

Political Economy and Corporate Governance

What Is Political Economy?

Léon Walras distinguishes three characteristics of political economy: *science*, *art*, and *ethics*.

- **Theoretical science** (pure economics): the study of natural laws governing price formation and exchange, and how resources are produced, distributed, and consumed.
- **Practical art** (applied economics): how to organise production and distribution in *real-world economies*. The goal is to achieve economic efficiency and social welfare. This emphasises the role of laws, property rights, and social structures in shaping economic outcomes.
- **Normative theory** (social economics): the moral and ethical aspects of wealth distribution. While pure economics is value-free, social economics introduces ethical considerations.

How Are Science, Art and Ethics Related?

Scientific truths are founded on accurate observation and careful deduction. Science lays down no rules, gives no advice and formulates no precepts, but simply observes and explains. As we will see in this course, pure economic theories explain the interaction between economic agents, which can be modelled by mathematics.

Léon Walras wrote in his *Elements of Pure Economics* (1911) (translated by William Jaffe 1954), "Science clarifies **art** with its wealth of knowledge, helps to perfect techniques, illumines the path and directs the course of art. The contributions of any one science can sometimes find use in many different arts. For example, geometry, the science of spatial relations, illuminates and guides the work of engineers, surveyors, artillerymen, navigators, shipbuilders, architects, and others. Chemistry is of assistance not only to the pharmacist but also to the dyer and to a host of other industrial callings." ¹

There is a theory of wealth, that is, a theory of exchange and value in exchange, which is a science, and a theory of the production of wealth, that is, a theory of agriculture, industry and trade, which is an art. There is a theory of firms, a science which explains and predicts the nature of the firm, company or corporation, including its existence, behaviour, structure, and relationship to the market. There is also the theory of corporate governance, an art which examines the structures, processes, policies, and principles that guide the behaviour of companies, their management, and stakeholders.

How about the **ethics**?

There is a key distinction in human affairs. We can divide them into two broad categories:

- **Actions Shaping the Natural World** – These involve human will directing natural forces, focusing on relationships between people and things. The goal is to make nature serve human purposes (e.g., farming, engineering), and the study of it is called **applied science** or **technology** ("**art**" in older terminology). We can label this category as "**industry**" (all human efforts to control nature).
- **Interactions Between People** – These arise when human actions affect others, focusing on relationships between people and people. The goal is to align individual lives for mutual benefit (e.g., laws, customs), and the study of it is called **ethics** or **social science** ("**moral science**" traditionally). We can label this category as "**institutions**" (systems governing human cooperation).

For something to qualify as an **institution**—and for its study to fall under **ethics**—it must meet two key criteria: (1) It must arise from human decisions (not natural forces); (2) it must involve relationships between people, specifically to align their lives cooperatively. For example, marriage and family structures are institutions because (1) they are created by human choices (e.g., cultural norms, legal contracts), and (2) they define roles (husband/wife, parent/child) to coordinate shared lives. Thus, their rules belong to **ethics**, not engineering or biology.

How Are Political Economy and Corporate Governance Related?

Walras' insight is that wealth creation depends on **institutional rules**, such as property rights and contracts. Modern corporate governance examines how legal and financial institutions, including shareholder rights and board structures, influence firm behaviour. In this course, we will explore how corporate governance theories, such as stakeholder theory, examine the ways in which firms balance wealth creation for shareholders, employees, and society. We will also examine various corporate governance institutional designs and how they operate in different cultures. Meanwhile, distributional **justice** is part of political economy. Since political economy studies the price of goods and services, we can examine CEO's pay as a price for labour, determined by institutional rules, and ask the question "whether high pay is justified." The answer is both intriguing and surprising.

1. Walras, L. (2013). *Elements of pure economics: Or the theory of social wealth*. Routledge. [↗](#)