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Political Economy, Markets and Institutions

Political Economy, Markets, and Institutions: Preference Formation as a Point of Entry

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Understanding the preferences of economic agents such as businesses, consumers, or governments is fundamental to political economy analyses at the micro level. Subsequently, aggregating and extrapolating from preferences at a macro level, economics explains the performance of markets, institutions, and the paths of national and international economies.

Currently, fundamental axioms are being reimagined and reformulated, returning us to the sources of economic conduct and change (Acemoglu and Robinson 2019; Rodrik 2017). This can entail a move from macro to micro rather than the other way around. Existing institutions, cultures, and technologies do not merely constrain preferences; they can also create or embed economic action in their folds. The economic disruption from information technologies in our current era is an obvious example. Less obvious might be the power of stories or cultural narratives to change economic behavior (Shiller 2017)

This essay shifts between micro- and macroeconomic issues to explain the challenges for political economic analyses and the need for further scholarship. Analyses of preference formation assist with understanding political-economic change, including periods of cultural turbulence and technological transformation, which challenge many long-standing suppositions in economics. Questions about economic or political preferences are currently behind issues such as economic nationalism, inequality, migration, or climate change. Understanding preference formation—individually or collectively, and as shaped through institutions—is a useful place to start. Starting with the assertion that it is insufficient to examine preferences in static contexts, this essay describes some recent developments for understanding dynamics of preference formation and implications for macro political economy.

QUESTIONING CETERIS PARIBUS

Since the neoclassical revolution in the later nineteenth century, economics largely understood preferences as "given." This meant taking preferences to be stable and holding underlying factors such as taste (culture), technology, and institutions to be constant or unchanging, in an assumption known as ceteris paribus. Given such stability, economic behavior could be modeled as chiefly responding to incentives such as prices. One of the normative implications was to look for (and remove) price distortions to allow for the smooth functioning of preferences and markets. This led sociologists to argue that such a view of economic actors is devoid of social relations or context and limits our understanding of economic behavior (Polanyi 1944; Smelser and Swedberg 1996; Smelser 2013). For example, in responding to price signals automatically and mechanically in predetermined ways, economic actors seem to be oversocialized. Sociologists also showed that many economic agents we believe to be fully socialized or well informed, such as accountants or stockbrokers, often are undersocialized to perform their economic tasks (Granovetter 1985, 2005). Social agents also behave differently in settled versus unsettled times and are more likely to adopt ideological orientations in unsettled contexts (Swidler 1986). Culture is more of a style or a habit through these contexts than a set of preferences (Swidler 1986, 275). Through periods of social transformation, existing tool kits can break down, making people turn to simplifying ideologies.

Historical and social contexts are increasingly important for understanding preference formation. Anthropologists have also shown that contrary to economists' assertions, market exchanges existed in historical contexts where they have been assumed to be nonexistent (Ferguson 2006; Guyer 2004; Sahlins 1972; Knight 1941). Market remediability, if necessary,

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would warrant an understanding of existing forms of exchange and moral economies, as well as their embeddedness in preferences.

The social, cultural, and technological stability assumed in economic models is under further stress on multiple fronts in the current global context. Despite positive or stable economic growth rates in prosperous economies, headlines about societal and national anxieties often posit the negative effects of the fast-moving global economy. Cultural anxiety, rather than economic satisfaction, underlies debates on issues such as employment opportunities, income inequalities, migration, demographic change, and governance challenges from local to transnational levels (Norris 2018; Mutz 2018). For example, as opposed to the underlying strength of the US economy in sectors such as services, the public policy headlines are now often focused on economic nationalism and tariffs, while societal worries are articulated in terms of the loss of manufacturing jobs or the fate of rural economies that are "left behind." Cultural nationalism is also at the fore in emerging economies such as those of Brazil and India, where such politics mask worrisome economic concerns. Whether one is examining emergent or prosperous economies, the artificial division between economic preferences devoid of social and cultural contexts is untenable. For economists, Brexit and the US-China trade war are economically inefficient, but that does not explain, taking US and UK elections into account, why voters "prefer" these outcomes.

At the same time, technologies have also reshaped economic performance. In the United States, technology-intensive "services" now account for nearly 80 percent of employment and gross domestic product. In 2018 the United States had a $260 billion trade surplus in high tech–driven services, while merchandise trade recorded a $887 billion deficit (World Trade Organization 2019). At an everyday level, international platforms such as YouTube, with nearly two billion monthly users (Statista 2019), or Uber, with $11.3 billion in revenue in 2018 (Wikipedia 2019), have changed the way we view global entertainment or travel. These technological developments have led to lively debates about sources of competitiveness among economies (discussed later in this essay). Besides changing the nature of economic performance, these technologies can be further linked with the cultural anxieties mentioned earlier: cultural and economic nationalisms have thrived in social media and infrastructural environments that often encourage homophily and stovepiping among societal groups holding similar values (Sunstein 2018; Singh 2013). These values can then be further exploited through tailored and divisive political or social messages.

NEW DEVELOPMENTS IN POLITICAL ECONOMY

Neoclassical economics forged an ideational revolution in social sciences that revolved around prices and associated economic factors such as allocation of scarce resources. The study of political economy, markets, and institutions has responded to developments mentioned above regarding cultural and technological factors that can no longer be assumed to be stable. This has meant going well beyond the early lessons of orthodox economics to complex problem-solving that involves insights from multiple disciplines. Understanding preference formation is a point of entry but one with multiple implications: the understandings can range from deepening the basis of rational choice, including models of socialization and learning, to recognition that group behavior and institutional constraints influence utilitarian calculations.

Neither preferences nor the underlying factors that account for preference formation are assumed to be constant in many current analyses. Holding fewer underlying factors constant need not mean throwing away the implications of existing economic models. A minimalist view, ostensibly Weberian, acknowledges that bringing in culture, for example, deepens the causal repertoire of economics: "Culture and rational choice are not incompatible: culture provides the broad, historically received set of alternatives from which actual preferences may be drawn" (Hausman 2020). Kahneman and Tversky (1984) explain different forms of decision-making through a distinction between experience values arising from utility versus decision values arising from underlying social norms; the former takes preferences as given while decision values explore subjective or normative logics. Nevertheless, Kahneman (2011) notes that even under institutional constraints, people remain rational because it is easier to understand economic behavior within a defined set of values than to show how those values arose in the first place. Cultural models also provide insights on values and institutions that affect fundamental preferences about societal trust and incentives for economic action (Greif 1993; Guiso, Sapienza, and Zingales 2006). Finally, the assumption of perfect information in economic orthodoxy has long given way to nuanced views of information constraints and asymmetries (Simon 1982; Akerlof 1970) and the formation of markets with increasing amounts of information that allow price signals to substitute for social hierarchies (Williamson 1983). Granovetter (1985), mentioned earlier, critiques Williamson's model for assuming away social embeddedness of economic action.

Less restrictive rational choice analyses start with social learning. Technology and culture are both about learning—the collective human experiences in times past and present that influence economic behavior. In

receiving the Nobel Prize in 1993, economist Douglass C. North (1994, 364) noted the following in his acceptance speech: "It is culture that provides the key to path dependence—a term used to describe the powerful influence of the past on the present and future. The current learning of any generation takes place within the context of the perceptions derived from collective learning." It may seem trivial to say that current theories of political economy are ultimately about how human beings "learn" as consumers, producers, or societal agents. However, this learning in institutional economics sits in contrast to the view that takes economic preferences as given or static and merely responsive to market signals such as prices. Human preferences are multifaceted. In stating that our models are about learning, political economy now attends to path dependence and adaptation, rather than only the mantra of allocative efficiency that guided neoclassical economics.

Political economy—in examining national economies or international commerce—now increasingly includes technology and culture as shapers of economic conduct. New trade theory "endogenizes" technology (Krugman 1987; Romer 1990; Helpman 1999). In common parlance, that means technology is taken to be the source of learning for businesses or firms. Commerce is not just about getting the price right in markets. It is also about learning and the growth of firms and organizations. Social relations also provide the clues to how complex global value chains resolve their internal governance problems through arm's-length or intrafirm internalized relationships (Gereffi, Humphrey, and Sturgeon 2005; Dallas, Ponte, and Sturgeon 2019).

Learning and adaptation also provide clues to long-term sources of innovation and growth. The varieties of capitalism debate in the last two decades notes that liberal market economies with flexible capital and labor markets are well suited for radical innovation, while coordinated market economies undertake incremental innovation (Hall and Soskice 2001). The preference for innovation is understood within institutional and political constraints. While the results are heavily debated (see, for example, Taylor 2004), the central claims on each side endogenize technology in explaining the preferences for differential forms of innovation. At an everyday level, these debates are particularly intense in Germany at present, with worries that this classic coordinated market economy has lagged in introducing information technologies and artificial intelligence to its historical sources of competitive advantage in automobiles, toolmaking, or even banking, whose shift from catering to local manufacturing to being a global player has been fraught with problems (Siebert 2005; Audretsch and Lehmann 2016; Crow and Storbeck 2019).

Finally, new sociotropic theories of preference formation have shown how group or social-level factors override economic bases of preference formation. The analogous concept of adaptive preferences shows how people alter their preferences to changing environmental or social contexts (Elster 1982; Sen 1999). Sociotropic preferences have been employed to explain protectionism toward trade even among groups that may benefit from exports or imports (Mansfield and Mutz 2009), explaining how education does not correlate well with openness toward migration (Hainmueller and Hopkins 2014), or explaining ambiguity with respect to trade openness (Rho and Tomz 2017) and the importance of social and cultural factors over economic "left behind" theses in accounting for the Brexit vote in the United Kingdom or the election of Donald Trump as president of the United States in 2016 (Norris 2018; Mutz 2018). My own research (Singh 2017) explores culturally shaped preferences in the global economy, specifically the ways they influence trade concessions in international negotiations; the book does not depart from major insights on trade theory and policy, but it does point out their cultural blind spots in not noticing how paternalism during the colonial era influenced postcolonial North-South trade.

Interdisciplinary conversations in political economy have moved toward changes in culture, technology, organizations, and institutions in accounting for the sources of interest formation and economic performance (North 1990; Throsby 2001; Rodrik 2017). As economic behavior is embedded in social norms, these analyses move from preference formation to resource allocation in complicated ways. For example, historical path dependence can affect allocations in the provision of public services, while social acceptance can affect labor markets and choice of occupations for individuals. Short-run economic gains such as tax cuts at the behest of businesses can blight long-run competitiveness if they support dysfunctional politics (Porter et al. 2019).

In general, the current scholarship in political economy and international commerce enhances understanding of prices and market behavior with insights from factors such as taste, technology, culture, and institutions. In doing so, we can begin to understand both the technological and the cultural upheavals of our times.

FURTHER GLOBAL PERSPECTIVES

Orthodoxies in various social sciences often do not acknowledge the cutting-edge interdisciplinary developments in understanding preference formation or institutional political economies that follow. Disciplines can quite often proceed as if "never the twain shall meet": reasons vary, from methodological disagreements on quantitative versus ethnographic methods to ideological suppositions about markets

and capitalism. Orthodox antagonists can then draw caricatures of each other: economists fault sociologists for their inability to explain human agency beyond its embeddedness in social relations, while sociologists fault economists for positing an automated and asocial *homo economicus.* While demonizing "others" benefits the maintenance of historical canons in each discipline, it does not explain the vast spaces that are fertile with interdisciplinary contributions on participation, deliberation, negotiations, exchange, contestation, and coercion among social and economic actors. Several economists have now explicitly dealt with issues of culture and cultural identity in modeling economic behavior (Akerlof and Kranton 2010; Sen 2006), while sociologists have shown the circumstances under which economic action responds to social versus market ties (Gereffi, Humphrey, and Sturgeon 2005), and Storper (2013) asks economists and sociologists to take economic geography seriously for understanding development.

Most current world problems demand forms of collective action for which preferences are but a starting point. The next step entails connecting preferences of economic actors with higher-level organizations, markets, and institutions to provide analyses for complex issues such as climate change, natural resources management, global commons, production and consumption patterns, competitiveness and innovation, and the relationship between growth, inequality, and poverty. New intellectual spaces are needed to provide an interdisciplinary forum for theoretical, empirical, and normative implications of issues detailed here. Interdisciplinarity is necessary to understand both the embeddedness of human action in taste, technology, and institutions, and the circumstances under which the utilitarian calculations of orthodox economics may be sufficient. Without interdisciplinary conversations, political economy even in the short run is dead.

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Professor Singh has advised the World Bank and the World Trade Organization for trade and international development, and the British Council and UNESCO on international cultural policies. He has played a leadership role in several professional organizations, and served as Editor from 2006-09 and dramatically increased the impact of *Review of Policy Research*, the journal specializing in the politics and policy of science and technology. Professor Singh currently edits and founded the journal Arts and International Affairs. He also edits Stanford's book series on Emerging Frontiers in the Global Economy. He holds a Ph.D. in Political Economy and Public Policy from the University of Southern California.

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