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Dominika Bochańczyk-Kupka
Renata Pęciak

SOME REFLECTIONS ON THE NEW CHALLENGES FACING THE MODERN STATE

Abstract

The debate among economists over the scope of state intervention in economic processes has a long history. After periods in which laissez-faire theories were dominant, views that promoted the active participation of the state in economic life increasingly came to the fore. Economic theory and business practice, both subject to fluctuations, have sometimes preferred the first approach and sometimes the second. The modern state operates in an increasingly globalized, dynamic, and turbulent environment. This changeable environment, the diversity of development levels, and the emergence of new institutions urge a redefinition of its role in modern economies. This paper contributes to the debate on the challenges and economic role of modern state and identifies some of those challenges.

Keywords: economic role of the state, theory of economics, institutions, contemporary economics.
JEL Classification: E02, H1, O43.

Dominika Bochańczyk-Kupka, University of Economics in Katowice, Faculty of Economics, Department of Economics, 1 Maja 50, 40-287 Katowice, Poland, e-mail: dominika.bochanczyk-kupka@ue.katowice.pl, ORCID: https://orcid.org/0000-0003-0428-3434.

Renata Pęciak, University of Economics in Katowice, Faculty of Economics, Department of Economics, 1 Maja 50, 40-287 Katowice, Poland, e-mail: renata.peciak@ue.katowice.pl, ORCID: https://orcid.org/0000-0001-7684-8137.

Everywhere that economists and their ilk mingle
we see them reaching for new answers

G. Akerlof and R. Shiller, *Animal Spirits:*
How Human Psychology Drives the Economy,
and Why It Matters for Global Capitalism

1. Introduction

The scope and power of the state's influence on economic processes are issues that are widely discussed both in the field of economic theory and in business practice. These issues are also the focus of social thought. The state's place and its tasks in the economy have been discussed for centuries. Since mercantilism people have been arguing over the role of this institution in economic life and the scope of its functions in the economy. Many arguments concerning the range and tools of a state's economic activity still are not widely accepted among members of the academic community. While there is consensus concerning the classical functions of the state, no clear delimitation of the areas and the extent of the impact on business processes has been made. Meanwhile, dynamic changes in social and economic space have changed the scope of the state's impact.

Economics has not kept pace with explaining modern socio-economic phenomena. Therefore, it is necessary to identify the modern social and economic challenges faced by the institution of the state. This identification can help to indicate new tasks, new areas of regulation, and new tools to be considered in the modern economy (Tanzi 2009).

The need for such an indication stems from the fact that many changes have taken place in a turbulent and dynamic environment. Additionally, modern states are fragile and frail with regard to economic policy (which is neither a counterweight not a solution to emerging challenges). The rules which nowadays apply to states were created many years ago under different economic conditions. These conditions have been constantly changing and thus the lack of consensus is understandable. However, many politicians and economists (even Nobel prize winners in the economic sciences) have been searching for solutions which would allow nations to restore equilibrium in the global economy and redefine the role of the state.

The main goal of this article is to present the fluctuation of economic points of view concerning the role of the state in the economy and then to identify and specify some of the challenges facing the modern state. The hypothesis is that the tasks of the modern state exceed the traditional approach adopted in the theory of economics and that new challenges require broadening its scope. In the first part of the article, different points of view concerning the role of the state are presented. It is necessary to understand the fluctuation of ideas. Then the authors describe some new challenges facing the modern state which are determined by a turbulent and dynamic environment.

2. The Fluctuation of Views Concerning the Role of State

There is widespread agreement among social scientists that development is a multi-dimensional phenomenon, with economic, political and social aspects, and that the different dimensions of the role of the state are interconnected with one another in complex ways. The understanding of the role of the state in the economy is strictly connected with a belief or disbelief in a perfectly-functioning market mechanism. Over the centuries, economic theory and business practice have been under the influence of opposing ideas. Opinions concerning the role of the state in the economy have been constantly evolving, and the idea of the state's power, as Milton Friedman noticed, has fluctuated (de Vroey & Malgrange 2011, Hoover 2003, Wakatabe 2009, Wray 2011).

The process of changes within socio-economic life, sometimes evolutionary, sometimes revolutionary, has accompanied humankind since the dawn of time. But nowadays these changes are more and more dynamic and therefore bring uncertainty, risk, and instability (Friedman & Friedman 1989).

From a historical perspective, the functioning of the institution of the state, and the scope and tools of its intervention, have been constantly evolving – from the Sumerian city-states and Greek polis, through the medieval state and the notion of absolute monarchy reflected in Louis XIV's famous dictum *L'État c'est moi*, to the Smithian liberal state, the interventional Keynesian state, and up to the present day. Throughout all of this history, the role of the state and the scope of its intervention and instruments of interaction have undergone numerous modifications. At the same time, changes in the socio-economic situation have shown a peculiar recurrence of views.

More than 250 years ago during the industrial revolution, a market system based on entrepreneurship, innovation, and a self-regulating mechanism began to spread. This system led to rapid economic and social development and civilizational progress, and then contributed to huge changes in the quality of life for people in the economies which had implemented it. Thus, the market became the *spiritus movens* of all changes.

The theoretical basis of this system was classical doctrine with the invisible hand of the market. While the list is rather arbitrary, a majority of economists would agree that the foundations of the market economy are: freedom of individual economic agents, private ownership of the means of production, and the existence of a market mechanism understood as an essential controller of all economic processes. This system, however, has been subject to strong evolutionary forces, although its foundations are based on the dominance of private property and the market mechanism function has remained relatively stable.

Nowadays, the list of basic assumptions and requirements of the market system is longer. Also noteworthy is the political system ensuring the stability of the legal order and democracy, which allows societies and social groups to achieve collective goals with the help of the state as the main representative of their interests and aspirations.

This elementary system, based on the doctrine of Adam Smith, was destroyed by the Great Depression that began in 1929, then by the New Deal implemented by F. D. Roosevelt, and finally after the publication in 1936 of John Maynard Keynes's *General Theory of Employment, Interest and Money*. Among the many reasons for its collapse, worth mentioning are the monopolization of developed economies, human greed, and excessive consumption in the years immediately preceding the Great Depression (Chang 2010, Snowdon 2015). The new and unexpected economic situation needed a redefinition of the place and role of the state in the economy and the exemplification of new tools of economic policy. The new ideas were very successful, and during that period the new tools of intervention policy helped stimulate the economy and overcome the worst depression in world economic history.

The main goal of the Keynesian revolution, which advocated an interventionist role for the state, resulted in the prevention of defects and market failures without changing the systemic foundation of the market economy. The success of Keynesian economic doctrine was legitimized by the taming of business cycles after the Second World War, which was possible thanks to the pursuit of economic policy explained by the Philips curve.

The adoption of the orthodox Keynesian interpretation of the Philips curve explained the constant, inverse relationship between the rate of inflation and the rate of unemployment to realize short-term economic policy goals (Snowdon, Vane & Wynarczyk 2005).

The Golden Age of Capitalism (the post-war economic expansion) was a period of strong economic growth and economic prosperity in highly--developed countries which lasted from the end of the Second World War until the early 1970s. Then, in the late 1960s and early 1970s, the emergence of concurrent high inflation and unemployment caused this relationship to be rejected.

In the 1970s, the supply shock on the raw materials market and the crisis of Keynesian economic policy contributed to a revival of the ideas and principles of classical economics and economic liberalism. The economic problems of the 1970s halted the triumphant march of Keynesian theory and facilitated a monetary counter-revolution (Snowdon, Vane & Wynarczyk 2005).

Then, the failure of the socialist model of economics contributed to a Washington revival of liberal trust in the need for deregulation. However, the problems of transition economies and the failures in realizing this Washington consensus revealed the shortcomings of this point of view (Stiglitz 2004). The crisis of 2007 was the next reason which questioned faith in the market mechanism.

Examples from the real-world economy show that the automatic resolution of economic problems by the market mechanism, which the proponents of neoliberal ideas believed in the past and continue to believe nowadays, is a dogma, and market failure is a reason for state interference. The existence of externalities, the growing importance of public goods, and the lack of perfect information are considered the main market failures that justify state interference. In addition, the economic literature mentions socially unacceptable income inequality, which fosters the need to redistribute income in society, and the occurrence of destabilizing macroeconomic phenomena such as high inflation, rising unemployment, and fluctuations in economic activity. Also, state inefficiencies can be found in the existence of shortages (Daoud 2011), the lack of institutional elasticity (Meiklejohn *et al.* 1999), the lagging process of institutional reforms in response to dynamic changes in the socio-economic environment, and the changing expectations of social groups. Market failures legitimize the introduction of legal, administrative and economic regulations, and therefore state interference.

On the other hand, the state as an institution is not able to guarantee the full effectiveness of the market. So both market and state failures expose society to numerous problems. Nowadays, society is forced to function in an insecure environment without any guarantee of effective action against increasing problems. One example of this is the recent financial crisis being strongly associated with market deregulation, uncontrolled and insatiable greed, and a propensity for excessive enrichment (Akerlof & Shiller 2009). The experiences of that crisis show that, just as in previous decades, future prospects seem to be very unstable and unpredictable (Roubini & Mihm 2011).

To sum up: the evolving conditions of the capitalist economy influence opinions about the role of the state, especially as history has evidenced many failures of economic doctrine, both liberal and Keynesian. There has been a recent wave of criticism of the dominant economic theories and their inability to explain certain mainstream economic phenomena as well as the obvious imperfections of the proposed models in explaining the impact of institutional solutions on economic growth and development. New studies have been undertaken based on a novel, institutional approach. The results of this research (often interdisciplinary in nature and related to the property rights theory of Harold Demsetz and Armen Alchian, developed by Douglass Cecil North, and to the transaction cost theory proposed by Ronald Coase and Oliver Williamson as well as contract theory and agency theory) have emphasized the importance of institutions, including the state, for economic growth and socio-economic development. At the turn of the century, the works of many authors have supported the hypothesis that institutions and the state determine the importance of long-term economic growth and explain the observed differences in per capita incomes across countries (North 1990, 1991, Hall & Jones 1999, Acemoglu, Johnson & Robinson 2001, 2004, Rodrik 2013).

Theoretical considerations require a broader approach, extending beyond contemporary analysis and taking into account a diversity of views. To explain complex economic realities as well as many the interdependencies in a market economy implies a need for methodological convergence and a need to consider not only the economic point of view but also interpretations of results from other social sciences (philosophy, sociology, political science, etc.). Mainstream economics is not able to explain, by itself, economic reality. This is the main reason for the development of heterodox economics.

3. Some New Challenges Facing the Modern State

Identifying problems that the modern state must face has exposed new areas where regulation is needed. It is impossible to list all the factors which influence the modern state or to sort them according to their importance or other aspects, but some are particularly noteworthy.

Nowadays, economists can identify many challenges that affect the current role of the state. It is very difficult to evaluate them, however, because states are very different. Modern states operate in diverse political, economic, social, cultural, and ecological environments. They have achieved various levels of development, experience different economic growth trends, and participate in different multinational agreements and organizations, etc. They have a variety of historical, cultural and even religious experiences and different hierarchies of social and economic goals. But some challenges seem to be important for the majority of states. These include: globalization, the rapid development of information and communication technologies, regionalization vs internationalization, and the appearance of new agents and unfavourable demographic changes, especially in highly-developed countries (Bloom & Williamson 1998).

Accelerated globalization has appeared as a sign of the times. This is a process of greater economic interdependence among countries, which is manifested in an increasing amount of cross-border trade in goods and services, an increasing volume of international financial flows, and increasing flows of labour. Globalization as a multi-dimensional and multi--level phenomenon affects all levels of socio-economic life, and its most important consequence is the formation of a global economy (Dunning 1992). Its main feature is the transformation of the modern market economy. This process takes place with great force and generates multi-dimensional effects, both in the lives of individuals and nations, and in the world as a whole. An evaluation of globalization is not straightforward, since both positive and negative consequences can be identified. Some of these negative aspects can be easily compensated for by the state using appropriate measures; in relation to others, the state is powerless or at least not very effective (Stiglitz 2003).

The progress of globalization processes has emphasized certain social and economic problems for the governments of well-developed countries. These include: rising unemployment, ageing societies, the high cost of social security incurred by the state, economic instability and income stratification, fiscal policy which is unable to simultaneously guarantee the effectiveness and implementation of the state's objectives, a more expensive state vs richer, more powerful and more influential transnational corporations, deficiencies in the functioning and implementation of basic state tasks, and a need to adapt to rapidly changing internal and external conditions. The effects of rapid globalization also call into question whether its gains are fairly distributed among all economic agents: individuals, organizations, nations, and regions (Intriligator 2004). This process of internationalization has also led to the strong interdependence of economies, including the transmission of local or regional cyclical fluctuations across borders. Globalization is conducive to the dynamic development of services thanks to a knowledge-based economy, but it slows the development of the industrial sector. It also pushes national economies into the background (Mrak 2000). All of the aforementioned problems create specific conditions under which the modern state operates, and the state as an institution has to face new challenges.

Future shocks, which in the 1970s were observed by Alvin Toffler (1970), resulted from rapid technological development. In contrast, increasing consumerism has become a part of societal life and an inherent feature of modern economies, entailing serious economic and social consequences. Psychophysical barriers related to the increasing inability of human beings to accommodate and adapt to rapid transformation are growing. Problems of knowledge absorption can potentially create situations where an unadjusted and unprepared society faces difficult moral and intellectual choices.

The rapid development of information and communication technologies, globalization, the dominance of the service sector over manufacturing, and the growing importance of knowledge (itself an independent factor of production) all generate new conditions for the functioning of the market economy (Noland, Park & Estrada 2012). A post-industrial period of scientific and technological revolution is changing the composition of economic forces. The triad model (households, businesses, and the state) in the new environment is complemented by economic agents whose importance changes the traditional balance on the social and economic stage.

Deepening processes of integration and regionalization and, consequently, the increasing role and importance of institutions and supranational organizations weaken nation-states. Transnational corporations have power over consumers, but also to some extent over the state apparatus (Bremmer 2010). Globalization dethrones the state and a majority of its tasks are acquired by transnational corporations (*Leviathans*… 2005, Herkenrath & Bornschier 2003).

Decentralization as a process of redistributing or dispersing the functions and powers of the state is becoming a common phenomenon in the modern world. This process assumes that the competence and ability to act are attributed primarily to social actors, in other words, non-governmental organizations.

The changing role and importance of economic agents reduces the role of the state in some aspects and reorganizes its activities. In other areas, the state itself relinquishes its rights to other economic agents. The control of economic policy is no longer the exclusive domain of the state, especially as regards monetary policy.

It is also necessary to consider the supranational and worldwide legal order and the role of the state in such structures, especially the process of internationalization of supranational interests and private-sector interests, mainly financial. The creation of new infrastructure on a global level entails formulating strong national foundations. Transition from a national to a global order requires careful analysis of the place and importance of the state in the market economy and its special role in protecting property and intellectual property rights.

The dynamic development of civilization over the past few decades has changed our understanding of the social and economic role of the state. In terms of turbo capitalism, which has accelerated social and economic changes within the scope of social expectations, a closer relationship with the world economy has taken place. The growing role of transnational corporations along with increasingly close vertical and horizontal integration has led to a loss of some part of national sovereignty and changed the perception of the traditional role of states in social and economic life.

The modern state is also involved in many new contradictions. On the one hand, globalization, the growing role of supranational institutions such as the IMF, WTO or World Bank (Stiglitz 2002), and the importance of transnational organizations reduce the role of the state and significantly weaken its strength as an economic agent (Rodrik 2009, Tonnaer 2013). On the other hand, the state is still a special participant in economic life: it acts as the organizer of the legal and institutional order and also as a buyer and producer. The state seems to be the only entity which can effectively limit the destructive operations of other economic actors and ensure social and economic equilibrium. However, the difficulties with how the state functions in turbulent times necessitate changing its place and role because, at the very least, its tasks are mismatched. In many cases, national institutions indicate weaknesses in the realization of social goals – evidenced by citizens' lack of economic security and the progressive polarization of incomes. Additionally, intergenerational responsibility remains a very important issue. New processes weaken the institution of the state and its interventionist tools. Meanwhile, the need for a strong state should be indisputable, since state weakness can undermine the protection of societal interests. New phenomena are changing the nature of the state and necessitate a redefinition of the state and its role and tasks.

It is also worth mentioning that the history of the greatest crises shows that they are preceded by antisocial behaviour on the part of economic agents. George Ackerlof and Robert Shiller, Nobel Prize winners in the economic sciences, have pointed to a wide range of antisocial behaviours. These derive from animal instincts and understanding them can allow us to better comprehend the modern economy and the behaviour of public and private agents, including the state, which is not an impartial institution because it is managed by people (Akerlof & Shiller 2009).

It is impossible to mention all the challenges facing the modern state. Some are constant and their importance and influence can be observed over decades, while the importance of others is changing rapidly. Finally, it is worth mentioning some of the most urgent and imminent challenges for the modern state: the erosion of trust in institutions, climate change, the growing number of military conflicts, and migration.

The financial crisis of 2008 was a systemic crisis related to the breakdown of the neoliberal model of capitalism. This crisis was a symptom of a larger erosion of the contemporary capitalist system and its main institutions (Colander *et al.* 2009, Kołodko 2010, Lawson 2009, Petras & Veltmeyer 2012, Posner 2009). This erosion is caused by several modern phenomena. Most important among them is the economic potency of "big players", especially transnational corporations and capital groups on one hand, and transnational organizations such as the WTO, World Bank, and OECD on the other. These institutions are public and private, so their goals have to be different because they represent different interests. Additionally, climate problems seem to be increasingly important and can only be solved at the international level. Military conflicts likewise do not only have a regional impact but influence many actors (states, international organizations) and cause anxiety and uncertainty in many markets.

One of the challenges of the modern state is its future evolution. This is because it is not just the working conditions of the state, but the state itself, which is constantly changing. In the traditional model (following the views of Napoleon and Hegel), the state and its civil servants are all-wise and all-powerful and should therefore decide what is best for the society as a whole. An extreme example of such a model was communism, which proved to be inefficient. The solution was state withdrawal from the market and the transfer of its prerogatives to the private sector and free market. This point of view was wrong, too, because people forgot that only the state could guarantee the free market and respect for the law, standards, and contracts (Fukuyama 2004). Nowadays, the power of the state does not derive from administrative excellence and a perfect system of hierarchy and supervision. It derives from the ability to solve problems for civil society and entrepreneurs (Goldsmith & Eggers 2004). A different perspective on the future of the state is presented by Micklethwait & Wooldrige (2015). The authors of *The Fourth Revolution* warn decision-makers and societies that if the state is not radically reformed and reduced, then Western democracy could suffer and the role of more innovative authoritarian regimes, notably in Asia, could increase.

Alternatively, Martinez (2009) describes how the flawed myth of the "invisible hand" distorted our understanding of how modern capitalist markets developed and actually worked. Martinez draws from history to show that political processes and the state are not only instrumental in making capitalist markets work but that there would be no capitalist markets or wealth creation without state intervention.

Such differences in how the future role of the state is perceived have led to many problems and therefore challenges. In the past, decision-makers and societies had a choice between a strong or a weak state. But both these concepts fail to explain current economic problems and seem to be wrong when thinking about the future. Also noteworthy is Tanzi's book, *Government versus Markets: The Changing Economic Role of the State* (2014). It addresses the fundamental question of what governments should do, or have attempted to do, in economic activities in past and recent periods, and also speculates on what they are likely or may be forced to do in future years. The investigation assembles a large set of statistical information that should prove useful to policy-makers and scholars in the perennial discussion of government's optimal economic roles. It has become an essential reference work on the analytical borders between the market and the state in the future.

4. Conclusions

The modern world is changing rapidly. Many new factors are influencing the conditions under which the state functions, and the modern state exemplifies many contradictions. Additionally, contemporary economics is unable to keep pace with a rapidly-changing environment and immediately react when new challenges appear. But the state is stable, and because of its tasks and functions, is the most important and crucial economic agent.

It is also the institution which can successfully influence other agents by regulating different social and economic spheres. Thus, the need for a strong state should be indisputable, since state weakness can undermine the protection of a society's interests. New solutions for modern states should, on the one hand, include a plan of action for market failures and, on the other, counteract institutional imperfections, especially public ones. Therefore, measures are necessary which can help to identify these factors and strengthen the state's position. The adopted solutions should comply with macroeconomic stabilization, which has to be accompanied by microeconomic and institutional policies focused on correcting failures in the market mechanism. Properly operating public institutions create a structure of incentives that are conducive to raising national competitiveness.

The new approach to the tasks of the state should respect the new challenges of the era. The state, in turn, should be equipped with new tools. A modern and efficient state has to be able to adapt to complex challenges in an unstable, global world. Therefore, the economic, political, social, and ecological dimensions must be taken into account.

This article is a contribution to the general debate on the challenges facing the modern state and the tools at its disposal. A change in the traditional perception of the role of the state in the economy is necessary. On the one hand, the volatile and changeable environment determined by dynamic social and economic processes requires a new definition of the state's place in the economy and a new specification for its tools. On the other hand, economists are unable to explain all the processes taking place in the modern economy and to define the role of state and exemplify its tools.

During the past few decades, we have observed fluctuations in how the role of the state in the economy is understood. Many theories have been created and implemented, and while some of these have helped to combat depression and stagnation in particular periods of economic history, none are universal or provide the right tools over longer periods. These theories are not able to predict the role of the state in future – they can only adapt to the present economic situation.

In order to find adequate and efficient tools, it is necessary to identify areas in which the state's intervention seems to be necessary. It is impossible to identify and describe all the factors influencing the role of the modern state, and that is not the aim of this article. Very often, the wide variety of factors does not allow one to draw clear conclusions, or the right ones.

Therefore, this article briefly describes the main challenges. It concludes that the current role of the state has to be redefined and that the traditional tools used by monetary and fiscal policy are at the very least insufficient.

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Abstract

O nowych wyzwaniach współczesnego państwa

Spór ekonomistów dotyczący zakresu interwencji państwa w procesy gospodarcze trwa od dawna. Po okresach dominacji teorii leseferystycznych następuje wzrost znaczenia nurtów promujących aktywny udział państwa w życiu gospodarczym. Teoria ekonomiczna i praktyka gospodarcza, poddawane fluktuacjom, preferują raz jedno, raz drugie podejście. Współczesne państwo działa w coraz bardziej zglobalizowanym, dynamicznym i turbulentnym otoczeniu. Konieczność redefinicji roli państwa wynika z dynamiki współczesnych procesów gospodarczych, zróżnicowania poziomów rozwoju społeczno-gospodarczego czy też wyłaniania się nowych instytucji. Artykuł stanowi głos w dyskusji dotyczącej dylematów związanych z ekonomiczną rolą państwa, a także wskazuje niektóre wyzwania stające przez współczesnym państwem.

Słowa kluczowe: ekonomiczna rola państwa, teoria ekonomii, instytucje, współczesna ekonomia.