a wider European context, the EU geared up for the single market in financial services, fostering further financial reform in member countries. Many developing countries liberalized unilaterally or under external pressure, or a combination of both. Meanwhile, the GATT process moved towards an agreement on the liberalization of trade in financial services, finally concluded by its successor, the WTO, in December 1997. This was driven in the main by G-10 state-market coalitions seeking access to those financial markets which remained relatively protected. Up until the Asian financial crisis of 1997–8, the momentum appeared unstoppable.

These developments were supported and facilitated by a further form of state-market initiative: regulatory and supervisory cooperation, centred on the Basle Committee on Banking Supervision for the banking industry, and the International Organisation of Securities Commissions (IOSCO) for the securities industries. Their work has become increasingly intertwined as the distinction between the banking and securities industries has become blurred. Their agreements most famously include the Basle Committee capital adequacy standards for credit risk, with radical new proposals in the final stages of adoption, and the committee's market risk accord, which overlaps considerably with EU and IOSCO standards. Recent attention has also focused on standard-setting in the reform of international financial architecture. The trend is towards more market-oriented methods of supervision and regulation in a global context, and a corresponding adjustment of national practices.

These cooperative agreements, negotiated within the policy community of the state-market condominium, serve to contain some of the risks of systemic financial and monetary instability which result from global financial market integration. Yet it is crucial to understand that transnational regulation and supervision through cooperative policy processes is more than a risk management device to protect the public interest. The development of global standards for banking and securities supervision and regulation serves also to contain the risks for market participants, and thus to facilitate the process of global market integration itself. If global markets are to work in a sustained fashion, the simultaneous development of a transnational state-market condominium is on the order paper and under construction. That is in many ways what the financial architecture reform debate is all about.

In this sense, market regulation and supervision are far from constituting evidence of ways in which states assert themselves over markets in an antagonistic relationship. It is instead systematic evidence of the ways in which market interests and state policy processes are integrated.²⁹ The outcome is of course

²⁸ See Michael Moran, *The politics of banking*, 2nd edn (London: Macmillan, 1986).

²⁹ Here I take issue with the more state-centric arguments of Kapstein, *Governing the global economy*.

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open-ended, and the interests of transnational firms are not the only ones which come to bear on the process of market development. Firms and state agencies do have their differences on policy issues. The development of global markets and corresponding regulatory and supervisory policies imposes a differentiated set of costs and benefits on the various players, public or private. The process could well be reversed through the agency of social forces inside or outside the sector, particularly if increased financial market instability led to a revolt by substantial segments of the business community. However, a combination of domestic regulatory reform and transnational regulatory and supervisory processes is currently driving and institutionalizing the emergence of global financial markets.

As with the textile case, an examination of the nature of the regulatory and supervisory policy communities in the financial sector confirms the contention that the state and the market are not antagonists competing to define the principles on which society will be based. State and market actors were a unity wherein private interests played a fundamental role in defining the purposes of public policy. The objectives of policy, designed through the interaction of both state and market players, extended the market across borders and permitted the reordering of the competitive practices of firms in the sector. While state agencies may sometimes have confronted market interests with their own 'autonomous' policy preferences, and compromises have emerged which differed from the expressed preferences of any one set of agents, the state-market condominium remains integral to financial market development. As in the textile case, the outcome was not necessarily favourable to developing countries, despite increased capital flows for some. Recurrent financial crisis became a problem of increasing dimensions, and the financial sectors of developing countries had to integrate and compete head-on with global financial giants, despite the historical importance of local financial institutions for local development.

Summary

The state-market condominium model provides for an empirically sustainable explanation of states, markets and governance in the context of the development process. According to the model, the adjustment process and pattern of economic interaction are managed simultaneously through the process of economic competition among firms on the one hand, and the policy and regulatory processes of the state on the other. Market agents enhance or protect their position and prosperity by simultaneously making calculations through their business strategies, deploying their competitive resources, and deploying their political resources in the decision-making processes of the state. 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, or in the close integration of private firms/associations into the system of bureaucratic management which characterizes the economic development process in Japan

and other ‘developmental states’ in 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 ‘capture’ of regulatory agencies in the United States economy should indicate the need to avoid the stereotypes developed in particularly the economics literature. A market without institutions and governance, including some form of judicial authority or arbitration, is inconceivable.

Of course, this conceptualization of states and markets appears counter-intuitive in our era of global integration increasingly dominated by private sector market processes. Our contemporary experience of modern capitalism and the prevalence of economic modes of analysis engraves on our minds the idea of the state–market dichotomy. Yet Adam Smith is again useful here: he pointed out that the very public responsibilities of generating and distributing wealth could be successfully accomplished by private agents. More worryingly, in Smith’s opinion, the reverse is also true, as will be seen below. Not that it renders the economy any less political: one can delegate authority and decision-making power, but one cannot depoliticize the system. It remains an ensemble of governance.

There is also nothing surprising in the idea that a transnational state–market condominium may have multiple institutions of authority, some state, some international. In this sense, the phenomenon of multiple state sovereignties in the global economy does not detract from the model. Anyone who lives in a federal state or indeed the European Union should be comfortable with this assertion. Furthermore, 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. 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 cooperation, 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 as a *transformation* of the state in symbiosis with the transformation of markets. We have not an emasculation as such but changing forms of state emphasizing different functions over others. There may be a retreat of the state from particular activities and functions, but if one properly understands the dynamics of the state–market condominium, it should be clear that the form and functions of the state will continue to evolve as indeed they have in the past.

Practical and policy implications for governance and development

This brings me to a brief discussion of the practical and policy implications of the model in a situation of increasingly multilevel governance. I have alluded to

some of these in the summary of the previous section. In this section I shall make six interrelated points.

(1) It should be clear that powerful state–market condominiums across a range of sectors in the North (G-10) shape and constrain development policy options in the South. This confirmation of essentially dependent relationships is hardly a new finding; but by picking apart these state–market ensembles we can see how the interests of private agents are often at the heart of this asymmetrical interdependence. The problem is not therefore simply limited to *government* policies; it also concerns the relationships between private groups and public policy in both North and South. It is all about how public and private agents come together, and what public agencies choose to make of their options. If developed countries wish to promote development—and they certainly claim that they do—then their own powerful private constituencies cannot have it all their own way. Despite the protests of (often transnational and organized) private interests in state–market condominiums, agencies representing the public good would do well to remember that development is not a zero-sum game. In the long run, controlling rent-seekers more effectively will be better for all, rent-seekers included, as trade and development create greater wealth and (along with state policies) a better distribution thereof over time.

(2) If we cease thinking about states and markets as opposing dynamics in a permanent tug-of-war with each other, we might put an end to a particularly sterile debate. We would stop expecting, or indeed hoping, that one might triumph over the other, whatever one's preferred outcome. It is not going to happen, because the two go together. We cannot somehow wish politics out of markets, while the behaviour of private market constituents is anyway inherently political, whether we choose to recognize it or not.

This both complicates the process of governance and liberates it from the constraints of more orthodox approaches to states and markets, particularly in developing countries. The model certainly implies that a variety of solutions is possible; but the choice may not be easy. Although we may opt for more or less liberal solutions, we cannot simply rely on market forces to 'sort it out', and must devote more time to the question: 'What kind of market, to serve what kind of society?' The nature of the market is inherently contestable, and there is no single equilibrium point which can be rationally determined. In this sense the outcome and potential solutions to problems are genuinely open-ended, and developed and developing societies are free to choose. Multiple equilibrium models are very much the order of the day, but the variables are political and institutional as well as 'economic' as such. This greatly complicates the task of decision-making. We need to confront this world of bewildering choice and imperfection head-on, remembering that perfection is itself nothing to do with the real world. It is an abstract concept which may inspire, but which can also get us into trouble through the pursuit of utopia and misplaced idealism.

For developing countries the dilemmas are especially acute. They do face an uphill battle at the global level, one which more public-spirited policies in the North might greatly ease. But private interests in the South are equally problematic: state-market condominiums in the South are hardly immune from rent-seeking private interests, especially where functioning democracy is absent or poorly embedded. Weak institutions (democratic or otherwise) make the clear definition of the public good difficult. Worse, states as a whole or state agencies in particular can be as rent-seeking as powerful and predatory MNCs. The south abounds in predatory, private interest states. In this sense, state-market condominiums which support a 'public good' notion of development must be *built*. The problem is far from straightforward, but democratic accountability is surely a first step.

(3) The model implies that *exclusive* reliance on concepts of perfect competition, optimality and general equilibrium is likely to yield misleading policy prescriptions and even a misunderstanding of the economic development problem at hand. By understanding that the market operates simultaneously through competitive processes and the policy process, now a policy process which extends across borders, we are in a much better position to come to terms with the rent-seeking behaviour of both private and public actors. If we do not expect firms or other market agents to behave according to models of perfect competition, we will more easily understand that rent-seeking behaviour is not the exception, but the rule. If we all admit that perfect competition is an abstraction from a messy, more prosaic reality of various forms of second-best market-fixing, we can begin to see more clearly the reality of political economy: if the state does not rig the market, private interests will. It is better that we make clear and well-informed decisions about how and why we want it rigged in particular ways.

We can never, therefore, disconnect the world of policy choice from the rather tawdry world of self-interest and particularistic advantage. This applies at the domestic as well as at the global level and implies some uncomfortable truths for Western democracies as well as corrupt regimes in the developing world. State and market agents need to take a look at themselves and at how their own sense of self-interest relates to credible notions of the public good. We should be aware that governments sometimes constitute the most private interests of all, and that a fully democratic process is desirable for a reason. We should also understand that there is nothing particularly noble about the interests of business or any other economic agent. Nobility of intent is bound to be in short supply, and there are disabilities to many political processes, as economists are wont to point out. Business in a market system, particularly big business, carries huge responsibilities in terms of the realization of public policy objectives. It does not exist in some purely private market domain where it can do nothing but good, or indeed ill to its detractors. None could be more clear on this point than Adam Smith, who advocated market solutions but remained guarded in important ways:

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The interest of the dealers ... in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and narrow the competition, is always in the interest of the dealers ... The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with the greatest precaution.³⁰

The purpose of democratic processes should be understood as keeping private interests accountable for the public interest functions they perform in our societies just as much as keeping politicians accountable to the electorate. The rhetoric of the free market makes it all too easy to forget this point. So does the rhetoric of dependency, or simple MNC- and WTO-bashing, which serve notionally to externalize many internal problems.

(4) If the state–market condominium model helps us to come to terms with the endemic nature of particularistic rent-seeking in the market, we might stop expecting a smooth process in equilibrium. The global integration process is not about the rational pursuit of optimality or spontaneous market development, but is driven by particularistic interests. Nowhere is this more obvious than on the tortuous route to successful development. As different constituencies in North and South alike compete to shape the process to their own advantage, the multiple equilibrium idea comes back to mind, and there are good and bad equilibria in various guises. Furthermore, as political and economic competition to control the terms of market integration gains momentum, it becomes apparent that we are not integrating like entities. Just as even the most ‘rational’ of corporate mergers often founders on tensions between contrasting corporate cultures, we should expect local and regional ways of doing things to come together in dynamic and sometimes difficult tension. Integration is not the amalgamation of like with like, but a linking together of diverse state–market condominiums. The problems for developing countries are great, and the pressures for convergence and adoption of potentially inappropriate institutions or policies strong. It will be a bumpy process, and diversity is bound to persist. Strict convergence to single ‘rational’ standards is unlikely to be possible or healthy, and there is no single formula which can admit of universal application. Many models will work, each infused with different values. The democratic process must ensure that a choice of values and solutions is consistently available, even to the weak and economically deprived. International development policy must give developing societies some room to breathe, at least as much as European and the US ‘catch-up’ economies had in their own development process.

(5) If global integration is an imperfect, bumpy process infused with rent-seeking activity and the pursuit of private gain, and a straightforward equilibrium outcome is unlikely, then we should expect and prepare for crisis, particularly financial crisis. The Asian crisis caught everyone napping, bar a few,

³⁰ Smith, *An inquiry into the nature and causes of the wealth of nations*, p. 250.

and we should have been better prepared. But there is a further point: if equilibrium is problematic and crises likely to occur, perhaps we should devote less time to casting aspersions on solutions which appear to ‘interfere’ with the rationality of the market, such as capital controls. Such policy devices can obviously be wrongly and inappropriately employed. But my model would indicate that the same can be said of free market solutions too. Private greed must not be allowed to plunge the political economy into troubled waters. The stakes for developing economies, and the people and societies in them, are far too high.

(6) Most importantly, the state–market condominium model allows us to understand how markets are integral to governance and the formal activities of government. The state *is* involved in the market and *should* be involved in the market; the market cannot function as a system without the political and regulatory processes which state agencies represent. We should be very wary, echoing Smith, of those who argue that the state should leave market agents alone to get on with the job; there is nothing sacred about them and market agents are more than likely pursuing a narrow private agenda. State interference may well be ill-informed or simply wrong; but the same can be said in relation to the public interest functions delegated to market agents. Recent corporate scandals in the United States reveal the extent to which private agents can fail in their duty to society, destroying in abundance the jobs and pensions of those who created the wealth in the first place.

Particularly problematic are collective action problems in poorer developing societies.³¹ Where infrastructure and public interest institutions are weak, either private economic interests dominate through oligopoly or a vibrant private sector simply fails to emerge. Linking private self-interest to the development process requires human artifice, as Smith argued; it is not a spontaneous process. This means pooling resources for resolving the collective action problems in poor societies, persuading the privileged that they should share the costs of development and that relative gains for the poor are not losses for themselves. When private market processes reveal only greed and privilege for the very few, the market becomes discredited as an instrument of policy.

Thus the market is also closely tied to the issue of political legitimacy, particularly in a democratic context. If the functioning of the market does not satisfy enough of the people enough of the time, we have a problem. This might apply as much to ‘no growth’ or ‘slow growth’ as it does to *unequal* growth. In this sense, distributional outcomes *do* matter:³² aggregate gains may not always be the crucial variable. If market pressures bring democratically unacceptable results, they must be rethought and redesigned, and they *can* be. If change induced by market forces comes at a politically unacceptable pace, the potential benefits of liberal solutions may be lost for lack of political realism. The bottom line is

³¹ See Schwartz, *States versus markets*, p. 85 and *passim*.

³² In contrast to the arguments presented by chairman of the US National Bureau of Economic Research, Martin Feldstein, *Income inequality and poverty*, NBER Working Paper no. W6770, October 1998.

therefore not an economic one, but a political one, and the *outcome* must be perceived as legitimate.

Conclusion

In this article, I have argued that we need to take a conceptual leap and to rethink the way in which we understand the relationship between states and markets in the context of an increasingly integrated global economy. I have argued, with supporting evidence from case material, that we should abandon models of state and market which see them as different, opposing dynamics in constant tension one with the other. We need to develop a model of states and markets which sees them as part of the same ensemble of governance. This implies a reassessment of the distinction between the public and the private, and of the nature of the public good.

It also implies rethinking the premises of ‘Washington consensus’ international development policy over the past decade or more. Nowhere is this more important than in global financial architecture. The central hypothesis is that, in the context of ongoing integration, emerging forms of governance involve a shift in power and authority from public sector institutions, across institutional layers, to forms of private sector and, increasingly, private interest governance. In addition, the role and influence of private sector firms and associations in the elaboration of public policy with regard to financial and monetary governance has been and continues to be considerably enhanced, again at both national and international levels. This situation pertains in both developed and emerging market economies. In such a context the realization of wider public sector policy objectives across a number of policy domains, from economic development goals to social policy objectives, has become more difficult. This is a result of the central importance of financial and monetary system governance to the wider context of economic development in a market system. In this sense the project involves an exploration of the changing nature of political authority in world political economy in relation to the objectives of democratic states, focusing on the constraints of short-term capital mobility and the monetary and financial volatility which has accompanied the liberalization of global finance over recent decades.

In the longer run, I believe that research will demonstrate that the state–market condominium model permits a more realistic assessment of the possibilities of and constraints on governance in our global era. This implies equally to developing as to developed economies. My argument is important because it re-establishes the role of agency, the capacity of human beings to make normatively informed policy choices about the nature and direction of change. We need to reflect on which political constituencies need to be challenged or encouraged in order to correct the balance of costs and benefits of global economic integration, particularly with reference to inequality and poverty.

The state–market condominium model will therefore underpin policy-relevant research in political economy and infuse our understanding of 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 which underpin 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 we cannot have one without the other. They exist in symbiosis.

Political authority is not just vested in the formal institutions of states and their offshoots of governance such as regimes, as legal and constitutional theory would have it. It 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 work in mysterious, private ways. Herein lies one of the most fundamental problems: our systems of democratic accountability are nationally based, whereas our systems of production and the market are so no longer. The EU is wrestling with this problem, and the speed of institutional adaptation is frustratingly slow. Many developing societies feel themselves adrift in this respect. The model suggests that if global capitalism is to remain stable and to produce benefits which outweigh the costs, then we must fully confront the Bretton Woods problem: whether liberalization is good or bad, it will work only if it satisfies enough of the people enough of the time. The ‘people’ are still organized in political communities called states, many with inherently weak economies. If the shadow of financial crisis so darkens their horizons, states can and will react and withdraw, with ugly results for us all as they default on debt and renege on their cooperatively negotiated obligations. This is not very likely in the advanced economies, which are relatively well placed to cope, but we all anxiously watch Brazil, Argentina and Turkey, among others. Other large and militarily powerful states with disastrously weak economies, like Russia, have been recently on the brink. We do not yet know the fate of the modernization process in China and India.

Whether we like it or not, we are in a situation of rapid change; we cannot go back. We must use what political agency we have in government and as citizens to shape the process in ways which tend towards stability, preserving vital aspects of local and national autonomy. We must help weaker societies to adapt, thus preventing the rise of political ugliness of the sort we saw in the 1930s, in the breakdown of Yugoslavia, or in the ongoing crisis in Indonesia. We know that markets often derail, and we should anticipate this. Europe, with its longstanding commitment to social justice, has a vital role to play, but has done little to develop the political coherence which its important place in the global economy presumes. There are many routes to global integration. We have choice, and we should exercise it.

