1. Introduction

This paper critically examines the neoliberal discourse that currently dominates the debate on the role of the state, and suggests an alternative theoretical framework to overcome its limitations. After tracing the evolution of the debate on the role of the state during the postwar period that has led to the current dominance of neoliberalism (section 2), I question some fundamental assumptions underlying the neoliberal discourse on the role of the state and point out the theoretical and practical problems that arise from these assumptions (section 3). I argue that, if we are to overcome these problems, a marginal tinkering with the neoliberal framework is not enough and that we need to develop an altogether different framework, which I propose to call *institutionalist political economy*. In the next section of the paper (section 4), I outline this alternative framework and show how its adoption will improve our understanding of the role of the state. A short section of concluding remarks follows (section 5).

2. The Evolution of the Debate: From "Golden Age Economics" to Neoliberalism

The end of the Second World War witnessed the worldwide rejection of the *laissez faire* doctrine, which had failed so spectacularly during the interwar period. During the following quarter-century or so, which is commonly known as the Golden Age of Capitalism, a variety of interventionist economic theories, such as welfare economics, Keynesianism and the early "development economics", set the agenda for the debate on the role of the state (Chang and Rowthorn, 1995a; also see Deane, 1989). These interventionist theories, which I collectively call Golden Age Economics (GAE), identified a horde of "market failures" and argued that active state involvement was necessary to correct these failures. Although the exact types and forms of policies recommended by different branches of GAE were different from each other, it was widely agreed that a "mixed economy" of one sort or another was necessary and desirable.

From the 1970s onward, however, following the economic and political changes that the Golden Age had brought about both nationally and internationally, there were marked changes in the terms of debate on the role of the state (on the rise and the decline of the Golden Age, see Marglin and Schor, 1990). The new terms of debate were set by neoliberal economists like Milton Friedman, Friedrich von Hayek, George Stigler, James Buchanan, Gordon Tullock, Anne Krueger, Ian Little and Alan Peacock (for critical reviews, see Mueller, 1979; Cullis and Jones, 1987; Chang, 1994a; and Stretton and Orchard, 1994).

Neoliberalism emerged out of an "unholy alliance" between neoclassical economics, which provided most of the analytical tools, and what may be called the Austrian-Libertarian tradition, which provided the underlying political and moral philosophy.[1] The central plank in its argument regarding state intervention is that we cannot assume the state to be an impartial and omnipotent social guardian as it is assumed in GAE. Instead, it is argued, we should see the

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[1] I say an "unholy alliance", because the gap between these two intellectual traditions is not a minor one, as those who are familiar with, for example, Hayek's scathing criticism of neoclassical economics would know (e.g., see essays in Hayek, 1949).

state as an organization run by self-seeking politicians and bureaucrats, who are not only limited in their ability to collect information and execute policies, but are also under pressures from interest groups. Neoliberal economists argue that this imperfect nature of the state results in "government failures": regulatory capture, rent seeking, corruption and so on. They argue that the costs of these government failures are typically greater than the costs of market failures, and therefore that it is usually better for the state not to try to correct market failures, because it may make the outcome even worse.

This attack was partly unfair, because many practitioners of GAE did not actually believe that real-life states are the modern equivalents of Plato's Philosopher King, but used such a state only as an ideal benchmark (Toye, 1991). However, it is also true that most of them did not have a clear theory of the state, and therefore made themselves vulnerable to the attack that their view of the state was "unrealistic" and "naïve".[2]

Once this attack was unleashed, what was regarded as a pretty robust theoretical consensus on the appropriate boundary between the market and the state proved fragile. This was because, contrary to what many people had believed, welfare economics, which provided most of the tools used in drawing this boundary at the time, does not actually have an inevitable position on the issue. All that welfare economics says, in fact, is that markets can fail, but whether a particular real-world market actually fails depends on the technological, political and institutional factors that define that particular market (see section 3.2). In other words, depending on various assumptions one makes about human motivation and psychology, technology, institutions and politics, one can draw *any* conclusion one likes on the appropriate boundary between the market and the state. Indeed, the logic of market failure has been used to justify anything from the minimal state to full-blown socialist planning (Pagano, 1985). Therefore, once the political consensus behind various models of the mixed economy that emerged during the Golden Age was undermined, it became impossible to defend them using the tools of welfare economics.

The same "non-committal" nature of welfare economics regarding the appropriate role of the state, however, ironically meant that, unlike Keynesianism, it could be absorbed by neoliberalism, albeit with some difficulty (see below). Given that the Austrian-Libertarian tradition had been on the margin of intellectual respectability until the 1970s, the neoliberals could not afford to do without the "scientific" respectability that neoclassical economics carried, in return for which the Austrian-Libertarian tradition supplied the popular appeal that neoclassical economics could never dream of supplying itself (whoever died in the name of Pareto optimality or general equilibrium?). Accepting the analytical tools of neoclassical economics, however, meant that the neoliberals had somehow to tame the logic of market failure that had by then become a central element in neoclassical economics, which it was not in

[2] Interestingly, around the same time, a very similar criticism was lodged by many Marxists, who emphasized the "class" nature of the state. They argued that, thanks to their control over state revenue, political funding and ideological machinery, the economically dominant class in a society (the capitalist class in the capitalist society) is able to determine state policies in its favour, subject to the need to maintain some degree of legitimacy among the dominated classes (see Jessop, 1982, for a review of Marxist theories of the state of the time).

the prewar period. Therefore, ways had to be found to ensure that any endorsement of state intervention was kept within a boundary acceptable to the neoliberal *political* agenda.

One such way is to argue that market failures, while logically possible anywhere, in reality exist only in a few limited areas—such as defence, law and order, and the provision of some large-scale physical infrastructure—and therefore that only a "minimal state" is necessary. The second way is to limit the spillage of the logic of market failure into policy actions by separating "serious" academic discourse from "popular" policy discourse. So, for example, neoclassical economists in universities may be doing research justifying stringent anti-trust policy, but policy makers may justify their lax anti-trust policy in terms of some other logic that has no place in neoclassical economics—say, by citing the need "not to discourage entrepreneurship". [3] The third way of taming the logic of market failure is to fully accept it and build models that may have strong interventionist policy conclusions, but later downplay the relevance of such models on the ground that real-life states cannot possibly be entrusted with policies that are so technically difficult (due to informational demands) and politically dangerous (due to bureaucratic abuse and/or interest group capture).[4]

These examples show that, despite its pretence of intellectual coherence and clear-cut messages, neoliberal discourse on the role of the state contains some serious internal tensions and therefore can be sustained only through some intellectual contortion and political compromise. But that is probably the least of its problems. As I shall argue in the next section, the more serious problems of the neoliberal discourse on the role of the state are to do with, first, the very way it conceptualizes the market, the state and institutions, and, second, the way it theorizes their interrelationships.

3. The Limits of Neoliberal Analysis of the Role of the State

In this section, I discuss the limitations of neoliberal analysis of the role of the state by questioning four aspects of the neoliberal doctrine that are considered so basic that they are rarely discussed. Through the discussion, I show why these limitations cannot be overcome through marginal tinkering with the neoliberal framework. This, I argue, requires an approach

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[3] The point is also poignantly illustrated by the experiences during the early days of "reform" in the former communist countries. What captured people's imagination in those days was the Austrian-Libertarian language of freedom and entrepreneurship, and *not* the arid neoclassical language of Pareto optimality and general equilibrium. However, when the post-communist governments in these countries chose their foreign economic advisers, it was according, largely, to how high a standing they had in the Western academic hierarchy, which was basically determined by how good they were in handling the concepts and tools of neoclassical economics.

[4] Works of the American trade economist Paul Krugman provide some of the best examples. In many of his articles, a few paragraphs of "pop political economy" analysis dismissing the integrity and the ability of the state are deployed to discredit his own elaborate strategic trade theory models endorsing state intervention that make up the bulk of the article. A leading neoliberal economist, Robert Lucas, reviewing Krugman's book with Helpmann, asked why they had written the book in the first place if they were going to say in the end that the interventionist policies that follow from their models cannot be recommended because of the political dangers that they carry (see Lucas, 1990). This example shows that, in this neoliberal age, economists may build models that recommend state intervention as far as they are "technically competent", but they have to prove their political credential by rubbishing their own models on political grounds, if they are to remain in the mainstream.

that takes the role of institutions and politics seriously, namely, what I propose to call "institutionalist political economy".

3.1 Defining the free market (and state intervention)

The neoliberal discourse on the role of the state, and indeed the welfare economics discourse that it dethroned, is about whether state intervention can improve upon the workings of the free market. Even many of those who do not agree with the conclusions that are drawn from this discourse seem to regard the mode of discourse itself as unproblematic. As can be seen in the enthusiasm that the more interventionist conclusions of new growth theory or strategic trade theory have generated among some critics of neoliberalism, these critics believe that the limitations of neoliberalism can be overcome by building more models that justify state intervention.

However, I argue that the mode of neoliberal discourse itself is problematic, as defining the free market, and therefore defining what counts as state intervention, is a highly complicated exercise. As it will become clearer below, the same state action can be, and has been, considered an "intervention" in one society but not in another (which could be the same society at different points of time). Why is this? Let me answer this question with some examples.

First, let us take the case of child labour. Few people in the advanced countries at present would consider the ban on child labour as a state "intervention" artificially restricting entry into the labour market, whereas many Third World capitalists regard it as just that (and indeed the capitalists in the now-advanced countries did, too, up until the early twentieth century). This is because in the advanced countries, the right of children not to toil is more or less universally regarded as having precedence over the right of producers to employ whomever they find most profitable.[5] As a result, in these countries, the ban on child labour is *not* even a legitimate subject of policy debate any more. In contrast, in the developing countries (of today and yesterday), this right of children is not so totally accepted, and therefore the state ban on child labour is considered an "intervention", whose impact on economic efficiency is still a legitimate subject of policy debate. The same argument can be applied to the case of slavery. In societies where the right to self-ownership is not universally accepted (say, the nineteenth century United States), an attempt by the state to ban slavery can be disputed as an efficiency-reducing intervention, but once the right to self-ownership is accepted as a fundamental right of all members of society, the ban will no longer be considered an "intervention".

Another example is provided by the many environmental regulations that were widely criticized as unwarranted intrusions on business and personal freedom (e.g., factory pollution standards, automobile emission standards) when they were first introduced in the advanced countries not so long ago. However, in these countries such regulations are these days rarely regarded as "interventions", as their citizens now regard the right to clean environment as having priority over the right to choose (sometimes harmful) technologies of production and

[5] This is also manifested in the existence of many institutions that support this particular hierarchy of rights (e.g., universal education, child benefits).

consumption (e.g., production technology, type of automobile). Therefore, there are few people in these countries who would say that their country's automobile market is not a "free" market simply because of these regulations. In contrast, some developing country exporters who do not accept the hierarchy of rights underlying such regulations as legitimate may consider them as "invisible trade barriers" that "distort" the workings of the "free" market.

As yet another example, many neoliberal economists, who criticize minimum wages and "excessively" high labour standards in the advanced countries as unwarranted state interventions that set up artificial barriers of entry into the labour market, do not regard the heavy restrictions on immigration that exist in these countries as state intervention (and indeed, many of them will support stringent immigration control). However, immigration control sets up an "artificial" entry barrier into the labour market, just as the other labour market interventions they criticize. This contradictory attitude is possible only because these economists (at least implicitly) accept the right of existing citizens of a country to dictate the terms of non-citizens' participation in "their" labour market, while rejecting the right of the same citizens to contest the rights of employers to offer the wages and working conditions they see fit, beyond what are dictated by what these economists themselves regard as "basic human rights".

The examples can go on, but the point is that, depending on which rights and obligations are regarded as legitimate and what kind of hierarchy between these rights and obligations is (explicitly and implicitly) accepted by the members of the society, the same state action could be considered an intervention in one society and not in another. And once a state action stops being considered an "intervention" in a particular society at a given time (e.g., ban on child labour or on slavery in the advanced countries of today), debating their "efficiency" becomes politically unacceptable—although there is no God-given reason why this should be the case.[6] This is most clearly revealed in the current disputes regarding the attempts to incorporate labour and environmental standards in the World Trade Organization (WTO) negotiation agenda, with one party (the developing countries) arguing that these are hidden protectionist measures that go against the very principle of free trade that the WTO is supposed to represent, and the other (the developed countries) arguing that these are "universal" standards that are perfectly compatible with free trade.

Therefore, if we want to decide whether a particular market is "free" or not, we need to take a position on the legitimacy of the underlying rights-obligations structure for the participants in the relevant market (and indeed certain non-participants, when there exist externalities). Thus, the apparently simple exercise of defining the free market (and therefore state intervention) is no longer so simple—and this is even *before* we can discuss whether some markets are "failing" and therefore state intervention may make them "more efficient".

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[6] Indeed, during the late twentieth century when slavery had become a distant memory and therefore less politically sensitive, some American economic historians started a debate on the "efficiency" of slavery, although even then many people found the attempt distasteful.

I would even go as far as saying that defining a free market is at the deepest level a pointless exercise, because no market is in the end "free", as all markets have some state regulations on who can participate in which markets and on what terms (see sections 3.4 and 4.1; see Trebilcock, 1993, for a discussion from a legal perspective). It is only because some state regulations (and the rights and the obligations that they support, or even create) can be so totally accepted (by those who are making the observation as well as by the participants in the market) that some markets appear to have no "intervention" at all and therefore appear to be "free".[7] Unless we recognize the ultimately political determination of the structure of rights and obligations that underlies market relationships, our discussion on the role of the state will be conducted with the pretence that our own opinions are based on "objective" analyses while those of our opponents are not, and are thus largely "politically motivated".

3.2 Defining market failure

"Market failure" refers to a situation when the market does not work like what is expected of the ideal market. But what is the ideal market supposed to do?

In the neoliberal framework, the ideal market is equated with the "perfectly competitive market" of neoclassical economics.[8] However, the neoclassical theory of the market is only one of the many legitimate theories of market, and not a particularly good one at that. There are, to borrow Hirschman's phrase, many "rival views of market society" (Hirschman, 1982a). And therefore the same market could be seen as failing by some people while others regard it as normally functioning, depending on their respective theories of the market.

For example, many people think that one of the biggest "failures" of the market is its tendency to generate an unacceptable level of income inequality (whatever the criteria for acceptability may be). However, in neoclassical economics, this is not considered a market failure, because the ideal neoclassical market (or at least in the Paretian version of it) is *not* supposed to generate equitable income distribution in the first place. This is *not* to deny that many well-intentioned neoclassical economists may dislike the income distribution prevailing in, say, Brazil, and may support some "non-distortionary" lump-sum income transfers to reduce inequality. However, even these economists would argue that an equitable income distribution is not what we should expect from the ideal market, and therefore that there is no market failure in Brazil in this sense.

A second example is that a non-competitive market is one of the most obvious examples of a failing market for neoclassical economics, while Marx and Schumpeter would have argued that

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[7] The same reasoning applies to the judgement on how interventionist a particular state is. For example, it is because of the political consensus that defence is one of the absolutely necessary functions of the state that many people underestimate the interventionism of the United States federal government, which has strongly influenced the country's industrial evolution through defence procurement programmes and defence-related research and development (R&D) contracts—especially in the computer, telecommunications and aviation industries (Johnson, 1982).

[8] Given its intellectual composition, the Austrian theory of the market, which denies the very notion of perfect competition, could have been the neoliberal theory of the market. However, this did not happen, as the whole point of the neoliberal alliance was to combine the political and moral appeals of the Austrian-Libertarian tradition with the "scientific" respectability of neoclassical economics (see section 2). Needless to say, there are still many Austrian economists who reject the neoclassical model of perfect competition.

the existence of non-competitive (in the neoclassical sense) markets is an inevitable, if a secondary[9], feature of a dynamic economy driven by technological innovation. Thus, a typical example of market failure in the neoclassical framework, namely, the non-competitive market, is regarded as an inevitable feature of a successful dynamic economy from Schumpeter's or Marx's point of view.[10] Or to put it differently, a market which is perfect in the neoclassical sense (e.g., perfect information, no market power) may look like an absolute failure to Schumpeter because perfect information, which is necessary for a perfectly competitive market to exist, will lead to an instantaneous diffusion of new technology and thus to an instantaneous dissipation of monopoly rents, which means that there will be no incentive for entrepreneurs to innovate and generate new knowledge and new wealth.

The point that I have just tried to illustrate with the above examples is that, when we talk about market failures, we need to make it clear what we expect from the ideal market, only against which the failures of the existing markets can be defined. Otherwise, the concept of market failure becomes empty, as in the same market where one person sees a perfection another person can see a miserable failure, and *vice versa* (the above example about non-competitive market illustrates this point very well). Only when we make our own theory of the market clear, can we make our notion of market failure clear.

Now, how much does market failure matter, however we may define it? The short answer is that it would matter greatly for the neoclassical economists while it may not matter so much for other types of economists, especially institutionalist economists. Neoclassical economics is, at its core, an economics about the market or, more precisely, about the barter exchange economy, where, to borrow Coase's analogy, "lone individuals exchang[e] nuts and berries on the edge of the forest" (Coase, 1992:718). In this world, even the firm exists only as a production function, and not as an "institution of production". Other institutions that make up the modern capitalist economy (e.g., formal producer associations, informal enterprise networks, trade unions) figure basically as "rigidities" that prevent the proper functioning of the market (for a criticism of the view of non-market institutions as "rigidities", see Chang, 1995).

Therefore, for neoclassical economists, for whom the market is essentially the economy, if the market fails, the economy fails. Of course, many neoclassical economists of neoliberal leaning would argue that market failures do not occur often and that, given the possibility of government failure, it is usually better to live with failing markets than attempting state intervention (see section 2). However, as far as they acknowledge the existence of market failure, the only alternative they will seriously contemplate (and ultimately reject) is state intervention, because no intermediate institutions or organizations have a place in their scheme.

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[9] Recall Schumpeter's famous metaphor that the relationship between the efficiency gains from competition through innovation, and those from (neoclassical) price competition was "as a bombardment is in comparison with forcing a door" (Schumpeter, 1987:84)

[10] This, needless to say, does not exclude the possibility (which is often realized) that an economy may be full of monopolies but undynamic.

In contrast, for the institutionalist economists, who regard the market as only one of the many institutions that make up the capitalist economic system, market failures may not matter as much, because they know that there are many institutions other than markets and state intervention through which we can organize, and have organized, our economic activities. In other words, when most economic interactions in the modern capitalist economy are actually conducted *within* organizations and not between them through the market (Simon, 1991), the fact that some (or even many) markets are "failing" according to one (that is, neoclassical) of many possible criteria may not really make a big difference for the performance of the economy as a whole.

For example, in many modern industries where there are high incidences of monopoly and oligopoly, markets are failing all the time according to the neoclassical criterion, but these industries are often very successful in more common-sensical terms because they generate high productivity growth and consequently high standards of living. This outcome is due to the success of modern business organizations, which enable the co-ordination of a most complex division of labour—so, where neoclassical economists see "market failure", institutionalist economists may see "organizational success" (Lazonick, 1991). And if this is indeed the case, state intervention in these markets, especially of the neoclassical anti-trust variety, may not be very necessary, and indeed under certain circumstances may be harmful.

The point that I am trying to make here is *not* that market failures do not exist or that they do not matter at all—on the contrary, the real world is full of market failures and they do matter. The real point is that the market is only one of the many institutions that make up what many people call the "market economy", or what I think is better called "capitalism". The capitalist system is made up of a range of institutions, including the markets as institutions of exchange, the firms as institutions of production, and the state as the creator and regulator of the institutions governing their relationships (while itself being a political institution), as well as other informal institutions such as social convention. Thus, focusing on the market (and market failure), as neoclassical economics does, really gives us a wrong perspective in the sense that we lose sight of a large chunk of the economic system and concentrate on one, albeit important, part only. This suggests that we badly need an explicitly "institutionalist" perspective that incorporates non-market, non-state institutions as integral elements, and not simply as add-ons.

3.3 The market primacy assumption

One fundamental assumption about the nature of the market and the state in neoliberal economics, which is also shared even by the neoclassical economists without a neoliberal leaning, is what I call the market primacy assumption—or the assumption that "in the beginning, there were the markets" (Williamson, 1975:20).[11] In this view, the state, as well as other non-market institutions, is seen as a man-made substitute which emerged only after market failures became unbearable (Arrow, 1974, is the most sophisticated example of this view).

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[11] Williamson defends this starting assumption on the ground of "expositional convenience", arguing that the logic of his analysis would be the same even if the starting assumption were that "in the beginning, there was central planning" (pp. 20–21). However, he never explains why and how one assumption makes the exposition more convenient than the other.

The most obvious example of the market primacy assumption is the Contractarian explanation of the origin of the state, which the Austrian-Libertarian wing of neoliberalism has used with great political effects. In this view, the state emerged as a "contractual" solution to the collective action problem of providing the public good of law and order, especially the security of private property, which is seen as necessary (and often sufficient) for markets to function (Nozick, 1974; Buchanan, 1986). Thus, this view explains even the very existence of the state itself as a market-like (contractual) reaction to market failure. It is well known, of course, that this explanation is at odds with the historical evidence, as even many of its proponents acknowledge. However, the fact that it is still taken so seriously among the neoliberal thinkers is symptomatic of their adherence to the market primacy assumption, where the "state of nature" is the state of the "free" market to the extreme degree (including in the provision of law and order), and that the "natural" reaction of "free" individuals to this undesirable state of affairs is to engage in the market-type behaviour of voluntarily signing a social "contract" to set up the state as the provider of law and order (for more detailed criticisms of the Contractarian argument, see Chang, 1994a:chapter 1).

At this point, it must be emphasized that the fact that someone attributes institutional primacy to the market does *not* necessarily mean that he/she endorses a minimal state view. There are many economists who start their analyses (at least implicitly) from the market supremacy assumption, but willingly endorse a relatively wide range of state intervention, as well as a range of other "institutional" solutions (e.g., Arrow, 1974; Schotter, 1985). However, these economists would still see state intervention, and the other non-market, non-state institutions (e.g., the firm) as man-made substitutes for the "natural" institution called the market.

The plain truth is that, in the beginning, there were *not* markets. Economic historians have repeatedly shown us that, except at the very local level (in supplying basic necessities) or at the very international level (in luxury trade), the market was *not* an important, and even less the dominant, part of human economic life until the rise of capitalism. In fact, although even Joseph Stiglitz, one of the most enlightened neoclassical economists of our generation, once argued that "markets develop naturally" (Stiglitz, 1992:75)[12], the emergence of markets was almost always deliberately engineered by the state, especially in the early stage of capitalist development (Polanyi, 1957, is the classic work making this point; also see Block, 1999).

Even in the United Kingdom, where the market economy is supposed to have emerged "spontaneously", state intervention played a critical role in the emergence of individual markets and of the market system. In Polanyi's words,

[12] However, more recently Stiglitz has moved away from this view and embraced a more (if not completely) institutionalist position. See, for example, Stiglitz, 1999.

> [t]he road to the free market was opened and kept open by *an enormous increase in continuous, centrally organized and controlled interventionism* [italics added]. To make Adam Smith's 'simple and natural liberty' compatible with the needs of a human society was a most complicated affair. Witness the complexity of the provisions in the innumerable enclosure laws; the amount of bureaucratic control involved in the administration of the New Poor Laws which for the first time since Queen Elizabeth's reign were effectively supervised by central authority; or the increase in governmental administration entailed in the meritorious task of municipal reform… (Polanyi, 1957:140).[13]

In the case of the Untied States as well, state intervention in establishing property rights, facilitating the provision of critical physical infrastructure (especially railways and telegraphy), funding of agricultural research, and so on, were key to successful early industrialization (Kozul-Wright, 1995; even the World Bank now recognizes this—see World Bank, 1997:21, box 1.2). Most importantly, the United States was the birthplace of the idea of infant industry protection (Freeman, 1989; Reinert, 1995), and was indeed the most heavily protected economy in the world for about a century, until the Second World War.[14]

Once we accept that even the United Kingdom and the United States, the two supposed models of market-based development, did not develop through spontaneous emergence of markets, it is much easier to see that virtually no country achieved the status of an industrialized country without at least some periods of heavy state involvement. (Hong Kong may be the only possible exception.) The exact focus of intervention has certainly varied across time and space, reflecting what I have elsewhere called the "institutional diversity of capitalism" (Chang, 1997; also see Albert, 1991; and Berger and Dore, 1996): "pre-emptive" welfare state in Bismarckian Germany; postwar French industrial policy; early Swedish state support of research and development; the postwar transformation of the Austrian manufacturing sector through dynamic public enterprises; the well-known state-led developments of the East Asian countries. Nevertheless, the fact remains that all successful developmental efforts involved substantial state intervention.

What we have just discussed is not simply of historical interest. For one thing, even in the most advanced capitalist economies of today, which already have well-developed market systems on the whole, the state is constantly involved in creating new markets and thus setting up new rights and obligations necessary for their functioning, on the one hand, and modifying the existing rights-obligations structure in order to accommodate them, on the other hand. The most prominent recent examples include the creation and the restructuring of markets by the state in mobile telecommunications, computer software, electricity and Internet service provision.

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[13] And he continues: "Administrators had to be constantly on the watch to ensure the free working of the system. Thus even those who wished most ardently to free the state from all unnecessary duties, and whose whole philosophy demanded the restriction of state activities, could not but entrust the self-same state with the new powers, organs and instruments required for the establishment of *laissez-faire* [italics original]" (p. 140).

[14] During this period, few countries had tariff autonomy, either because of colonial rule or unequal treaties. For example, Japan got tariff autonomy only in 1899 on expiration of the unequal treaties it had signed following its opening-up in 1853. Of the countries with tariff autonomy, the United States had by far the highest tariff rates. Average rates since the 1820s had never been below 25 per cent, and had usually been around 40 per cent, when those in other countries for which the data are available, such as Austria, Belgium, France, Italy and Sweden, had rarely been over 20 per cent. For details, see World Bank, 1991:97, box table 5.2; and Kozul-Wright, 1995:97, table 4.8.

But perhaps more importantly, whether or not we accord institutional primacy to the market makes a critical difference to how we design developmental policies for countries that have yet to set up a fully developed market system. For example, the severe economic crisis experienced during the last several years by many former communist countries that opted for a "big bang" reform is one striking example of how the establishment of a well-functioning market economy is impossible without a well-functioning state (see Chang and Nolan, 1995; and Stiglitz, 1999). In fact, if markets evolved as "naturally" as the neoliberal economists believe, these countries would not be in such trouble now. Likewise, the developmental crises that many developing countries have gone through during the last two decades or so show how dangerous it is to assume the primacy of the market and believe that it will naturally develop as far as the state does not interfere with its evolution.

Thus taking issue with the market primacy assumption in neoliberal theory is not merely a theoretical quibbling, nor is it a quest for historical "truth". This assumption deeply affects the very way in which we understand the nature and the development of the market, as well as its interrelationship with the state and other institutions. Unless we abandon this assumption and develop a theory that deals with the market, the state and other institutions on a more equal footing, our understanding of the role of the state will remain incomplete and severely biased.

3.4 Market, state and politics

As we mentioned earlier, the neoliberal world of politics is populated by self-seeking bureaucrats, and politicians with limited capabilities operating under the influence of interest groups. In this view, politics opens the door for sectional interests to "distort" the "rationality" of the market system. The neoliberal solution to this problem is to "depoliticize" the economy. This is, according to their view, to be achieved by restricting the scope of the state (through deregulation and privatization) and by reducing the room for policy discretion in those few areas where it is allowed to operate, for example, by strengthening the rules on bureaucratic conduct or by setting up "politically independent" policy agencies bound by rigid rules (e.g., an independent central bank, independent regulatory agencies).

Many studies that take issue with the neoliberal view of human motivation that underlies this political economy analysis (Cullis and Jones, 1987; Chang, 1994a; Stretton and Orchard, 1994). These studies argue that, contrary to the neoliberal assumption, self-seeking is not the only human motivation even in the "private" domain of the market, and that people do not operate with the same degree of selfishness in the public domain as in the private domain. Once this assumption of pure self-seeking is dropped, the anti-statist conclusions of neoliberalism need to be seriously modified, as the moral views and social norms held by individuals may restrain the extent to which they advance their interests by finding ways to "distort" market outcomes through political means—that is, even if all political modifications of existing rights and obligations can be interpreted as market "distortion" through political means. (I showed why this cannot be the case in section 3.1.)

As this point is already well known and as I shall develop this theme further later (section 4.2), in this section I would like to criticize the neoliberal view of politics from another angle. My

point here is that the market itself is a political construct, and therefore the neoliberal proposal for its de-politicization is at best self-contradictory and at worst dishonest.[15] But what does it mean, exactly, to say that markets are political constructs?

To begin with, the establishment and distribution of property rights and other entitlements that define the "endowments" of market participants, which neoliberal economists take as given, is a highly political exercise. The most extreme examples are the various episodes of "original accumulation" in which property rights were redistributed through the most naked forms of politics, involving corruption, theft and even violence—such as the Great Plunder or the Enclosure in the early days of British capitalism, or the shady deals that dominate the privatization process in many developing and ex-communist countries these days.

Even basic knowledge of the history of the advanced countries over the last two centuries reveals how many of those rights that are now regarded as so "fundamental" that very few, if any, of their citizens would question them were perfectly contestable and often fiercely contested in the past—examples include the right to self-ownership (denied to slaves), the right to vote (and thus to have a say in the political modification of market outcomes), the right to minimum working hours, the right to organize and the right not to be subject to physical abuse in the workplace. More recent struggles regarding rights in areas such as the environment, equal treatment regardless of sex or ethnicity, and consumer protection are reminders that the political struggles surrounding the establishment, sustenance and modification of the rights-obligations structure underlying markets will never end.

Moreover, even when we accept the existing rights-obligations structure as uncontestable, there are practically no prices in reality which are not subject to "political" influences, including those that are *not* perceived as such even by many neoliberals. To begin with, two critical prices that affect almost every sector—wages and interest rates—are politically determined to a very large degree. Wages are politically modified not simply by minimum wage legislation, but also by various regulations regarding union activities, labour standards, welfare entitlements and, most importantly, immigration control. Interest rates are also highly political prices, even when they are determined by a "politically independent" central bank (for further discussions, see Grabel, 2000). The recent debate in Europe on the relationship between political sovereignty and autonomy in monetary policy, which was prompted by the European Monetary Union, shows this very clearly. When we add to these, the numerous regulations in product markets regarding safety, pollution, import contents and so on, there is virtually no price that is free from politics.[16]

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[15] For further criticisms of neoliberal political economy, see, in chronological order, King, 1987; Gamble, 1988; Toye, 1991; Stretton and Orchard, 1994; Chang, 1994a and 1994b; Evans, 1995; Weiss, 1998; and Woo-Cumings, 1999.

[16] We were reminded of this clearly in the British coal crisis under the Conservative government in the early 1990s, when British coal miners were told to accept the logic of the "world market" and face mine closures with grace. However, world market prices, which the then British government argued to be beyond political negotiation, turned out to be determined by the "political" decision of the German government to subsidize German coal, of the French government to allow the export of subsidized French nuclear electricity, and of the many developing country governments to allow, at least *de facto*, child labour in their coal mines.

In other words, the "market rationality" that the neoliberals want to rescue from the "corrupting" influences of politics can only be meaningfully defined with reference to the existing institutional structure, which itself is a product of politics (see Vira, 1997, for further exposition of this point). And if this is the case, what the neoliberals really do when they talk of de-politicization of the market is to assume that the particular boundary between market and the state *they* wish to draw is the "correct" one, and that any attempt to contest *that* boundary is a "politically minded" one. However, as we argued in section 3.1, there is no one "correct" way to draw such a boundary. If there appears to be a solid boundary between the two in certain instances, it is only because those who are concerned do not even realize that the rights-obligations structure underpinning that boundary is potentially contestable. So, if some people feel that central banks should be politically independent, it is *only because* they contest the right of the people to influence monetary policy through their elected representatives, and *not because* there is some "rational" reason that monetary policy should not be politically influenced.

Moreover, in calling for de-politicization of the economy, the neoliberals are not only dressing up their own political views as "objective" ones that are "above politics", but are also undermining, willy-nilly, the principle of democratic control. The neoliberal call for de-politicization is often justified in populist rhetoric as an attempt to defend the "silent majority" from corrupt politicians, fiefdom-building bureaucrats and powerful interest groups. However, the diminution of the legitimate domain of politics that the neoliberal proposal for de-politicization will bring about only serves to further diminish what little political influence the so-called "silent majority" have to modify market outcomes, which, we repeat, are heavily influenced by politically determined institutional parameters in the first place. Like the old liberals, the neoliberals deep down believe that allowing political power to those who "do not have a stake" in the existing system will inevitably result in "irrational" modifications of the status quo (for a critical exposition of old liberalism along this line, see Bobbio, 1990). However, unlike the old liberals, the neoliberals cannot openly oppose democracy, so they try to do it by discrediting *politics in general* and making proposals that ostensibly seek to reduce the influence of "untrustworthy" politicians and bureaucrats—but ultimately diminish democratic control itself. [17]

Thus seen, the market is ultimately a political construct, and therefore a full de-politicization of the market is not only an impossibility, but also has a dangerous anti-democratic undertone. Note, however, that by saying this we are not denying that a certain degree of de-politicization of the resource allocation process may be necessary. For one thing, unless the resource allocation process is at least to a degree accepted as "objective" by the members of the society, the political legitimacy of the economic system itself may be threatened. Moreover, high transaction costs would be incurred in search and bargaining activities if every allocative decision were regarded as potentially contestable, as was the case in the former communist countries. However, this is not the same as arguing, as the neoliberals do, that no market under any circumstance should be subject to political modifications—again because, in the final analysis, there is no market that can be really free from politics.

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[17] We should also note that political activities are often ends in themselves, and people may derive value from the activities *per se* as well as from the products of such activities (see Hirschman, 1982b:85-86).

4. The Way Forward: Toward an Institutionalist Political Economy

My discussion so far has revealed some important limitations of the currently dominant neoliberal discourse on the role of the state. In this section, I argue that these problems can be overcome only by adopting an alternative approach that incorporates politics and institutions into its analytical core, which I propose to call "institutionalist political economy" (IPE).[18] As it is beyond the scope of this paper to develop this approach fully, in the rest of this section I attempt to describe the central theoretical features that distinguish it from the neoliberal approach in the analyses of the market, the state and politics, and suggest how these analyses may be developed.

But before we proceed, one thing needs to be made clear. As the reader may have noticed already, and as will become clearer later, when I say "institutionalist" approach, I do not mean it to be of the new institutionalist economics (NIE) kind, but a development of the tradition found in the classic works of authors such as Karl Marx, Thorstein Veblen, Joseph Schumpeter, Karl Polanyi, Andrew Shonfield and Herbert Simon (recent developments of this tradition can be found in Hodgson, 1988, 1993 and 2000; Lazonick, 1991; Evans, 1995; Block, 1999; Chang and Evans, 2000; and Burlamaqui et al., 2000). This tradition, which is sometimes called the "old institutional economics", differs from the NIE in a number of important respects (see Rutherford, 1996; and Hodgson, 2000), but most importantly in seeing institutions not simply as constraints on the behaviour of the pre-formed and unchanging individual as in the NIE, but in seeing them also as shaping the individuals themselves. With this in mind, let me now sketch out what I think need to be the distinguishing features of IPE.

4.1 Analysis of the market

As I argued above, in the neoliberal discourse, the market is seen as a "natural" economic phenomenon that spontaneously grows out of the universal human nature to exploit gains from trading (see section 3.3). While, when pressed, most neoliberal economists would admit that the market itself is an economic institution and while, given the recent influence of the NIE, many of them may even talk about some (albeit not all) non-market institutions such as the firm, their analysis of the market itself involves only a minimal, and often implicit, institutional specification. Usually, some simplified notion of private property rights is all that exists in the neoliberal analysis of the market, although some may also consider those institutions that are needed for effective exercise and modification of property rights (e.g., the court system, contract law).

In contrast, IPE highlights the institutional complexity of the market. It argues that, in order to understand the workings of the market, we need to understand a wide range of institutions that affect and are affected by it. These institutions are not, of course, simply formal institutions like law and state regulation. They also include private-sector self-regulatory institutions (e.g., professional associations, producer associations) and informal institutions such as social conventions, although many of these institutions are supported by formal institutions (e.g.,

[18] I have attempted to develop elements of this theory in a number of my previous works. See Chang, 1994b; Chang, 1995; Chang and Rowthorn, 1995b; and Chang, 1997.

decisions by professional associations or social conventions are, when it comes to the crunch, enforceable through the legal system).

Many of these institutions that need to be incorporated into the analysis of the market are often "invisible" because the rights-obligations structure that underlies them is taken so much for granted that it is seen as an inalienable component of naturally ordered free markets (see section 3.1). However, no institution, however "natural" it may look, can be regarded as such, and although in many cases we may choose to accept many institutions as given, in the final analysis we should be willing and able to subject all institutions that support markets to analytical and political scrutiny.

To begin with, all markets are based on institutions that regulate who can participate. For example, laws may stipulate that certain types of individuals (e.g., slaves, foreigners) cannot own property. Banking laws or pension laws may limit the range of assets that banks or pension funds own and therefore limit the range of asset markets that they can enter. Who can participate in which labour market will be affected not only by formal regulations by the state and by private sector agents (e.g., laws regulating professional qualifications, rules of unions and professional associations) but also by social conventions regarding caste, gender and ethnicity. Company laws and industrial licensing rules will decide who can participate in the product market, while stock market listing rules and brokerage regulations determine who can participate in the stock market.

Second, there are institutions that determine the legitimate objects of market exchange (and, by implication, ownership). In most countries, there are laws illegalizing transactions in things like addictive drugs, "indecent" publications, human organs or firearms (although different societies have different views on what count as, say, addictive drugs or indecent publications). Laws on slavery, child labour and immigration will stipulate, respectively, that human beings, labour service of children and labour service of illegal immigrants may not be legitimate objects of exchange.

Third, even when the legitimate participants in and the legitimate objects of exchange have been stipulated, we need institutions that define what exactly each agent's rights and obligations are in which areas. So, for example, zoning laws, environmental regulations (e.g., regarding pollution or noise), fire regulations and so on, define how property rights in land can be exercised (e.g., what kinds of buildings can be constructed where). For another example, laws regarding health, safety and grievance resolution in the workplace will define the rights and the obligations of the workers and the employers.

Fourth, there are numerous institutions that regulate the process of exchange itself. For example, there are rules regarding fraud, breach of contract, default, bankruptcy and other disruptions in the exchange process, which are backed up by the police, the court system and other legal institutions. Consumer laws and liability laws, for yet another example, will stipulate when and how buyers of unsatisfactory or faulty products may annul the act of

purchase and/or claim compensation from the sellers. Social conventions (e.g., those regarding fairness and probity) or codes of conduct issued by trade associations (e.g., bankers' associations) may also influence the way economic agents behave in economic transactions.

To sum up the discussion in this section, understanding the market requires consideration of a much wider range of institutions than what are normally discussed by the neoliberals. In addition to property rights and the legal infrastructure that help their exercise and modification, which the neoliberals focus on, we also need to consider all the other formal and informal institutions that define who can hold what kinds of property and participate in what kinds of exchange, what the legitimate objects of exchange are, what the acceptable conducts in the exchange process are, on what terms different types of agent may participate in which markets, and so on. In other words, neoliberal markets are institutionally very under-specified, and we need a fuller institutional specification of markets if we are to understand them properly.

Emphasizing the institutional nature of the market in the way discussed above also requires that we bring politics explicitly into the analysis of the market (and not just into the analysis of the state) and stop pretending that markets need to be, and can be, "de-politicized". Markets are in the end political constructs in the sense that they are defined by a range of formal and informal institutions that embody certain rights and obligations, whose legitimacy (and therefore whose contestability) is ultimately determined in the realm of politics. Consequently, IPE adopts a "political economy" approach not only in analysis of the state, but also in analysis of the market.

4.2 Analysis of the state

The neoliberal analysis of the state starts by questioning the "public" nature of the motivations of the agents that make up the state, such as politicians and state bureaucrats. The theory of human motivation and behaviour underlying this analysis, and for that matter neoliberalism as a whole, asserts that self-seeking is the only "genuine" human motivation, except perhaps vis-à-vis family members (Williamson, 1993, presents this view passionately).

However, as many critics in the institutionalist tradition have pointed out, human motivations are multifaceted and there are just too many non-selfish human behaviours, which cannot be explained without admitting a range of non-selfish motivations and assuming a complex interaction between them (Simon, 1983; Basu, 1983; McPherson, 1984; Etzioni, 1988; Frey, 1997; Ellerman, 1999; also see section 3.4). And this criticism applies even more to the analysis of the state and other aspects of public life. This is not only because individuals often join public life with commitments to certain non-selfish values (e.g., public service ethic, social reform, liberalism, party loyalty, nationalism) but also because, operating in an explicitly "public" sphere of life, they end up internalizing many "publicly oriented" values.

In addition to accepting the variety and the complexity of human motivations, we also need to acknowledge that human beings are fundamentally shaped by institutions. In neoliberal theories (including the NIE models), individual motivations (which they usually call "preferences") are treated as the ultimate data. In these theories, institutions may be able to

shape individual *behaviours* by punishing or rewarding particular types of conduct, but they are not able to change the *motivation* itself (Ellerman, 1999; Hodgson, 2000). In contrast, IPE does not see these motivations as given but as being fundamentally shaped by the institutions surrounding the individuals. This is because institutions embody certain "values" (worldviews, moral codes, social norms, or whatever one may choose to call them), and, by operating under these institutions, individuals inevitably internalize some of these values and thereby have their selves changed. This is what we elsewhere proposed to call the "constitutive role of institutions" (Chang and Evans, 2000), or what Hodgson (2000) calls the "downward reconstitutive causation from institutions to individuals", and is a central hallmark of a truly "institutionalist" approach, different from the neoliberal institutionalism of the NIE.

Of course, IPE's emphasis on the constitutive nature of institutions should *not* be interpreted to mean that people's motivations are more or less determined by institutional structure. If IPE is not to lapse into unwarranted structural determinism, we need to accept that individuals also influence the way institutions are formed and run, as it is typically done in the NIE models. However, IPE differs from NIE in that it postulates a two-way causation between individual motivation and social institutions, rather than a one-way causation from individuals to institutions, although IPE would agree that in the final analysis a truly institutionalist analysis should see institutions as at least "temporally" prior to individuals (Hodgson, 2000).

Now let me illustrate with some examples how an "institutionalist" analysis of the relationship between motivation, behaviour and institutions may improve our thinking about the role of the state.

In societies where high standards of behaviour in public life have long been established, government officials may act with more probity compared to their counterparts in other societies without such behavioural norms, even if they are subject to the same institutions involving individualistically designed sanctions and rewards of the kinds that the neoliberals recommend (e.g., more thorough monitoring, higher relative salaries, tougher punishments). IPE acknowledges the usefulness of these institutions that target *behaviours* directly, but would argue that behavioural standards can also be improved, and in some cases more effectively improved, by changing the *motivations* of public personages. This, in turn, can happen through direct ideological exhortation (e.g., emphasizing a public service ethic in bureaucratic training), but perhaps more indirectly (given the constitutive role of institutions) through changing the institutions that surround them (e.g., devising incentive systems that reward teamwork in the bureaucracy in order to boost *esprit de corps*).

Indeed, I would go a step further and argue that some of the neoliberal recommendations that are intended to improve the behavioural standards of public personages may be downright counter-productive, if they undermine the non-selfish motivations that had previously motivated the public personages in question—that is, if they cause what Ellerman (1999) calls the "atrophy of intrinsic motivation". Therefore, increased monitoring of public figures may make them *behave* in a more "moral" way in areas where monitoring is easier (e.g., diligently documenting their expenses for business trips). However, it may make them less *motivated* to

behave in a moral way and take initiatives in areas where monitoring is difficult (e.g., taking intellectual initiatives without material compensation). This is because it will make them feel that they are not trusted as "moral" agents, and therefore that they are under no obligation to behave morally unless they are forced to do so.

Let me summarize the argument in this section. In order to overcome the limitations of the neoliberal analysis of the state, we need to abandon its arguably most crucial assumption, namely that individuals have predetermined motivations (or "preferences" in the neoliberal language) that are selfish, and adopt a more complex view of the interrelationship between motivation, behaviour and institutions than what exists in the neoliberal discourse.

IPE proposes that we accept, from the start, that human motivations are varied and interact with each other in complex ways. Moreover, it argues, individual motivations are fundamentally formed by the institutions that surround the individuals. Thus seen, we should acknowledge that there is no need for selfish motivations to dominate behaviour in the public sphere of the state, where non-selfish values are institutionally emphasized, and therefore that actors internalize many such values. Moreover, it must be emphasized that even in the private sphere the importance of self-seeking motivation is much less than what the neoliberals believe. IPE argues that behaviours may be changed not only through changing institutions that define the incentives for individuals, but also through ideological and institutional changes that influence individual motivations themselves.

4.3 Analysis of politics

Neoliberalism has made an important contribution to the debate on the role of the state by bringing politics back into the analysis of state action. Since I am advocating an institutionalist "political economy", I am naturally sympathetic to the neoliberal attempt to emphasize the role of politics. However, the neoliberals claim that politics inevitably generates state actions that go against market "rationality". In doing so, they are effectively making two claims, both of which are highly problematic.

First of all, they are claiming that markets should be, and can be, free from politics. However, as I have argued, it is a myth that markets can be free from politics. I accept that this myth may be useful, or even necessary, in containing the potentially disruptive effects of a very high degree of contestation of the rights-obligations structure underlying existing markets. However, the usefulness of this myth does not change the fact that it is still a myth. IPE argues that markets are fundamentally political constructs and therefore that it is not possible, or even desirable, to try to completely rid markets of politics, as the neoliberals wish (see section 3.4).

Second, by portraying the particular boundary of the market that they are advocating (into which, they argue, political influences should not be allowed) as the "rational" one, the neoliberals are claiming an objectivity for their view that no theory can claim. However, once we accept the political nature of the market, we can see that there is no "objective" way to decide the "correct" boundary between the market and the state, as one's political view will deeply influence whether one sees a particular boundary as a legitimate (or "rational" in their

language) one. In contrast, IPE argues that we need to see politics as a process through which people with different, and equally legitimate, views on the contestability of the existing rights-obligations structure vie with each other, rather than as a process in which interest groups try to change the "natural" order of "free markets" according to their own sectional interests.

Therefore, IPE treats politics not as something alien and damaging to the market, but as an integral part of its construction, operation and change, although it acknowledges the harm that excessive politicization can do. It also emphasizes that there is no such thing as a "correct" political view and therefore that no one should be able to claim the boundary between the market and the state that he/she believes in to be the "correct" one.

I would go even further and criticize the neoliberal analysis of politics for its failure to recognize the extent to which politics itself is an institutionally structured process (see Chang and Evans, 2000; March and Olsen, 1991, argues along this line from a political science point of view).

Of course, I am not saying that institutions do not feature in the neoliberal analysis of politics. On the contrary, it has tried to analyse, often with success, how the formal and informal institutions that govern the way interests are organized and power exercised affect political actions (e.g., electoral rules, rules regulating the behaviour of public figures, rules on agenda formation and voting in parliamentary committees). However, like the other neoliberal analyses involving institutions, it has not gone beyond seeing institutions as "constraining" factors on human behaviour, and fails to see that institutions are also "constitutive", that is, that they can influence politics not only by affecting human actions but also by influencing individual motivations and worldviews (Chang and Evans, 2000; also see section 4.2). We can talk about three related, but different, mechanisms that are involved here.

First of all, institutions influence the very perception of their interests by individuals. So, for example, in societies where political parties have more class-conscious organizations (e.g., formal affiliation of political parties with trade unions or employers' associations), many more voters will vote along "class lines" than in societies without such parties.

Second, institutions influence people's views on what kinds of issues are legitimate targets of political action. So, for example, in societies where child labour is no longer a legitimate policy issue, not even people who will potentially benefit from the practice will start lobbying for its re-introduction—not simply because they fear some formal or informal sanctions, but more importantly because they do not even think the issue to be a legitimate item on the agenda for political action by any group (see Goodin, 1986, for further discussion of the issue of "public agenda formation").

Third, institutions influence how individuals perceive the legitimacy of particular types of political actions. So, for example, rent seeking is likely to be less widespread in societies where open lobbying is, even if legal, considered "poor taste", than in societies where it is not, even if both societies have the same scopes for rent seeking.

To summarize the argument in this section, the neoliberal claim that politics inevitably corrupts the market is problematic, not only because markets themselves are political constructs, but also because the neoliberal notion of the "uncorrupted" market is based on a particular set of political beliefs that cannot claim superiority over other sets of political beliefs. Moreover, the neoliberals fail to see politics as an institutionally structured process in the deepest sense. They see institutions as constraining political actions but fail to see that institutions also affect people's motivations and perceptions.

IPE argues that politics is an institutionally structured process, not only because institutions shape people's political actions, given their motivations and perceptions, but because they influence people's perception of their own interests, of the legitimate boundary of politics, and of the appropriate standards of behaviour in politics. Unless we break the neoliberal mould and see institutions as both constraining people's behaviour and being constitutive of their motivations and perceptions, our understanding of politics will remain biased and incomplete.

5. Concluding Remarks

In this paper, after pointing out the internal contradictions of the neoliberal view on the role of the state that arises from the tensions between its neoclassical and Austrian-Libertarian components, we critically examined some of its basic concepts and assumptions from the institutionalist point of view. Four main points were raised: the definition of the free market; the definition and the implications of market failure; the market primacy assumption (namely the view that the market is logically and temporally prior to other institutions, including the state); and the analysis of politics.

My main criticism of the neoliberal analysis of the role of the state is *not* that its policy recommendations are too anti-interventionist, as some of its critics argue. My main criticism is that the very way in which it envisages the market, the state, institutions and politics, as well as their mutual relationships, is highly problematic. Therefore, I suggested that overcoming the limitations of the neoliberal discourse on the role of the state cannot be done by looking for more interventionist models within the neoliberal mould, but only by breaking this mould and developing an alternative framework that brings institutions and politics to its analytical core. I proposed to call this an institutionalist political economy approach, and sketched out how its analyses of the market, the sate and politics differ from those offered by the neoliberal discourse.

IPE is a "political economy" approach because, like the neoliberal analysis, it puts emphasis on the role of political factors in determining state policy. However, the political economy of IPE goes much further than its neoliberal counterpart in that it emphasizes the fundamentally political nature of the market and applies the political economy logic to the analysis of the market, and not just to the analysis of the state. At the same time, IPE is an "institutionalist" approach because, like the new institutionalist branch of neoliberal economics, it emphasizes the role of institutions in affecting human actions, including those within and surrounding the state. However, the institutionalism of IPE goes much further than that of NIE in that it

emphasizes the "temporal priority" of institutions over individuals (rather than the temporal priority of individuals over institutions, as it is done in the NIE) and that it sees institutions as not simply "constraining" individual *behaviour* (as in the NIE) but also as being "constitutive" of individual *motivations*.

Admittedly, this paper is only the first step on a potentially long and laborious road to developing a full-blown institutionalist political economy, especially given that the broader institutionalist framework that should provide a background to this approach is still not fully developed. However, it is hoped that it will serve a useful role by proposing a new research agenda that will allow us to break the mould of current debate on the role of the state, which is set by the very powerful and informative, but fundamentally flawed and misleading, discourse of neoliberalism.

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