The Inseparability of Economics and Politics

-Overture-

Before economics became its own academic discipline, it was part of another field of study—political economy [1]. The history of political economy can be traced back thousands of years back to ancient Mesopotamia, China, Egypt, and India. It studied key aspects of trade, production, and income distribution and was often combined with components of philosophy and religion, later systematically elaborated on and detailed by scholars such as Confucious and Kautilya. Much later, in 18th and 19th century Europe, thinkers such as Adam Smith, Karl Marx, and John Stuart Mill all made their unique contributions to the science, analyzing and theorizing about how economics and political institutions interact or should interact [2].

The time of Smith, Marx, and Mill, however, also coincided with the start of the demise of political economy as a discipline. Instead of continuing with research about the economic conditions of nations and how they relate to power and wealth, economists such as Carl Menger and Alfred Marshall pushed for a paradigm shift within the study, starting to focus on understanding the incentives and actions of individuals that shaped the economy using mathematical theorems and quantitative analysis [2]. While there is no clear, definitive event that marks the end of political economy and the emergence of modern microeconomics and macroeconomics—new specialized fields that put little consideration towards political science—this paradigm shift no doubt heavily contributed to it.

As human knowledge progresses, it is natural that specialization occurs, as in the case of the evolution of economics and politics as separate fields from political economy. However, it is hard to argue that one can wholeheartedly pursue just one discipline without knowing anything about the other. What I believe are the three most important reasons politics and economics should be studied together more often are listed below and elaborated on.

Reciprocal Institutional Effects

According to Karl Marx, society consists of a base and a superstructure. The base refers to methods of production (such as labor, resources, and technology) and relations within production processes (concerned with property and income distribution); the superstructure mainly refers to the sociopolitical structure of a society—culture, moral values, and most importantly, mechanisms the ruling class uses to govern the people. Marx believes that the base and superstructure affect each other reciprocally (though the former is generally dominant), with changes in one transforming the other [3]. In other words, economic conditions and relations determine political institutions and political institutions cycle back to affect economic conditions and relations.

A modern continuation of Marx's theory on the reciprocal effects of economics and politics can be found in the 2012 book *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. *Why Nations Fail*'s neoliberal perspective is wildly different from Karl Marx's, yet its central thesis remains similar—political institutions, often influenced by economic conditions, determine economic institutions that create individual incentives for innovation, production, and growth. While *Why Nations Fail* mostly focuses on the latter part of this relationship—how politics affect economics—an example provided at the start of the book perfectly illustrates the reciprocal effects they have on each other.

In the 16th and 17th centuries, after the continent's discovery, Spain was quick to colonize Central America. The already dense native population, along with an abundance of natural resources (mostly gold) resulted in the successful implementation of the encomenida system—a system for the ruling class to extract resources from the native inhabitants, not unlike slavery. Later, during the English colonization up north, however, the more sparsely distributed native population and increased rarity of gold made such a system impossible to reinvent. Any attempt to exploit the native population was unlikely to succeed, as it was simply too much work to concentrate them all together; the colonists themselves were also hard to exploit, as it was simply too easy for them to desert the colonies and live self-dependently in the nearby unpopulated lands. Hence, in the following decades and centuries, while Latin and Central America continued to be plagued by forced labor and extractive institutions, North America increasingly started growing towards inclusive policies geared towards guaranteeing economic freedom, democracy, and technological innovation, as those were the only viable options to promote productivity and growth [4].

In this example, differences in economic conditions—the amount of usable labor, land, and natural resources—resulted in different political outcomes: the U.S. went on to gain independence and guaranteed political rights to members of its gradually expanding franchise, while Latin America's political institutions remained unfair and extractive, even after encomenida was abolished and colonization ended. More importantly, however, were the economic effects of these political disparities: the inclusive political institutions of the U.S. guaranteed the rule of law, legal equality of all citizens, and secure property rights, promoting innovation through creative destruction and hence economic growth; in Latin America, however, extractive rulers continued to unfairly exploit the labor of their people, destroying any incentives for innovation or productivity since what was produced was to be taken away anyways [4]. A complete cycle is thus complete —economic conditions affected the creation of political institutions, and those political institutions went on affecting economic institutions which produced different economic results.

A more modern example of the reciprocal effects between politics and economics is provided in another recent book, *The Crisis of Democratic Capitalism*. Out of the many main points made in this book, one is how economic well-being and increased life quality affect political ideologies, and subsequently, economic policies. Martin Wolf, the author, notes how when incomes and welfare gradually rise in well-established democracies, people demand a bigger—not smaller—government because such a government is better at guaranteeing equality and security to a broad amount of citizens [5]. Put in simpler terms, improving economic conditions creates changing political demands that aim to further solidify and reinforce those economic improvements.

Political Entrepreneurship

Political entrepreneurship, more often referred to as rent-seeking, refers to when individuals and corporations take advantage of government favors to use government funds to invest in their business and/or exploit the "rules of the game" to enforce a monopoly and earn monetary gain to the detriment of the public good. These government favors typically include federal grants, tax breaks, and excessive patents. Political entrepreneurs maximize their own profits, yet create deadweight loss with every transaction by avoiding the inconveniences they must face in the free and competitive market.

One significant example of rent-seeking in the United States is legal tax avoidance by big corporations. It is common for big companies to pay very little, if not no taxes; in 2020 alone, 55 companies with a combined income of over 40 billion dollars enjoyed a tax break of 12 billion dollars, effectively resulting in all of them avoiding taxes for the entire year [6]. This is possible because of the existence of many already well-known loopholes in U.S. tax codes, such as provisions for accelerated depreciation of equipment, unfair tax credits, and offshore profit-shifting [7]. Instead of working to fix the situation, lawmakers actually consent to it, because the corporations that benefit from these tax codes are exactly the corporations that fund their campaigns [8]. Even when politicians in power try to patch up the loopholes, they are faced with strong opposition. For instance, in 2021, Joe Biden proposed a plan to reverse the tax breaks the aforementioned 55 companies exploited to pay zero taxes, only to be met with fierce opposition from lobbyists basing their arguments on faulty claims [9].

Perhaps an even more serious issue with political entrepreneurship is big pharma. In the U.S., companies that manufacture medicine often set their prices extraordinarily high to the point that it becomes nearly unaffordable to a majority of the public. In no way is this because of high input costs or extensive resource expenditures. Instead, the culprit is, again, political lobbying. In the year 2023 alone, companies focusing on pharmaceutical and health products spent over 378 million dollars in lobbying, far more than any other industry, including air transport, oil, electric utilities, education, and real estate [10]. The rewards these companies receive in exchange are blatant examples of rent-seeking—lawmakers enable big pharmaceutical companies to constantly renew their patents on medicine by simply changing out a few unimportant ingredients every few years, allowing them to profit by protecting their illegal monopolies on medicine [11].

Both of these examples show how government favors often greatly contribute to the economic success of political entrepreneurs, illustrating how politics often plays a role even in private economic activities. Furthermore, as clearly demonstrated, the way corporations gain these government favors, more often than not, is through political lobbying—funding the campaigns of politicians in exchange for preferable treatment after they successfully get elected.

Political lobbying, being the root of all these issues mentioned above, is hence perhaps the ugliest part of the alliance between politics and economics. Furthermore, it clearly demonstrates how economic power—the ability to contribute monetarily to certain candidates during campaigns—is directly tied to political power—the amount of influence you have in political decisions via the politicians you financially support. This is certainly true in the United States, with people in the top 10% of the income ladder having, on average, about 15 times more influence on political decisions than the rest [12]. Other studies support this as well, finding that the rich gain better representation in government compared to the poor [13].

Aligned Goals

Generally, the field of economics studies scarce resources, and it does so in two ways. The first is through a "positive" view, where economic phenomena are measured, evaluated, and described through quantitative measures and analysis of cause-and-effect relationships. The second is through a "normative" view. Instead of exploring the "what is" and "why is" aspects of economics, normative economics typically answers the question of "what should be" and "how".

Therefore, while positive economics is inherently objective (in the sense that all conclusions reached must be verifiably true or false), normative economics is inherently subjective, as its conclusions are largely reached through value judgments. For instance, positive economics might focus on finding the specific rate of unemployment within a society at a given time—a tangible number that indeed exists—and the factors contributing to it, while normative economics may conclude that the risks of increasing inflation outweigh the benefits of reducing unemployment, and hence no policy should be implemented in such a situation.

In politics, the same kind of separation between "positive" and "normative" perspectives also exists. Positive politics may be concerned about the causes of political violence or the effects of a change in government power. Normative politics, on the other hand, focuses on another issue—what the "best" regime should look like. In a sense, normative politics is more like political philosophy, as it aims to answer questions regarding topics such as the best form of governance, the correct balance of power between governments and the people, and the best set of values (liberty, safety, cohesion, etc.) for a state to prioritize. Again, positive political theory is objective, while economic political theory is subjective.

By dividing both disciplines into their "normative" and "positive" versions, the inseparability of economics and politics becomes even clearer. First, positive economics and positive politics are related, as economic phenomena often have political causes or effects, while political phenomena often have economic causes or effects, something repeatedly mentioned and demonstrated. The connection between normative economics and normative politics is even more intimate: both require subjective value judgments and hence a moral framework defining what the best value to pursue is. Despite the fact that the "best value" differs from scholar to scholar, in such a pursuit, economics and politics share a common goal under such a framework—to make the world a better place.

-Coda-

Due to the reciprocal effects of political and economic institutions, political and economic phenomena must be studied side by side. Because of political entrepreneurs, political behavior affects economic activity, and economic power influences political power. Finally, because both fields require normative statements on what the best thing to do in a certain situation is, these two fields both require value judgments to guide policy decisions aimed at improving the world.

The fact that the practical use of economics or politics cannot be achieved by only one without the other is not an attempt to discredit the work that scholars focused on just one of these fields have made. As mentioned, specialization in one direction necessarily requires less attention devoted to other directions, and strictly economic or political theories/models certainly do have their uses. However, the inherent separability of these two disciplines means they must be studied side by side—and unless you're already an expert in one of them, you should do so as well.

Endnotes:

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