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AMBO UNIVERSITY  
WOLISO CAMPUS  
SCHOOL OF GRADUATE STUDIES  
COLLEGE OF BUSINESS & ECONOMICS  
**INSTITUTIONAL ECONOMICS**  
LECTURE 5  
THE STATE AND THE MARKET

1/23/2019

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# Lecture content

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1. Introduction
2. State ideologies
3. The changing role of state in the economy
4. Why state interventions?
5. Market failure and state failure: which is more detrimental?



# Introduction

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1. Which one is good for sustainable development:
  - i. State versus market?
  - ii. Agricultural input subsidy versus agricultural output subsidy?
2. How long should a government continue distributing basic goods in Ethiopia?
3. Does political ideology influence the economy?

# The State and Political Ideologies

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- Political Ideology is :
  - ✓ A coherent set of ideas of on how people should live together.
  - ✓ A plan of action for applying these ideas

# The State and Political ...

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1. What was political ideology of EPRDF before the current leadership?
2. What is the political ideology of the current Ethiopian leadership?
3. In your opinion, how political ideology affects:
  - i. market?
  - ii. Economy?
  - iii. Institutional development

# The State and Political ...

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- Four key functions of political ideologies :
  1. Explanatory- How the world Works (empirical)?
  2. Evaluative - Deciding whether things are good or bad (Normative)
  3. Orientation- Supplies the holder with a sense of identity.
  4. Programmatic - What to do and how to do it?

# The State and Political ...

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## ❑ Foundational Disputes of the ideologies:

1. Human Nature: two view.
  - ✓ Rational, 'Naturally' good, cooperative,
  - ✓ Irrational, inherently flawed, evil, dangerous
2. Primacy of individual versus Collective rights
  - ✓ *A normative choice with empirical implications*
3. Conception of freedom
4. Market

## ❑ Five political ideologies.

# The State and Political ...

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## 1. Liberalism

- ✓ Desire for a free, open, tolerant society
- ✓ Humans as rational and able to recognize and promote self-interest.
- ✓ Liberty and equality of opportunity.
- ✓ Classical liberty and modern liberty (welfare)
- ✓ Free market



# The State and Political .....

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- Explanatory: Social conditions are the result of individual choices and actions.
- Evaluative: Societies work best when individuals are free to do as they wish without harming or violating rights of others.
- Orientation: rational, self-interested individuals and hence equal.
- Programmatic: programs for promoting individual liberty (classical) and opportunity (welfare)

# The State and Political ...

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## 2. Conservatism

- Assumes:

- ✓ Human imperfection
- ✓ Focused on conserving existing social order  
Custom and tradition as 'latent wisdom'
- ✓ Organic view of society
- ✓ Acceptance of inequality
- ✓ Freedom and order

# The State and Political...

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- ✓ Explanatory: Social conditions are the result of human imperfections -intellectual and moral
- ✓ Evaluative: Success is a question of social order and harmony.
- ✓ Orientation: Each of us is part of a greater whole, and we should act with interest of society - not just self in mind
- ✓ Programmatic: advocates slow and cautious change.

# The State and Political...

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## 3. Socialism

### □ Recognizes

- ✓ Flaws of Liberalism
- ✓ Economic Equality as ‘True Equality’
- ✓ Economic Planning and the Welfare State
- ✓ Limited role of market

# The State and Political...

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- ✓ Explanatory: Social conditions can only be understood by reference to economic and class relations.
- ✓ Evaluative: Sharpness of economic divisions determines health of Society.
- ✓ Orientation: People should think of themselves in terms of their economic (class) position.
- ✓ Programmatic: Policies must be put into place to advance economic equality (which is a prerequisite for 'true' political equality).

# The State and Political...

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## 4. Communism

- Historical Materialism

  - ✓ Economic (material) foundation of social change

  - ✓ Class conflict as engine of history

- Historical progression expected:

  - Primitive Communism - Slave-based Empires -Feudalism -Capitalism - Communism

  - Revolution as inevitable phenomena?

# The State and Political...

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- ✓ Explanatory: Social conditions determined by economic and class relations
- ✓ Evaluative: Sharpness of class divisions determines ‘stage of development’
- ✓ Orientation: People should think of themselves in terms of their class position
- ✓ Programmatic: Policies must be put into place to advance movement toward communist revolution and ‘classless society’

# The State and Political...

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## 5. Fascism

- ✓ Organic view of society (society *over* individual)
- ✓ Mussolini Slogan: Believe, obey, fight!
- ✓ Irrationalism
- ✓ Rejection of democracy
- ✓ Elitism
- ✓ Statism
- ✓ Militarism
- ✓ Hyper nationalism/Racism
  - Nation/People as determining identity



# The State and Political...

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- ✓ Explanatory: Problems from 'enemies of the nation or people' (scapegoats)
- ✓ Evaluative: Strength and unity of the nation or people
- ✓ Orientation: Define yourself as part of nation/people (not as individual)
- ✓ Programmatic: Establish fascist elite in uncontested power (Believe, obey, fight).

# The changing role of state in the economy

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- ❑ Adam Smith (the Wealth of Nations, 1789)
  - Advocated unregulated market.
  - the market was capable of generating efficient signals for the economic units- there was an ‘invisible hand’ which guided every economic unit.

## The changing role of state ...

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- ... individuals' interest should take precedence over the public interest and the government has no right to redistribute the wealth of the individuals.
  - ✓ A person's life chance is simply the out come of the market.
  - ✓ The market out come well reflects one's innate abilities to earn one's livelihood.

## The changing role of state ...

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- The market outcome can be fortune for some ones and unfortunate for others, but it is fair.
- Goods and services that market can't allocate:
  - ✓ social overheads, defense, and maintenance of law and order, as well as maintenance of the state itself.
  - ✓ All economy need these goods and services.

## The changing role of state ...

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- ✓ The market could not provide them either due to the lack of commercial profitability or some other reasons.
- ✓ Government need to finance these by resources contributions from those who can contribute!

## The changing role of state ...

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### □ World Economic crisis of 1930s:

- ✓ reversal of socio-economic development,
- ✓ During 1940s, Keynes and Galbraith developed the concept of welfare state
- ✓ each individual is part and parcel of the community and it can not function with out the community and therefore, it is not autonomous.

## The changing role of state ...

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- Call for state interventions in the economy
- State expanded its activities in various directions and the concept of welfare state become popular
- State taking roles in:
  - ✓ Provisions of negative rights,
  - ✓ economic stability, economic growth, employment, inflation, balance of payments, regional imbalances, and so on.

## The changing role of state ...

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- ❑ During early 1950s and 1960s:
  - ✓ state-led development was encouraged and supported by the international community. there were revivals in the economies of most developing countries
  - ✓ After couples of decades, however, the economies of these state-led developments started declining.



## The changing role of state ...

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- ❑ Great economic recession during 1973.
  - Friedman and Hayek:
    - ✓ accept the concept of market principle,
    - ✓ But, argue that market outcome could be unfair because not every one has the same opportunity to earn one's livelihood through flair, initiative and hard work.

## The changing role of state ...

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- Argued that state has to ensure that every one has:
  - ✓ the same opportunity to secure an adequate standard of living through creation of equal opportunity.
  - ✓ But, not necessarily equal out come of development.

## The changing role of state ...

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### □ During 1970s and early 1980s:

- ✓ state-led development was criticized as inefficient and distorting in the light of growing debt and macroeconomic instability, especially in Africa and Latin America.
- ✓ state intervention in the economy in many of the developing countries was considered as wasteful,
- ✓ Resulted in a succession of national economic crises.

# The changing role of state ...

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- ❑ During early 1980s:
  - ✓ Call for the rejection of the state-led model of development:
    - ✓ a return to a market-based economy.
    - ✓ Issuances of Neo-liberal economic policies,
    - ✓ IMF and the World Bank put SAP as a preconditions for getting loan for developing counties,
    - ✓ Acceptance of Washington consensus

# The changing role of state ...

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- Blanket policy recommendations for developing countries.
- Rejections of individual country's characteristic.
- *Reading assignment: Ha-Joon Chang (2002). Kicking Away the Ladder: How the economic and intellectual histories of capitalism have been re-written ...?*

# The changing role of state ...

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- ❑ As most developing countries in adopted the concept of Structural Adjustment Policy packages (SAPs).
  - Positive Effects of the policies:
    - ✓ Helped to restore macroeconomic stability in most countries, at least for short period of time (Positive effect).

# The changing role of state ...

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- Negative effects:
  - ✓ detrimental effects on state capacity.
  - ✓ There were inadequate provision and delivery of basic social services was poor maintenance or lack of modernization of the civil services.
  - ✓ the privatization of key economic sectors was carried out in a rush without a transparent bidding process → resulted in the creation of ineffective private monopolies rather than increased market competitiveness.

# The changing role of state ...

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- ✓ Eventually, in LDCs, neither the private sector nor local NGOs had the capacity to provide services without relying on the state to play a sound coordinating and regulating role.
- ✓ the neo-liberal paradigm has led the LDCs to the other dead-ends, which severely affect the welfare of the poor in particular.



# The changing role of state ...

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## □ Since the mid-1990s:

- ✓ the roles of states in development have returned to the centre of international policy debate.
- ✓ This new thinking is evolved as a result of the economies of most African and Latin American countries continued reversing, showing the failure of the Neo-liberal thinking.

# The changing role of state ...

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- ✓ the recognition of very different experience of state-led development in a number of Asian countries, especially in East Asia, (the experiences of ‘Asian tigers’ which includes: Japan, Korea, Taiwan, Hong Kong, Singapore, South Korea)
- ✓ These countries underwent rapid economic growth and a radical socioeconomic transformation, moving from being poor agrarian societies in 1960s to producers of high technology, high value-added goods by the 1990s.

# The changing role of state ...

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- ✓ accelerated development with active role of state has spread further in Asia, and is increasingly including the Indian sub-continent along with China and Vietnam since the end of the 1990s.
- ✓ the World Bank reaffirmed the position that ‘the state is central to economic and social development’.
- ✓ increasing recognitions given to the state-led development.

# The changing role of state ...

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- ✓ the orientation and effectiveness of the state is the critical variable explaining why some East Asian countries succeed whereas most African and Latin American countries fail in meeting development goals.
- ✓ recognizing the failures of the past development paradigms and the miraculous achievements of the East Asian countries' EPRDF has officially declared the rejection of the neo-liberal thinking and its readiness to emulate the state- led development .

# Why state interventions?

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- Why government interventions?

# Why state interventions...

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- Pervasive Market failures
- Information asymmetry.
- Externality
- Provisions of negative rights?
- Social capital development (institutional building)
- Technological capability accumulation



# State failure and Market failure

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1. When a state fails?
2. Why a state fails?
3. What are the manifestations of state failure?



# State failure and Market ...

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1. When market fails?
2. What are the manifestations of market failure?



# State failure and Market ...

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- In your opinion, which failure is more damaging: state failure or market failure? Why?

# Conclusion

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- using the complementarities between market and non-market institutions in policy endeavors to improve the welfare of the society.
- avoiding prejudice to either the market or state and take the middle path for one can't substitute the other.
- efficiency and equity should be considered simultaneously in evaluating the role of either the market or the state

# Reading Assignment

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- Book: Sen. A. K. (2000). Development as Freedom, Alfred A. Knopf, Inc. New York.
  1. Chapter 5: Markets, state and social opportunism; PP. 111-145
  2. Chapter 6: The importance of democracy; pp. 246-259
- Summarize each chapter within maximum of 3 pages and submit for evaluation

A graphic of a spiral-bound notebook with a brown cover and a light beige page. The spiral binding is on the left side. A horizontal line is drawn across the page, just above the text.

**THANK YOU**

1/23/2019

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