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State and Market -Uneasy but inseparable relation

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1. Introduction

In every modern society, the market, state and society go hand in hand (Polanyi 1944). Therefore, the essence of this relationship lies in striking the right balance as the market is incapable of dealing with issues as income distribution and deprivation and poverty (Nayak 1996).

This essay explores the evolution of market patterns and a self-regulating market (which commercialized land and labour) - the shortcomings of which had to be dealt with protective measures allowing state and market to function simultaneously as highlighted by Polanyi (1944). The essay then goes on to highlight how state's interference and social movements have always been a part of modern market societies (showing the historical inseparability of both the entities) and that social protective measures are significant in mitigating the ill effects of modern industry and economy (Polanyi 1944).

Walter C. Neale (1991) gives a Polanyian assessment of Change and Turmoil in Eastern Europe and its effect on State, society and market and the resultant uneasiness. He emphasizes the necessity and process of creating institutions and not pursuing an unthinking rush towards a free market system (Neale 1991). Through C. Rangarajan's (2000) work "State, Market and the Economy the Shifting Frontiers", this essay seeks to understand, through international experiences, when must markets be allowed to function freely and when state intervention becomes a necessity, thereby providing a framework for the interplay of market and state (Rangarajan 2000).

2. Evolution of market patterns

Polanyi (1944) tries to provide a historical development of the market society (local, national and external markets). A market is a place for barter or buying or selling (Polanyi 1944:59). The market pattern is the only one that has a corresponding institution designed solely for the functioning of the principle of barter i.e. markets. This economic arrangement has an impact on the entire organization of society as social relations are embedded in the economic system and thus market economy forces society to run in relation to it (Polanyi 1944).

The transition to a market economy from individual markets is however not a natural state of affairs. For Polanyi (1944), **markets began as institutions aimed at long-distance trade**, functioning outside individual economies. These forms of external trade transitioned into peaceful exchanges through conditions laid down by parties involved and competition emerged only with the emergence of local markets. However, it was **state intervention** and not local markets that led to the creation of national or internal trade. Nations were only political units and consisted of loosely assembled municipalities and the countryside. In the municipal towns, long-distance and local trade (which was regulated) was kept separate. The regulations were a safeguard against the disintegration of towns by uncontrolled foreign trade. This gave rise to the development of the territorial state and its interventions to **"nationalize" the municipal markets.** The mercantilist state emergent in the 15^{th} century Europe imposed the mercantile system on the protectionist towns. In addition, the state-regulated completion and monopoly protect

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established national markets. This reflects how the market **economy is a result of state intervention** and how the existence of the market form is ensured by state intervention (Polanyi 1944).

3. The growth of self-regulating markets and the necessity for state regulation

Polanyi (1944) talks about the **emergence of self-regulatory markets** (caused due to development in the factory system as a result of the Industrial Revolution) in the 19th century from the mercantilist form of market. Such markets worked on the principle of maximizing profitability by equating the supply of goods and services with their demand. This was done by fixing prices, ensuring a balance between production and distribution. Self-regulatory markets lead to certain elements like land, labour and capital being treated as **commodities** (even though they aren't produced for profitability), subjecting them to the mechanisms of demand and supply, interconnecting them to form "One Big Market" . This in Polanyi's view is the cause of **social destruction** as the market becomes the sole decider of human beings and their natural environment. These circumstances led to **the economy being prioritized in comparison to society**. This led to protective measures being set in place to cope with the changing socio-economic times, allowing both the state and the market to function simultaneously. Polanyi (1944) claimed this to be a double movement (Polanyi 1944).

4. Labor market and state interference

Self-regulating markets are **independent of larger social structures**. This leads to labour being separated from all other activities of life (creating conditions as alienation, commodification), thereby leading to the formation of a **labour market**- a feature of the modern economy. Here, labourers are forced to sell their labour. Polanyi (1944) points out that the principle of a free market, non-intervention of state and other non-contractual aspects is false. The European experience goes on to show how state interference and social movements are a part of modern society. It went on to show how the free labour market is always challenged by social demands/protests, nationalist ideologies, state actions etc. The 19th century **Owenite Movement** aimed at protecting men from alienating the impact of machines and believed in the inheritance of cooperative life. The **Chartist movement** led the fight against political corruption, for democracy & political rights like the right to vote etc., in an industrial society. Its opposition to wage cuts & unemployment attracted mass support. The **labour markets functionality was dependent on its safeguarding the interests of labourers** (Polanyi 1944).

5. Market, land and labor

A land apart from having its economic functions has other sociocultural aspects necessary for societies to flourish. The market system tries to separate the traditionally interconnected land and labour, failing to consider the integrity of the soil and its resources. This process took centuries in Western Europe while it only took years in colonies due to the Industrial Revolution’s influence on these areas. Throughout Tudor England, agricultural capitalism required the **treatment of land as individualized property** that was commercialized and separated from man .Free trade proposal upset landowners as it would’ve eroded their powers but was cheered for by the working class as it had the potential of reducing the cost of food. The Great War threatened the market system for the countries began to hoard food-producing capacity. For economic liberals, this problem could be solved by avoiding war forever in a utopian fashion. Their arguments showed the fragility of self-regulating markets and ultimately the need for state intervention (Polanyi 1944).

6. Free market system: the european case study

Walter C. Neale (1991) talks about the changes that occurred in Europe after the collapse of the Soviet system which was characterized by an apparent **unthinking rush towards a market system**. For Polanyi (1944) , rights, liberties, duties and powers are realized only by institutionalizing the protection of rights and the processes of authorizing the exercise of power (Neale 1991:467).

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The collapse gave Europeans the freedom that chose not to endorse the centrally planned economies. Since the collapse was greater at the periphery, Europeans demand an end to the soviet planning system and a restoration of free markets and democracy. This objection to socialism was marked with pre-existing nationalist sentiments as socialism was imposed by Russia (Neale 1991).

Polanyi (1944) would, according to Neale (1991) welcome the demand for democracy but fear the consequence of the insistence upon markets. Even though Polanyian writings show how the privilege of private property undermined the effectiveness of rights and liberties, the experience of East Europe shows how the propertied state is a far greater threat to rights and liberties (Neale 1991).

It must be noted that the backward, unresponsive character of the economies of eastern Europe are by-products of Slavic socialism and not a necessary consequence of market control as believed by Europeans. Thus, the challenge for the east Europeans was to institutionalize economic and political structures which were more responsive and enlarged the rights and liberties for all (Neale 1991).

Neale (1991) states that private property; free markets and individual economic responsibility are outcomes of specific histories and not something "out there" as seen by east Europeans. This is exemplified through private property and its broad contours. He believes that these considerations begin the "process of specifying the structure of the new institutions" such a process needs more questions about government and individual and group responsibilities (Neale 1991).

7. Striking the right balance

Thus, market incapacity to deal with problems of income deprivation and distribution leads us to the question of **striking a balance** between the market and the state. Nayak (1996) states that the market- an institution where agents get together to buy and sell goods and services anchored in the private ownership economy and since this initial distribution is iniquitous, it can't be presumed that markets would bring about equity. Market systems inefficiency is exposed in the presence of monopolistic elements, externalities or public goods or decreasing cost industries. This brings us to the understanding that government intervention by creating and regulating financial market institutions and directly intervening in the capital market is necessary to ensure the efficiency of resource use and efficiently supply **public goods** (Nayak, 1996). For example, in countries like Japan, South Korea etc., the state has intervened in areas like "…credit availability and provision of industrial and export infrastructure to boost the growth rates of those economies " (Nayak 1996:19).The state can moreover **adapt to dynamic changes** as seen in the example of South Korea where the state has created infrastructure and made credit available at the appropriate time (Nayak 1996).

Socially controlled production however doesn't provide necessary incentives to economic agents and thus have failed. However, there exists a distinction between **social ownership** and the **role of the state**. This is exemplified in Marx's theories where he emphasized not a monolithic state but a means of production consistent with a decentralized cooperative collective action (Nayak 1996).

Adam Smith believed that the common good was ensured by individuals pursuing their **self-interest** (held in check by competition) as the market automatically decided through the price mechanism the basic question of what, how and for whom to produce. Even though he claimed that government intervention was the greatest barrier to spontaneity, yet he demarcated certain areas requiring government intervention- the foremost being defence and justice. The third "…concerned the erection and maintenance of those public works and institutions which are useful but not capable of bringing in a profit to individuals" (Nayak 1996: 19). What the Smith-Say construct didn't account for was the low level of **effective demand** leading to unemployment in a free-market system. This in turn requires state intervention in the form of higher government expenditure (Nayak 1996).

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The government intervention is brought upon by the considerations of resource allocation and stabilization. It is required in the form of tax subsidy schemes or the setting up of markets that otherwise won't be established. The strategic role of the government is enhanced by the fact that savings and investment are regulated by different economic agents and a mismatch between the two can cause problems to national income and employment and thus need corrective measures by government intervention becomes essential to increase the propensity to consume .For Keynes, the stability of the capitalist system is disturbed by a lack of effective demand created by the urge for accumulation and thereby requires the boosting of aggregate demand via government expenditure (Nayak 1996).

8. Understanding state-market relation through historical experiences

8.1 East Asia

The extraordinary progress made by these countries was a result of market complementary interventions and investment in human resource development. However, the recent economic meltdown has been attributed to a government and market failure. The former was implicated for the regulation of financial markets has been regarded as state responsibility and banks and non-banks weren’t subjected to prudent regulation and supervision (Rangarajan 2000).

8.2 Russia

The communist system was able to eradicate poverty but wasn’t able to cope with the situation of rising and diversified demand. The economic crisis made the return to state monopoly impossible. This sparked a mix of state and private enterprise (Rangarajan 2000).

8.3 India

The planners had to define the roles of state and market. Planning had to be guided by the state and operated party by the state and partly by private enterprises. Scarce resources had to be optimally allocated and planned targets for industry and licensing machinery had to be set up (Rangarajan 2000:1389). However, the right balance has been difficult to find as extensive control mechanism reduces competition and also public investment requires budgetary support etc. (Rangarajan 2000).

The state role as a producer has decreased and as a regulator, facilitator and welfare provider has increased. The state's role in introducing appropriate legislation to maintain competition has increased and also the state's role in the area of social infrastructure has multiplied (Rangarajan 2000).

The question arises as to when the state should shift responsibility to the markets and how this transition is to be managed. In this regard, 3 transitions are to be managed vis-à-vis excessive to reduced state intervention, intervention for the neglected areas and reliance on prices as an instrument of policy (Rangarajan 2000). More market doesn't mean less government but a different government (Rangarajan 2000:1389).

The test for determining the role of state and market is through an understanding of comparative advantage i.e., which entity state or market would be more effective in achieving a defined objective. The government should allocate more resources in areas where it has a comparative advantage. Combining governments and markets in different proportions can also be explored (Rangarajan 2000).

“It is necessary to create a matrix of activities and the kind of intervention and determine for each activity what form of intervention is best. The activities can be broadly classified as manufactures, physical infrastructure, social infrastructure and financial and other services. Forms of intervention can be divided into two - market and state. State intervention can be further classified into a direct investment, regulatory, indicative and unbundling “(Rangarajan 2000:1390).

All these cases show how the state and market share an uneasy relationship. Though inseparable, the only optimal regulatory function of the state is essential to ensure equity otherwise collapse of the economy is inevitable. A boundary problem appears when regulated activities are intermingled with non-regulated ones.

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