

STATE AS AN INSTITUTION OF THE ECONOMIC PROCESS:
AN INFERENCE FROM KARL POLANYI

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ABSTRACT

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This thesis is build up on the idea that state could be described as an institution of the economic process, which imbues it with certain degree of endurance and protects it from the instability and uncertainty of the free markets. If this idea could be proved, then the mainstream tendency to exclude state from the realm of economics and leave the governance of the economic process solely to self-regulating markets will appear to be a fallacy based on the myth of liberalism. Only after this could be achieved, state could get its proper place in the existing economic system and a solution may be found to the impasse into which societies have been dragged by the free market order that is defended jauntily by liberal economists.

Keywords: State, Institution, Economic Process, Liberalism.

ÖZ

İKTİSADİ SÜRECİN BİR KURUMU OLARAK DEVLET: KARL POLANYİ'DEN BİR ÇIKARIM

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Yüksel Lisans, İktisat Bölümü

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Bu tez, devletin iktisadi sürecin, ona belli derecede direnç kazandıran ve onu serbest piyasaların bilinmezliği ve dengesizliğinden koruyan bir kurumu olduğu düşüncesi üzerine kurulmuştur. Eğer bu düşünce ispatlanabilirse, o zaman devleti iktisadi süreçten dışlayan ve onun yönetilmesini sadece kendi kendini düzenleyebilen piyasalara bırakan egemen eğilimin, liberal efsaneyi temel alan bir yanılğı olduğu ortaya çıkacaktır. İşte ancak bu gerçekleştirilebildiği zaman, devlet iktisadi sistemdeki yerini alabilir ve liberal iktisatçıların fütursuzca savundukları serbest piyasa düzeninin toplumları sürüklediği çıkmaza bir çözüm bulunabilir.

Anahtar Kelimeler: Devlet, Kurum, İktisadi Süreç, Liberalizm.

To My Parents

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CHAPTER 1

INTRODUCTION

The object of this work is to identify and analyze the state intervention to economic process outside the realm of orthodox economics, and to set the state action back to its most proper place in the socio-economic sphere.

Study of state as an effectual force on economies is not a new subject to scholarly efforts. However, most of them treated it either as an irrelevant factor of modern economics or as a minor force confined in certain boundaries. Even the most generous ones could not go further than suggesting that state should always remain in the 'business', since we need it. Not by more than a few skeptics, were there thorough analyses of state and its role in economic process. Nevertheless, after consequential shocks to the world-economy in recent days, even the most liberally driven minds realized reluctantly the critical role states have and the potential they possess. Despite this fact, still the mainstream neoclassical economist treats the state as an 'exogenous' factor of the economic process, not even mentioning their rejection of the economy as a process at all. Such neglect stems from the formal economic analysis they stick to use, its inability to pose a profound explanation to dynamic processes and its inapplicability to subjects beyond the frontiers of price-making market economy. Keeping the state outside the real economy is an essential

part of liberal economics, because state is seen as a hindrance to the liberalization of an economy. Paradoxically, the so called 'liberal economies' of today were established with assiduous works of governments, and today many liberals call for the help of states so as to maintain stability without obstructing self-regulating market forces. A critique of the liberal approach, we should consider and treat the state and its actions as germane to the socio-economic system, which are very well fed by the system and in turn have impacts on that setting.

From our point of view, state intervention is identified as 'endogenous' to the system, rather than ignoring its role. However, such an augmentation is not a mere addition of government expenses of 'G' to a general equilibrium model as a static factor, but it is rather an amalgamation; melting the state in to an heterogeneous mixture called socio-economy. Therefore, the consequential substance will be imbued with the state element and this will perhaps give the socio-economic system a considerable degree of rigidity and unity.

In doing so, the first step is to understand the institution itself, without which it would be impossible to construct the idea of state as an institution of the economic process. Hence, the second chapter after the introduction is devoted to review of the literature of the original institutional economics so as to reveal the common characteristics of institutions. Afterwards in the following chapter, another critical topic of this work will be explained, the state. State is used in quotations throughout this work, and this should be explained in detail. What is the state in author's mind?

How does it differ from the general concept of state? Moreover, in the third chapter, state will be taken in hand within the thought of institutional economics; thus emphasis will be on institutional characteristics of the state. After defining state as an institution and depicting its institutional pattern, the next task will be putting the state institution into its proper place in the economic process. The economy could be explained well as a process, as Polanyi (1957) did, and states have been a crucial institution of this process for many centuries in the past, up to the 19th century. Therefore, with an adherence to Polanyi's study, evidences of information on states role as an institution of the economic process will be collated so as to be able to claim that states intervened in the economic process and institutionalized it in distinct periods and societies of history. However, this trend was forced to change with the introduction of the market economy and liberalism, which brought the 19th century industrial society a thorough transformation. Then, the fifth chapter deals with this transformation, its repercussions on states and their actions. Lastly, this work will be finalized with a brief summary and some concluding remarks in the conclusion part.

CHAPTER 2

THE CONTENTS OF 'INSTITUTION'

The second chapter of this work is devoted to a precise understanding of what an institution is in the eye of institutional economists via revealing the common characteristics of the concept.

Thanks to the close interest of a wide range of social sciences in the topics of institutional economics in recent years and to the reluctant efforts of many mainstream economists to integrate institutions into *the gargantuan economic formula* of their own, institution has become a fashionable phenomenon of present academic literature. Although the term institution was introduced even before the 19th century and lived its heyday through the first quarter of the 20th century, a broad academic consensus on what an institution is could not be reached yet (Hodgson, 2006: 1). As a result of this and the fact that the essence of the author's work is constituted of institutions, it is unavoidable to present and explain the term as it appears in the literature.

Currents of thought in institutional economics could be divided into three categories (Chavance, 2009: 1-3). (1) First and foremost, the original institutionalists, among whom Thorstein Veblen, Wesley Mitchell, John Roger Commons, Walton Hamilton were most influential minds, the father of the German Historical School Gustav von

Schmoller, who shared very similar ideas with institutionalists, and Karl Polanyi, who addressed institutional topics in his works, rejected the classical approach to economics and proposed an institutional and evolutionary alternative. (2) Then, the Austrian school with Carl Menger and Friedrich von Hayek shared some ideas with institutional economics in their *Methodenstreit* with the German Historical School, but regarding the rest of their arguments they did never belong to institutional economics. (3) The new institutional economics appeared not as a substitute for neoclassical theories but it constituted rather a complementary part of it. Nevertheless, works of Oliver Williamson and Douglas C. North share some common but minor aspects with the original institutionalism. Moreover, the European current of institutionalism, in which Geoffrey Hodgson deserves special attention, should be added to the original institutionalism, since it is an attempt to revive original institutionalism by adopting a Veblenian evolutionary approach and to bring institutions back again to the agenda of economic science.

Since the original institutionalism represents the core ideas of institutional economics, its approach will be employed in explaining institutions. In this context, Schmoller, Veblen, Commons and Hamilton constitute the focus of this chapter. Their views will be enriched with Walter C. Neale's and Geoffrey Hodgson's ideas.

2.1. Gustav von Schmoller

As all institutional economists would agree, Thorstein Veblen constitutes the rigid core of institutionalism. However, one author, who had a significant influence on Veblen's ideas, should be mentioned before Veblen himself. Gustav von Schmoller, with his critique of the classical political economy in his work *Principles of Political Economy*, asserts that "institutions and organs" deserve closer attention by political economists since they are the counterpart of anatomy for physical body (Chavance, 2009: 4).

"By *institutions*, of a political, legal or economic nature, we mean an arrangement at a particular point in the life of the community, serving set objectives, that has attained its own existence and development and which forms a framework or mould for the action of successive generations over hundreds or thousands of years." (Schmoller, cited in Chavance, 2009: 4)

The citation above is quite illuminating for understanding Schmoller's notion of institution. First of all, institutions could be in several forms such as political, economic or legal, although no definite distinction was made by Schmoller between different types of institutions. Additionally, they are inherently capable of sustaining themselves and extending their limits; they are persistent. Institutions are continuously developing or more precisely evolving 'moulds' that shape society's decisions and actions. An institution is "a set of habits and rules of morals, custom and law, which have a common centre or goal, which are considered with each other and which constitute a system" (Schmoller, cited in Chavance, 2009: 5). Hence,

institutions are interdependent with other institutions, probably change one another's course and they represent organic parts of a larger body, a system. Institutions are not "an obstacle but a stimulus"¹ (2009: 6).

Beside institution, Schmolter also defines what 'organs' are. They are the *people* aspect of institutions. If a group of people is organized around a common set of beliefs and objectives, then they form an organ. Organs are at least as essential as institutions are, since institutions are arranged within organs. This is a rather distinctive isolation of organs, or namely *organizations*, from institutions, since most of the original institutional economists treat organizations, such as firms, as a special type of institution. Nonetheless, organs are alike institutions in one aspect that they are interdependent with other organs and they can either trigger or evolve into a different organ formation. Moreover, organs, especially the larger ones, are persistent due to a rigid hierarchical setting among the members of organs. Authorities of large organs could be resistant to individual dissolution of the organs. Lastly, an organ could be the result of deliberate action or could be of spontaneous nature; the latter contributing greater to cultural development (2009: 5).

¹ This positive view of institutions could also be seen in Common's assertions.

2.2. Thorstein Veblen

For Veblen, institutions are “the *prevalent habits of thought and action* in the social community.”(Chavance, 2009: 11)

The institutions are, in substance, prevalent habits of thought with respect to particular relations and particular functions of the individual and of the community; and the scheme of life, which is made up of the aggregate of institutions in force at a given time or at a given point in the development of any society, may, on psychological side, be broadly characterized as prevalent spiritual attitude or a prevalent theory of life. (Veblen, 1953: 132)

Moreover, institutions evolve according to:

. . . [A] natural selection of the fittest habits of thoughts and to a process of enforced adaptation of individuals to an environment which has progressively changed with the growth of the community and with the changing institutions under which men have lived. (Veblen, 1953: 131)

They are originated from continuous opposition of ‘instincts’ at different levels such as the interaction between instinct of workmanship and predatory instinct which creates the stimulus for evolution (Chavance, 2009: 12).

Therefore for Veblen, evolution with certain dependence to the past is critical for institutions. This idea of *path-dependence* is quite similar to the one posed by Schmoller as persistence of organs.

The institutions – that is to say the habits of thought – under the guidance of which men live are in this way received from an earlier time; more or less remotely earlier, but in any event they have been elaborated in and

received from the past. Institutions are products of the past process, are adapted to past circumstances, and are therefore never full accord with the requirements of the present. (Veblen, 1953: 133)

Veblen observes economic life as an “unfolding sequence”, in which institutions play crucial role as centers of inertia (Veblen, 1898: 375). This sequence is unfolding since it could not be divided into separate sections that are totally or partly independent of each other. All the elements of this process, whether it is economic, social or political, are connected to one another. Considering these parts of the sequence as institutions of different types, it could be concluded that institutions are interdependent for Veblen. Moreover, those closely knit units of economic process are altogether the process itself. Hence, institutions are the source of the change in the process, but are also affected by that change circularly: an idea which will later be coined as *Cumulative Circular Causation*.

Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or at the same time special methods of life and of human relations. So that the changing institutions in their turn make for a further selection of individuals endowed with the fittest temperament, and a further adaptation of individual temperament and habits to the changing environment through the formation of new institutions. (Veblen, 1953: 131)

Not only have the habits of men changed with the changing exigencies of the situation, but these changing exigencies have also brought about a correlative [interdependent] change in human nature. (Veblen, 1953: 146)

The growth of culture is a cumulative sequence of habituation, and the ways and means of it are the habitual response of human nature to exigencies that vary incontinently, cumulatively, but with something of a consistent sequence in the cumulative variations that so go forward –

incontinently, because each new move creates a new situation which induces a further new variation in the habitual manner of response; cumulatively, because each new situation is a variation of what has gone before it and embodies as causal factors all that has been effected by what went before . . . (Veblen, 1909: 628)

As opposed to Schmoller's fairly positive attitude towards institutions perceived as stimulus for progress, Veblen was more skeptical and observed institutions as formations of social rigidity (2009: 12). However, it should be noted that Veblen has been misunderstood by many authors in his argument of *ceremonial* versus *instrumental*. Although Veblen uses the terms ceremonial and institution side by side and contrasts these with instrumental and technology, his intention was not to say institutions are purely ceremonial (Neale, 1987: 1197-8). Ceremonial (traditional) and instrumental (productive) forces cohabit in institutions. Ceremonial forces are in constant opposition to the inertia technology brings. The ultimate result of this perpetual conflict between two distinct social forces – one pulling the other pushing – is the nonlinear evolution. To Veblen, future is unpredictable due to this nonlinearity of social evolution. Evolution does not necessarily mean progress. If ceremonial forces end up being more powerful than instrumental forces, then evolution may bring regression from the present state. However, a change, no matter what its direction is, should be taken for granted since it creates possibilities for new institutional arrangements (Chavance, 2009: 14).

2.3. Walton Hamilton

Although Hamilton perceives institution in a broad perspective and leaves many definitions open-ended, very first paragraph of his article elicits his view.

Institution . . . connotes a way of thought or action of some prevalence and permanence, which is embedded in the habits of a group or the customs of a people. In ordinary speech, it is another word for procedure, convention or arrangement; . . . Institutions fix the confines of and impose form upon the activities of human beings. The world of use and wont . . . is a tangled and unbroken web of institutions. (Hamilton, 1932: 235-6)

Therefore, similar to Veblen's definition, institutions have past-binding aspects. They are aggregations of 'uses and wont' that draw boundaries to individual and social actions. For Hamilton, "any informal body of usage" such as the common law, athletics, the higher learning, literary criticism, the moral code and "any formal organization" like the government, the church, the university, the corporation, and the trade union are within the broad range of institutions (1932: 236). An institution could be intentionally arranged or could be of spontaneous nature. Independent of whether its formation is deliberate or natural, "an institution has no origin apart from its development." (1932: 237) Therefore, evolution of institutions is critical to establishment of new arrangements. Usually institutional change is so gradual that new arrangements appear together with old establishments. As Hamilton puts it; "In the course of events the fact arrives before the word and new wine must be put up in old bottles" (1932: 237).

Institutions could be rigid or flexible establishments. Hamilton gives Christian Gospel as an example of flexible institutions. The longer the life of an institution is, the better it adapts to changing social conditions (1932: 238). From reverse, the more adaptable an institution is, the later it expires. Nevertheless, it should be noted that even the most flexible institutions could not escape “slavery to its past” (1932: 239). Hence, institutions bear both flexible and rigid characteristics. This indeed imbues them with stability, but on the other hand with a constant tendency to evolve. Hamilton adds that, if institutions lose their rigidity in the course of time, they may be converted to function in a way that they are not naturally formed for, or they may even lose their functionality at all (1932: 240).

Hamilton concludes: “Thus an institution like the living thing it is has a tangled identity.” (1932: 243) This kind of blur in definition of institution is because institutions are cultural and time-dependent. The very same institution such as marriage attains different meanings for a medieval society and for a modern society. Although institutions impose certain rigidity over societies, they are constantly evolving and gaining new characteristics. Therefore, if one is to define an institution, one should consider the past and the present cultural traits of the society in which the institution concerned is engraved. This embeddedness is reinforced by a cumulative circular motion. As Hamilton notes; “Its [institution’s] identity through the impact of idea upon circumstance and the rebound of circumstance upon idea is forever being remade.” (1932: 244) Apart from that, Hamilton implicitly shares Veblen’s idea about unpredictability of the future due to nonlinear evolution of institutions as both

authors describe. Moreover, Hamilton states that the existing school of thought also represents an institution. Our prevailing way of understanding and analyzing things is shaped by this institution. If we are to change our perspective of world, then the institution of “ways of knowledge” should evolve into the ‘institutional approach’ (1932: 244).

2.4. John R. Commons

Commons did not have ideas as sharp as Veblen, although he was one of the most influential minds in American institutionalism after Veblen. If we consider Veblen as the core of original institutional economics, then we should place Commons to the periphery, since Commons and Veblen differ in their approach to certain crucial themes of institutional economics.

Commons’ main interest was in social reform for a better capitalist order rather than focusing on exploration of institutional evolution. Veblen was the utmost opponent of classical and neo-classical economic thought, whereas Commons’ idea was to incorporate them to institutional theory after stressing and treating their defects. Commons did not adopt a Darwinian evolution for institutional change as Veblen did. His focus was in fact on deliberate change and ‘managed equilibriums’ (Chavance, 2009: 21-2).

Commons defines advanced capitalism as an economic set of rules imposed by organizations or in other words “going concerns” that are in three different forms – economic, political and cultural (Chavance, 2009: 23).

. . . [T]here types of transaction are brought together in a larger unit of economic investigation, which, in British and American practice, is named a Going Concern. It is these going concerns, with the working rules that keep them agoing . . . that we name Institutions. The passive concept is a “group”; the active is a “going concern.” (Commons, 1959: 69)

Similar to Schmoller’s definition, the main content of Commons’s organization is people. However, the difference between two authors stems from Commons identifying organizations as institutions.

For organizations – institutions – to operate, they need working rules and collective action of their members (Chavance, 2009: 26). There are two forms that collective action takes: custom and going concern. In an institution, “Collective Action [is] in Control of Individual Action” (Commons, 1959: 69). However, the restraint of individual action imposed by collective action is not actually a hindrance to the former; it is indeed freed of individual constraints caused by egoistic tendencies among the members of organization. This is a fairly positive attitude towards institutions compared to the Veblen’s critical approach.

And Collective Action is more than restraint and liberation of individual action – it is *expansion* of the will of the individual far beyond that he can do by his own puny acts. (Commons, 1959: 73)

2.5. Walter C. Neale

Neale defines ‘the core idea’ about institutions generally as the *government* of individual choices through cultural use and wont (Neale, 1987: 1179). However, he sees this definition as a broad and vague one and indulges himself in clarification of this core idea.

Institutions, in Neale’s terms, imply “an observable arrangement of people’s affairs that contrast with characterizations of people’s activities deriving from assumptions, intuitions or introspection” (1987: 1181). Moreover, institutions vary according to time and place in consideration. Therefore for Neale, although American middle class family is an institution, love and reproduction are not because they are not defined with time and place specifications.

To Neale, an identification of institution necessitates three characteristics of institution (1987: 1182). The first is the *people doing*, participants of an institution. The second is the *rules*. Rules are permanently repeated acts that may vary in detail, but show regularity and consistence in pattern under similar circumstances.

The *rules* are identified by ordering the doings into repetitive event sequences. The analyst observes and records what happens and he can after a number of observations, state that in such-and-such a kind of situation this person will do thus-and-such and another will do thus-and-so, with some variation in the detail and style with which is done. (1987: 1182)

Neale, in his argument of rules, expands Veblen's definition of institutions as habits of thought. Rules are more like habits for Neale. Nevertheless, rules per se are not adequate for indentifying an institution. Therefore, Neale explains the third characteristic as *folkviews* (1987: 1183).

Folkviews represent justifications of rules. Rules are how things are done; on the other hand folkviews are answers of people doing to whys. These answers are shaped by the culture of the people doing. Thus, they are past-dependent. Folkviews are also observable notions like rules. While we observe rules with eyes, folkviews spread through ears.

Despite the fact that all three characteristics of institution are observable, institution itself is usually not. As Neale puts it; "an institution is a mental construct" (1987: 1184). Nonetheless, he defines *situation* in which activities of people doing are observed.

A situation is the total relevant context in which a participant in a society finds himself at any moment . . . An institution may thus be regarded as a grouping of situations in accordance with the "organizing ideas" of the folkview . . . (1987: 1184)

In his argument about the origins of institutions, Neale restates an important view of original institutionalism. Due to the culture specific and past dependent aspects of institutions, it is nearly impossible to reveal origin of any institution (1987: 1194). Any task attempting to do so will be misled by our prevailing habits of economic

thought (rules), and our current cultural view (folkviews). How and why institutions evolve are more critical questions than asking from where they originate (1987: 1195).

Another discussion of Neale is on interdependence of institutions. An institution is not a stand-alone entity.

. . . It fits into the system of institutions, so that changing the rules of one institution means that the rules of other institutions must adapt to change . . . (1987: 1195)

Hence, institutional evolution operates in a *cumulative circular pattern* as stated by the most original institutionalist, namely Veblen.

2.6. Geoffrey M. Hodgson

Hodgson's definition of institution is quite similar to Neale's. For Hodgson, institutions consist of "established and prevalent social rules" (Hodgson, 2006: 2). Institutions, via regulating individual thoughts according to rules, open up new social choices that would have never emerged spontaneously. Rules are "socially transmitted" norms and regularities, which represent a persistent way of doing things under similar circumstances (2006: 3). For a norm to be socially transmitted it has to be derived from social culture and spread through language. Rules include social norms, conventions and legal rules. Legal rules are mostly codifiable. However, not

all codified statements are legal rules. Such statements should find approval among society so as to be legal rules. Such normative content must exist for any kind of rule. Nonetheless, for Hodgson, an agreement of social members upon a rule does not necessarily be explicit or intentional as it is imposed by some authority. Hodgson's view of rules covers both legal rules and norms of behavior that may imply sanctions for society or not (2006: 4-5). Therefore, institutions are mostly of spontaneous nature.

Considering how institutions operate, Hodgson defines *habits* in relation to the Veblenian tradition (2006: 6-7). Not all repeated behavior is habit, although regularity of behavior is important for habit. Habits are not necessarily used regularly as we do in persistent behavior, but comprise a significant place in "rule-following behavior". If a habit is normally accepted, potentially inscribable and permanent, then it will happen to be a rule, a custom. Habits provide institutions with the power of normative authority. Mutually, institutions enhance normative agreement upon habits and people begin intentionally participating in those habits. Therefore, habits emerge due to an implicit and unintentional agreement of society and transforms into deliberately adopted beliefs, which creates intentionality (2006: 7). This is a result of 'partial reconstitutive downward causation' or in other words *cumulative circular causation* of institutions back on individual aspirations. This backward influence of institutions on individuals invests in institutions a 'self-reinforcement' and 'self-perpetuating' aspect.

Hodgson's criticism of Douglas North for his approach to institutions reveals Hodgson's view of organizations. He does not treat organizations as entities that are separable and distinct from institutions, contrary to North's definition as "players of the game" (2006: 8-9). Organizations are all institutions designed according to specific rules to distinguish their frontiers and members, with definitive hierarchy to assign managers and with chains of command to assign responsibilities to members.

Hodgson expands his argument of institutions further with a discussion of "self-enforcement" and "external-enforcement" (2006: 13). What he means by self-enforcement is institution's being capable enough to be independent of all other institutions by exerting rules to its participants. Those are 'self-organizing' institutions. This is impossible for Hodgson, except the institution of language, since "language does not presuppose other institutions". All institutions, beside language, are externally dependent since they are interdependent parts of an organic whole as would most institutional economists agree. Nevertheless, all institutions could maintain some degree of self-policing even if they are still dependent on some other institutions or authorities for full functionality.

The last discussion of Hodgson is on "agent-sensitiveness" and "agent-insensitiveness". In brief, if an institution is agent-sensitive, then the decisions taken by participants affect the course the institution will take. On the other hand, institution is agent-insensitive when individual actions do not influence the institutional operation. For Hodgson, institutions are in neither extreme form as far as

agent-sensitivity is concerned; “they exhibit different degrees of agent sensitivity and insensitivity” (2006: 17).

2.7. Common Aspects of Institution

Thus, after reviewing the core ideas about what institutions are, some widely recognized aspects of institutions are revealed.

First and foremost, culture is the common denominator of all institutions. *Habits of thought, rules and conventions, folkviews* are all based on the existing socio-cultural system of beliefs. In this context; legally codified rules and the institutions operating according to these rules find acceptance, only if they are supported by society’s cultural norms. Institutions are inseparable parts of the whole socio-cultural system; they are embedded into our thoughts and life.

Another aspect as critical as the first, is the feedback provided by the institutions to other institutions and individuals’ thoughts and actions. The patterns of causation, which is referred in the literature as “cumulative circular causation” and “reconstitutive downward causation”, lead to nonlinear evolution of institutions and the system as a whole.

Furthermore, institutions are *path-dependent*, which means that they represent a continuity of the past to present. Institutions are created in past, operate at present

and evolve into future. However, they usually have “no origin apart from their development”.

The immediate result of path-dependent institutions is their rigid, constraining nature. Institutions impose restrictions and regularities on individual behavior since they carry *ceremonial* features of the past. However, they are not purely traditional settings, but they also possess *instrumental* features. What decides an institution’s being “imbecile” or not, is the result of continuous conflict between those traditional and productive forces within the institution (Veblen, 1964: 25). Therefore, constraining nature of institutions could in fact lead the social process into a more unrestrained state; unrestrained of individual egoism and rent-seeking.

Institutions could vary in their content such as political, economic, legal or social, as they could vary in whether they are agent-sensitive or not, self-policing or not. The main purpose should not be to discover an ideal institution that purely fits into one of these groups since institutions are mixed phenomena. They could be converted by individuals so as to fit their purpose. They could totally lose meaning through time. However, the more flexible an institution is, the longer it will exist. This flexibility stems from institution’s mixed content.

CHAPTER 3

PERCEIVING STATE AS AN INSTITUTION

After depicting prime characteristics of institutions in the previous chapter, now the stage is ready to present the actor in the leading role. However, let us note that for a further analysis of what we are up to, this analogy is partly misleading. In order to refer to state as an ‘actor’, one should approach state as if it is an entity of a single man or an assembly of men. In this regard, the analogy above would, in fact, fit precisely to several definitions of state in the literature. On the other hand, to attribute state the ‘leading role’, especially in economy, is an approach that is recognized up to the last two centuries.

The intention of this chapter is neither to present a literature survey of what state is nor to suggest an alternative theory of state formation and origins of state, attempt of which would be beyond the scope of this work. The main hypothesis here, that suggests the possibility of observing state as an institution, is constructed through this chapter by establishing a relation between concrete foundations of institutions and state. However before that, the meaning that the author attributes to the “state” should be revealed.

3.1. The ‘State’ Idea

State in general sense is identified as a complex political organization that emerges in complex social systems due to the necessity of governing, directing, regulating, administering – all of which are essentially the same – of the complexities of that system. Therefore, state could not be seen in all societies since it is not formed when not needed (Krader, 1968:15-7). The society itself is responsible for the incapability of self-administration, thus society created an apparatus called state, which is “properly the sum total of social entities that alone are qualified to speak and act in the name of society.” (Durkheim, 1986: 45)

This “social entities” could be a single man as emperor or king, or could be a group of men as in democratic regimes. In modern theory of state, individuals “confer all their power and strength upon one man or upon one assembly of men...” (Hobbes as cited in Steinberger, 2004: 42)

Hence in contemporary political thought, state is clearly distinguished from society (Steinberger, 2004: 8). There is a civil society or ‘commonwealth’ on the one hand, and the state or the ‘government’ that protects individual freedom on the other.

The state as suggested in this work is not defined according to the modern theory, since it lacks in some perspectives. First of all, the author agrees with the idea that state emerges as a result of complexity. However, this is not to suggest that a primitive society is less complex than a 20th century European society. The Kula ring of the Trobriand Islanders in western Melanesia, with its enormous extent and the

complex social arrangements that had to be done for its operation, is a demonstration of this fact (Polanyi, 2001: 49-52). Moreover, one could discover the complexity of most basic technical process such as making a stone tool or pottery (Levi-Strauss, 1952: 34-5).

To transform a need into a cultivated plant, a wild beast into domestic animal, to produce, in either of these, nutritious or technologically useful properties which were originally completely absent or could only be guessed at; . . . to work out techniques, often long and complex, which permit cultivation without soil or alternatively without water; to change toxic roots or needs into foodstuffs or again to use their poison for hunting, war or ritual – there is no doubt that all these achievements required genuinely scientific attitude, sustained and watchful interest and a desire to knowledge for its own sake (Levi-Strauss, 1970: 14)

A society should not be described solely according to the economic practices and technological conditions of its community, in case of which one could occasionally misleadingly conclude that the most advanced societies are contemporary capitalist ones². Society is composed of language, customs and beliefs and these are shaped by culture. The complexity of a society comes from the complexity of its culture, of its system of beliefs, of its language. Therefore, a primitive society could be well defined as a complex society since its language or its religious beliefs are complex. For instance, the richness of technical language used for identifying various kinds of ‘known’ and ‘used’ plants and animals astonishes many botanists and zoologists

² This is the rhetoric of liberal-minded economists, who deliberately insist on a linear pattern of modernity that is based solely on material wealth of contemporary *market economies*. However, Polanyi, as well as Veblen and Schumpeter, avowedly counters this idea of linear progress and employs a rather *non-dogmatic evolutionary* approach to economic and social development. (Özveren, 2007)

(Levi-Strauss, 1970: 1-9) From a point of view, polytheistic religions are indeed more complex compared to monotheistic religions because of several distinct religious practices differs from one deity to another. Even in economic sphere, different organizations have their own complexity and difficulties such as in reciprocity and redistribution. In this perspective, suggesting that primitive societies are less complex, by which it is usually meant that those societies are less developed, is a consequence of mere economic outlook. With a wider view of study, one could probably prove otherwise and the “original affluent societies” could be shed light upon (Sahlins, 1972: 1-41).

A second pitfall of the modern state idea is its separation of state and society. As mentioned above, those are two inseparable phenomena since the former is embedded in the latter. State would not emerge without a society, since it is nurtured by society. If state is a “structure of judgments about what is true and what is not”, then those rights and wrongs are rested upon the cultural background of society (Steinberger, 2004: 13).

If the state in the author’s mind here could not be traditionally defined, then how should it be? It is in fact defined above shortly as “structure of judgments about what is true and what is not”. However, this definition deserves a better explanation.

It is asserted that the foundations of the state lie in society. The rights and wrongs are functions of cultural beliefs and social consent. Therefore, to-do and not-to-do are ideas based on some other ones. And consequently, if state is a sum of those

judgments, then state is an idea itself, which is also derived from cultural and social norms of society.

The state could be best understood as a *structure of intelligibility* . . . As such, they reflect a complex and comprehensive intellectual world – an immense world of concepts and beliefs. (Steinberger, 2004:13)

The idea of state is embodied with the sovereignty of an emperor, or with the government of an assembly, or with the wisdom of a chief. Therefore, state is an idea that exists and functions (Steinberger, 2004: 14). To move the argument even further, institutions could also be considered as they are constituted of and regulated by the ideas. However, those ideas do not occur to come to people's mind from nowhere. They are products of society's habits. This is why habits are deliberately referred as *habits of thought*. As mere members of two interconnected social settings, family and society, we inherit certain kinds of habits and learn others on our way. These habits transform into ideas and thoughts so as to be transferred to other members of the social setting, which in the end creates the society's habits of thought³. Therefore, if ideas are constituents of institutions and state is an idea itself, then with basic inference, state appears to be another institution.

³ "Individuals begin as babies. They learn the custom of language, of cooperation with other individuals, of working towards common ends, of negotiations to eliminate conflicts of interest, of subordination to the working rules of the many concerns of which they are members. They meet each other, not as physiological bodies moved by glands, nor as "globules of desire" moved by pain and pleasure, similar to the forces of physical and animal nature, but as prepared more or less by habit, induced by the pressure of custom, to engage in those highly artificial transactions created by the collective human will." (Commons, 1959: 73-4)

Another useful concept that is related to the state is *governance*. Governance could be basically defined as the act of governing. However, governance should not be necessarily done by governments or as by states in traditional meaning (Gamble, 2000: 110-1). The “art of government”, *vis-à-vis* the “Machiavellian *prince*”, is indeed a “plurality of forms of government and their immanence to the state” (Foucault, 1991: 91).

The art of government . . . is essentially concerned with answering the question of how to introduce economy – that is to say, the correct manner within the family . . . and of making the family fortunes prosper – how to introduce this meticulous attention of the father towards his family into the management of the state. (Foucault, 1991: 92)

What does it mean to govern a ship? It means clearly to take charge of the sailors, but also of the boat and its cargo; to take care of a ship means also to reckon with winds, rocks and storms; and it consists in that activity of establishing a relation between the sailors who are to be taken care of and the ship which is to be taken care of, and the cargo which is to be brought safely to port, and all those eventualities like winds, rocks, storms and so on . . . (Foucault, 1991: 93-4)

When state is perceived as an idea, then it is synonymous with governance. State is the idea of governance itself. Note that, governance could not be confined solely to ‘supervising’. This would be a neoclassical view. Governance does also mean direct interference to the subject matter. For instance, economic governance means that the state as an idea is embedded in the process, rather than an agent supervising it. Therefore, from now on in this work, state is referred in nontraditional sense, as the idea of governance that appears and functions sometimes in the hands of a chief, other times in the hands of a monarch or an assembly. No matter who is responsible

for the functioning of state, it has always been more than a landscape or offices of bureaucracy.

With a clear definition of state in hand, now it is time to match the functionality of state idea with the features of institutions as reviewed in the previous chapter. If characteristics of an institution fit to the state as it is defined, then state could be perceived as an institution. With a special reference to state's activities in economic history, it could even be possible to exhibit state as an economic institution.

3.2. An Institutional View of State

Although it would be contradictory for an institutional economist to attempt an “institutionalist theory of the state”, since it requires unification and generalization of the state idea, state has never been an overshadowed concept in the literature of institutional economics (Waller, 2006: 14-9). Due to the great extent of American pragmatist influence on original institutionalism, state was analyzed with regard to its pragmatic functionality. For instance, Veblen commented on state mostly as a “predatory institution” webbed by vested interests of dominant parties. Those parties use state functionality in order to fulfill their dynastic and imperial goals, thus they corrupt the state institution. On the contrary; Commons, parallel to his positive attitude towards institutions, approaches state as a more benign institution, and points to its reconciling force. When Galbraith is added to those two authors, with his view

of state as a 'safe harbor' for industrial economies that protects the industry from the destabilizing effects of markets, then it could be claimed that what those institutional economists had in mind was 'Pragmatic State'.

3.2.1. Path-Dependent Evolution of State

Pragmatic state, with three definite characteristics attributable to it, is more a picture of modern state. Sovereignty, policy powers and public interest are those characteristics (Waller, 2006: 19-22). The first one is quite important because of what it signifies. Sovereignty is a representation of political and geographical freedom. Such freedom leads into the attachment of people within those boundaries to the sovereignty more than the physical bond of a land. Citizenry, no matter it is of a town, of a nation, or of an empire is a persistent and habitual phenomenon. Even if boundaries of sovereignty collapse, people persist in feeling an attachment to that sovereignty. In many cases like the collapse of Ottoman sovereignty, it often requires a sudden break of that persistence usually in revolutionary ways (what Mustafa Kemal definitely did) so as to establish a new sovereignty. However, despite the sharpness of the revolution, people's attachment to the ideas represented by the previous sovereign could only be partly replaced. Again for the Turkish case, that habituation of citizenry still finds its representation among Turkish society, and a considerable amount of Turkish citizens still feel not historical but rather nostalgic attachments to the Ottomans. For the European case, that habituation of citizenry is

exhibited in the shift from medieval city-states to nation-states. In Europe, towns are turned into nations and town citizenship expanded into national citizenry. Moreover, city governors' political and economic responsibilities, such as protection of both internal and external commerce were reincarnated under the national rule of monarchs or assemblies in the form of 'mercantilism'. Another illustration could be nation-state's replacing manorial landlords in protecting agricultural production (Hicks, 1969: 101-21). The mutual economic dependency between serfs and landlords is continued between free peasants and territorial states. Schumpeter observed this path-dependency from a similar view and concludes that "[t]he steel frame of that [structure of absolute monarchy] still constituted of the human material of feudal society and this material still behaved according to precapitalist patterns." (Schumpeter, 1974: 136)

Such a path-dependent pattern of state evolution could be seen in many other formations of state. Hintze underlines the fact that the Ottoman Empire transformed its old military and patriarchal class inherited from its nomadic past – which I guess is *sipahis* – so as to use them for a new formation of state, an empire (Hintze, 1975: 169). Likewise, absolutism in the Continental Europe, rather than destroying previous social setting of the Estates', based its system of government on it (Hintze, 1975: 175). Lastly, English parliamentarism in its early period was constituted of neither the trading nor the manufacturing class, but was structured on the rural aristocracy (Hintze, 1975: 175-6).

From all these instances it could be derived that sovereignty is a way of how state becomes path-dependent. Moreover, it is observed also that state evolves in functionality and responsibility, although this gradual change is dependent on its past. Even after the revolutionary attempts to fasten up the pace of change, society was so rigid that it insisted on carrying past ideas and habits to present.

3.2.2. Social Embeddedness

Social embeddedness of state idea could be illustrated by looking at how a tribal chief's role in that primitive economy is shaped by cultural beliefs. Since it was already discussed if a chief could be described as state, the author is in no position to restate that idea. Raymond Firth (1965) explains in detail an early 20th century Polynesian society, inhabiting Tikopia Island of the southwestern Pacific. In his work, one chapter is devoted to "economic functions of the chiefs" (Firth, 1965: 187-235). In Tikopian society, succession to chieftainship requires anything but a public approval.

He [the chief] said: "The Chief is made *tapu* (sacred) indeed by the body of the land, not to shoulder burdens." By "the body of the land" is meant the mass of people as a whole. (Firth, 1965: 192)

This prerequisite of social consent for the chief makes his decisions and acts open to criticism from public. Moreover, socio-cultural beliefs and habits of the public

impose restrictions on the chief. For instance, the chief should not go out to sea during a fish hunt since it is believed that this brings misfortune and scantiness. However, the chief often broke this rule and was mostly held responsible for a probable poor catch.

Conspicuous consumption of state elites such as princes, lords, aristocrats and bureaucrats is also an example of socio-cultural repercussions on state. A wealthy appearance to the public has always stood for a way of establishing and enhancing social dignity among society, especially after material wealth began to be perceived as an indication of power.

A contrary relation could also be spoken of, which is the effect of state on socio-culture. Large feasts given by lords, kings, emperors served the purpose of redistribution on the one hand and social cohesion on the other. As a specific instance of this, Mycenaean Greece of the Aegean Bronze Age (1400-1200 B.C.) will be perfect (Bennet, 2007: 205). Likewise, the “Annual Customs” of the 18th century Dahomey in western Africa – which is later to be called People’s Republic of Benin – was a yearly organized redistribution ceremony (Polanyi, 1971: 207-8). The purpose of the Customs was not only redistributive, but it was also “a symbol of religious and political unification of the peoples of Dahomey under Aladoxonu kings.” (Polanyi, 1971: 208)

A last instance of the relation between economic governance and social system is gift trade of states. Gift trade of tribesman and especially of chiefs is an important part of

reciprocal arrangements in primitive societies. Such kind of trade operates on kinship based relations. A further specific example is the gift trade of princes in the Ancient East as a common rule of peaceful times (Weber, 2007: 197). There is evidence of lively gift trade between Pharaohs and the Levantine rulers after 1400 B.C. Through free gift trade, a certain degree of trust and faith was established between states, and this further turned into commercial trade. This is an important illustration of how a socio-economic action (the gift trade) could pave the way for further economic relations, by means of enhancing social bonds (trust) between states.

From all of the historical illustrations above, one fact appears vividly. It is the fact that state, or more precisely economic governance, is not separable from the social and cultural whole. State, first of all by definition, is a social norm. Its actions and its meaning are dependent on the complete setting of the society. Can you think of a state, speaking a language other than that of its citizens, in which case the society could not establish a bond to that state, or even understand its actions? There are indeed a great variety of states that managed to do so for fairly long periods. Gellner suggests most of the states in agrarian societies fit to this description, because literacy was so low that only highest strata in these societies was in its reach, which made written culture concentrate and centralize in the hands of administration, clergy, soldiers or any kind of ruling class (Gellner, 1983: 8-9). However, such centralization of culture and sharp separation of statesmanship and society became unbearable when literacy began to gradually increase – parallel to the advent of industrial society in the age of a “universal high culture” – and societies of agrarian

states became aware of the states' affairs (Gellner, 1983: 35). This could well be counted as one of the minor reasons that paved the way for collapse of agrarian empires, in which state language differed from that of society, such as the Ottomans or the Austria-Hungarians. Language is the most general type of social bond of the state to its society, but that bond could not be restricted solely to language. One may speak of a re-loosening of that bond, of that embeddedness, after the "Great Transformation" (in Polanyi's words). The rise of nation-states that emphasized and necessitated an existence of national language was like a parenthesis in the history of human civilization. The place of state in capitalist society, or specifically in capitalist economies is an important argument that will be left for further examination.

3.2.3. *'Cumulative Circular Causation' and State*

Another important feature of an institution is its relation to the system within a cumulative circular pattern. This means that the causation among institutions, and between institutions and the whole system (economy in this case), move mutually. As a general instance, monarchs and kings began to protect the merchants dependent on them so as to reap the benefit of high taxes and customs revenue from the commerce going on. This was generally shaped by the mutual relation between cities and states, especially after middle ages in Europe. The former created the capital concentration that was necessary for growth of national states and the latter provided the city capital with the powerful coercive methods (Tilly, 1992: 51-3). A more

striking instance is the state's involvement in use of money as standard of payment (Hicks, 1969: 65-8). Money, as in its early forms, was used for store of value purposes. However, it owes its wide acceptance and popularity as a standard of payment to states' undertaking of minting and printing money. After coinage was invented by the Lydians, it spread to other city-states of the Mediterranean as the king's money. However, what was the initiative for a non-mercantile king to take the responsibility of money? For a mercantile city-state, it is understandable to involve in coinage minting as a profitable business, in which minting was offered to merchants as a charged public service. But, for a non-commercially minded monarch, this is an invalid explanation. What he had in mind was always to maintain a high level of consumption, usually conspicuously, through a constant flux of goods to his country, and specifically to his palace. Then, if state engages in minting coins with a stamp of a reputable king on it, it will definitely find a wider acceptance among traders and thus will spread faster. Therefore, as king's money reaches further and further, he can collect taxes and tributes in that money form. From then on, his wealth takes the form of his money. Thus, when it is time to purchase goods for consumption, the king will have a great array of choices. To put briefly, state involves itself in minting money, which expands the usage, and this expansion in return helps state to raise its wealth. As a result, state voluntarily establishes a monopoly over money creation. This has further repercussions on an economy (Hicks, 1969: 81-100) States are prone to indebtedness. Without decent public policies and tax systems, pre-capitalist states are even more prone to this. On the other hand, in pre-capitalist economies, due to

the lack of proper, fully functional financial institutions and regulations, and one should add the reluctance of states to pay their debts to private lenders; states' creditworthiness was considerably low compared to other owners. States, experiencing severe difficulties to raise their revenues either with taxes or with borrowing on the one hand and having constantly growing expenditures due to endless wars on the other, invented several ways to solve their problem. One of these ways was debasing money. Through debasing money, states seek to refill their coffers. However, their means proved wrong soon with the inflating prices and further worsening of their indebtedness. Here is a complete cycle of cumulative causation created by an action of state, turning back to its origin and creating a new effect.

This cumulative circular causation pattern could also be traced within the state itself. For Hintze, as shifts in social structure within state have repercussions on the formation of that state, "alternations in the external existence of a state" have effect on its internal structure (Hintze, 1975: 159). Relations of states with their surroundings have immediate effect on the external shape of states, which are size of states, their congruity and even their ethnic composition (Hintze, 1975: 160). This is also apparent in Tilly's argument of how wars trigger state formation and transformation (Tilly, 1992: 20).

In the nature of the case, national states always appear in competition with each other, and gain their identities by contrast with rival states; they belong to *systems* of states. (Tilly, 1992: 23)

In Roman history, expansion of the state's territory had an important impact on its internal structure (Hintze, 1975: 164, 184). The expansion of Roman territories, which was on the one hand possible with a standing army, on the other hand made that standing army a necessity for defense of vast territory. In accordance, field commanders were sent to far provinces, where they became independent lords in conflict with one another, and this triggered the transformation of emperor into a monarch.

3.2.4. Instrumental vs. Ceremonial

In the previous chapter, institutions were explained as a juncture of instrumental and ceremonial forces. State is not an exception.

First, look at tribal societies and chiefs' economic role. A chief is responsible for the daily undertakings of his household. The food consumed by a chief's household is primarily provided by their own means since the "tribute" brought to chief is returned to society as gifts (Firth, 1965: 190-1). The chief's eldest son leads hunting trips or cooking for ceremonial activities. Moreover, by the productive activities chief does, he stands as an aspiration for his tribe. He paddles the canoe himself even if he is not alone on the canoe. He does not participate in hard works in making a canoe but helps with easier works. Despite the instrumental characteristics of a chief,

he is confined in some ceremonial or “magico-religious” (in Firth’s words) practices.

For instance, he is exempt from carrying burdens.

Finally, reference should be made to the energy expended by the chiefs in carrying out their non-economic ritual duties, which sometimes involve considerable effort. (Firth, 1965: 198)

Therefore, chief of a tribal society bears both instrumental and ceremonial duties, though the degree of restrictions imposed by ceremonial aspects over instrumental activities depends on the priority society attaches to ceremonial practices.

Different states in history had various ceremonial features such as conspicuous consumption for maintaining social dignity or public ceremonies that had to be done as a symbol of power and sovereignty. However, two crucial points remain for discussion. The first critical assertion is; states that do not exercise secular governance are more inclined to ceremonial restraint. That was mostly observed of European states in the period before the Christian Reformation. In the pre-Reform era, states were under significant influence of churches. Therefore, states’ actions were constrained with church’s decisions and declarations. Churches sometimes stood as an insurmountable obstacle for kings, since it would provoke public disapproval to act contrary to religious traditions. This is one of the reasons why European society opposed to change and remained stagnant up to 15th century.

A similar argument could be made for religious governments of Islamic Middle East. Although *mosque* could not be the counter part of church in exercising political and

economic power, in the late Ottoman Empire *tariqahs* had a considerable influence on decisions of both the central state and local governors⁴. It is meant indeed that as long as state was open to influence from religious courts, people always tried to use their influence on state by means of a powerful tool, called religion. When people in reach of religious power did not want an idea to diffuse, or a tool to be used, by declaring it unsacred or *haram*, they managed to abolish that thing⁵.

3.2.5. *Agent Sensitivity of the State*

State's sensitivity to its agents is related to the level of its representation and the level of corruption among these agents.

The level of representation is how much a society's view is represented by the state. It is similar to the concept of democratic representation, but more is implied. By definition of the state, which takes state as an idea that society has consent with, one expects the level of representation to be fairly high for almost all kinds of states. However, this depends on many conditions; hence differ even among same kinds of state formations. In primitive societies, for instance, level of representation is assumed to be very high since primitive state mostly depends on and is shaped by society's beliefs, culture and customs. Nonetheless; depending on how much

⁴ Nevertheless, it is not to say that both Islam and Christianity are inherently incapable of promoting change and they are both an obstacle for societies.

⁵ So as to prevent such ceremonial constraints with the use of religion out of its content, Mustafa Kemal abolished caliphate in 1923 and founded the government of Turkish Republic.

importance chief attributes to social norms, the level of representation varies. The more chief pays attention to norms, the higher the representation is. At the city-state level, distinction is according to the ruling authority. The governor's being a king, a manorial lord, or a group of aristocrats determines the level. Since kingdoms are mostly ruled dynastically, level of representation is lower compared to aristocratic governments. Moreover, a king usually claims divine power, as if his right to be king is given by god, which saves his decisions of public criticism. On the other hand, aristocratic government is more open to criticism, which implicitly enforces social restrictions on it. Monarchical and imperial governance are even worse than the two above, since a larger territory is governed. Although monarchs may employ local governors for distant regions of their country, the level of representation still remains low due to the reluctance of local governors to listen to the preferences of the public. With parliaments' advent, level of representation seems to increase compared to earlier forms of governments. However, together with the spread of liberal ideas and individualism, social integrity of societies loosens. Individual freedom gets priority over social consent, and societies break apart in terms of common sense. Social norms become individual rights. Without general wisdom among individuals, which makes them a society as a whole, states are no more based on public opinion but on individual interests. The class which holds the economic power in hand – the capitalist class – managed to turn those individual interests to group interests, since that interest was nothing but endless capital accumulation. Nonetheless, the relation

of capital accumulation to different modes of representation and intervention should be investigated due to its repercussions on the current discussion.

“The [capitalist] state is an institutional complex of forms of representation and intervention.” (Jessop, 1990: 118) Parliamentarism, corporatism and “tripartism” are three distinct “modes of articulation” or disarticulation between representation and intervention (Jessop, 1990: 119). The first one combines democratically elected parliamentary government as a mode of representation with the legislations and general policies within the constraints of law as a mode of intervention. Parliamentarism is significant with the separation of political and economic realms. On the other hand, corporatism, which assembles political representation and state intervention under the hood of corporations, tends to fuse those two realms (Jessop, 1990: 120). Lastly, tripartism is a hybrid form of the previous two modes of articulation in the sense that it requires corporatist intervention in parallel with parliamentary representation (Jessop, 1990: 121). Both parliamentarism and corporatism are limited in their extent to ameliorate capital accumulation. Parliamentarism was applicable to capitalist states in the period of liberal competitive capitalism, since political representation of the masses had not been expanded enough to influence state policies in a way to hamper capitalist interests (Jessop, 1990: 123). But, corporatism has been more feasible for the state monopoly capitalism due to the fact that it resolved the dilemma of the governments under parliamentarism to satisfy capitalist needs on the one hand and to respond to the voting masses’ demands so as to be reelected. But just like the former, corporatism is

also vulnerable to the political crises emerging within the corporation, which definitely ceases capital accumulation (Jessop, 1990: 124-5). Therefore, this proneness to political crises of corporatism and parliamentarism, prevents both to be the best mode of political representation for capital accumulation. However, this is not to conclude that level of representation was relatively higher in both modes than in other historical modes. Parliamentarism was the dominant mode of representation anyhow in a capitalist period in which political representation of the masses was not expanded. When it was expanded, revolutionary tendencies among them was suppressed through realizing their economic significance for capital accumulation and treating them *supposedly* equal in terms of political rights under the hood of corporations (Jessop, 1990: 164). Another mode of representation is “clientalism” in which “political support is exchanged for particular benefits . . . (including licenses, legal monopolies, state contracts, subsidies, and so forth)” (Jessop, 1990: 163). This, again, poses a problem to capital accumulation, since it requires many costly practices.

“Social democracy is the most appropriate social base for liberal corporatism [corporate capitalism] since it secures the support of the largest and most powerful of the dominant class in state monopoly capitalism.” (Jessop, 1990: 131) However, it is still not the most favorable mode of representation for the dominated classes, since the democracy was not very democratic at all. Especially if one looks at the democracy from a utilitarian viewpoint, which the mainstream doctrine of democracy does, then it is impossible to avoid the fallacies of the “common good” and “common

will” of the people (Schumpeter, 1974: 250-2). They are false assumptions, first of all, due to the fact that there could be no common will of the people whose rationale depends solely on individual calculation of risks and benefits. Second, even if one could define a common good for a group of people, this does not imply that people will agree on the possible ways to reach that desired end. Lastly, because of the two reasons proposed, the assumption of the common will is automatically falsified, since without a given common good for the people, they will not develop a common will for that.

In practice democratic rights are often eroded by a number of very serious obstacles resulting from deliberate political action and/or the unintended effects of particular institutional arrangements.

Moreover, even where such deliberate barriers to formal democracy are minimized in the electoral process, similar barriers may be erected to prevent elected representative controlling the exercise of state power. (Jessop, 1990: 177)

Besides these, there are three structural constraints of formal democracy (Jessop, 1990: 178). First, under already unequally distributed conditions, such as education or income – the former usually presupposes the latter anyway – it is the most naïve belief to expect classes or individuals to attain equal political representation. Secondly, political agenda is bounded to specific zones of jurisdictions which exclude many issues like women’s liberation or homosexual rights from the scope of governments. The third constraint is an essential feature of capitalist market economies, separation of the politics and the economy. Such separation of two

embedded spheres of social life detains state from controlling the economy according to its will and obliges state to ensure working of capitalist system for its own survival (Jessop, 1990: 179). Apart from this, social democracy is already weakened by a striking contradiction of it.

Even Social Democracy, which in principle is against everything connected with militarism, not only owes to it the discipline on which its party organization largely rests . . . (Hintze, 1975: 211)

Therefore, state is enforced to mostly represent capitalist interests and it succeeded in this thanks to militarism as a powerful coercive method. Under such a circumstance, it is impossible to talk about a high level of representation, as long as it is the general will of the society that matters most, if that sort of thing still remains.

The level of corruption and representation are closely related issues. To put briefly and generally, the less the level of representation of society is, the more corrupted the state agents are. Low representation level means state cares less about public opinion and social norms established within the society. Therefore, it will not matter for agents of state whether they act according to legal laws, social norms and customs or not. State is an organization; and all organizations are expected to further their members' interests (Olson, 1971: 6-7). State's members are citizens; then citizens demand state action analogous to their interests. Even if members of a state organization have some common interest in forming that state, individuals may choose to divert from that common goal and pursue their own interests. This usually

happens when members of an organization are not restricted with “social pressure” of other members of the group (Olson, 1971: 60). What is meant with social pressure is the necessity of obeying common interests of the group, on the contrary of which social dignity, prestige and self-esteem are lost. The larger an organization is, the lesser the social pressure is on the members, because in large organizations members do not necessarily know each other and the social bond between members are looser. Therefore, in larger state formations, the tendency of members to pursue self-interest is higher, which usually leads to corruption. But, how are this and the representation related to agent sensitivity?

If an institution is agent sensitive, then the output of that institution could be changed via actions of agents within that institution. If state is an institution expected to act according to society’s needs and preferences, and if it is assumed to be dependent on the social system, then a specific state should function irrespective of which entity it is embodied in. For instance, a modern state’s economic policies should not vary significantly when a new parliament is elected. However; if public common sense is not represented well enough, and state agents are corrupted in parallel with this, then functionality of state will greatly vary with decisions and acts of its agents.

In conclusion to this chapter, it is seen that state exhibits all the important characteristics of an institution, which are path-dependence, social embeddedness, cumulative circular causation and agent sensitivity. Although state is analyzed regarding its intervention to economy, it still could not be defined specifically as an

economic institution. It is not crucial whether it is economic, political, social or cultural, since every institution is a collation of all. What should be emphasized are the multiple functions fulfilled by an institution. State, besides many other functions, also apparently fulfills significant economic functions. Therefore, one still has to show that state is indeed a part of the economic process. This will be the topic of the next chapter.

CHAPTER 4

STATE AS AN INSTITUTION OF THE ECONOMIC PROCESS

Main purpose of this chapter is to analyze the governance of economic process with the concepts Karl Polanyi explained in his work “The Economy as Instituted Process” (1957). Polanyi depicts a panoramic picture of the economy by approaching it from an institutional perspective. There are some crucial elements of his study that could also be employed in an analysis of state within an institutional framework. The idea is to answer the questions: What is the place of state in economic process and how does it change historically?

4.1. Meanings of State

The first concept that could be related to state is the distinction Polanyi made before anything else. There are two meanings of the term economic which are in their essence very distinct from each other, but mainstream economics tries to melt one meaning into another in order to universalize the meaning that is in fact valid only within necessary conditions. These are *substantive* and *formal* meanings (Polanyi, 1957: 243). The same distinction applies to the meaning of state or more conveniently to governance in a similar way.

Substantive meaning of governance arises from the active role played by a dominant authority in economic process. Metaphorically, a team leader who is actively playing in a sports game takes action to alter the way his teammates play, which means that he possesses a substantive and influential role in the game. Contrariwise, the referee decides whether the actions taken by players are contrary to rules or not. Therefore, he has a limited role, which is formally defined, as an authority. A critique may suggest that both entities have distinct substantive meanings. They do indeed. However, the substantive role played by the team leader is not a formally defined and restricted one. As an active competent on the field, the player is capable of direct involvement in the game. On the other hand, the referee could neither shoot nor catch the ball for a team's sake. The referee's role is officially defined though it is still substantial. From this analogy, it is obvious that substantive meaning of state is to do with the state's being an active agent in the economy. As Polanyi defines: "The substantive concept can be briefly defined as an instituted process of interaction between man and his environment . . ." (1957: 248) Similarly, the substantive meaning of state is the interaction of state, individuals and environment. State could either be the producer and supplier of goods or services, or it could be on the demand side. On the other hand, choosing not to be a side in the game, state could be the ruler at the top. With the juridical and ceremonial power it possesses, state may well choose to set the rules through law-making. One step further, state could be a player and the referee of the game simultaneously. Hence, one meaning does not annul or necessitate the other. They are both valid even if they occur side by side. However,

under different social and economic structures, one meaning becomes more prominent compared to the other. In tribal ruling systems, assuming the chief as the source of governance, formal and ritualistic governance was more significant than substantive governance. The chief was responsible for drawing frontiers of economic processes, like the animals to be hunted, the lands to be cultivated, the amount of food to be bartered or stored. It was a rare instance that the chief was directly involved in hunting parties. In archaic societies, substantive meaning gains importance. This has to do with the expansion of economic activities both in space and in amount. In early periods of history, markets were not widespread and transportation was primitive. Therefore, it was dangerous to launch individual ventures for long-distance trading. State-led trading, on the other hand, was safer and more effective. Substantive governance is seen more frequently as economies and societies become more complex, despite the fact that private initiative gains self-confidence, technology improves, and markets spread. Again, this generalization may not apply for different societies. Although late Ottoman Empire assumed a much more substantive role in economy compared to the early Ottoman Empire, it may not have been enthusiastic to maintain an active role in economy as well as the Chinese Empire of the same era, or vice versa. But when we come to the era of capitalism, the tendency becomes obvious. States have never been involved in the economies to this extent in history as they have been for the past two centuries. The complexity of the capitalist economic processes necessitates this. A dilemma is immediately noticed. According to the definition Polanyi made in his article, formal

economics presupposes insufficiency of resources (1957: 246). With a similar approach, a pure formal meaning of governance could be possible only with the sufficiency of private initiative. Without directly getting involved in economic activities, a minimalist state only has pure juridical authority and a ceremonial role. Then, it is contradictory that governance is much more substantive in capitalist era while private initiative has peaked with *laissez-faire*. The question is: Why substantive role played by the state has become more significant although people have been enjoying an incomparable freedom in economic activities since the 19th century? The answer is in the nature of capitalism: unhindered competition. Polanyi argues in his article that formal economics could only be useful for explaining partly a definite type of economy, which is the market economy as appeared in the last two centuries. Meaning of economics has become more formal rather than substantive due to the mistake of generalizing formal economics to both the economies of the past and the present. A similar transformation has occurred reversely since 19th century when the meaning of governance is considered. Governance gained a much more substantive meaning, not due to a deliberate mistake, but because of the nature of capitalism.

Another aspect of the economy touched upon by Polanyi is its being “process”. To Polanyi, if something is a process, then it involves a change of places (locational movements) and for a change of hands (appropriative movements) (1957: 248). If state appears in any of these movements, then it is part of the process. First, locational movements could be governed since state frequently engages in

production and transportation of goods and services. Second, state usually trades and interferes with trading. State could set rates for individual contracts and it could make contract itself with other states or with individuals. Both actions possess the substantive meaning of governance. The state directly affects the process of trading in both instances. In setting rates for individual contracts, state changes the boundaries of the trading game played by the partners. If state were to act as a formal authority at the top of players, then it would only check whether the game is played within the given boundaries and rules. However, changing the rules is a direct interference with the process and is more likely to be a substantive action. Likewise, contract making is clearly an involvement in the process. But there is a distinction that should be made. Up to the 19th century, contract making of states was usually a ceremonial act. It represented a good-will of one state to another. In some examples, contracts are made solely for taxing purposes. In few instances, states made contract with individuals and states so as to change the course of trading or with a mere purpose of buying and selling. However, after the 19th century contract making gains a significant substantive meaning and becomes one of the active roles played by the states. State led trade is mostly non-market trade, since state has the power to circumvent market prices. Moreover, state intervenes in trade, when markets fail to operate for the benefit of trading parties. Last but not the least, disposition of state property, especially land and facilities such as manufactories or buildings, is not a recent phenomenon. In many great agro-empires, land was owned by the state and rented to privates in return for tax, soldiers or crop. In addition, like in the model

known as build-operate-transfer, state usually rents or sells the operating rights of a service facility.

4.2. Forms of Integration for State

Another concept Polanyi introduces in relation to the economic process is the form of integration. There are three forms of integration, through which man and his environment are integrated into each other, communicate and construct an amalgamation. These are reciprocity, redistribution and exchange (1957: 250). Exactly the same forms are also responsible for the integration of state into the economic process.

To begin with reciprocity, it would be impossible without a priori symmetrical organization. Symmetry does not only exist between individuals, but exists also between states. Think about the medieval city-states in Europe or Greek *poleis* in archaic period; they both represent formal and substantive governance that were actively engaging in regional affairs and equivalent in power with surrounding states. The city-states of Genoa, Venice, Milano, Florence, polis of Sparta, Athens, Corinth, Thebes, the Dutch city-states like Amsterdam, the United Kingdom were all dominant actors of their territory and were in a constant relation with their surroundings no matter whether that relation was peaceful or not. They were signing contracts so as to form economic and political alliances and *leagues* (Dutch League),

trading for the sake of benefit or for tradition (gift trade), making wars with each other, hosting immigrants; in brief they were political, social and economic centers that were related to one another in different degrees. There are also more primitive instances to symmetrical relations between authorities such as inter-tribal economic relations. Moreover, reciprocity could be observed in intra-state economic ties. This has to do with kinship bonds that members of closely knit social groups possess. Citizens of a monarchy who mostly belong to a definite cultural background constitute a coherent social group and they are symmetrically connected to one another. If that monarchy is constituted of citizens from several cultural backgrounds, then each social group gets internally organized with a certain degree of symmetry. Here, culture is a dominant factor in establishing kinship ties and consequently reciprocity relations. In this respect, state acts as a catalyst and it fastens the establishment of common cultural bonds. In fact this is a two-sided relation. A state, which depends highly on public's will-power, is founded due to the presence of a shared cultural background. However, once it is founded, it tightens already existing social and cultural bonds. Then, besides developing reciprocity relations with other states, governing authorities are also capable of fastening reciprocity among their citizens even when they do not intend to do so. If a capitalist state acts strong enough to establish cultural and social bonds among citizens, those closely knit citizens become more resistant to any opposing idea coming from the state.

Redistribution is a different form of integration. Unlike reciprocity, its necessary condition is central organization. Every type of governmental organization, from primitive tribal authorities and puny city-states to large empires and modern capitalist states, is a central organization on its own right. One of the primary reasons, why a central authority is formed in the first place is to organize and control redistributive economic actions. The larger and more powerful the central organization is, the more frequent the redistribution. However, there must be a limit to the vastness of centrality, since after a point as the center expands its perimeter expands too much that peripheral zones become unreachable for redistribution. In this case, redistribution takes place around lesser centers, which may or may not be connected to the top.

As the last form of integration, exchange usually requires a certain type of system that is price-making markets. However, this does not mean that exchange and markets are indivisibly connected to each other. Only market exchange in specific is purely an element of markets and we should be clearly referring to it if we are talking about exchange as a form of integration. This is due to the fact that; unless exchange takes place in price-making markets at a bargained rate, it could not be a form of integration, but rather distinct elements institute and integrate the economic process. There are three kinds of exchange as Polanyi defines: operational, decisional and integrative (1954: 254). Operational exchange is simply changing hands. Decisional exchange happens at an administered fixed rate and integrative exchange took place at a bargained rate. The latter is clearly referred as market exchange. The only type in

which governance exists and that requires neither exchange nor markets as an integrative force is certainly decisional exchange. Exchange rate could be set by either of the trading parties or by both. In this case trading must be permanent between two parties and a trust must have been established. Then, parties could decide to exchange at a rate they both agreed upon. Permanency is maintained though peaceful relations between states if we are talking about an international exchange. Rate of exchange could also directly be set by the state according to an agreement made with another state. This could mean private exchange would take place at that rate with the stated country or states would engage in exchange directly at the set rate. Last but not least, states could fix exchange rate of tradable goods domestically. A frequent measure taken by capitalist states in economic recessions and famines is a ceiling price, which is an adulterated fixed rate.

After seeing how state is embedded in the economic process by three forms of integration and how governance could speed up the process, it is crucial to remind ourselves that these forms of integration do not represent a linear pattern through history. One form of integration is not superior to another form. Reciprocity is not only an attribute of primitive societies, but it can also be observed in medieval city-states or in imperial states, even in capitalist states which are mostly integrated into economy through exchange. Reciprocal arrangements are a natural result of our social habits and they could not disappear as long as we remain as humans. Redistribution could exist together with reciprocity. Its degree depends on the level of centricity existing in the state. In a small city-state, spread to a smaller geography,

redistribution would take place at lower levels compared to a monarchic state with a vast territory. Reciprocity does not prevent redistribution and vice-versa. Redistribution could also be observed in states where exchange dominantly takes place. Taxing is a way of redistribution if implemented correctly. A rather unique in nature but practically common instance is a combination of redistribution and exchange in which state purchases certain agricultural products at a fixed rate and sells through state's agricultural offices.

4.3. Forms of Trade, Money Uses, and Market Elements in Relation to 'State'

Polanyi discusses forms of trade, money uses and market elements so as to show that not all trade is market trade, similarly money is not used solely for exchange and not all markets are price-making markets (1957: 256-7). In relation to the concepts introduced by Polanyi, let's try to find the relevancy between them and the state.

4.3.1. Forms of Trade

Polanyi reveals certain motives behind trading (1957: 259). The profit motive is the one we observe in market trading. However, there is another one, status motive, which is dominant outside the realm of price-making markets. The idea to trade with such a motive results from the trader's desire to improve social status. If we are

talking about the governing force, then the king or the emperor trades for the purpose of signifying his state's prosperity. Or at a lower level, a state bureaucrat could trade in order to reinforce his standing in society. From a different perspective, a state official could trade to fulfill his duty. Especially, this kind of status motive is closely related with state. A third motive could be added to these motives. From the viewpoint of an individual, people may sometimes prefer to trade due to kinship ties, even if it is not profitable. A familiar clause people used to hear in Turkey: "Give five Liras more, if it is from a friend". One explanation to such kind of an *irrational behavior* – a well-known neoclassical criticism – could be trust to the person we know. Even if he sells at a higher price, we believe that in case of a problem with the commodity we purchased, he will be forced to be helpful with it due to the social bond. Another reason could be our inclination to help through trading with a kin and helping him to earn his life. Thinking at a larger scale, states may prefer to engage in trade with one another due to a mutual trust between the trading countries.

Another issue discussed by Polanyi is the originality of trading organization (1957: 260-1). Each trading venture in early times was specific both in its path and in its content. Therefore, trading on an individual basis could not maintain a continuous characteristic. Each good to be traded had its own difficulties to be overcome. However, if trading is governed and regulated by a state or a state-like power, then things were much easier. Governance of trade per se institutionalizes the trade. On the other hand, market homogenizes trade. Market turns everything into something that is bought and sold, since everything has a price. Such kind of commodification

should not be confused with the institutionalizing role of states. While the former – commodification – is an attempt to unify, the latter – institutionalizing – is an attempt to stabilize and to give endurance to the process. That is to say; governance of trade is neither a cause nor a result of a simplified and downgraded universal type of trading, which is specifically market oriented. In fact, governance of trade amplifies, diversifies and prolongs trading process contrary to the impoverishing effects of market mechanism on trading.

At this point, it is useful to point out the types of trade listed by Polanyi (1957: 262). Those are gift trade, administered trade and market trade. Gift trade is based on the reciprocity principle and run through kinship ties. Administered trade is based on state treaties. Market trade is based on exchange. In all types of trade, governance could exist. Gifts are traded between chiefs, kings, emperors or ministers as a result of status motive and social intention. Administered trade is state run or regulated trade. If exchange is made at set rate and in protected grounds like *ports of trade*, then it is governed. In societies where markets were not widespread or market trading was not safe, administered trade constituted the greater part of trading. Rent-seeking activity is a common feature of state-related trading, especially if the trade is market oriented. We mentioned about the status motive as a dominant factor in trading before price-making markets spread. However, with the flux of price-making markets and the trade originating from and inhabiting in it, the status motive in state-related forms of trade was adulterated and profit motive has become the dominant instinct among the officers responsible for trade activities. Bribery has been the

easiest option for an officer to increase his revenues. If the officer was not bribed, he was sure of a future gain that will be coming from the beneficiary of misconduct in office, such as a high rank position in the company. From a different angle of view, bribery could also be counted as a distinct form of trade. Bribe was not also given in return of an illegal help from the state officers, but sometimes given for them to do exactly what they are supposed to do legally. That kind of bribery could be called *encouragement bonus*. With such kind of a payment you guarantee the legal service of the officer, which should have been done already without the payment and that makes it strictly illegal again. Therefore, governance of trade or economy creates a different type of trading: *Service Trading*.

4.3.2. Money Uses

Polanyi explains different uses of money as payment, standard and exchange (1957: 264-5). In our context, standard use is worth to mention. It is basically the accounting use of money so as to attach numerical values to the goods stored or bartered. First of all, if money had begun to be used as a standard solely with individual efforts, then there would have been several standards based on different individuals' measures, which would have definitely led to a skein of standards. Then, it was very important for a central authority to introduce such a standard and expand its use for the sake of clarity in accounting. For redistribution to flow easily, use of money standard was essential. Exchange use of money expanded due to printing of money by a central

authority. Another use of money could be added to those three uses, since money has not been printed only for exchange purpose. States have often printed money for administrative purposes. Money was printed on Sultan's or Khan's behalf after his succession to throne in order to announce his reign ostentatiously. This was on the top of the to-do-lists of new rulers, since it was the ruler's presentation of himself to the public. With printing money that has new sovereign's insignia on, the administrative power was declaring implicitly that everything that belongs to the previous ruler, such as money, land or the army, is no more valid since they are replaced by the new one both formally and substantively. Printing money was also used unwisely as a way of economic policy; to pay for government debt or implement monetary policies. With usage of money by state in various ways contributed to diversity of money uses and monetization of the economy. As states used and spread money more, money became more closely related with states. That led to *statization* of money and money lost its meaning and value without a state attached to it.

4.3.3. Market Elements

Exchange and markets have distinct characteristics with respect to their substantive meanings (1957: 266-7). Exchange could be at set or at bargained prices. At bargained prices, exchange operates as a form of integration and it is restricted to price-making market structure. However, exchange at set prices possesses different

aspects. Administration of rates is crucial for this kind of exchange to take place. States could definitely exert force on trade rates through contract-making and taxing. Besides that, states could also indulge in exchange at bargained prices as a supplier or as a demander.

One market element that has crucial repercussion is competition. Polanyi restricts economic competition to markets, but not only to price-making markets (1957: 267). Taking the argument further, competition in genuine is more than a market competition. International rivalry between states is a form of competition. There could be a social competition in the sense that individuals compete with one another for attaining a higher social status or to be employed in a better position – neoclassics would mostly call the latter market competition. All these kinds of competition trigger state protection. State tends to protect society from the devastating effects of competition. International rivalry was the primary reason why long-distance traders always needed the physical protection of kings or emperors before the world was globalized. Market competition has always been a phenomenon that must be evaded. Redistribution and administered prices are ways of circumventing market competition.

Two market elements that form a market institution together are supply crowds and demand crowds (1957: 268). Although these two elements are distinct in their nature, price-making markets tend to unify them by ignoring their essential characteristics.

Governance of economic process helps to make a distinction between supply and demand crowds through administered auctions and submissions.

Price is a market element, which should not only be attributed to price-making markets (1957: 268-9). Price is essentially associated with equivalency; therefore it is a fixed quantity. Although price is, in its nature, a rigid quantity that represents the relation between values of different goods or services; with the enforcement of markets, price turned into a fluctuating quantity, without which price-making markets are meaningless. However, before that specific type of market setting, price was fixed for trade to move on smoothly. Think of redistributive and reciprocal arrangements. Would it be easier to establish these arrangements with one another in the case of fluctuating prices, or would not? Therefore, for these arrangements to be run smoothly, prices were to be fixed either by the partners or by an administrative authority. Even for the market exchange, this holds to be true. For the market exchange to take place regularly and profitably, prices should not fluctuate extremely. Only if prices remain between certain boundaries, or are fixed rigidly, traders agree to exchange. Fixation of prices is regularly done by trading partners at a limited extent and for a limited time. For a more expansive measure, prices should be governed by the state. The more price-making markets enforce prices to fluctuate, the more necessary it becomes for the state to control prices. Hence, from 19th century onwards, the need for governance of prices has become more and more critical.

4.4. Concluding Remarks

In this chapter, the task was to analyze the governance of economic process as explained in Karl Polanyi's. Polanyi defines economy as a process, which is engraved in the social structure and could not be restricted to the narrow boundaries of price-making markets. This process is diverse and has its unique features depending on the history and social structure surrounding the economy. Governance of this process definitely gives stability and balance, but not homogeneity and equilibrium to the economy. If something is in equilibrium, then the inertia is zero⁶. Considering the economic process, when the process leads to an equilibrium point, at that point it stops to be a process. On the other hand, if the process keeps up in balance and in harmony with its sub-processes, it does not necessarily reach an ultimate point and a universal unity. Inertia and diversity are the essences of progress. Therefore, with the suppression of plurality and imposing equilibrium upon the economic process, price-making markets hamper progress.

Employing the definitions of Polanyi, we tried to explain state as an integrated part of the economic process. It could neither be excluded from the economy nor could its role be underestimated. This is not to say that state is superior or inferior to some other elements of the economic process, and it is not suggested that economic

⁶ From a different point of view, at equilibrium point, economic process does not stop – look at the classical growth theory, which foresees a constant growth rate at a stable equilibrium. However, this is a poor conceptualization of the term 'process', since the agents of the seemingly active economy have to behave – supply and demand – at given equilibrium points so as not to deviate from the stable equilibrium. Nevertheless, since economy never reaches equilibrium, agents never tend to maintain that equilibrium. They, indeed, behave in a way that changes the path of the economic process continually, which makes a stable equilibrium unattainable at all.

process should be governed by the states at all, which would not be indeed very different from a mainstream statement.

CHAPTER 5

THE TRANSFORMATION OF STATE

Up to this point, state, within the context of this work, was revealed as an institution of the economic process. It is embedded in the social whole and bears a significant role, which could not be performed as thoroughly as state did by any substitute. However, Karl Polanyi underlined long ago the transformation the societies of the world underwent during the 19th century in his, *The Great Transformation: the political and economic origins of our time* (Polanyi, 2001). In accordance with this, this last chapter deals with the artificial change in the meaning and the function of the state analogous to the transformation of the 19th century industrial society brought about by the liberal market economy.

Up to the 19th century shift in the current of thought on economies and societies, as depicted in the previous chapter, economy was an instituted process and embedded in the social and cultural setting. The substantive meaning of economics is derived from this ‘institutedness’ and ‘embeddedness’⁷ of the economic process. However, the

⁷ Jessop distinguishes between three levels of embeddedness as ‘social’, ‘institutional’ and ‘societal’ embeddedness. We refer to the social embeddedness exclusively, so does Polanyi. However, Polanyi implicitly employs the ‘institutional’ embeddedness in his discussion of the economy as an instituted process. However, note that institutional disembodiedness does not have to accompany social disembodiedness. Market economy, while it is primarily a socially disembodied type of economic system, is on the other hand institutionally embedded with the market exchange as the dominant form of integration and market as the embedding institution. Therefore, market economy could be best described with ‘societal’ embeddedness of “functionally differentiated institutional orders in a complex, de-centred societal formation.” (Jessop, 2002: 209-10)

market system re-instituted the economy not according to the laws of society and culture, but rather according to a distinct set of rules; therefore the economic process was disembedded from society (Mendell, 2007: 95). Transformation of state, from its ‘substantive’ role in economy to ‘formal’ role – which were defined in the previous chapter – was directed hand-in-hand with the disembedding of economy from society and reduction of substantive sense of economy to formal sense under the dominance of self-regulating market mechanism (Maucourant, 2002: 153).

In the previous chapter, it was seen that economy and society are integrated to each other with three distinct forms – reciprocity, redistribution and exchange. In all these forms of integration, state had its part in the economic process sometimes by instituting different forms of trade, money uses or market elements. However, after the market exchange became the dominant form of integration in the market economy, economy began to be instituted by the price making markets. Therefore, state’s role as an institution of the economic process was diminished to the ‘formal’ monitoring organ of the economy. The origins of this transformation are tracked down in Polanyi’s *Great Transformation* in the following.

5.1. Intellectual and Functional Transformation of State

State is already defined as an idea. It is, at first, an idea of the society, of the individuals as a whole, which makes that idea dependent upon public consent. Then,

it is an idea of the intellectuals, of the people who are capable of influencing the ideas of society's other parts. It is, at last, an idea of the state as an institution itself, of the embodiment of the state idea, such as a king, an emperor, a chief or an assembly. Without being an idea of the society, state may cease to be operational and meaningful. Only if new ideas from intellectuals, or from within state, find approval and contribution from the society, then those ideas may be realized and put into action. On the other hand, the idea of self-regulating markets and the broader concept of laissez-faire, which have been mistakenly defined as liberalism for centuries, have been far from maintaining unanimous consent not only among society but also among its believers.

Disposal of state from the economy, separation of politics from economy has been one of the pillars of the market economy. In this regard, traditional ideas of state had to be abandoned so as to achieve an economic system, in which state has little influence and primarily governed by the market mechanism. Remember that we explained the path-dependency of state as an institution previously. In this respect, what we seen in the 19th century transformation of the *idea* of state is a loosening of that dependency to its past. Traditionally, states assumed a crucial role of slowing down and directing unregulated change, which usually happens to the deficit of society (2001: 35). Anti-enclosure measures of the Tudors and the early Stuarts in England are a clear illustration of this traditional view of state (2001: 36). In that period, arable lands were turned into pastures through enclosing and claiming property on land. Although this trend could be described, with a good faith, as a

factor that fostered economic development since a domestic supply of wool rapidly rose to a level that can sustain early woolen industries and this provided the foundations of cotton industry and Industrial Revolution in England possible; this will be a blind commitment to the virtues of economic improvement, since those enclosures, if it was not for the state, would have abruptly dislocated the rural population and disrupted the social dynamics once and for all. Thanks to the strict measures taken by the state, the rural society in England had a chance to prepare for the change taking place, and was rescued from the edge of social deterioration (2001: 37-40). However, approximately 150 years later, English society was threatened by a dislocation of different origin namely, the Industrial Revolution. Since the traditionally minded state was replaced with a state operated by the Parliament under great influence of industrial and merchant classes, a great dislocation and degradation of the industrial society in England could not be prevented. (2001: 41-4)

This time also the event was peculiar to England; this time also seaborne trade was the source of a movement which affected the country as a whole; and this time again it was improvement on the grandest scale which wrought unprecedented havoc with the habitation of the common people. (2001: 41)

Therefore, the transformation brought by the advent of self-regulating markets was deleterious to 19th century society in no match to any other transformation in history. The change was ungoverned, and society was defenseless. Nonetheless, the transformation of the state was not complete until 19th century, and in the days of

Industrial Revolution, even if it was unconscious, society began to develop reflexes for its own protection.

Speenhamland Law is a product of these reflexes (2001: 81). Labor market was the last market to be liberalized in England. Before that, English labor organization was defined with the Statute of Artificers and the Poor Laws (2001: 90-1). The former was for the employed, the latter for the poor, which is constituted of both the employed and the unemployed. Further control and regulation of labor was intensified with the Settlement and Removal Act, which greatly immobilized labor and bonded it to the parish that was responsible for its relief. All three actions of the English state represent the traditional statesmanship of the era. Nonetheless, with the initiation of the Industrial Revolution through The 18th century, it became a necessity for the industrialists to find cheap supply of labor for expanding production. Therefore, the Settlement and Removal Act was repealed partly in 1795 and an important hindrance to a free labor market at a national scale was eliminated (2001: 82). However, in the very same year, Speenhamland Law was enacted, which was an expansion of the Poor Laws' scope to every poor earning under a set scale of wage, no matter whether they were employed or not. It was definitely a protectionist act of the state, although Speenhamland led to further degradation of the employed and the unemployed, which was the most unexpected result of the law (2001: 83-4).

Catastrophic results of the Speenhamland inspired intellectuals to search for new ways of explaining human nature and its relation to the emerging market economy.

In this regard, the Speenhamland Law signifies the turning point in the transformation of views on state and its relation to economy. Let us look at the shift in understanding society from Adam Smith to Joseph Townsend. Smith is the last representative of an intellectual age significant with great emphasis on state. His *Wealth of Nations* is addressed to the statesmen who were, to Smith, responsible for the improvement of economy and society. Although Smith took economy and its related concepts, such as material wealth, as a separate field of study and gave the modern economics its early shape, his great emphasis had never been on the nature of things. What should be considered, from his point of view, was in fact what was natural to man (2001: 116-7).

. . . Natural is that which is in accordance with the principles embodied in the mind of man; and the natural order is that which is in accordance with those principles . . . Political economy should be a human science; it should deal with that which was natural to man, not to Nature. (2001: 117)

Townsend, on the contrary, visions human beings as animals driven by natural constraints and conditions, such as scarcity of food or hunger. He, therefore, eliminates the necessity of a state as the governor of society, since humans could be better governed by the laws of the nature (2001: 118-9). By approaching human community from the animal side, Townsend bypassed the supposedly unavoidable question as to the foundations of government; and in doing so introduced a new concept of law into human affairs, that of the laws of Nature (2001: 119).

Separation of the state from society and from the economy in parallel, and the tendency to minimize it, constitutes the foundation of the society emerging in 19th century.

Malthus's population law and the law of diminishing returns as handled by Ricardo made the fertility of man and soil constitutive elements of the new realm the existence of which had been uncovered. Economic society had emerged as distinct from the political state." (2001: 120)

Repeal of the Poor Laws was defended in this line. Since it was possible to make poor earn their subsistence at a lower cost to the public by letting the markets determine the price of their labor, then why should the state bother to support the poor while, on the other hand, the capitalist owners of industries were craving to pay for the labor of the poor? (2001: 121-2). Such an intellectual shift and the shift in the functions of state were conducted parallel to each other, which altogether catalyzed the transformation of society. "Social not technical invention was the intellectual mainspring of the Industrial Revolution." (2001: 124).

Especially in economies integrated with redistribution, state's functions had always been central to socio-economic system for centuries until the 19th century market economy. There are numerous evidences for this argument. In the society of Trobriand Islanders of Western Melanesia, the chief's role in redistribution was a social rule. His role as the centre of redistribution was far more than a mere economic function attached to him; it was a habit derived from noneconomic customs (2001: 50-1). It was usually aimed to increase political reputation through

redistributing goods. It was an honorary act to display wealth and redistribute it. On the other hand, by redistribution of his wealth, the chief was morally forcing recipients to return the favor, which makes redistribution not only an economically, but also a socially integrative force (2001: 53).

Note that, neither redistribution nor the state's function could be confined to primitive societies, since it was also a general instance in archaic societies, such as Kingdom of Hammurabi, New Kingdom of Egypt, Ancient China, Kingdom of India and Empires of Inca (2001: 53). Later, feudalism was again a system based on redistribution mainly, since in many feudal settings over the world, as in the stratified societies of Africa, a socially higher stratified man – herdsman for African instance – collects gifts from lower stratified people – agriculturalists – in the form of agricultural products and redistributes those gifts in the form of livestock. Nevertheless, Western European feudalism was an exception to such pattern, because gifts were collected as tributes in return for protection (2001: 54-5). Furthermore, in a totally different period of history, in Greco-Roman period, despite advanced trade, markets did not play a significant role; redistribution of grain constituted the pillar of the “householding economy” of that period (2001: 57). Lastly, only in the mercantile period economy, states became considerably interested in markets, since markets were widespread and operative in that era. Nonetheless, markets were still dominated by social norms and rules, not otherwise. Therefore, not until the 19th century, any version of socio-economic systems could be described as a market economy, a

special attribute of which is self-regulating markets purified of state and paternalism (2001: 58).

Mercantilist period in England was significant of the state's achievements in protecting the two main elements of production, land and labor, from becoming tradable objects (2001: 73). The Statute of Artificers (1563), the Poor Law (1601), as well as the anti-enclosures of the Tudors and early Stuarts, were designed for this purpose. Mercantilists, despite their vast interest in the commercialization of the economy, never thought of an economy based solely on markets, and in this vein, they shared a similarity with the conservative feudalists. The Speenhamland Law was not a less protectionist act, and its repeal made the transformation of the 19th century society visible enough to trigger the "double-movement" (2001: 136-40).

Let us return to what we have called the double movement. It can be personified as the action of two organizing principles in society, each of them setting itself specific institutional aims, having the support of definite social forces and using its own distinctive methods. The one was the principle of economic liberalism, aiming at the establishment of a self-regulating market, relying on the support of the trading classes, and using largely laissez-faire and free trade as its methods; the other was the principle of social protection aiming at the conservation of man and nature as well as productive organization, relying on the varying support of those most immediately affected by the deleterious action of the market – primarily, but not exclusively, the working and the landed class – and using protective legislation, restrictive associations, and other instruments of intervention as its methods. (2001: 138-9).

Amendment of the Poor Law in 1834, after the Parliamentary Reform in 1832, redefined the poor and kept the unemployed labor out of the category for the sake of

labor markets (2001: 232). For the defenders of the New Poor Law, if the unemployed did not face the fierce choice between being pauperized in workhouses or starving to death, then they would not supply their labor cheaply, which would impede the operation of labor markets.

5.2. The Impossibility of Pure Liberalism

In the essence of the self-regulating market mechanism lies the free market. Local markets that were centers of towns' trade before mercantilist period and even through it, could not be defined as free, since they were under the monopoly of town merchants. Accordingly, self-regulating markets owe their existence to the emergence of national markets in Western Europe, which is nothing but a creation of deliberate state action (2001: 66). Up to the Commercial Revolution, what was known as national trade was, in fact, based on trade of cities such as Hamburg, Venice or Lyon. Countryside was extensively excluded from trading activities in Europe. Town's trade was exclusively run on either on overseas grounds or on a regional scale, between neighboring towns. Nonetheless, in the 15th and 16th centuries centralized state 'nationalized' trade and broke down the barriers brought to long-distance and local trading by towns (2001: 68).

Nationalization of trade in Western Europe was very crucial in relation to self-regulating markets. Since trade was extended to the national scale, countryside and

small towns that were formerly not in reach of market trade were integrated with it. However, what became national was not free trade or laissez-faire. Territorial state was now responsible for the protection of trade from international competition and monopolization attempts, which were formerly tackled by towns successfully (2001: 69).

Not until 1820s had liberalism or laissez-faire taken its present meaning (2001: 141). Contrary to the mainstream assumption, liberalism was not fully realized first in the mid-18th century France in the writings of the Physiocrats led by Francois Quesnay. Their argument consisted of free export of grain so as to raise incomes in an agricultural society. On the other hand, rest of their system was based on a strict regulation and direction of a powerful state. Likewise, the English also had a narrow understanding of laissez-faire (2001: 142). However, contrary to these loud French demands for free trade, the actual expectation was for less regulation in production. Despite the fact that the English cotton industry had already flourished before the Industrial Revolution, export of tools for manufacturing and import of cotton were subject to strict restrictions.

Liberalism rests on three tenets⁸; free trade, an automatic gold standard, and a competitive labor market (2001: 144). Even if one of these conditions is hampered, liberalism disappears. Because not until 1834, the amendment of the Poor Law, did a free labor market emerge, it is impossible to speak of liberalism before that date.

⁸ This could be generously extended to four, since liberal state is also a crucial institution of market economy (Cangiani, 2007: 29; McClintock and Stanfield, 1991: 58).

Moreover, it would be naïve to expect all these conditions to emerge simultaneously and spontaneously. If it were not for the British state, the freeing of labor market on the island could be never possible. Without the deliberate acts of the state, trade would have not been nationalized and free trade would not have been even discussed. Actually, “[t]here was nothing natural about laissez-faire; free markets could never have come into being merely by allowing things to take their course.” (2001: 145). Even if markets could be freed from state intervention, they were still prone to “monopolistic practices” that are inherent in the capitalist process (Schumpeter, 1974: 87-106). Therefore, neither perfect competition nor was liberalism the rule of the capitalism, but they were rather exceptions of history (Schumpeter, 1974: 78)

Is a *purely* economic system feasible in the long run? In other words: Can ‘the political’ and ‘the economic’ be detached from each other permanently in the context of a socio-economic system? Polanyi’s answer to this question would be an equally blatant ‘no’. (Özçelik, 2006: 156, emphasis mine)

Not only a pure form of liberalism, but also of any social, economic or political setting is bound to collapse, according to the “principles of dominance and impurity” (Özçelik and Özveren, 2006: 415). Dominated, yet non inferior, elements of a social system are the essence of *impurity*, and thus *complexity* – in a positive sense – and *plurality* of the system. It is the *purification* of a system from this variety that leads to the withering of that system at first, then to its disintegration at all.

This was to be realized soon by utilitarianism and its proponents recommended state run liberalism as a social project for the welfare of the society⁹. To Jeremy Bentham, economic success could be achieved with inclination, knowledge and power. An individual could only possess inclination. Government, on the other hand, could administer both knowledge and power much more cheaply compared to individuals. In this vein; from 1830s onwards, markets were gradually freed with increasing state intervention to the economy. Although liberalism was intended to replace the state governance of economy with the market governance, in the end it turned out that liberalism needed and caused the expansion of state regulation and intervention.

The road to free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism . . . Witness the complexity of the provisions in the innumerable enclosure laws; the amount of bureaucratic control involved in the administration of the New Poor Law 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. And yet all these strongholds of governmental interference were erected with a view to the organizing of some simple freedom – such as that of land, labor, or municipal administration. (2001: 146-7)

5.3. The “Double Movement” and the ‘Supposed’ Revival of Protectionist State

While liberalism was rapidly spreading first all over the Europe, then to the world in the 19th century, a contrasting movement was also taking shape in the European

⁹ This is a fact also realized not only by classical liberal economists, but also by some of the neoclassical economists. For instance, Hayek, in his proposal of “planning for competition”, accepts the necessity of state action in the economic process, even though he suggests that necessity only emerges in case of a hampering of the self-regulating market mechanism. (Özçelik, 2006: 170-1)

society. Economically and socially depressed labor class and the landed class that lost its importance as productive factors in economies were sources of this counter movement (2001: 138).

Socio-economic degradation of the landed class was due to a relatively earlier change in circumstances. In their venture of nationalizing markets and trade, states played voluntary roles in the commercialization of land so as to take power from the landed class. Relating to this, several acts were passed in England before Industrial Revolution took place, in France Code Napoleon marked the commercialization of soil (2001: 188-9). Therefore, even if it was not without reluctance, landed class found itself in a position to oppose free trade and markets. On the contrary, state, once the sole protector of society against enclosures, became the greatest proponent of commercialization of land and free markets with the Industrial Revolution and onwards.

The gaining of consciousness by the laboring classes was not a different story. After being crushed with the perils of the Industrial Revolution throughout the 18th century and further degraded with the Speenhamland Law, the breaking-point for the English working class was the amendment of the Poor Law in 1834. With the New Poor Law, the working class was officially defined as distinct from the pauper and was excluded from the poor relief (2001: 174). Since the working class found its meaning, it began taking its place in the market economy. While the landed class committed itself to the protection of two basic elements of production – land and labor – the working

class began to unionize around a common interest, namely better living and working conditions. Robert Owen's inspirational achievements in New Lanark began to spread within society, which led to the spring of labor unions (2001: 175-7). Then comes the six demands of *People's Charter* from the English state for a grant of vote to the common people (2001: 180-1). Although, the Chartist Movement was already erased from the memories in a few years, it signifies the extent that the counter movement in society had come to. On the other hand, after half a century, when Industrial Revolution arrived in the Continent, working classes of Europe had a better chance to enjoy considerable political influence on states, since they did not share the fate of the English class as it was already crushed by the Speenhamland and the Poor Laws (2001: 182-4).

State liberalism had become the major source of the "double movement" in society by the end of the 19th century. "Laissez-faire was planned, planning was not" (2001: 147). Restrictions, due to the lack of faith in market mechanism especially after the agrarian crises that struck Europe between 1873 and 1886, of spontaneous nature were raised all around Europe independent of one another during 1870s and 80s (2001: 151-2, 223). Liberal conspiracy of "collectivist" protectionism, which was accepted generally as an agreement of anti-liberals on weakening the market economy and abolishing liberalism from the agenda of society, was wrong in their assumption of collectivism. In fact, protectionist movements came from societies with distinct political and ideological backgrounds, entered into an anti-liberal period after being exposed to liberalism intensively in the 19th century (2001: 153-4).

Victorian England, the Prussia of Bismarck, France of the Third Republic and the Empire of the Hapsburgs were all forced by their societies and by the failure of markets to take protectionist measures.

Protectionist tendencies grew up to the Great War. Post-war period did not see a weakening in this tendency. Even in the United States, which was seen as an example of functioning of self-regulating markets flawlessly without any intervention of the state, establishment of the Federal Reserve System in 1913 signifies to the extent of the “double movement” (2001: 210-1). The protection of the economy’s productive elements, land and labor, at a scale never realized in Europe came later. Protectionist components of the society were extending their power and scope everywhere. There was a great emphasis on monetary freedom and sound currency due to the weakened reserves of the war’s wagers. A new social unit, analogous to increasing monetary protection, took its shape. The new nations were more attached to their sovereignty, a must have of which is sound and strong national currency (2001: 211). Therefore, monetary policies of states became one of the most unifying economic forces (2001: 213). “Politically, the nation’s identity was established by the government; economically it was vested in the central bank.” (2001: 214).

From all the instances up to now, state appears to be the focal point of the counter movement in society. However, to assume state as the prime initiator of this movement would be contrary to the idea of state’s transformation along with the 19th

century liberalism. Counter movement sprang from the ranks of society, the landed and the working classes, which resisted to the ongoing transformation as a result of deteriorating social positions of these classes. Nevertheless, as labor gained political influence on the state and as the impossibility of the liberal creed without a guardian state was realized, states were forced to play their role as the executer of protection. Since the state had been subject to the transformation of the 19th century, it was more or less separated from society. ‘Political’ was no more engraved in the ‘social’. Therefore, with the 19th century onwards, state intervened in the economic process, mostly for the rescue of the markets. Geneva’s almost successful attempt to “free economy under a strong government” signifies the fact that liberalism could call for state intervention and temporary abandoning of free market practices in case of emergency¹⁰ (2001: 241-2). As long as markets seemed to operate, free trade flowed, labor found its regular price in the market, state was meant to stay out of the business. Only when one of the three conditions of liberalism, free trade, gold standard and competitive labor market, ceased to operate, states were called for action. If governments were to make a choice between guarding liberalism and protecting society, either their will was for the former or they were expelled. When labor government in Britain faced the dilemma of either cutting social services or letting the pound depreciate by insisting on the gold standard, which they were

¹⁰ When the post World War I economies faced the fact of deep inflation and sudden depreciation of currencies world-wide, several governments of the capitalist world summoned a meeting in Geneva and urged the need for restoring currencies with strong government intervention in the 1920s. “Deflation was the primary need; domestic institutions had to adjust as best they might. For the time being, even the restoration of free internal markets and liberal state had to be postponed.” (Polanyi, 2001: 241)

unsuccessful in solving, they were forced out of office in 1931 (2001: 235-6). Similar scenarios occurred in other European states. Austria in 1923, Belgium and France in 1926, Germany in 1931 witnessed the expulsion of labor parties from the office (2001: 237).

Colonization of many European states extended largely through the end of the 19th century, and this is related to the subject of “double movement”. Liberals have been partly wrong in their argument of state as the womb of imperialistic passions that always destroyed achievements of liberal economies (2001: 220-1). Not all states were necessarily expansionist; in fact modern capitalist era began with a long period of imperial contraction. ‘Hundred years peace’ from 1815 to 1914 was the ultimate product of this trend; former foes became friends with the help of *haute finance* and a peaceful balance-of-power was maintained for the sake of new emerging economic reality (2001: 3-20). Colonization by not only England, but also France, Germany and other European states came to a halt, whereas, capitalist companies had just begun their overseas ventures and economic invasions. By that way, separation of economics and politics was expanded into international affairs (2001: 222). By the end of the 19th century, however, things began to turn with the agrarian crisis in Europe, and it was realized once again that markets need the guidance and intervention of states for their operation (2001: 223). Protectionist measures were put in action and free trade among major European states stopped. Therefore, a new wave of European colonialism became necessary for selling goods to countries with relatively low political power and economic protection (2001: 224).

A parenthesis should be opened at this point of the current analysis and we should turn back to our previous argument on agent-sensitivity of state. At the end of that discussion, we explained agent-sensitivity of state in relation to two concepts: the level of representation and the level of corruption. If the former is higher and the latter is lower, then agent-sensitivity is expected to be lower for state. And then, we identified a historical tendency of state's agent-sensitivity to increase up to the *market society*. In accordance with this, we know see that that tendency is also applicable to the state 19th century onwards. The major factor has been the “double-movement” as defined by Polanyi. Although, state has never been the initiator of the counter movement towards liberalism – since it was primarily designed as a liberal one – it was, nonetheless, at the centre of that movement. Therefore, depending on the balance-of-power between the liberals and the protective forces among society, state's role in the economic process displayed major shifts. As an institution, state was agent-sensitive and flexible enough to turn into so-called *welfare state*.

In conclusion, the 19th century was marked with two clashing movements that shaped the characteristics of the 19th-century society. While one of these movements drag societies to a transformation and tried to bring them to the orbit of markets, the other constantly opposed the former and aimed to preserve the cooperation between social, economic and political spheres of the society and protect productive forces from the perils of free markets. States, as well as societies, were transformed in this process. This began in England and spread first to Europe, then all over the world after the 19th century. Both practically and ideologically, paternalistic states of the ‘non-

market societies' of the past, more or less became liberal capitalist states. They may seem to play a protective role in the "double movement", but they had usually done this for the sake of free markets and liberalism. Only when labor class gained significant influence on governments, states behaved proactively protectionist for the sake of society. Therefore, the transformed states of the post-19th century have been "self-regulating states" in the sense that they are disembedded from society and operating often disregardful of it (Godbout, 1991: 124). Nevertheless, because of the double-movement, the disembedding of either the economy or state from society has never been fully completed (Harriss, 2007: 43). The rise of the welfare-state in the post-war period and an adjacent flourish of monopoly capitalism are *ex ante* results of this (Stanfield, 1980: 598, 607).

CHAPTER 6

CONCLUSION

What was analyzed within the content of this work is the possibility of assessing state as institution of the economic process. This was a four partied task. Before anything else, one had to clarify the institution in general. In the first chapter after introduction, the author dealt with this problem and revealed some *sine qua non* aspects of institutions. First of all, institutions are engraved in the social whole. There is no institution deprived of the social ingredients which fortify institutions with the embracement of society. Institutions are all ‘culturally and socially embedded’. Second, and as a direct result of this, institutions are *path-dependent*; they carry features of the past together with novelties of the present and obscurities of the future. Therefore, as a third aspect, they evolve but in a gradual way; they are at the same time, castles of resistance and sanctuaries of change. Furthermore, connected to the last, institutions accommodate both *ceremonial* and *instrumental* forces. Fifth, all institutions are connected to each other in a way that diffuses the effect created by one institution into the whole system of institutions, and that effect is multiplied in a *cumulative circular* pattern. Moreover, institutions could be agent sensitive or insensitive, self-policing or not, designed or spontaneous, which are all important for nothing but practical purposes, since it is impossible to find an

institution that perfectly fits into these categories. They are flexible, hence easy to exploit for different purposes.

Then, it was necessary to put the state into the framework created in the first chapter. State is explained as a 'social idea' at first, and then as an institution. In doing so, it is elucidated that state exhibits all the characteristics of an institution, social embeddedness, path-dependence, cumulative circular causation, ceremonial and instrumental features, and agent sensitivity.

After it became obvious that state fits in the definition of an institution, in the third chapter, state's functionality as an institution is discovered in the economic process, with direct reference to the work of Polanyi, which already exposed that process. State's 'substantive' and 'formal' meanings are revealed, how state institutionalizes different forms of trade and money uses is analyzed, and the relation of state to market elements is put forward. As a result, it is observed that state historically had many important functions in the economic process, and some of those functionalities could even be observed in the contemporary economic system.

However, with the construction of liberalism by the 19th century, the world entered into an era of free markets, in which societies began to be subordinated by the market mechanism. Especially after the completion of three liberal tenets – free trade, automatic gold standard and free labor market – with the repealing of Speenhamland Law in 1832 and the amendment of Poor Law in 1834, first the English society, then the others were crushed under the hegemony of self-regulating markets. Such

degradation of social integrity inescapably created counter movements in every society, and the 19th-century market order collapsed and entered into a period which Polanyi himself calls the “Great Transformation”. In the last chapter of this research, the change in state’s meaning and functionality, analogous to the advent of liberal creed and to the “double movement” that followed, are inferred from Polanyi’s discussion.

It is seen that without such a transformation of state, realization of liberal ideas would have been improbable, since liberal capitalist state fulfilled some crucial tasks like nationalization of markets and securing freedom of contract, which could not be accomplished with individual initiatives only. Moreover, when liberalism was at stake, state never hesitated to intervene in the economic process and to abandon free market practices until the crisis were overcome and markets were restored to order. The counter movements had direct impact on change of states’ attitude towards free markets and shaped economic and social policies as long as they exercised political influence on states.

After some period of liberalization, every society developed counter reflexes to the perils of self-regulating markets; capitalist states were in the middle of these double movements, albeit their intention was to revive free market practices. Especially after the Great Depression, the tendency of states to intervene in the economic process was reinforced so as not to experience a similar breakdown of the world economy again. The trend was not reversed after the World War II, and state regulated growth

marked the period in 50s and 60s as ‘the golden age’ of capitalism (Marglin and Schor, 1990). However, when the oil crises of 1973 and 1978 struck markets and newly emerging industrial economies were pulled into deep financial crises, liberal voices began to increase for ultimate freedom of markets, which is incomparable in scale and scope to any other liberalization in history. Neo-liberal policies dominated the economies in the last two decades of the second millennia, and capitalist economies were ‘rescued’ from public interventions.

Societies are still subordinated by self-regulating markets in the neoliberal era. Once more and even harsher this time, peoples are faced with the perils of deregulated markets. Repeated crises hit world economies, and unemployment reaches record levels. Once more, societies are disrupted by free markets. However, there is a crucial difference with the experience of the 19th century. First of all, not all societies, but only underdeveloped ones, are crushed as severely as the 19th century market societies, which were dehumanized in industrial slumps. More developed and industrialized ones, thanks to maintenance of higher standards for the labor, are less prone to social degradation, and they use this as a role-model for the less developed societies so as to alleviate the growing disturbance. Second, there is not one single *non-capitalist* state that enjoys political and military power like the Soviet Union did in the mid-20th century. Therefore, the only practical alternative to the contemporary system disappeared – or *destroyed* – and capitalism seemingly proved its ideological and technical superiority to that system, even though capitalism and major capitalist states were severely weakened in the process. Thirdly, the dominant mode of

political representation, social democracy, guarantees the support of the dominated class, which could be the only source of counter movement.

According to Schumpeter, capitalism is a “process of creative destruction” (Schumpeter, 1974: 81-6). New methods are discovered and new markets are opened so as to reap the benefits of these creations. In this creative process old ones are destroyed. From my point of view, the counter movement appeared after the 19th century liberalism, saved capitalism from reaching to the end of its creative destruction. If it was reached, deregulated markets would have destroyed new creations immediately once their benefits are realized by other market participants. Therefore, investment opportunity would have been vanished and capitalism could not survive anymore (Schumpeter, 1974: 111-20). Nevertheless, capitalism owes much to the counter movement of the society, since it protected the investment opportunity from disappearing and the productive forces of the societies from total destruction. Capitalism in the neo-liberal age may not be similarly lucky, since it is deprived of creating an opposing movement within the society, according to three important differences proposed above. Therefore, just because capitalism failed to create a balance within the social system, it may be doomed by its own dynamics. Nonetheless, it seems that we are on the eve of another great transformation; and we will soon see if this one could be completed.

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