Role of Government

State, in its wider sense, refers to a set of institutions that possess the means of legitimate coercion, exercised over a defined territory and its population, referred to as society. The state monopolizes rulemaking within its territory through the medium of an organized government.

The essential or fundamental role of the state is not to correct for market failures, but to make the market work as efficiently as possible. When the state focuses on correcting the market, it often prevents the market from developing.

Historical Background: Industrial Countries

1. Laissez-Faire Period

   Adam Smith and Basic Role of State

   As a reaction to Mercantilism

   Focus on allocation and institutions

   Level of public spending before First World War

2. Changing Role of State: Structural Factors:

- New work relationships
- Urbanization
- Limitation to tax revenue (and the First World War)

3. Changing Role of the State: Intellectual Factors:

- Socialist ideology
- Soviet Russia – Challenge from
- Wagner and redistributive role of state
- Keynes and the end of laissez-faire
- Fascism in Germany and Italy
- Impact of the Great Depression and the New Deal
- Democratization and role of masses
- Keynes and stabilization role
- The Keynesian Revolution

Functions of the government

- Allocation of resources-efficiency
- Distribution of Income-equity
- Stabilization
- Welfare

7. Role of State through its main instruments:

- Public spending
- Tax expenditures
- Regulations
- Differences in use among countries

II. Historical Background: Developing Countries

1. Lower time span – since Second World War
2. Impact of decolonization

    on nationalization of enterprises

    on role of state

3. Structural Factors:

Low taxing capacity

Informal economy

Low human capital

Weak private sector

4. Early intellectual influences:

Public sector as driving force

Taxation and public spending

Focus on resource mobilization

Allocation role of state

Great use of regulations as substitute for spending

5. Later influences:

- Growing attention to equity
- Growing role of human capital:
  - And spending on education
  - And spending on health
- Growing dependence on
  foreign assistance
- Consequence for role of public sector

- Market failure reasons:
  Existence of Imperfect Markets
  Public Goods
  Externalities
  Natural monopolies
  Incomplete markets
  Asymmetric information

After World War II:

- Market failure as a justification for larger government role
- Larger government role prevented the development of many markets
- This perpetuated the justification for continuation of government role

In more recent years:

- Private markets have been created or have developed in many areas
- Technological developments have challenged the notion of natural monopolies
- Globalization has opened many opportunities

Furthermore:

- Demographic changes can put pressure on future spending without reform
- "Fiscal termites" can reduce capacity to raise high tax levels
- Therefore:

State-dominated developmenthas failed, but so will stateless development. Development without an effective state is impossible.

Need to rely more on markets

Need to make spending programs more targeted