Chapter 15

What is the role of the state in economics?

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Introduction

Economists' views on the role of the state have ranged from advocating the doctrine of laissez-faire (i.e. non-interference) to favouring an active role for the state in the economy. Although Classical economists recognised what is known today as market failure, they strongly defended the doctrine of laissez-faire believing that the free market system is the guarantor of economic freedom as well as liberty. For Mill (1848/1985, p. 314) state intervention if not "required by some great good," reduces individuals' welfare and liberty. This view has dominated economic thought since the publication of the *Wealth of Nations* in 1776 but was challenged by the crisis of the 1930s. The severity and the scale of the crisis led economists to rethink the fundamental assumptions and views of the dominant doctrine, especially those related to the role of the state in the economy.

Writing during the crisis of the 1930s, Keynes (1936) took issue with the dominant economic doctrine of his time, and advocated increasing government spending to stimulate the economy. With declining levels of private investment and high levels of unemployment, Keynes (1936/2013, p. 164) "expect[s] the State ... taking an ever greater responsibility for directly organising investment."

* I wish to thank Freddie Meade for his comments and criticism. The usual disclaimer applies.

A particular interpretation of Keynes as offered by Hicks (1937), Modigliani (1944), and Samuelson (1955), also known as the Neoclassical Synthesis[1] dominated economics departments and policy making circles and served as the ideology in support of the macroeconomic management of the post-war period. The new social contract, also known as the welfare state, sought to minimise output and employment fluctuations. However, by the 1970s the welfare state was abandoned in favour of an ideology that claims to be a revival of the Classical creed of laissez-faire.

Uncompromising in its critique of the welfare state, Neoliberalism maintains that state intervention stifles private initiative and produces inefficient outcomes. However, Neoliberals do not advocate the abolition of the state. Rather they are in favour of reshaping its functions to create an institutional framework conducive to private enterprise and protective of economic rights such as private property. The financial crisis of 2007/2008, however, challenged the Neoliberal consensus and put into question the assumption of the rationality of the market, and revived the discussion about the role of the state. According to the Institutionalists, in particular those in line with Old Institutionalism, the deregulations that have been implemented since the 1980s, especially of the financial sector, are to be blamed for the crisis. Moreover, they take issue with the 'market primacy' assumption and argue that the market is as important as other institutions such as the state, and that well-functioning markets require a well-functioning state (Chang, 2002). For Marxists, however, the state is nothing but an instrument of oppression in the hand of the dominant class—the bourgeoisie. The task of the working class is to organise, seize power in a revolution that overthrows the bourgeois state, and nationalise the economy ushering in a workers' state that would over time wither away giving way to a classless society based on the communist principle of the common ownership of the means of production.

This chapter provides an overview of the views of the major historic and influential schools and traditions of economic thought on the role of the state in the economy. It starts by outlining, briefly, the main aspects of the Neoclassical theory of state intervention which proceeds entirely on the basis of market failure. We then turn to the Classics who viewed state intervention as an exception to the rule of laissez-faire. Subsequently we discuss Keynes who, writing in the middle of the crisis of the 1930s, supported state intervention in the form of an increase of government spending in order to stimulate the economy. The chapter then considers the views of authors like Hayek (the Austrian School of Economics) and Friedman (the Monetarist School) who were instrumental in the advent of the ideology of Neoliberalism. Drawing upon the work of North and Chang, the Institutionalist approach with regard to the role of the state is reviewed, before finally reviewing the Marxist position.

Neoclassical economics: Market failure and state intervention

Notwithstanding the diversity of views on the role of the state in the history of economic thought, the standard economics textbook promotes a stylised version of the economy where the state is typically absent or mentioned to draw attention to the allegedly deleterious effect of its intervention. George (1990, p. 863) notes that the mainstream textbook presents the government as an "Intrusive Alien … emerging only after the private sector had established itself." In the absence of a state, mainstream economics models society as a perfectly competitive market with utility-maximising, self-interested, rational consumers buying goods and service from competing profit-maximising firms (see Chapters 4 and 5). In this economy firms hire labour which is paid its marginal product in order to sell goods and services at the ongoing prices (see Chapter 7). The individual firm does not influence the price, it is said to be price taker. The worker, however, who according to Neoclassical economics dislikes work, trades off work (hence consumption) and leisure. The consumer, on the other hand, modelled as a sophisticated calculating machine is constantly processing complex algorithms involving the ranking of bundles of goods and services based on the level of utility they generate. The Neoclassical consumer is always interested in the bundle that generates the highest level of utility given a budget constraint and other relevant information (see Chapter 5).

Assuming an initial distribution of resources, symmetry of information, the rationality of economic agents, as well as a free market setting (that is no state interference), the mainstream economic textbook posits that interaction between economic agents produces the most efficient outcome. In this scenario, the market plays a central role in ensuring the efficient allocation of resources. State interference, however, is undesirable because it disturbs the finely tuned logic of the market and leads to a loss in welfare. Subsidies, price ceilings, and price floors, for example, are generally opposed by mainstream economists because they are seen as distortions leading to an inefficient allocation of resources except in a well-defined set of exceptions of market failure.

While Neoclassical economics strongly advocates laissez-faire as a rule, it argues that state intervention is needed to address market failure. Market failure refers to a situation whereby the market fails to allocate resources efficiently. Cases of market failure include provision for public goods, lack of property rights, abuse of market power, asymmetry of information, and externalities. State intervention via taxes, regulations, and subsidies is required to tackle those failures and ensure an efficient allocation of resources. One typical example used in the standard textbook to illustrate market failure is national defence (Mankiw and Taylor, 2014; Greenlaw and Taylor, 2017). Once provided, all residents benefit from the defence system whether or not they pay for it. Another example is market failure arising from the abuse of market power where a monopoly (single seller) or a monopsony (single buyer) can influence prices or output. This type of market failure is typically addressed by antitrust law (also known as competition law) which aims to penalise anticompetitive behaviour. Asymmetric information is another instance that gives rise to market failure and occurs when one party to the contract has an advantage over the other party by having more information. A typical example in the standard textbook of this type of market failure is car selling. Unlike the salesperson, the buyer is likely to have limited knowledge about the vehicle (e.g. service history, past accidents, reliability). In this case market failure occurs when the buyer pays more than what the car is actually worth. A fourth example of market failure are negative externalities, that is the negative effect of a particular economic activity. A negative externality refers to a harmful effect on a third party caused by an economic activity such as pollution (see Chapter 14). In the presence of such externalies, the social cost is not covered by the private cost, and in order to correct for that a tax should be imposed on the activity in question. The tax (known as a Pigouvian tax) should be equal to the social cost of the negative externality to offset its impact (Pigou, 1932).

The Classics: state intervention as an exception to the rule of laissez-faire

The economic doctrine that dominated for one and a half centuries following the publication of *The Wealth of Nations* advocates the superiority of the free market as an economic system conducive to prosperity as well as liberty. Classical political economists like Smith, Ricardo, Say, and Mill shared the view that self-interested economic agents interacting in a free-market setting and unfettered by state intervention will reach the maximum level of satisfaction. In a well-known passage in *The Wealth of Nations*, Smith (1776/2012, p. 19) argues that:

> "[i]t is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but

of their advantages."

In pursuing their own interest in the selfish manner described by Smith, economic agents would inadvertently promote the welfare of the community as a whole. Smith (1776/2012, p. 445) argues that "[e]very individual… neither intends to promote the public interest, nor knows how much he is promoting it… he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain; and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention… By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it." It follows that the maximum level of welfare is attained when individuals are free in deciding how to spend their time or in what manner to employ the resources available to them, because "[e]very individual, it is evident, can in his local situation judge much better than any statesman or lawgiver can do for him" (Smith, 1776/2012, pp. 445-446).

Taking the example of France in the late eighteenth century, Say (1803/1971, p. 144), notes that state interference went to such lengths to "persecute, and even [bring] to the scaffold" people who saw an opportunity of making more profit in converting corn-land into pasturage. Say (1803/1971, p. 144) concludes that "[w]hen authority throws itself in the way of [the] natural course of things … it evidently directs a portion of the productive energies of the nation towards an object of less desire, at the expense of another of more urgent desire," leading to an inefficient use of resources and a loss in the nation's welfare.

Agreeing with Smith, Mill posits that the maximum level of happiness for the greatest number derives from a policy of non-interference with individuals' actions, because "neither one person, nor any number of persons, is warranted in saying to another human creature of ripe years, that he shall not do with his life for his own benefit what he chooses to do with it. He is the person most interested in his own well-being" (Mill, 1859/2005, p. 93). For Mill (1848/1985, p. 314) "laissez-faire, in short, should be the general practice: every departure from it, unless required by some great good, is a certain evil." Individuals are better off without interference, be it from a government, from a group of individuals, or from any other kind of authority. However, restrictions on individual's freedom "starve the development of some portion of the bodily or mental faculties" (Mill, 1848, p. 314).

Like the domestic economy, international trade should be based on the principle of non-interference. In 1815 the British parliament, dominated by the landed interests, enacted the Corn Law. The legislation was designed to protect the domestic market by imposing tariffs on the importation of wheat and other grains, referred to collectively as corn, into Britain. In a pamphlet published later that year, Ricardo argued that the Corn Law would increase the cost of living for the working class (see Chapter 7) which would, in turn, hurt the profit of the capitalist class. Ricardo maintained that as the profit rate declines at home, domestic capital would leave England in pursuit of higher remuneration abroad. He concludes that "this consideration ought therefore to be a powerful reason to prevent us from restricting [the] importation [of corn]" (Ricardo, 1815, fn p. 13). Appealing to the principle of laissez-faire, Ricardo writes that "[h]igh rent and low profits, for they invariably accompany each other, ought never to be the subject of complaint, if they are the effect of the natural course of things" (Ricardo, 1815, p. 20). Two years after his polemical pamphlet, Ricardo reiterates his commitment to the principle of laissez-faire in his work *Principles of Political Economy and Taxation*. He argues that "[u]nder a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each" (Ricardo, 1817/1996, p. 93). He goes on to advise that "wine shall be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England" (Ricardo, 1817/1996, p. 93). And just like Smith's invisible hand that promotes the general interest inadvertently by individuals pursuing their own interests, Ricardo notes that specialisation, while it increases "the general mass of productions, it diffuses general benefit, and binds together by one common tie of interest and intercourse, the universal society of nations throughout the civilized world" (Ricardo, 1817/1996, p. 93).

Despite their strong commitment to the doctrine of non-interference, the Classics recognise exceptions to the rule of laissez-faire, and attribute some roles to the state. For Smith (1776/2012, p. 686):

> "the sovereign [i.e. the state] has only three duties to attend to …: first, the duty of protecting the society from violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual, or small number of individuals, to erect and maintain."

Mill adds education to Smith's list of the duties assigned to the state, and argues that education should be provided by the state and made mandatory for children regardless of their parents' consent. Moreover, while he believes that individuals are the best judges of their own interest, Mill argues that there is no reason to assume that the private sphere is a better judge than the state of the interests of a third party. He maintains that if a business is managed by an agent on behalf of the owner, there is no reason to suppose that private management is better than public management. Mill (1848/1985, p. 326) writes that:

> “[g]overnment management is, indeed, proverbially jobbing, careless, and ineffective, but so likewise has generally been joint-stock management. The directors of a joint-stock company, it is true, are always shareholders; but also the members of a government are invariably taxpayers; and in the case of directors, no more than in that of governments, is their proportional share of the benefits of good management equal to the interest they may possibly have in mismanagement, even without reckoning the interest of their case.”

Writing on what some refer to in modern jargon as “good governance,” Say (1803/1971, pp. 131-132) argues that:

> “public authority [when] is not itself a spoliator, it procures to the nation the greatest of all blessings, protection from spoliation by others. Without this protection of each individual by the united force of the whole community it is impossible to conceive any considerable development of the productive powers of man, of land, and of capital; or even to conceive the existence of capital at all.”

The French economist concludes that:

> “[t]his is the reason why no nation has ever arrived at any degree of opulence, that has not been subject to a regular government. Civilized nations are indebted to political organization for the innumerable and infinitely various productions, that satisfy their infinite wants, as well as for the fine arts and the opportunities of leisure that accumulation affords, without which the faculties of the mind could never be cultivated,

or man by their means attain the full dignity, whereof his nature is susceptible."

The views of the Classics about the role of the state are best summarised by Mill's maxim that the highest level of happiness for the greatest number follows from a strict policy of non-interference. Accordingly, and as a rule, state intervention "unless required by some great good," leads not only to an inefficient use of resources but also starves freedom and liberty.

The pragmatism of Keynes

On 15 October 1929, optimistic Fisher (cited in Keen, 2011, p. 270) wrote in *The New York Times* that the "[s]tock prices have reached what looks like a permanently high plateau. I do not feel that there will soon, if ever, be a fifty or sixty point break below present levels … I expect to see the stock market a good deal higher than it is today within a few months." Two weeks later, however, the newspaper reported that "[s]tock prices virtually collapsed yesterday ... Billions of dollars in open market values were wiped out as prices crumbled under the pressure of liquidation of securities which had to be sold at any price."[2] Writing on the magnitude of the crash, Keen (2011, p. 271) notes that "the Dow Jones Industrial Average closed 12.8% below its previous level, and fell another 11.7% the following day …. Three years later, the stock market indices had fallen 90%." The collapse of the US stock market had far-reaching consequences and the global economy plunged into a depression.

Up until the crisis, the dominant economic orthodoxy assumed that markets are efficient, rational, and self-regulating. While occasional mismatches between supply and demand occur causing oscillations around the equilibrium (see Chapter 6), nothing like the 1929 financial crash was expected. The economic crisis that followed put into question a number of assumptions. According to the dominant economic doctrine unemployment is voluntary or frictional. In other words, if there is unemployment in the economy it is because some people choose not to work at the ongoing wage rate, or because people are moving from one job to another (frictional unemployment). The economic crisis, however, showed that unemployment could be involuntary. There were people willing to work at the ongoing wage rate who could not find employment. Moreover, the severity of the crisis showed that markets were not as efficient or as self-regulating as had been presumed.

While accepting the underlying principles of the free-market economy, Keynes took a pragmatic position in opposing the laissez-faire dogmatism of his time. He advised that the government should increase spending to stimulate the economy, and avoid "the destruction of existing economic forms [i.e. capitalism] in their entirety" (Keynes, 1936/2013, p. 380). The "choice between a controlled and a 'free' economy no longer existed; there was only the choice between different sets of controllers," comments Mattick (1974, p. 113). However, persuading the dogmatic proponents of laissez-faire, who saw Keynes's views a threat to the free-market system, would not be an easy task. Keynes (1936/2013, p. 380) was aware that "[although] the enlargement of the functions of government … would seem to a nineteenth-century publicist or to a contemporary American financier to be a terrific encroachment on individualism, [he] defend[s] it." Commenting on Keynes's position, Mattick (1974, p. 113) writes that the British economist understood that it was "the duty of the government to save the reluctant capitalists from their own folly… Centralizing control of the amount of economic activity in the hands of the government was the only way to overcome capitalist inertia."

Noting that a rise in unemployment and a fall in income "once started, might proceed to extreme lengths," Keynes (1936/2013, p. 98) argues:

> "that employment can only increase pari passu [i.e. at the same rate] with an increase in investment; unless, indeed, there is a change in the propensity to consume. For since consumers will spend less than the increase in aggregate supply price when employment is increased, the increased employment will prove unprofitable unless there is an increase in investment to fill the gap."

Who is going to fill the investment gap? The state, answers Keynes. Sceptical of the efficacy of the monetary policy in stimulating investment, Keynes (1936/2013, p. 164) "expect[s] to see the State … taking an ever greater responsibility for directly organising investment." At the extreme, the British economist (Keynes, 1936/2013, p. 129) reasons as follows to bring home his point:

> "[i]f the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coal mines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well-tried principles of laissez-faire to dig the notes up again … there need be no more unemployment and, with the help of the repercussions, the real income of the community, and its capital wealth also, would probably become a good deal greater than it actually is. It would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would be better than nothing."

Was Keynes the economist who figured out a solution to the crisis? In a BBC show on Keynes, (part of the Masters of Money series) Mervyn King, the former governor of the Bank of England, stated that "the intellectual climate [of the post-war period] was driven by the idea that Keynes had solved the economic problem" of his time. The evidence, however, suggests otherwise. Politicians were already contemplating increasing government spending as a way of stimulating the economy, but they probably were reluctant for political reasons.[3] In 1933 the US president Hoover tried to stimulate the economy with government-funded projects. The programme, however, was limited and the downward economic spiral continued; investment continued falling and unemployment rising. In March 1933, Roosevelt was installed president and he expanded the programme under the banner of the New Deal. In 1934, that is two years before the publication of *The General Theory* and one year after the introduction of the New Deal, Keynes, during a visit to the US and upon noticing how government spending could stimulate the economy recommended expanding the programme. Nonetheless, the US data shows that Keynes's advice was practically ignored and the impact of the New Deal was limited.[4] What enabled the US economy to recover from the crisis was the massive government spending during the years of the war (1939-1945). This "conclusion appears in the works of numerous economists and historians. The consensus has been that federal fiscal policies associated with the War brought the economy to potential output (that is, full-employment output), with monetary policies aiding the process by accommodating the fiscal stimulus" (Vernon, 1994, p. 850).

The Neoliberal state or market fundamentalism

Between 1945 and the 1970s, a period of three decades dubbed by the French demographer and economist Jean Fourastié *Les Trente Glorieuses*, the advanced capitalist economies registered high levels of economic growth. Chang (2011b, p. 484) documents that during that period characterised by a heavy involvement of the state in the economy, the advanced capitalist economies "grew three to four times faster than during the period of classical liberalism (1820-1950) and twice faster than during the subsequent neo-liberal period (1980-2009)."

By the late 1960s, however, what was also known as the Golden Age of capitalism started to unravel. The advanced capitalist economies started to show signs of growth slowdown, rising inflation and rising unemployment. By the mid-1970s, various OECD economies were experiencing a full blown economic recession and the Keynesian consensus that had provided the ideological foundation for state intervention during the post-war period started to unravel. Hayek of the Austrian School and a key architect of the ideology of Neoliberalism maintained that inflation was caused by labour's collective bargaining, and that the state should intervene to reverse that trend and save the existing social order. "Once government undertakes to determine the whole wage structure and is thereby forced to control employment and production, there will be a far greater destruction of the present powers of the unions" (Hayek, 2011, p. 238). For Friedman (cited in Backhouse, 2009, p. 21), an influential Monetarist and a Neoliberal theorist, "if governments increased aggregate demand and pushed unemployment below its 'natural' rate, the result would be an unsustainable wage-price spiral and accelerating inflation." The recommendation was for strict monetary policy to be combined with supply-side policies and to replace fiscal policy. Governments were recommended to impose strict cash-limits on their spending, to raise interest rates to slow down the growth of the money supply, and to undertake a raft of reforms allegedly aimed at increasing the efficiency of the private sector. These included labour market deregulation, privatisation, and financial deregulation.

With the election of Margaret Thatcher as prime minister in the UK in 1979, and Ronald Reagan as president in the United States in 1980, the debate over inflation was settled in favour of the monetarists and their politically conservative allies. Since then a new set of economic policies and priorities replaced those of the post-war period. The shift to the right in the countries of the North had far-reaching consequences. It also had an impact on international institutions, and via them on the economies of the Global South through the policies of 'stabilisation' and structural adjustment imposed by the World Bank and the International Monetary Fund (see Chapter 12).

Central to the ideology of Neoliberalism is the belief that "the welfare state had become so generous that it robbed individuals of discipline and initiative, and that the growing intrusion of the state in the economy hobbled private enterprise" (Rapley, 2002, p. 51). In opposing state intervention, some Neoliberals go to the extent of advocating the abolition of the state and its various institutions. Rothbard (2006, p. 276), for example, argues that "the government and its central bank act precisely as would a Grand Counterfeiter, with very similar social and economic effects." What needs to be done "is not term limits for elected politicians, but the abolition of the civil service … and, above all, [the] elimination of the despotic judiciary" (Rothbard, 2006, p. 486).

Unfettered markets, we are told, are prerequisites for the price system to function properly. State interference in the form of subsidies, minimum wage, or price floors and ceilings, or in the form of planning are opposed because it creates distortions and lead to inefficient outcomes. Hayek argues that "[w]e must look at the price system as such a mechanism for communication of information if we want to understand its real function." Only a system of "decentralised planning by many separate persons [would allow for a] fuller use … of the existing knowledge" (Hayek, 1945, pp. 526, 526, 521), and achieve more efficient outcomes. In this statement Hayek reiterates what Mises wrote in 1920 on what he described as the problem of calculation in a planned economy. Mises (cited in Brue and Grant, 2012, p. 436) states that "[w]here there is no free market, there is no pricing mechanism; without a pricing mechanism, there is no economic calculation." Accordingly, no matter how sophisticated the state is, it will always miss out bits of the available knowledge and therefore make ill-informed decisions leading to inefficient outcomes. The problem the state faces in using aggregate statistics for economic planning is that the data "which such a central authority would have to use would have to be arrived at precisely by abstracting from minor differences." And it is those differences involving the "location, quality, and other particulars" (Hayek, 1945, p. 524) of the exchanged goods and services unknown to the central planner but known to individual economic agents that make the free market more efficient.

In advocating free-market and opposing state intervention, Neoliberalism presents itself as the heir of Classical liberalism. Mirowski (2009, p. 433), however, maintains that unlike Classical liberalism which had a concern for:

> "individual liberty, political equality and human rights [Neoliberalism is] a purely economic ideology whose concerns lie with the establishment of free markets and in keeping state intervention in such markets at bay. Neoliberalism thus understood is primarily a theory of how the economy ought to be organized, and not a political ideology in the same sense as political liberalism."

The Institutionalists: "there is no such thing as a free market"

In 1933 president Roosevelt signed the Glass-Steagall Act into law. The purpose of the new legislation is the regulation of banking activities that were blamed for the 1929 financial crash. Crawford (2011, p. 128) notes that in the 1970s "the lobbying efforts to loosen the restrictions of Glass-Steagall increased significantly … In the 1980s, numerous congressional bills to repeal the Glass-Steagall Act were introduced." In 1999 the lobbying efforts paid off and the Act was repealed; a Neoliberal victory. A decade later, however, the financial meltdown which turned into a severe economic recession challenged the Neoliberal consensus over the efficiency and the rationality of the market that dominated policy-making circles since the early 1980s.

"The free market doesn't exist. Every market has some rules and boundaries that restrict freedom of choice," writes Institutional political economist Chang. Taking the example of child labour, Chang argues that in today's advanced capitalist societies "even the most ardent free-market proponents … would not think of bringing child labour back as part of the market liberalization package that they so want." If some perceive a given market as free it is because they "totally accept the regulations that are propping them up that they become invisible" (Chang 2011a, pp. 1, 2, 3). So, the extent to which one views a market to be free depends on a number of factors including values, norms, customs and so on and these vary from one society to another. Regulations are everywhere, and they are codified in laws and legislations, and the state via its different institutions and agencies enforces them.

According to North (1991, p. 97) "[i]nstitutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)." The mere existence of rules and regulations and even a general acceptance of them, however, does not by itself guarantee their enforcement. There need to be some agency that oversees the rule of law and intervenes when the law is broken. In modern societies, that agency is the state. The state via its different bodies and institutions (for example, the executive, the parliament, the judiciary, the police) enacts laws and regulations and enforces them. Once in place, institutions, argue the New Institutionalist approach, function as parameters or boundaries that reduce uncertainty and enable economic agents to make informed decisions and to formulate clear expectations upon which they can act. For North (1991, p. 97) institutions "define the choice set and therefore determine transaction and production costs and hence the profitability and feasibility of engaging in economic activity."

"While firmly believing that markets and private property are essential institutions for economic prosperity,"[1] Chang takes issue with what he describes as the "market primacy assumption" that characterises North's approach. According to this assumption, non-market institutions are "man-made substitutes for the 'natural' institution called the market" (Chang, 2002, p. 547). The notion that the market is *the* natural order of things is simplistic and overlooks the relationship between the institution of the market and other institutions such as the state. Chang (2002, p. 547, emphasis in original.) notes that "the market was *not* an important, and even less the dominant, part of human economic life until the rise of capitalism." Moreover, the view that the market evolved and developed naturally is not supported by historical evidence. In line with Polanyi (1944/2001), Chang (2002, p. 547) notes that "the emergence of markets was almost always deliberately engineered by the state, especially in the early stage of capitalist development." Even in contemporary capitalism, the state still plays a central role in shaping and designing markets. Chang (2002) maintains that a well-functioning market requires a well-functioning state.

The Marxist view: the state as an instrument of oppression

In the mainstream economic literature, the concepts of state and government are used interchangeably. This is a common mistake. The government, the military, the police, the judiciary, the parliament, and local authorities are all institutions "which make up 'the state', and whose interrelationship shapes the form of the state system" (Miliband, 1970, p. 54).

1 Chang (2011b), p. 3.

Unlike the liberal tradition that regards the state as an institution that embodies collective norms and values voluntarily agreed to (Barry, 1982), Marxists view it as an instrument of oppression in the hand of the dominant class, and if it appears to be agreed to by the majority of the people it is because various institutions like the educational system, the media, and religion engineer an environment conducive to that end. The state in capitalist society serves as a instrument to preserve and advance the interests of the bourgeoisie. Marx and Engels write in the *Manifesto of the Communist Party* that the bourgeoisie has, "since the establishment of Modern Industry and of the world market, conquered for itself, in the modern representative State, exclusive political sway." The authors of the *Manifesto* add that "[t]he executive of the modern State is nothing but a committee for managing the common affairs of the whole bourgeoisie." The workers are, however, the "slaves of the bourgeois class, and of the bourgeois State" (Marx and Engels, 1848/2002, pp. 221, 221, 227).

Following Marx and Engels, Lenin (1919/1961, p. 286) argues that "[t]he state is a machine for the oppression of one class by another, a machine for holding in obedience to one class other, subordinated classes." Facing state oppression and capitalist exploitation, workers fight back in order to preserve and advance their interests. The antagonism between the different interests which sometimes manifests itself in uprisings and revolutions is referred to as class struggle, and the role of the state in the capitalist society is to manage that conflict of interests. In order that those "classes with conflicting economic interests, shall not consume themselves and society in fruitless struggle, a power, apparently standing above society, has become necessary to moderate the conflict and keep it within the bounds of 'order'; and this power, arisen out of society but placing itself above it, and increasingly alienating itself from it, is the state" (Engels, 1884/1981, p. 229).

Critics, however, argue that the relationship between the workers and the capitalists is based on mutual benefits. This is the view of Butler (2013, p. 89), for example, who writes that "capitalism has always brought [the masses] material improvements." Butler's point has, however, been addressed by Luxemburg (1900/2008, p. 61) over a hundred years ago when she argued that while the state in the capitalist society is an organisation representative of the interests of the bourgeoisie, it does actually assume "functions favouring social development" which might benefit the working class. However, the bourgeoisie would only favour the social developments that coincide with its interests. The political and economic arrangements of the post-war period in the advanced capitalist economies illustrate this point. While it had benefited the working classes (employment, health care, social welfare, education), the welfare state enabled the ruling classes to rebuild the productive capacities of their economies, that is to restore the material conditions for the accumulation of capital.

Unlike theorists of the liberal persuasion, Marxists have studied the capitalist system not only to understand its modus operandi but to propose an alternative. The "first step in the revolution," write Marx and Engels (1848/2002, p. 243), "is to raise the proletariat to the position of ruling class, to win the battle of democracy." Once in power, the task of the working class is to turn "the means of production in the first instance into state property" (Engels, 1877/1954, p. 388). The economic programme of the workers' state as spelled out in the *Communist Manifesto*, includes the abolition of property of land and inheritance rights; the implementation of a progressive taxation system; nationalisation of banks and the means of communication and transportation; and the establishment of a free and public educational system. Viewed as a stage in the transition towards communism, the workers' state, besides its economic functions, protects the interests of the working class from foreign aggression as well as domestic reaction. "Because imperialism still exists, because domestic reaction still exists, because classes still exist [the] task [of the working class in the transitional stage] is to strengthen the people's state apparatus … in order to consolidate national defence and protect the people's interests," argues Mao (1949/1961, p. 418).

What Mao refers to, that is imperialism, is the stage capitalism reached by the turn of 20th century. Drawing upon the work of Hobson (1902) and Hilferding (1910/1985), Lenin (1917/1967) describes imperialism as the highest stage of capitalism and notes that that stage is characterised by the dominance of monopolies and finance capital. For Luxemburg (1913/2016, p. 325) imperialism is "the political expression of the accumulation of capital in its competitive struggle for what remains still open of the non-capitalist environment." The high level of development the capitalist countries have reached by the end of the 19th century and the need to capitalise their surplus values put them in fierce competition in expanding beyond their national borders. Luxemburg (1913/2016, p. 325) notes that this process, that is imperialism, has increased the levels of "lawlessness and violence, both in aggression against the non-capitalist world and in ever more serious conflicts among the competing capitalist countries." Indeed, as early as the 19th century imperialist powers understood that the colonisation of other parts of the globe was a question of bread and butter—as Cecil Rhodes, a British statesman and an ardent supporter of colonialism, put it. For Rhodes (cited in Lenin, 1917/1967, p. 76) imperialism was inevitable if the British ruling class "want[s] to avoid [a bloody] civil war." On the other side of the channel, similar views were expressed by the French statesman Jules Ferry. An advocate of colonial expansion, Ferry (1890, pp. 40, 42, 43) states that the "[c]olonial policy is the offspring of the policy of industrialisation… Social peace is, in the industrial age of humanity, a question of markets… we must cause fresh categories of consumers to appear in other parts of the world, for, if we fail to do so, modern society will go bankrupt."[5]

Despite the end of the colonial enterprise in the sense of the direct application of military and political force, states still play a crucial role in preserving and advancing the interests of their capitalist classes around the world. This is particularly true for imperialist states like the US, Western Europe, and Japan, which interfere with international institutions and occasionally intervene militarily in other countries. Tandon (2015) documents how the US and European states interfere with the WTO rules and pressure African countries to accept trade agreements that have an adverse impact on the lives of their populations but beneficial to US and European corporations. According to Amin (2014), the countries of the centre, especially the imperialist Triad (that is US, Western Europe, and Japan) maintain their control over the global economy through five monopolies, namely: technology, access to natural resources of the planet, global integration of the monetary and financial system, systems of communication and information, and weapons of mass destruction.

Conclusion

The mainstream economics textbook promotes the view that the state is an alien intruder interfering with the finely tuned logic of the market. This view is presented to students as the consensus, while other views are conveniently ignored. However, the diversity of views of the various schools and traditions of economic thought on the role of the state shows that what is presented as a consensus is actually one view among others. The Classics, for example, while advocating laissez-faire as a rule, assign some roles to the state. Those roles include upholding the law, national defence, and the provision for an educational system. The doctrine of laissez-faire which dominated economic thought since the publication of the *Wealth of Nations* was challenged by the crisis of the 1930s. Writing during the years of the Great Depression, Keynes supported increasing government spending to stimulate the economy. A particular interpretation of the views of Keynes, known as the Neoclasical Synthesis, formed the consensus that provided the ideological foundation of the economic model of the post-war period. However, by the late 1960s the advanced capitalist economies started to show signs of growth slowdown. By the late 1970s, Neoliberalism, an ideology that claims to be the revival of the Classical creed of laissez-faire, replaced the Keynesian consensus of the post-war period. Uncompromising in its opposition of state intervention, Neoliberalism claims that the policies of the welfare state had led to inefficient outcomes and stifled private initiative. Accordingly, the role of the state is to create an institutional framework conducive to private enterprise and, above all, to protect economic rights such as private property. However, the economic crisis that followed the financial crash of the late 2000s put into question the Neoliberal consensus over the rationality of the market, and revived the debate about the role of the state. For the Institutionalists the crisis was caused by the deregulations that have been implemented since the early 1980s, especially, of the financial sector. Unlike Neoliberals who view the market as the natural order of things, Institutionalists argue that the market institution is as important as other institutions such as the state, and that well-functioning markets require a well-functioning state. In their analyses of its nature and role, Marxists view the state as an instrument of oppression in the hand of the bourgeoisie—the dominant class under capitalism. The workers, however, are the slaves of that class and its state. In order to end exploitation, the proletariat need to organise, seize the state apparatus and nationalise the economy ushering in a classless society based on the common ownership and management of the means of production.

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[1] For a brief overview of the Neoclassical Synthesis from a mainstream perspective see Blanchard (1991).

[2] *The New York Times,* 30 October 1929. http://www.nytimes.com/library/financial/103029crash-lede.html

[3] In a lecture given to the Marshall Society in Cambridge in 1942, Kalecki argued that "under a regime of permanent full employment, 'the sack' would cease to play its role as a disciplinary measure. The social position of the boss would be undermined, and the self-assurance and class-consciousness of the working class would grow. Strikes for wage increases and improvements in conditions of work would create political tension. It is true that profits would be higher under a regime of full employment than they are on the average under *laissez-faire* … But 'discipline in the factories' and 'political stability' are more appreciated than profits by business leaders" (Kalecki, 1943, p. 326).

[4] The data reported in Cole and Ohanian (1999, p. 5) shows that in 1939 real output in the United States was estimated at 27 percent below its 1929 level. Moreover, government spending remained relatively stable.

[5] Jules Ferry (1890, pp. 40, 42, 43) writes that: "La politique coloniale est fille de la politique industrielle… La paix sociale est, dans l'âge industriel de l'humanité, une question de débouchés… La consommation européenne est saturée, il faut faire surgir des autres parties du globe de nouvelles couches de consommateurs, sous peine de mettre la société moderne en faillite et de préparer pour l'aurore du vingtième siècle une liquidation sociale par voie de cataclysme, dont on ne saurait calculer les conséquences."