FROM STATE TO MARKET* (and back to State?)
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Setelah dari awal abad ini telah membawa perekonomian dunia banyak dipengaruhi oleh peran pemerintah, sedangkan abad berikutnya terjadi pergeseran ke arah orientasi pasar. Tulisan ini mencoba mengajak pergerakan paradigma tersebut. Fokus utamanya adalah negara-negara barat terutama Inggris, yang merupakan wilayah perpana impor terus melibatkan industri yang sangat pesat. Analisis perubahan paradigma selanjutnya diarahkan pada konteks wilayah Asia dengan bebera petani tanah batubara mengenai krisis Asia.


Keywords: economic nationalism; free market; free trade; general agreement on tariff and trade (GATT); globalization; great depression; hot money; brave new; Welfare State; World War I and II; period of prolonged upheaval; Keynesian revolution

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The first half of this century brought a striking increase in the role of the State in the economy, the second half equally pronounced move towards the Market. The object of this paper is to try to explain this paradigm shift.

Pre-History

During the 100 years before 1960, the industrial revolution and the rise of the middle class had promoted emancipation from absolutism and mercantilism, with Britain in the lead. The origins of liberalism as a political philosophy go back further—to Locke and the Glorious Revolution of 1688 in Britain, to the Declaration of Independence of the United States and to Voltaire, Rousseau and the 1789 Revolution in France. But economic liberalism is a 19th century phenomenon. On the theoretical foundations laid by Adam Smith and Ricardo, the Reform Act of 1832 and the abolition of the Corn Laws of 1846 signalled the ascendancy of manufacturing over rural interests. Laissez-faire and free trade became the dominant ideology for the next fifty years, challenged but not significantly weakened by Chartists and other critics. Even on the European Continent the socialist movement remained in opposition for the rest of the century.

1900-1950: To State

1. Growth of the Welfare State. The intellectual climate began to change, and impinge on public policy, around the turn of the century. The depression of the 1890s widened concern about urban poverty and unemployment and strengthened the newly enfranchised working class and growing trade unions. The first moves towards the welfare state came in Germany when Bismarck, to take the wind out of the sails of the social-democratic party, in 1883 introduced health and other social insurance. In Britain, the Fabian socialists began to influence policy in the first decade of this century. Beatrice Webb’s 1905 minority report of the Royal Commission on the Poor Law led Lloyd George in 1908 to introduce a modest unemployment insurance scheme designed by a young William Beveridge. The next three decades saw only minor advances in government provision of housing and other social services in western countries, but public support for a full-blown welfare state grew under the impact of catastrophic political and economic developments. Welfare economics, Pigou and others, developed the theoretical underpinning by distinguishing the social from the personal marginal product (Myint, 1948).

2. Period of Prolonged Upheaval. The outbreak of World War I put a sudden end to the relatively untroubled peace and prosperity of the 19th century. It initiated what has been called a “period of prolonged upheaval” (Kindleberger, 1976). Mobilization of the economy for war brought unprecedented state intervention. The economic consequences of the war shifted world hegemony from Britain to the United States and loosened the peace treaty saved the economic foundations of Nazism in Germany. The Bolshevik Revolution in Russia dramatically suggested an alternative to capitalism. The severe post-war depression promoted the first Labour Government in Britain and after a few years of seemingly normal prosperity, the post-1929 US slump led into the Great Depression, a catastrophic decline in economic activity and massive unemployment. Preoccupation about the future of capitalism became widespread. The upheaval reached its climax with World War II and Hiroshima.
3. The Great Depression. The collapse of the boom of the 1920s assumed dimen-
sions far exceeding normal cyclical downturn. Among the reasons were structural 
ines of the war—pri-
ary product prices sustained too long by commodity agreements, British loss of 
industrial competitiveness aggravating by 
restoration of the gold standard at the 
pre-war parity in 1925, and European balance of payments deficits financed by US cap-
tal outflows suddenly reversed in 1929— 
and adherence, even as economic activity and employment declined year by year, to 
the doctrine of "orthodox" finance that budget deficits are inflationary. Govern-
ments reacted in various ways without clear understanding of the problem. Hot 
money flows forced Britain off the gold 
standard in 1931, followed by abandon-
ment of free trade. In Germany, Hitler 
embraced successively a policy of full 
employment through rearmament. In the 
USA, President Roosevelt, elected in 
the depth of the depression, after tackling 
the banking crisis and devaluing the dollar, 
launched the New Deal. Its "pump prim-
ing" effort was quite inadequate to restore 
full employment, but it involved a persis-
tive increase of government intervention 
in the economy (Anis, 1944).

4. Keynes. The Keynesian Revolution pro-
foundly changed thinking about the capi-
talist economy. In the General Theory of 
Employment, Interest and Money (1936), 
Keynes argued that macroeconomic equi-
librium—full employment without infla-
tion—cannot be left to the market. The 
neo-classical view that the rate of interest 
maintains balance between saving and in-
vestment is wrong because, unlike the 
expected rate of profit, it cannot be nega-
tive and because investment in any case 
tends to be interest-inelastic. Wage policy 
cannot restore full employment because 
(at least in a closed economy) cuts in 
money wages do not reduce real wages. 
What is needed is an active counter-cycli-
cal macroeconomic policy, demand man-
agement, and the appropriate instrument is 
not monetary policy but fiscal policy, 
budget deficits to stimulate economic ac-
tivity and employment, and budget sur-
pluses to counter inflation. Keynesianism 
did not significantly influence policy be-
fore World War II and was applied only 
slightly on war finance, but by the time the 
war ended it had come to dominate west-
ern economic thought. "All of us were 
Keynesians" (Henderson, 1965).

5. World War II. Mobilization of the 
economy for total war quickly required the 
imposition of direct controls over virtually 
all economic activity. Price and allocation 
controls, rationing, and foreign trade and 
exchange controls largely suspended the 
operations of the market in all belligerent 
countries. Most business remained under 
private ownership and management, but in 
other respects the western capitalist econo-
1989 mies came to resemble that of their Rus-
sian ally. The overriding single objective 
of victory in the war made planned re-
source allocation a relatively minor task. 
The end of the war brought substantial 
decommercial, and a much smoother shift of 
resources back from war to peace pro-
duction than after World War I. But in 
Britain and other western countries, a good 
many direct controls remained in place for 
some years, and the triumph of the welfare 
state and Keynesianism was signed and 
tainted by the two immensely influential 
Bertram reports on Social Security and 
Full Employment and in official docu-
ments such as the British White Paper on 
Employment Policy and the US Employ-
ment Act. Already, however, there were 
whiffs in the air which suggested that a 
new wind might blow in the second half of 
the century.
1950-2000: To Market

1. Towards Free Trade. It was in the arena of international trade that the first, most sustained and relatively most effective moves were made. The initiative came from the United States which, with its newfound competitive superiority, and as a surplus country most exposed to discrimination, had the strongest interest in freer trade and payments. Roosevelt's Secretary of State, Cordell Hull, as a Southerner predisposed to free trade, had in 1934 secured the passage through Congress of a Reciprocal Trade Agreements Act which empowered the President to conclude reciprocal trade agreements with foreign countries for the reduction of tariffs and other trade restrictions, subject to unconditional MFN (most favored nation) treatment. "Equal access to trade" through non-discrimination became one of the Western Allies' war aims, proclaimed by Roosevelt and Churchill in the Atlantic Charter of 1941, and the basic principle of the Havana Charter of 1946 from which emerged, as residual legates of the stillborn International Trade Organisation, the GATT (General Agreement on Tariffs and Trade).

Meanwhile, the Bretton Woods Conference of 1944 had established the International Monetary Fund, with the object of restoring stable (but adjustable) exchange rates and (gradually) free convertibility of currencies, and the International Bank for Reconstruction and Development (later World Bank) which, through the provision of long-term credit to war-damaged and less developed countries, would promote the flow of trade.

In the following decades, the GATT staunchly pushed trade liberalisation in successive rounds of multilateral negotiations, yielding in 1997 the establishment of the World Trade Organisation. As Japan and other East Asian countries gained in competitiveueness, the USA and Europe put pressure on them to open their protected markets. Regional trading arrangements, mostly preferential, such as the European Common Market, EFTA, NAFTA, AFTA, and APIC contributed to a rate of expansion of world trade twice as fast as growth of world GDP.

2. The Long Boom. Domestically, change came more slowly. In Britain, some of the economists who as wartime civil servants had gained first-hand experience of the inefficiency of bureaucratic controls, such as Jewkes and Wilson, proclaimed the virtues of a free market economy (Jewkes, 1948; Wilson, 1950, 1962). Others, such as James Meade (1948) and Arthur Lewis (1949) looked for a middle way. In Germany, Ludwig Erhard, a convert to Roepke's economic liberalism, spectacularly demonstrated its merits in guiding the country's rapid economic recovery (Erhard, 1958).

For nearly two decades, the world enjoyed full employment without any apparent need to resort to Keynesian demand management. There was no repetition of the post-World War I depression. Catch-up of consumption and investment demand deferred during years of depression and war, reinforced by new technology (cars, planes, TV etc.) and heavy military expenditure, sustained a long boom. First Marshall Aid and then Korean War US deficits overcame "dollar shortage" in the rest of the world. Unemployment rarely exceeded 2 percent. There was a striking revival of optimism about the future of capitalism, though not without occasional dissent on the Left.

3. The End of Keynesianism. The Keynesian consensus lasted into the 1970s.
In 1958 it was embodied in the Phillips curve: the curve of macroeconomic demand management was the trade-off between unemployment and inflation. A reduction in unemployment could be purchased at the price of higher inflation, and vice versa. In the United Kingdom the 1950s brought increasing wage-price pressures; price stability became the chief concern, not least to maintain the exchange rate at the Breton Woods sterling parity. In the United States, economic policy came to be increasingly dominated by the Cold War. The Soviet "Sputnik" in 1957 sparked anxious questioning whether US economic growth would be sufficient to sustain US hegemony. In both countries, growth was anathema, the economic weapon in the UK (influenced by a misunderstanding of French experience under de Gaullc) with a penchant for "impositive planning" (Amdt., 1978).

For two decades after 1945, the OECD economies (as they came to be called) maintained fairly steady macroeconomic balance, unemployment and inflation both remaining most of the time below 2 percent. The break came in 1965 with President Johnson's tax cut and increase in military expenditure on the Vietnam War. It was the beginning of the US double (budget and current account) deficit which in 1971 led President Nixon to abandon gold convertibility of the US dollar, in effect jettisoning the Bretton Woods system. Freed from the international discipline of stable exchange rates, the double-deficit-propelled expansion of money supply, reinforced by the OPEC oil price increases of 1973/4 and 1978/80, turned the 1970s into a decade of high inflation. The combination of wage-price pressures and monetary expansion gave rise to a phenomenon unprecedented and totally out of odds with Keynesianism and the Phillips curve—stagflation. From around 1970, inflation accelerated in Western countries, but simultaneously unemployment rose. The explanation put forward by Milton Friedman constituted a doctrinal revolution as fundamental as the Keynesian Revolution of the 1930s.

Friedman's macroeconomics consisted of two main propositions: (1) The cruval macroeconomic variable is not aggregate spending but money supply; governments therefore have to rely on monetary rather than on fiscal policy, and since unpredictable lags rule out fine tuning other than in monetary or in fiscal policy the safest rule is to aim at a constant rate of growth of money supply. (2) Unemployment in market economies is mainly structural, caused by rigidities in the labour market, and therefore not amenable to demand management, any attempt to reduce unemployment below its "natural" rate—in effect, a vertical Phillips curve, later called NAIRU (the non-accelerating inflation-rate of unemployment)—merely causes inflation.

Since the early 1970s macroeconomics in Western countries has been monetarist rather than Keynesian in complexion. Fiscal policy, while still employed to assist in the maintenance of internal and external balance, has been subordinate to monetary policy. Central banks—price Friedman—have continued to attempt fine tuning and have relied on the short-term rate of interest as the main instrument. But control of inflation has been the chief objective of macroeconomic policy. While unemployment has increased tragically in most Western countries, Friedman's view that it is a macroeconomic problem, chiefly due to ill-adjusted and inflexible labour markets and requiring macroeconomic measures, has come to be generally accepted.

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But Friedman’s influence extended well beyond macroeconomics, though in the role of miliatary rather than peacemaker. Ever since the 1930s, animosity among econonists and other intellectuals had spoken out against the growth of the state, socialism and Keynesianism. Prominent among them were the Austrian school, represented by Mises and Hayek. The latter’s Road to Serfdom (1945) was a trumpet call, widely exerted but influential.

In England, econonists such as Robbins spoke out for private enterprise, competition and free markets, philosophers such as Pigou for the open society. In the United States, the University of Chicago which Friedman joined in 1945 became the Olympus of economic liberalism. Knight, Viner, Simons, Becker, Schultz, Sugihara and others developed new theorectical foundations for economic liberalism—theory of human capital, public choice, poverty rights, new ways of looking at consumer behaviour, institutions and 19th century industrialisation. (Lappage, 1978). From around 1960, thinktanks, such as the Institute of Econonic Affairs in the UK and the Center for Competitive Studies in Australia, propagated the gospel.

4. Economic Rationalism. By the end of the 1970s, this outlook—economic liberalism (in the English sense)—had gained majority support among the voting public in the United States and England and in varying degrees in other western countries. With the election of Margaret Thatcher in the UK in 1979 and Ronald Reagan in the USA in 1980, it came to dominate public policy.

The long boom bad ended in stagflation, high rates of inflation, growing unemployment and slowdown of economic growth. The relentless expansion of government expenditure on welfare and other services met increasing opposition from taxpayers, particularly once declining rate of inflation deprived governmet of easy access to income tax revenue through ‘bracket creep’. Efforts to control inflation through price and other direct controls were rendered. Wage pressures made industrial relations more than usually contentious. Whatasocialists and Keynesians viewed as a ‘conservative revolution’ was greeted by followers of Friedman, Thatcher and Reagan as an overdue affirmation of Capitalism and Freedom (Friedman, 1962), individual choice, private enterprise and competitive markets.

During the ten decades from 1980, governments adopted a broad range of market-oriented economic policies. Macroeconomic management gave priority to control of inflation through monetary policy and less exchange rates largely to the market. Microeconomics policies were designed to reduce the size of the public sector and to deregulate the private sector. Taxes were cut—by Reagan under the influence of the bizarre ‘ Marxist cure’ theory that revenue would grow through supply-side responses, thankings the budget balance—and the tax structure shifted from income to consumption (value added tax or GST). Nationalised industries and public utilities were privatized. banks and vaginal markets were substantially decontrolled. attempts were made to impose competition policies on business and enterprise bargaining on trade unions, and under the aegis of successive OAT’s “council”, foreign trade related payments were fixed up to an extent that would have been thought impossible and indeed undesirable thirty years earlier.

Now was the shift to the market confined to western industrial countries or in
these countries to the conservative side of politics. Developing countries, first in East Asia but later also in Latin America and South Asia, moved from import substitution to export-oriented industrialization, encouraged capital inflow and technology transfer through direct foreign investment and cautiously deregulated their financial systems. The integration of national economies into the world market economy which was furthered by liberalisation of trade and capital movements and by technical progress in transport and communication, came to be known as “globalisation”. With Gorbachev’s perestroika and the collapse of communism in the Soviet Union, the end of the Berlin Wall and Deng Xiaoping’s reform in China, the Market made conquers that nobody would have predicted in 1950 or 1960.

In Japan and throughout East Asia (with the conspicuous exception of Hong Kong), the shift towards export orientation and trade liberalisation did not greatly reduce the role of the state in the domestic economy. What came to be known as “industry policy” relied on state intervention to promote hoped-for growth industries—"picking winners"—and phasing out declining industries, financial deregulation also made limited progress, and in most countries domestic industry remained heavily protected. Even in Singapore, which, next to Hong Kong, most fully embraced free trade, government retained substantial control over the directions of industrial development. In varying degree, this applied to most other developing countries.

How far this interventionist approach to development in East Asia accounts for their spectacular economic growth during the 1980s, as some have contended (cf. Chalmers Johnson, 1982; Amaden, 1989; Wade, 1990) or for their troubles in the later 1990s, remains a contentious question. In most other developing countries (Chile, Mexico and one or two other Latin American countries are becoming significant exceptions) intervention in the economy by relatively inefficient and frequently corrupt governments remains just one aspect of underdevelopment.

The paradigm shift from state to market is therefore in the main a feature of twentieth century economic history in western, and indeed chiefly the Anglo-Saxon, countries. On the European continent, in France, Germany, the Netherlands and Scandinavia, the shift has occurred but has been qualified by retention of collectivist (“social market”) elements of economic and social policy.

In 1976 the last British Labour Prime Minister before Mrs. Thatcher, James Callaghan, told the Labour Party conference: “We used to think that you could just spend your way out of recession and increase employment by cutting taxes and boosting government spending. I tell you in all candour that that option no longer exists, and that insofar as it ever did exist, it worked by injecting inflation into the economy” (Brett, 1985, 165). What came to be called “economic rationalism” - policies of trade liberalisation and deregulation, policies aimed at economic efficiency and growth, were pursued, or at least not reversed, by left-of-centre governments such as the Blair “New Labour” government in the UK. In fact, the spectrum from pro to anti market-oriented policies cut across the traditional political spectrum from Left the Right. In Mrs. Thatcher’s doxonomy terminology, many on the Right were “wet” and many on the Left “dry”.

Reaction

What distinguished Keynesian economist J.K. Galbraith has called “the poison of economic rationalism”
(Calverth, 1997) is vociferously con-
demned from the Left and the Right. 
Left-of-centre voices complain that "both 
Labor and the non-Labor governments regard 
heavy unemployment as inevitable and 
ignore the human and social conse-
quences. Both favour large-scale outlays in 
the public arena. The results are a 
chronically sick economy, declining in-
dustries, widespread social breakdown and 
pervasive human misery" (Maddew & 
Crewal, 1997). A right-wing commentator 
speaks of the "blind ideology" which "op-
perates through budget balancing, in 
great part by selling off every marketable public utility... through continuos 'downsizing' 
and constant attempts to cut real wages 
and social services" and predicts that "the 
surge of the ordinary people will continue 
to grow" (Santamaria, 1997). Economi-
sists alike believe that Australian could be 
faced with the UK and USA.

The general tone of such criticisms of 
economic policy is the Keynesian objec-
tions to the "austenian with inflation". "The 
shift to the Right in macroeconomic policy 
during the past two decades has deliber-
ately used the blunt instrument of slow 
economic growth and high unemployment 
to fight inflation" (Bell, G/89). The crit-
ics refuse to accept the Friedman thesis 
that unemployment cannot be significantly reduced by deficit spending. In so far as 
they accept the view that high unemploy-
ment in western economies is structural, 
they advocate wage subsidies or even 
a negative income tax, rather than a reduc-
tion in minimum wages. The 1997 Eco-
nomic Report to the UI President ques-
tioned whether there was any need to go 
for zero inflation, "a little bit of inflation is 
probably good for you" (quoting Australi-

The trade liberalisation agenda has 
predictably been subjected to criticism by 
ideological protectionists and by the lob-
bies of protected industries. Financial 
liberalisation has come under attack, par-
ticularly in the wake of the 1997/98 Asian 
crisis. The abandonment of the exchange 
rate system of visible exchange rates, it is 
claimed, has removed international dis-
cipline over domestic macroeconomic 
policy and has thus contributed to infla-
tion; failure to control short-term interna-
tional capital movements, "hot money", 
has led the same disastrous effects as in 
the 1930s, failure by central banks to exer-
cise prudent surveillance has left a legacy 
of malcooperating banks throughout East Asia; 
and "globalisation" is substituting na-
tional interests to those of foreign compa-
nies.

Such specifically economic criticisms 
have been reinforced by root-and-branch 
attacks against "economic rational-
misation" or non-economic grounds. Depra-
tionary budget-cutting and disinvestment 
policies, it is claimed, have by widening 
income disparities benefited the 0.1 that 
the expenses of the poor. Social workers and 
spokesmen for welfare bobbies, in 
almost Marxist terms, demanded a distribu-
tion of income "to each according to his 
need". More generally, economists and 
other supporters of "economic rational-
ism", have been criticised for focusing too 
narrowly on economic objectives, effi-
ciency and growth, and ignoring, or giving 
insufficient attention to, non-economic 
objectives—equality, social welfare, the 
environment, community, national iden-
tity (Mead, 1995; Arg, 1991). Some, in 
the spirit of King Canute, demand "con-
struction".

Conclusion

Does all this clamour mean that the 
paradigm shift to the market is being re-
visited? Is the pendulum swinging back?
The first point to note is that economic nationalism has been faring against the winds. All the push for smaller government has quite failed to halt the inevitable increase in the size of the public sector and the role of government in the economy. In 1979, the year Mrs. Thatcher became Prime Minister, the share of government expenditure in British GNP was 38.0 percent; by the end of her term, in 1990, it was 38.2 percent. In the USA, it rose during Reagan’s Presidency from 33.7 percent in 1980 to 36.1 percent in 1988. Between 1980 and 1991 the share rose in all western countries except in the Netherlands where it had already reached 52.5 percent in 1980 (World Bank, 1993). Judging by the volume of legislation passed or by the number of regulatory agencies installed, deregulation has at best slowed down the growth in government regulatory activity. In all western countries, social welfare expenditures inevitably rise with increasing unemployment, the cost of pensions with ageing of the population, hospital and other health expenditures with more costly technology and technology.

International trade and payments have undoubtedly grown rapidly with liberalisation. But the Common Agricultural Policy of the European Union, ubiquitous resistance to (or circumvention of) Uruguayan Round commitments, and safeguarding of domestic industries through visible and invisible tariffs are evidence that protection remains entrenched in most parts of the world.

But the picture is by no means all black. The western countries, especially the USA and UK with their relatively flexible labour markets, have experienced sustained growth and fairly moderate unemployment for the past decade. Statistics suggest that income distribution has deteriorated; some rich people have become a lot richer, and (mainly because of unemployment) an increasing number are below the poverty line, especially among immigrant and other ethnic minorities. But the great majority are enjoying living standards rising with economic growth. Economic development in much of Latin America has benefitted greatly from the adoption of export and market-oriented policies, and there is every reason to believe that the countries of East Asia will return to quite high growth rates as the effects of the 1997/8 crisis are overcome in the next two to three years.

Economic prophecy is risky. But it is perhaps not unrealistic to expect support for market-oriented policies to continue to moderate the pressures for state intervention in the economy, to prevent the pendulum swinging back too far.

Postscript

And now a postscript: What light has the Asian crisis thrown on the relative roles of state and market in the economy? Three points stand out:

First, the crisis has highlighted the enormous problem presented by the volume and volatility of international short-term capital flows. The near-consensus of professional opinion in favour of open capital accounts—only because of doubt whether capital exchange controls are enforceable—has been questioned by prominent economists, such as Stiglitz (1999) and Bhagwati (1998), and even the IMF appears prepared to contemplate at least greater scrutiny of international short-term flows.

Secondly, the role of the banks in the crisis has led to reconsideration of financial deregulation. The collapse of the Indonesian banking system and the formal or de facto insolvency of major banks in Japan and Korea have made banking reform the most urgent step in crisis management. The preferred answer is not re-imposition of direct government controls.
of the kind in optimation before deregulation, but built-out and reconstruction in the short term and a new regime requiring greater transparency and some form of presidential surveillance in the longer term. Banking reform does not impose on the larger malaise of the financial system, the investment and stock exchange boom which has endangered economic stability in Japan and may yet do so in the United States. But this is a problem for monetary policy which, by general agreement, is a legitimate field of state intervention in the economy.

Thirdly, the threat of worldwide recession or even depression, spreading from Japan, has led to renewed discussion of demand management. World Bank Vice-

President Severino has advocated "Keynesian expansionary measures" in Japan (Severino, 1998). Those who take this view argue that there has never yet been scope for Keynesian full employment policy. From 1939 until 1970 the problem was to contain inflation; after 1970 expansionary measures were inappropriate, since unemployment in Western Europe was mainly structural and not amenable to demand management, so that expansionary measures would merely cause inflation and balance of payments problems. Japan in the 1990s presents the first opportunity since the 1930s for a Keynesian full employment policy because Japan’s balance of Payments position is not vulnerable.

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