The State and Market Failures

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Abstract: *Considering the theoretical and practical importance of this matter, a veritable theorizing has been made of the role played by the state in the economy. The difficulty of such undertaking arises among others from the multiple belonging of the researched theme, calling for enough thoroughness regarding the used concepts, techniques and methods of investigation.*

By this article we have aimed for a brief analysis of the content and economic functions played by the state. The gained experience and complexity of the current economic issues emphasize the imperfect nature of the market and State and call for an equilibrium of such economic regulation mechanisms.

Keywords: welfare-state, market failures, state failures, mixed economy, public intervention, state strategies.

The state's intervention in the economy represents one of the oldest traditions ever since the 16th century, however especially after the industrial revolution.

Consequent to the increased speed in the changes and the increased number of "players" in the economic system, state activities have become increasingly numerous and diverse, however the diversity and particular features of the various national economies make it necessary for nuanced approaches to be used, far from expressing generalities regarding the state's economic role. Also, this role should be analyzed based on the existence of the two conceptions regarding the state's role in the economy: the state in a strict sense, based on a restrictive conception according to which the state identifies with public administrations and organisms of social security. It is based on such delimitations that the nature, length, tools and implications of the state's intervention in the economic life should be assessed.

The traditional measure supporting the economic role of the state is supported by the share of fiscal collections and social contributions. By such, the state's intervention has referred to two correlated aspects, the social one (family, society and so on) and the economic intervention.

For a long time period, the public expenses of the state were destined to financing some activities (upholding the order, justice and national defense), corresponding to the "guarding state".

In the first half of the 20th century the economic and social intervention of the state has increased. The situation specific to the after war period, the increased concern of the state for simultaneously ensuring full occupation level, economic growth and social justice contributed to the establishment in 1945 of the "providence state". In a strict and historical sense, this refers to the state's intervention in the social field by means of social securities, aiming to guarantee a certain income for persons affected by social risks (labor injuries, illness, unemployment, aging etc.). The providence state or welfare state is the one supplying the material means necessary for this collective projection. Nonetheless, expenses for social securities explain only in part the social intervention of the state. In the same time, it supports economic growth and occupational level, ensuring the orientation of production.

Depending on the state intervention level, a number of *types of economic systems* have occurred, which have had decisive influences over resources allocation and incomes distribution. Thus, throughout the 20th century the *mixed economy* has occurred and developed, which was characterized by coexistence of specific market means for resources allocation upon public sector manifestation. The transfer towards such an economy occurred due to the extension in the state's activities and the state's increased role. The state permanently expanded its objectives, by taking over some functions which had previously been achieved by the public study or by the market sector of the economy. The object of the *public sector economy* is to analyze the effects of public expenses and taxes over the economic system. Thus, it is important to establish the effects of the public sector over resources allocation in the private or market sector, as well as on the allocation of wealth throughout the economy. Such characteristic of the modern economies calls for a nuance analysis of the state's economic role in the public and private sectors.

Therefore, economic literature defines the role of the state in the following areas: efficient resources allocation, ensuring the correct resources distribution and stabilization of the macro-economy.

Nonetheless, in the opinion of many specialists the state also fulfils the role of correcting the macro-economic imperfections (insufficiencies) of the market economy. Thus, there are of relevancy in the economic theory six large *types of market imperfections*, representing as many reasons justifying the state's intervention: business cycle, public goods, externalities, information insufficiency, monopoly and market power, redistribution of incomes and merit goods.

In the opinion of R. A. Musgrave, the existence of more categories of market imperfection determines the manifestation of the state's role in a number of directions: the resources allocation role, the distribution role, concretized in ensuring social equity and justice in distributing incomes and welfare under market system conditions; the stabilization role by intervention in the economy upon budgetary, fiscal and monetary policies in order to solve problems regarding inflation, unemployment, payment balances disequilibrium and so on; the regulatory role, represented by setting up the general system of laws to direct the economic agents' sector.

In the same time, it is also admitted the existence of certain imperfections of the *state's intervention*, as well as the fact that sometimes governmental programs can act less efficient. Mainly, weaknesses in the state's activities are a matter of the fact that the intervention consists in changes which are many times impracticable, of the difficulty in clearly setting out the objectives of the governmental policies, bureaucracy accompanying the government's activity and so on. Furthermore, those emphasizing the low efficiency of the state's intervention assert that the state serves the interests of the strong social groups, as well as the private interests of politicians and bureaucrats.

This proves that on the contrary, the market and the state are imperfect institutions.

However, the optimization of the economic system should be grounded on the correct assessment of the imperfections, and the option regarding the share of one or the other of such institutions (market or state) should have as a criterion the number and length of the imperfections.

The Economic Functions of the State

The functions the state can or have to fulfill have represented a widely controversial theme amongst economists, sociologists and politics theoreticians.

The political conception over the state represents the defining element in establishing its economic functions. Designing typologies of such functions represents a daring attempt, grounded on the very diversity of the approaches regarding the state.

Not few are the cases when the functions are undertaken with no difference whatsoever being made, eluding the specific area of the state's activity, the exercising level, the achievement means and tools and so on.

When referring to the state's activity in the field of economic processes, the term of "intervention" is preferred to the one of "function". The first term, say some authors, can be used in order to reveal the relation between the state and the economy. This option is supported by the fact that it refers to a set of activities or results which can manifest or not, as well as by their rather flexible nature and the possibility of emphasizing that the presence of the state in the economic activity takes various, national and transnational forms.

The state's functions can be grouped in a variety of forms, and some can be found in more than one category.

The consecrated analyses of the state's functions emphasize the mobility and possibility of transferring some of the said towards the market. By demonstrating the improvable nature of the state and market, the preference is suggested for that category of institution which, upon a certain moment, provides the lowest number of insufficiencies. Such types of comparisons lead to the conclusion that certain functions can be delegated to the private sector.

As regards the functions undertaken by the sate, various opinions exist. Some argue that the state should only provide for those goods and services which cannot be provided by the markets. For others, no limits should exist in defining the stat's objectives, because such represent the materialization of the citizens' will and the expression of the political process. The theory of public elections, studying the way in which the state directs the economy and establishes its choices, makes a distinction between the regulatory role of the state – meaning types of economic functions which the state should undertake – and positive analysis, aiming to describe the state's behavior.

To a great extent, economists have undertaken the classification of the state's general functions as it was designed by R.A. Musgrave: efficient resources allocation, correct incomes distribution and macroeconomic stabilization.

The American economists P. Samuelson and W. Nordhaus treated both the economic functions of the state, and the main economic functions undertaken by the state in a modern mixed economy.

a) Establishing the legal framework allowing for the market economy regulation. It should be noted the continuous evolution of this legal framework representing a condition for the economic behavior.

b) Interventions over the resources allocation for the purpose of improving economic efficiency.

c) Stabilization of programs for improving incomes distribution.

d) Economy stabilization by macroeconomic policies. Stabilizing the economy represents the economic function most recently undertaken by Western states.

An important role is played by public authorities not only in correcting the market's microeconomic insufficiencies (pollution, public goods and so on), but also of macroeconomic insufficiencies of the market economy. The premise is used that the market economy is instable by default and that the public behavior refers to the economic policy tools used in order to promote macroeconomic stability. These include taxation and expenses policies, banks control policies, interest rates and financial markets and so on.

The opinion also exists objecting to the instable nature of the private economy and saying that to a great extent unemployment and inflation are due to economic policy errors. By such attention is drawn that governmental programs can act less efficient.

The state's economic role is achieved on a micro and macroeconomic level. The four economic roles can be summarized as it follows: allocation, distribution, regulation and stabilization. While the first three ones are exercised on a microeconomic level, the stabilization role is of macroeconomic content. It should also be noticed the interaction of these roles regardless the level where they are achieved. Thus, the action of the fiscal policy, which is characteristic to the stabilizing role, calls for changes in the taxation and public expenses programs, also affecting the incomes distribution.

Despite the complexity of the governing forms, certain basic functions exits, which are common to all states. Nonetheless, over time both the volume of the functions, and the size of the achieved operations. Thus, a standard set of functions exists, which is applicable to most states. Some are market insufficiencies, others are not. Gradually, new functions have added to the basic ones, destined to contribute to increasing the social welfare.

The performed functions, which also define the economic role of the state, can be either compatible or conflicting. Thus, expenses for fighting against unemployment have at the same time economic and social objectives, however not all governmental objectives are compatible. Incomes re-distribution, to the extent in which it contributes to reducing investments, can affect the economic growth stimulation policy.

In some countries, it is entirely to the central authorities to perform some functions or such can be transferred to local authorities. In federal government states (USA, Germany, India, Nigeria), the performance of functions can be in charge of feudal, state or local governments. The scission and volume of the performed functions can be established by the political and economic system, as well as by the level of economic development.

Rationality and intervention techniques are closely dependant on the ways or types of achievement. In general, the types of intervention refer to the ways in which political strategies pursue the rebuilding and reorganization of a certain configuration of the social system. Their features can be emphasized by presenting the main dominant state strategies.

a) The neo-liberal strategy represented a new intervention of the modern policies in the USA and England and produced an ideological mutation in the political discourse. From the maxim occupational level objective, achieved by expansionist fiscal policy, the accent is shifted to the control of inflation and reduction of payment balances deficits, by using incomes and monetary policies. By such the transfer is registered of the governmental economic policy towards the micro level and the economy of offer.

b) Neo-state strategies (France, Japan), characterized by fighting against the market forces and by strong bureaucratic control. Contrasting to the neo-liberal strategy, neo-state strategies include an active structural policy for improving and directing the market forces.

c) Neo-corporatist strategies (Sweden, Denmark), the essence of which consists in building strong mixed economies, characterized by combining liberal and Keynesian elements.

As regards the nature of their effects over the economic system, the public intervention modalities can be classified as it follows: urging interventions (markets organization, promoting competition and monopoly control, correcting externalities, coordinating certain behaviors of economic agents); productive interventions (public production and competition with the private sector, monopoly public production, public orders, supplying collective goods); redistributive interventions (creating incomes and ensuring equity; redistributing incomes by direct taxation and transfers).

The types of interventions are changed from one phase to another. The state has always pursued economic objectives, even if such have not been explicit and have been expressed in non-economic terms. However its role of manager of the economy, with explicit and certain purposes has developed after the Second World War II. Thus, this function of economic management is a relatively new one.

Intervention tools, namely the mechanisms used in situations when public action are justified have become increasingly diversified, and their manipulation, increasingly frequent. For the purpose of stimulating economic policies more and more sophisticated economic models are being used.

Establishing the types and tools for achieving the state's intervention should be subordinated to the prerequisite of instating an optimal level of such. With good reason, it is considered that the main problem is not the global reduction of the intervention, but the increase of its efficiency.

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