CHAPTER 11

Leviathan or the Philosopher King?

THE ROLE OF THE STATE

‘Government exists to protect us from each other. Where government has gone beyond its limits is in deciding to protect us from ourselves.’
RONALD REAGAN

‘The proof that the state is a creation of nature and prior to the individual is that the individual, when isolated, is not self-sufficing; and therefore he is like a part in relation to the whole.’
ARISTOTLE

The State and Economics

Political economy: a more ‘honest’ name?

In the old days, no country had a Ministry of Defence. They all had a Ministry of War because, well, war is what it really does. Patents used to be called patent monopolies, as they were (and still are) artificially created monopolies, even though they may be socially useful. So there you have it. Sometimes, an old, forgotten name conveys the essence of the thing it is describing much better than the modern one does.

The same goes for the old name of economics – political economy, or the study of *political* management of the economy. In this day and age, when economics has become the ‘science of everything’, one can easily get the impression that government economic policy is really not particularly central to economics. However, much of economics is still about actions by the state, or the government – or recommendations against them.* And indeed even those economists who try to sell economics as a science of everything by showing that ‘economic’ (rational) decision is everywhere are – at least unwittingly – contributing to the debate on the role of the state in the economy. When they show that people behave rationally even in the most unlikely areas of life – family life, sumo wrestling and what not – they are saying that, in plain terms, people know what is good for them and how to achieve it. The implication is that they should be left alone: no paternalistic government telling people what to do, believing that it knows what is good for them.

Of course, no serious economic theory says that the government should be abolished altogether. But there is a huge spectrum of opinion on the appropriate role of the state. At one end of the spectrum, we have the free-market view, which wants no more than the minimal state that provides military defence, protection of property rights and infrastructure (like roads and ports). At the other end, we have the Marxist view, which believes that markets should be marginalized – or even abolished altogether – and the whole economy coordinated through central planning by the state.

Once we depart from these two extreme views, the possible permutations of exactly what the government should or should not do become mind-bogglingly numerous. Indeed, even those who want the 'extreme' solutions of the minimal state or central planning cannot quite agree amongst themselves on, respectively, what exactly the minimal state should do or to what degree of detail the economy should be planned.

The Morality of State Intervention

The state cannot be above individuals: the contractarian view

A perennial theme in the debate on the role of the state is a moral one – whether the state has the right to tell individuals what to do.

Most economists these days believe in individualism, namely, the view that there can be no higher authority than individuals. In its purest form, this philosophical stance leads to the view that the government is a product of a social contract between sovereign individuals and thus cannot be *above* individuals. In this view, known as contractarianism, a state action can be justified only when every individual gives his/her consent.

'Nasty, brutish, and short': Thomas Hobbes and the original contractarian argument

There are different theories of social contract, but the currently most influential version is based on the ideas of the seventeenth-century English political philosopher Thomas Hobbes. In his famous 1651 book, *Leviathan*, named after the biblical sea monster, Hobbes starts by presuming a 'state of nature', in which free individuals existed without a government. In that world, Hobbes argued, individuals were engaged in what he called the 'war of all against all', and as a result their lives were 'solitary, poor, nasty, brutish, and short'. In order to overcome this state of affairs, individuals voluntarily agreed to accept certain restrictions on their freedom imposed by a government so that they could have social peace.

Modern contractarian, or libertarian, argument on the role of the state

Hobbes himself actually used this theory to justify absolute monarchy. He advocated a total submission by individuals to the monarch's authority, which is justified by its ability to elevate humanity out of its state of nature. However, the philosopher Robert Nozick, the economist James Buchanan, the winner of the 1986 Nobel Prize in Economics, and other modern advocates of contractarianism have developed Hobbes's ideas in a different direction and advanced a political philosophy to justify the minimal state. In this pro-free-market version of contractarianism, more commonly known as libertarianism in the US, Leviathan came to depict the state as a potential monster that needs to be restrained (which is *not* what Hobbes intended). This view is best summed up in Ronald Reagan's comment that 'Government exists to protect us from each other. Where government has gone beyond its limits is in deciding to protect us from ourselves.'

According to the libertarians, any state intervention without the *unanimous* consent of all individuals in society is illegitimate. Therefore, the only justified actions of the government are things like provision of law and order (especially the protection of property rights), national defence and supply of infrastructure. These are services that are absolutely necessary for a functioning market economy to exist and thus whose provision by the state would be accepted by all individuals (were they to be asked). Anything beyond these minimal functions – whether it is minimum wages legislation, the welfare state or tariff protection – is seen as violating the sovereignty of individuals and thus the first step on 'the road to serfdom', as the title of Friedrich von Hayek's famous 1944 book goes.

The modern contractarian, or libertarian, philosophical position has to be taken seriously. Once you begin to believe that the state is 'above' its citizens, it becomes very easy to demand sacrifices by a minority for the 'greater good', arbitrarily defined by those who control the state. Indeed, the world has suffered from too many political rulers believing that they know what is good for everyone else – from Pol Pot and Stalin on the left to Pinochet and Hitler on the right – and imposing their views, often through violent means. Asserting that the state is not above its citizens is a very important defence of individuals against the abuse of power by the state, or, rather, by those who control the state machinery.

The contractarian argument exaggerates individuals' independence from society

Nevertheless, the contractarian position also has some important limitations. To begin with, it is based on a fictional, rather than real, history, as Buchanan and Nozick themselves readily admit. Human beings have never existed as free-contracting individuals in a 'state of nature' but have always lived as members of some society (for further discussions, see the section on the 'embedded individual' in Chapter 5). The very idea of the free-standing individual is a product of capitalism, which emerged well after the state.

Thus seen, by basing their theory on a fictitious history, the contractarians have vastly exaggerated individuals' independence from society and underestimated the legitimacy of collective entities, especially (but not exclusively) the state.

Market Failures

Markets may fail to produce socially optimal outcomes – this is known as market failure. I have already discussed the basic idea behind the concept in Chapter 4, using the case of externality. But here we investigate it in greater depth, as it gives us very important analytical tools to explore different roles that the state may play.

Some goods have to be collectively provided: public goods

Many goods (and services) are private goods in the sense that, once I pay for it – say, an apple or a holiday – only I can consume it. However, there are some goods whose use by non-payers cannot be prevented, once they are supplied. Such goods (and services) are known as public goods. The existence of public goods is arguably the most frequently cited type of market failure, even more than externality, the original market failure.

Classic examples of public goods include roads, bridges, lighthouses, flood defence systems and other infrastructure. If you can drive on a road without having paid for its construction, why should you, as a car owner, volunteer to pay up when someone is trying to raise money to build one? A lighthouse cannot selectively block its light from your ship because you have not contributed to its construction and upkeep, so you, as a ship owner, can let others pay for it and still enjoy its service.

In other words, if you can free-ride on other people to pay for a public good, you don't have the incentive to voluntarily pay for it. But if everyone thinks the same way, no one will pay for it, which means that the good is not going to be provided at all. At most, it may be provided in sub-optimal quantities by large consumers who would rather let some people free-ride on them than not have the good at all. A big company dominating an area may build a road and let other people use it for free, as the cost of not having a good road may be too high for its business. Even in this case, however, the road capacity will be determined by the company's needs, rather than by those of the society, and thus sub-optimal from the social point of view.

It is therefore widely accepted that public goods can be supplied in optimal quantities only if the government taxes all potential users (which often means all citizens and residents) and uses the proceeds either to provide them itself or to pay some supplier to provide them.

Most public goods are 'public' for political reasons: relatively few goods have to be public goods

It is important to note that there are actually relatively few goods that *have to be* public goods. There are, of course, some goods from whose use it is impossible (or at least absurdly expensive) to exclude the non-payers. National defence is a classic example. It is impossible to fight a war in a way that only protects those who have paid for 'defence service'. Flood defence system is another example. You just cannot selectively flood the houses of those who have not paid for the construction of the system. But, in many cases, public goods are public goods only because we decide them to be so. Many 'public goods' that are financed by taxes and provided by the government can easily be turned into private goods. We can introduce tollbooths to roads and bridges, as many countries do. These days, it is even technically possible to replace lighthouses with radio signal services that can be provided only to the payers. Despite this, many governments provide a wide range of goods and services for (good and bad) political reasons.

Small numbers of suppliers lead to social inefficiency: imperfect competition

More controversially, many economists talk of market failure when there is monopoly or oligopoly – states of affairs collectively known as imperfect competition in Neoclassical economics.

In a market with a lot of competitors, producers do not have the freedom to set the price, as a rival can always undercut them until the point where lowering the price further will result in a loss. But a monopolistic or oligopolistic firm has the market power to decide – fully in the case of the former and partly in the case of the latter – the price it charges by varying the quantity it produces, as I explained in Chapter 2. In the case of oligopoly, the firms can form cartels and behave as if they are a monopoly, which allows them to charge the higher, monopoly, price.

However, according to Neoclassical economics, it is not the transfer of extra profit from consumers to the firms with market power that is considered to be a market failure. The failure is due to the social loss that even the firms with market power cannot appropriate – known as allocative deadweight loss.*

Break up, nationalize or regulate?: dealing with imperfect competition

If a market is dominated by firms with market power, it is argued, the government may try to reduce the deadweight loss by reducing their market power.

The most drastic of such measures is to break up the firm(s) with market power and thus increase competition in the market. The US government actually did this in 1984 with AT&T, the telephone service giant, which was divided into seven 'Baby Bells'. More usually, the government can ban oligopolistic firms from forming cartels and colluding in setting their prices. It can also keep the price in such a market down to a level as close as possible to what would have prevailed under perfect competition.

The case of natural monopoly – which is found in industries like electricity, water, gas and railways – poses a unique challenge. In these industries, having multiple suppliers each with their own networks of, say, water pipes or railways, increases the production cost so much that monopoly is the most cost-efficient arrangement. In such a case, the government may set up an SOE and run it as if it is *not* a monopoly. Alternatively, the government may allow monopoly by a private-sector firm but regulate its pricing behaviour, making it set its price equal to costs per unit (or average costs).*

Compared to the cases of public goods or externality, the case of market failure due to imperfect competition is more controversial

Few economists would dispute that public goods and externalities cause market failure, although they may dispute the actual extents of those phenomena. When it comes to imperfect competition, however, the case is far more controversial.

As I discussed in Chapter 4, the Schumpeterians and the Austrians denounce the state of perfect competition, which the Neoclassical economists idealize, as a state of economic stasis, where there is no innovation. When the lure of (temporary) monopoly profit is exactly what motivates firms to innovate, clamping down on – or even breaking up – monopolies will reduce innovation and bring about technological stagnation. In what Schumpeter calls the 'gales of creative destruction', they argue, no monopoly is safe in the long run; General Motors, IBM, Xerox, Kodak, Microsoft, Sony, BlackBerry, Nokia and many other companies that once had near-monopoly of their respective markets and had been considered invincible have lost such positions and even disappeared into the dustbin of history, as in the case of Kodak.[1]

What constitutes a market failure depends on your theory of how markets work

I have just shown that the same market dominated by a monopoly can be seen as a most successful one by one school of economics (the Schumpeterian school or the Austrian school) and as a case of most abject failure by another (the Neoclassical school). The case of monopoly may be the most extreme example, but throughout the book we have seen many cases in which some schools see a market success where others see a market failure. For example, I have pointed out that a Neoclassical economist might praise free trade for allowing all nations to maximize their incomes, *given* their resources and productive capabilities, but a developmentalist economist might criticize it for preventing more backward economies from *changing* their productive capabilities and thus maximizing their incomes in the long run.

The point is that what constitutes a market failure – and thus a justification for government action – depends on your theory of how markets work. Given this, if different economic theories have different views on how markets work or fail to work, we cannot make a balanced judgement on the role of the state without knowing a whole gamut of relevant economic theories. This point strengthens the case for a pluralistic approach to economics that I have made in Chapter 4.

Government Failure

The fact that a market is failing, some free-market economists rightly point out, does not necessarily mean that we will be better off with government intervention. These economists, such as Anne Krueger, James Buchanan and Alan Peacock and their followers, criticize the market failure argument for uncritically assuming that the state is a modern reincarnation of Plato's 'philosopher king' – benevolent, all knowing and all powerful. They point out that real-world governments are not like the ideal and may not be able to – or, worse, may not even want to – correct for market failures. According to this argument, known as the government failure argument or sometimes the public choice theory, the costs of government failure are usually higher than those of market failures. Thus, it is usually better to accept a failing market than to have the government intervene and mess things up even more.

Dictators, politicians, bureaucrats and interest groups: the government – or rather those who control it – may not even want to promote the greater good

The government failure argument cites a number of reasons as to why a government may not even *want to* implement the 'right' policies, even if it could.

In some cases, the government is controlled by a dictator who is interested not in citizens' welfare but in their own personal enrichment. Mobutu Sese Seko (Zaire, 1965–97) and Ferdinand Marcos (the Philippines, 1965–86) are the classic examples. These 'predatory states' or, rather, the strongmen who control them – are squeezing the economy through taxation and bribery, with disastrous long-term consequences.

In a democracy, the government is controlled by politicians whose primary goal is to gain and retain power, rather than promote public interests. They will consequently implement policies that maximize their chances in elections – increasing government spending without simultaneously increasing revenues, for example. In an electoral system based on constituencies rather than party lists, politicians will try to channel public finances to projects that develop their own constituencies, even when they create waste from the national point of view; this is why, for example, many countries have more airports and sports stadiums than they really need.

Even if politicians somehow choose the right policies, they may not be properly implemented because bureaucrats who run them have their own agendas. They will design policies in such a way that serves themselves rather than the electorate – inflating their departmental budgets, minimizing their efforts, reducing cooperation with other departments in order to defend their own 'turf' and so on. This theory is known as that of 'self-seeking bureaucrats'. If you want to see it in action, watch the BBC TV classic *Yes, Minister* and its sequel, *Yes, Prime Minister*, with the legendary South African actor Nigel Hawthorn (of *The Madness of King George* fame) playing the suave and devious mandarin Sir Humphrey Appleby.

Last but not least, there is lobbying from various interest groups – bankers lobbying for more lenient financial regulation, industrialists asking for increased trade protection, trade unions pushing for higher minimum wages, whatever the consequences, respectively, for national financial stability, consumer prices or unemployment. Sometimes those interest groups do not simply lobby but effectively take over the very government agencies that are supposed to regulate them – this is known as the theory of 'regulatory capture'. For example, reflecting the strength of the US financial industry, during the last thirty-two years (between Ronald Reagan's first presidency, 1981–5, and Barack Obama's first, 2009–13), six out of the ten holders of the US treasury secretary position (collectively in office for 21.5 years) had worked in the financial industry.[2] Two of them – Robert Rubin and Hank Paulson – had worked for one firm, Goldman Sachs.

The common point in all these theories is that the government is controlled and influenced by individuals who are like all other individuals – they are selfish. It is naive, if not exactly delusional, to expect them to put public interests before their own.

The government may not be able to correct for market failures, even if it wants to, due to asymmetric information and resource constraints

In addition to questioning the motives of the government – or, rather, of those who control the government – the government failure argument questions whether it is even capable of correcting for market failures, even in the unlikely case of it genuinely wanting to improve social welfare.

Government policies may fail due to asymmetric information. Asymmetric information, to remind you, means that a party in an interaction may know more about the activity that it is engaged in than does the other party. The government, for example, may continue infant industry protection for an industry because its lobbyists say that the industry has failed to 'grow up' due to bad luck, rather than a lack of effort to enhance productivity. Even when it has overcome the informational problem and somehow designed a good policy, the government, especially in poor countries, may simply lack the human and financial resources to properly implement it.

Depoliticization: rid the market of politics

When the intention and the ability of the government are suspect, the government failure argument emphasizes, letting the government intervene in the name of correcting for market failure may actually make things worse. Markets may fail, but governments almost always fail even more, is the conclusion.

The solution offered is to rid the market of politics – or, in fancier words, the depoliticization of the economy. To achieve this, the argument goes, the government should be shrunk to the minimum by cutting its spending (and thus taxes), deregulating markets and privatizing SOEs. In those few areas in which we still need the government, such as the provision of monetary stability or the regulation of natural monopolies, the policy process should be insulated from politics by granting political independence to the government agencies that actually do these things. An independent central bank and independent regulatory authorities of natural monopolies (e.g., gas, telecommunications) are the most frequently recommended examples.

Government failures need to be taken seriously, but with a large pinch of salt

Government failures are real and need to be taken seriously. The government failure argument has done a service to our understanding of the economy by reminding us that real-life governments are not as perfect as the textbook government. Except for the 'predatory state', which is actually quite rare, all the examples of government failures raised by the argument are all around us. However, the government failure argument exaggerates the extent to which governments fail. When you think about it, if what it says is true, it would be a major miracle if there were any decent government at all in this world. In reality, many governments function quite well, while some do even excellently.

One reason is, of course, that politicians, bureaucrats and interest groups are not as selfish as the government failure argument depicts. There are many examples in real life of politicians striving to promote national interests rather than their chances of election, bureaucrats working in the spirit of public service rather than to have a cushy life and interest groups holding back their sectional interests for the greater good. On top of that, there are ways to control self-seeking behaviours of people in public life, ranging from the promotion of public service ethics to the introduction of rules on bribery and other corrupt practices (e.g., nepotism in hiring). True, these rules can be – and have been – circumvented or even perverted, as the government failure argument points out. But the fact that those rules are not perfect does not mean that they are totally ineffective. Imperfect they may be, but the fact is that we have the standards of public life that we have today in large part because of those rules.[3]

The proposal to depoliticize is anti-democratic

Given the possibility of government failure, it sounds like a great idea to depoliticize the economy by rolling back the state and giving political independence to essential agencies like the central bank. But what is this 'politics' whose influence we are recommended to curtail? In democratic countries, it is the influence of the people. Markets run according to the 'one-dollar-one-vote' rule, while democratic politics run on the principle of 'one-person-one-vote'. Thus, the proposal for greater depoliticization of the economy in a democracy is in the end an anti-democratic project that wants to give more power in the running of the society to those with more money.

There isn't a single 'scientific' way to draw the boundary between market and politics

The government failure argument asserts that economics, or the logic of the market, should trump politics – and indeed other domains of life, such as arts, academia and so on. This argument is these days so widely accepted that most people take it for granted. But it is a seriously flawed argument.

First of all – and this is a point that seems obvious to non-economists but that many economists find difficult to accept – there is no reason why the market logic should prevail over other domains of life. We do not live by bread alone.

Moreover, the argument is based on the implicit assumption that there is one correct, 'scientific' way of deciding what should belong in the domain of the market and what should belong in the domain of politics. For example, the proponents of the government failure argument say that things like minimum-wage legislation or tariff protection for infant industries are intrusions of 'political' logic into the sacrosanct sphere of the market logic. But there are economic theories that justify such policies. Given this, what these economists are doing is, in effect, labelling other economic theories as 'political', and therefore lesser, arguments while claiming that their own economic theory is somehow the right economic theory – or even 'the' economic theory.

Even if we accepted that the economic theory that the proponents of the government failure argument adopt is the 'correct' one, it is not possible to draw a clear boundary between economics and politics. This is because the very boundary of the market is in the end determined by politics and not by an economic theory – of whatever variety.

Before we even begin market transactions, we need (explicit and implicit) rules on what can be traded, who can trade them and how they can be traded in the market. All of these rules are restrictive in some ways, and therefore no market is genuinely 'free'.* And these ground rules cannot be determined by economic logic. There is no 'scientific' list of what should (or shouldn't) be bought and sold in the market. The decision is a political one.

All societies keep certain things off the market – human beings (slavery), human organs, child labour, firearms, public offices, health care, qualifications to practise medicine, human blood, educational certificates and so on. But there is no 'economic' reason why any of these should not be bought and sold in markets. Indeed, all of them are or were legal objects of market transactions in different times and places.

At the other end of the spectrum, we have made certain things into objects of market transaction that had not been so before. Before the introduction of the laws to protect patents, copyrights and trademarks in the eighteenth and the nineteenth centuries, 'ideas' (intellectual property) were not traded in markets. Today we buy and sell the rights to pollute ('carbon trading') or bets on notional economic variables (e.g., derivatives based on stock market index or on inflation rate), but these things did not even exist until one or two generations ago.

The government also sets the basic rules regarding what economic actors can and cannot do even within the domain of the market. False advertising, sales based on misleading information, insider trading† and other practices are all prohibited. Regulations regarding minimum wages, workplace health and safety and working hours set boundaries on how firms can treat workers. Emission standards, carbon quotas and noise pollution controls regulate how firms may produce their outputs. And so on.

So politics is creating, shaping and reshaping markets before any transaction can begin. It is like the 'Deeper Magic' that had existed before the dawn of time, which is known to Aslan (the Lion) but not to the White Witch in *The Lion, The Witch, and The Wardrobe*, the children's classic by C. S. Lewis.

What Governments Do

These days, the government produces a huge range of goods and services – defence, law and order, infrastructure, education, research, health, pensions, unemployment benefits, childcare, care for the elderly, income support for poor people and cultural services (e.g., upkeep of museums and national monuments, subsidies to the national movie industry). The list is endless. Most governments also own SOEs that produce goods and services that private firms produce in other countries – electricity, oil, steel, semi-conductors, banking, airline services and so on.

In order to do all this, the government hires a lot of people and spends a lot of money to purchase inputs, ranging from pencils to nuclear reactors. The salaries of government employees and the material inputs are paid for by taxes and other sources of government revenue. Taxes include personal income tax, corporate income tax (tax on incomes of companies), property tax, value added tax (or sales tax), tax on specified goods (e.g., alcohol, petrol) and so on. Other sources of revenue include dividends from SOEs, interest payments from financial assets that it owns and, in the case of developing countries, transfers from rich countries (foreign aid).

The government also transfers a lot of money from one part of the economy to another; it taxes some people and uses the proceeds to subsidize other people. Social welfare payments are the most important of government-mediated transfers. But they also include subsidies for particular types of production activities (e.g., agriculture, infant industries, declining industries) and investments (e.g., R&D by private-sector firms, energy-saving refurbishment of houses).

In addition to direct production, spending and transfers, the government sometimes uses its sheer weight to affect the level of activity in the economy. This is known as fiscal policy. Simply by spending more (or less) or taxing less (or more), regardless of the exact content of that spending and taxation, it can boost (or dampen) the economy. Using its monopoly over note issue, it conducts monetary policy, through the central bank, by varying interest rates or changing the amount of money in circulation, thus affecting the level of economic activity.

REAL-LIFE NUMBERS

The size of the government, measured by government expenditure as a proportion of GDP, has grown a lot in the last century and a half

Until the nineteenth century, governments were quite small everywhere, as they did relatively few things. In 1880, among countries for which the data are available, the biggest government was that of France, whose expenditure was equivalent to 15 per cent of national output. In the UK and the US, government expenditure was equivalent to 10 per cent of GDP. The Swedish one was only 6 per cent.[4]

Over the last century and a half, with the requirements of the modern economy, governments have grown a lot in size. Even in developing countries that tend to have a smaller government than do the rich countries, government expenditure typically is equivalent to 15–25 per cent of GDP.[*] The figure is 30–55 per cent for the rich countries, with an average of around 45 per cent (the OECD average in 2009). At the lower end of the distribution (30–40 per cent) are, in ascending order, Korea, Switzerland, Australia and Japan. At the other end (over 55 per cent) are, in descending order, Denmark, Finland, France, Sweden and Belgium. In the middle are the US and New Zealand (over 40 per cent), Germany and Norway (around 45 per cent) and the Netherlands and the UK (around 50 per cent).[5]

A lot of government expenditure is transfer, rather than own consumption or investment

Now, note that a lot of government expenditure is not consumed or invested by the government itself. It involves transfer of money from one part of the economy to another, especially social protection programmes, such as income support for the poor and unemployment benefits. Therefore, when you calculate GDP you need to count the transfer elements out.

Transfer payments are equivalent to between 10 per cent and 25 per cent of GDP in the rich countries. So, for example, a government whose total expenditure is equivalent to 55 per cent of GDP may actually account for only 30 per cent of GDP, if the transfer payments it makes are equivalent to 25 per cent of GDP.

Transfer in the form of social spending is much lower in developing countries, so the gap between government expenditure as a proportion of GDP and the share of GDP produced by the government is much smaller in those countries. According to the World Bank data, social spending ranges from practically zero (e.g., Paraguay, the Philippines) to 4–5 per cent of GDP (e.g., Mauritius, Ethiopia) in most developing countries.

Despite the fact that it makes the government look bigger than it really is in GDP terms, most people still use the expenditure data (rather than value-added data) as the indicator of how important the government is in a country's economy. This may be justified on the grounds that something being a transfer does *not* mean that it has no effect. It is well known that, positively or negatively, social spending programmes affect people's attitudes and behaviours in terms of savings, retirement and work. They may even encourage people to take greater risk in terms of career choice, entrepreneurial activity and willingness to change jobs, by providing them with a 'safety net' – one famous slogan of the Swedish Social Democratic Party is 'secure people dare'.

The influence of the government cannot be fully captured by numbers

In no area of human life can numbers fully capture the reality. There are always aspects that are difficult to quantify, and, moreover, all numbers are constructed on the bases of particular theories, which by definition focus on some aspects of the reality while ignoring others, including quantifiable ones (recall the exclusion of household work in the construction of GDP).

But this problem is more serious in relation to the government because it is an actor that is uniquely endowed with the power to set rules that constrain and compel others. Regardless of the size of its budget or the number of SOEs it has, it can exert a strong influence on the rest of the economy if it sets a lot of rules and has the power to enforce them.

This is not an esoteric theoretical quibble. Until the 1980s, many people believed that the 'miracle' economies of East Asia, such as Japan, Taiwan or Korea, were paragons of free-market policies on the grounds that they had small governments (measured by their budget). However, being small did not mean that these governments were following a laissez-faire approach. During the 'miracle' years, they exercised a huge influence on the evolution of their economies through economic planning, regulation and other directive measures. By looking at only the budgetary numbers, people had come to seriously misunderstand the true nature and significance of the government in these countries.

Concluding Remarks: Economics Is a Political Argument

In the run-up to the US presidential election in 2000, there was an opinion poll, reported in the *Financial Times*, that asked people not just which candidate they supported but also why they didn't support the other candidate. Most frequently cited as the reason for not supporting 'the other guy', both by the Bush supporters and the Gore supporters, was that he was 'too political'.

Were those Americans seriously suggesting that they wanted to elect someone who wasn't good at politics for the biggest political office in the world? Of course not. They were saying those things because 'politics' had become a dirty word and therefore calling a politician 'political' has turned into a powerful way to discredit him or her.

Americans are actually not alone in this. There are some young democracies where politics arouses such passion that elections prompt riots and deaths. But in many other countries, we keep hearing about the lowest ever voter turnout in elections. Political parties are bleeding membership all around. From Imran Khan, the cricket player, in Pakistan to Beppo Grillo, the comedian, in Italy, many politicians come to prominence exactly because they are – how can I put it? – not politicians.

The growing mistrust in politics is partly the politicians' own doing. All around the world, they have done their best to discredit themselves, with Silvio Berlusconi in Italy being the master of the art. However, it has also been crucially promoted by free-market economics. Free-market economists, more specifically the proponents of the government failure argument, have persuaded the rest of the world, including many politicians and bureaucrats themselves, that we cannot trust those who run the government to act in public interests. Therefore, they have told us, the less a government does, the better it is. Even in areas where the government is a 'necessary evil', it should be constrained by rigid rules that politicians cannot mess around with. And this distrust in politics has in turn helped to popularize free-market economics, with its proposals to minimize the influence of politics on the economy.

But this view is based on very problematic theories, as I have explained in this chapter. It is not supported by evidence either. As I have shown throughout the book, virtually all economic success stories have been facilitated, if not necessarily orchestrated, by an active state.

Examples of successful state intervention do not, of course, mean that more government is always better. Real-life governments may not necessarily be the Leviathan of the libertarian discourse, but they are not the modern reincarnation of Plato's Philosopher King either. There are many governments that have harmed the economy, sometimes even disastrously. But the fact remains that the state still remains the most powerful organizational technology that humankind has invented and thus big economic (and social) changes are very difficult to achieve without it.

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follow through a re-employment strategy. See Basu and Stuckler, *The Body Economic*, Chapter 7.

10. In many poor countries, a lot of children below the threshold age work. Their employment is often not recognized in the official employment/unemployment statistics.
11. In order to deal with the difficulties created by discouraged workers, economists sometimes look at the labour force participation rate, which is the share of the economically active population (the employed *and* the officially unemployed) in the working-age population. A sudden fall in that rate is likely to indicate that there has been an increase in the number of discouraged workers, who are not counted as unemployed any more.

CHAPTER 11: LEVIATHAN OR THE PHILOSOPHER KING?: THE ROLE OF THE STATE

1. Some economists, including myself, go even further and argue that, in industries that require large capital investments for productivity growth (e.g., steel, automobile), 'anti-competitive' arrangements among oligopolistic firms – such as cartels – can be socially useful. In such industries, unfettered price competition reduces profit margins of the firms to the extent that it reduces their ability to invest, harming their long-term growth. When such competition leads to bankruptcy of certain firms, the machines and the workers deployed in them may be lost to the society, as they cannot be easily deployed in other industries. For example, see H.-J. Chang, *The Political Economy of Industrial Policy* (Basingstoke: Macmillan Press, 1994), Chapter 3, and A. Amsden and A. Singh, 'The optimal degree of competition and dynamic efficiency in Japan and Korea', *European Economic Review*, vol. 38, nos. 3/4 (1994).
2. The holders with a finance background were Donald Regan (January 1981–February 1985), Nicholas Brady (September 1988–January 1993), Lloyd Bentsen (January 1993–December 1994), Robert Rubin (January 1995–July 1999), Henry Paulson (July 2006–January 2009), Tim Geithner (January 2009–January 2013).
3. For information on corruption and other ills of public life in today's rich countries in the past, see Chang, *Kicking Away the Ladder*, Chapter 3, especially pp. 71–81, and Chang, *Bad Samaritans*, Chapter 8.
4. World Bank, *World Development Report 1991* (Washington, DC: The World Bank, 1991), p. 139, table 7.4.
5. The data are from OECD, *Government at a Glance, 2011* (Paris: OECD, 2011).

CHAPTER 12: 'ALL THINGS IN PROLIFIC ABUNDANCE': THE INTERNATIONAL DIMENSION