Рыночные провалы и экономическая роль правительства

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Аннотация

Данное исследование направлено на изучение сущности провалов рынка, всех их возможных причин и влияния на экономику государства и мира. Также важно оценить роль и значение государства в экономике: так ли важна государственная поддержка для рыночной экономики или достаточно «невидимой руки рынка», чтобы рынок работал бесперебойно. Особое внимание будет уделено кризисам как наиболее заметным и разрушительным примерам провалов рынка.

Эта работа сосредоточена на доказательстве того, что правительство должно регулировать рынок, чтобы предотвратить его большие рыночные сбои. Только государство имеет достаточно сил, чтобы поддерживать свою страну в экстремальных экономических условиях. Правительство должно осторожно и обдуманно применять свою экономическую силу, чтобы помочь рынку, а не навредить ему.

Ключевые слова: кризис, состояние в экономике, экономическая свобода, Великая депрессия, «невидимая рука».

Market failures and the economic role of government

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Abstract

This research is aimed to investigate the essence of the market failures, all its possible causes and effect on state's and word's economy. It is also important to evaluate the role and importance of government in the economy: is state's support vital for the market economy or "the invisible hand of the market" is enough for market to perform smoothly. Particular attention will be divided to crises as the most visible and damaging examples of market failures.

This work is focused on proving that government must regulate market in order to prevent it from great market failures. Only state has enough force to support its country is extreme economic

conditions. Government should apply its economic force carefully and thoughtfully to help and not to harm the market.

Keywords: the crisis, the state in the economy, economic freedom, the Great Depression, the "invisible hand".

The topic remains relevant. Despite the fact that in recent decades, the world community has created mechanisms to prevent global crises (strengthening state regulation of economic processes, the creation of international financial organizations, monitoring, etc.), as evidenced by the history of world economic cataclysms, it is impossible to accurately predict or even avoid them.

1.1 The concept of market failure

Modern economic theory links the need for government regulation with the fiasco, or failures, of the market. Market failures are situation where the market mechanism is not able to effectively allocate resources, or achieve Pareto-optimal distribution.

Wilfredo Pareto (1848-1923), investigating the efficiency of production and distribution of goods in the market system of economy with limited resources, came to the conclusion: *no one can improve their condition without worsening the situation of at least one of the market participants*. This understanding of efficiency in the economic literature is called optimum Pareto.[1]

Furthermore, the individual incentives for rational behaviour do not lead to rational outcomes for the group. Another words, each individual makes the correct decision for themselves, but the wrong decisions for the group. In traditional microeconomics, this is shown as a state disequilibrium in which the quantity supplied does not equal the quantity demanded.

1.2 Causes of market failure

The main problem of the market economy is that fair and open competition in the market – a key for the success of the "invisible hand" – is not necessarily balanced in the long term. The most efficient companies crowd out the rest, and then acquire such power that they change the rules of the game in their favor and limit the entry of potential competitors to the market. Paradoxically, competition itself may eventually become a victim of competition.[2]

The main reasons for market failures are: monopoly (also monopsony); asymmetry and lack of information; externality; the inability of the market to provide public goods; incompleteness of markets

[1] Atkinson A.B, Stiglitz J. – Lectures on Public Economics, 1980, (p 133)
[2] Гуриев С.М. «Мифы экономики. Заблуждения и стереотипы, которые распространяют СМИ и политики», 2010 (p. 179)

The price in a *monopoly* exceeds the price of perfect competition, and the volume of sales of the monopoly does not reach its level in perfect competition. As a result, society as a whole suffers losses

Asymmetry of information is another reason for market failures. In can be expressed in differences of the information possessed by the parties when making a market transaction.

Examples of asymmetries in information are in the areas of health and education. Here, the buyer of the service has no control over the producer, as he is forced to choose the manufacturer before the actual service is provided, and the assessment of the quality of the future service is based on assumptions and previous experience.

The lack of information asymmetry is often compensated with reputation. In some cases the problem can be solved by state intervention in the form of licensing, direct production of certain goods and services, and state control over their production and marketing.

External effects (externalities), i.e. benefits or costs received by economic actors that are not reflected in the price of benefits. External effects can be both positive and negative.

Incompleteness of markets. The system of markets is called incomplete if there are no insurance instruments or their number is not enough to cover all uncertainties. A particularly illustrative example of the incompleteness of markets is the situation of public risks (war, terrorist acts, hyperinflation, etc.). It is unlikely that a private firm will take on the task of insuring the population against such risks.

2.1 Functions of government

As in the days of Adam Smith, in most situations the "invisible hand" of the market effectively protects the interests of society. However it needs protection itself. The role of the state and society is precisely to support and protect the "invisible hand" from the inevitable attempts to limit its capabilities.[3]

In theory, the state performs functions that are unanimously approved by members of society. It makes possible to improve the economic situation from the standpoint of Pareto efficiency, i.e. to provide at least one person with greater welfare in such a way that it does not reduce the welfare of anyone else.[4]

Minimize external effects.

Society faces negative external effects (a typical example is the pollution of the environment by a factory dumping the waste into the river). Society suffers losses, as cost of dealing with externalities is not reflected in the price of the product. The state can influence externalities by introducing laws, restrictions and taxes to avoid external factors

[3] Гуриев С.М. «Мифы экономики. Заблуждения и стереотипы, которые распространяют СМИ и политики», 2010 (p. 334)
[4] Atkinson A.B, Stiglitz J. – Lectures on Public Economics, 1980 (p. 133)

The ways of regulating negative external effects.

- Ban on the production and consumption of certain products.
- Introduction of excise duty on "harmful" goods (alcoholic beverages, tobacco products, gasoline, etc.).
- Social anti-advertising.

The ways of increasing the positive external effects.

- Government subsidies to firms that produce products that produce positive externalities (children's goods, textbooks, medicines).
- Indirect payments to employees of the enterprise, stimulating the consumption of "useful" goods (payment for training, books, magazines).
- Social advertising.

Providing public goods.

Market mechanisms cannot provide public goods in optimal amount for the society. The private sector has no incentive to produce these benefits, as they are consumed by everyone, whether they pay for it or not (free-rider problem).

Public goods (national defense, street lighting, weather forecasts, etc.) are indivisible goods for collective use. They differ from private goods in that they have two basic properties: non-exclusivity in their consumption and non-competition in consumption.

Suppression of asymmetric information and compensation for incomplete markets.

In situations where there is an asymmetry of information between the seller and the buyer in the market, government intervention is economically justified. The state establishes certain quality standards, monitors their observance and carries out other administrative measures to suppress and punish unscrupulous producers. The incompleteness of the markets can be compensated by the system of state insurance of bank deposits, the provision of information on investment risks by state.

Limiting the power of monopolies in the market, supporting competition.

The market mechanism does not protect perfect competition from attempts to establish monopoly power. Monopolization of the market brings losses to society associated with the production of a quantity of goods less than the optimal volume and the establishment of prices above the level of competitive equilibrium. In these cases, the intervention of antimonopoly authorities is reasonable and economically justified.

Maintaining macroeconomic stability.

The market does not guarantee sustainable economic growth on a national scale. Periodic fluctuations in business activity associated with recessions and high unemployment, or, on the

contrary, "overheating" of the economy and inflation, result in high socio-economic losses for society. In this regard, the state conducts macroeconomic stabilization policy

Social policy

Government provides more equitable distribution of income in society. The market mechanism itself is asocial or socially neutral. The state, through its policy of redistributing income (charging taxes at a higher rate on the rich and transferring part of the income received from the state budget in the form of social benefits to the poor), contributes to social stability and creates more equal opportunities for all citizens.

The market is a system of voluntary exchange. It is important to ensure this voluntariness, to create a legal framework that protects market players from violence (fraud, theft, extortion). John. Buchanan uses the term "protecting state" in his work "The Limits of Liberty ". It monitors compliance with the "rules of the game". It is important to emphasize here that the right of coercion belongs only to the state.

Economic actors delegate the right to control the execution of transactions (contracts) to a third party - the state. Hence the definition of the state as an institution with a monopoly on violence. The state uses coercion and violence to protect citizens from violence against each other, to prevent "war of all against all". The state is an institution that complements and corrects the market mechanism, but not its antipode

2.2 Forms and methods of governmental influence on the market economy

Forms of state regulation of the economy differ in objects, objectives, nature of management impact and tools used. There are the following forms of state regulation of the economy:

State forecasting and programming of the economy — development and adoption of various plans.

Budgetary regulation – state consumption, selective financial support for industries, regional systems, individual business structures and social groups are provided through budget and tax regulation.

State consumption — government purchases and orders for goods (industrial, agricultural), various services (educational, scientific, medical, etc.), military products.

Public purchasing attracts companies with guaranteed sales, no risk of non-payment, the ability to use industrial and research equipment owned by the state, the presence of various kinds of benefits (credit, tax, etc.). In order to smooth the economic cycle, the state can increase the volume of public purchases in times of crisis and depression and reduce it during periods of recovery in order to avoid overheating of the economy.

Selective financial support for industries, regions, enterprises, as well as public consumption, is associated with the use of budgetary funds. Its objectives: restructuring of the

economy; improvement of industries in crisis; support for the activities of low-profit enterprises and industries; smoothing imbalances in the socio-economic development of certain regions of the country; support for certain forms and types of business (small, innovative, industrial, consulting, leasing, etc.).); implementation of major environmental and economic programs.

Monetary regulation has the main objectives: to protect and ensure the stability of the national currency, its purchasing power; to create conditions to meet the needs of the economy in credit resources; to strengthen the banking system.

Privatization and nationalization of property are forms of state regulation used to solve a set of socio-economic problems.

Methods of state regulation of the economy

Methods can be classified the by nature of the actions: administrative and economic methods

Administrative methods are based on the power of the authorities and provide:

- legislative restrictions
- mandatory requirements for economic entities to achieve their clearly defined parameters of economic activitythe procedure for the organization, conduct and liquidation of business

Such methods are formalized, mostly prescriptive, affect the choice of economic entities options.

Economic methods are designed to take into account the diversity of interests and motives of different economic entities, to create conditions conducive to their choice of economic behavior that allows balancing public and private interests. These methods include state financing and loans, preferential taxation, etc. These methods can be formalized and non-formalized. They affect not only the choice of economic entities options for action, but also the processes of formation of their goals of economic activity.

There are methods of direct and indirect influence.

Methods of direct influence imply such regulation of the economy, in which the state initiatively carries out certain actions, using the objects and resources belonging to it. It establishes the profile and activities of state-owned enterprises, approves their plans, monitors financial transactions, sets prices for their products; conducts administrative separation of monopolistic associations; forcibly acquires blocks of shares or entire enterprises; carries out research and development work in the state research centers, etc. Through the same impact is planned and ensured the execution of the budget.

Methods of indirect influence are designed to create conditions in which economic actors will be interested in making decisions that are consistent with the objectives of the economic policy

of the state. Their advantage is the ability to balance public and private interests, the disadvantage is that it takes more time between the application of measures and the result.

Indirect regulation is carried out primarily through the tax, monetary, budgetary, price, and foreign economic policy of the state.

3. The Great Depression of 1929

In the 20s, the US economy was growing. GDP grew by 14.3% from 90.5 to 103.6 billion dollars. The development of the economy increased the standard of living of the population, people's savings, which also positively influenced the development of the stock market. In 1929 it reached almost 86% of GDP. The FED pursued a "soft" monetary policy, the key rate for the period from 1921 to 1927 decreased from 6.5% to 4.0%. The economic ideology of that time was dominated by the doctrine of non-interference of the state in the economy "laissez faire", postulating that market forces have unlimited opportunities for self-regulation. By 1928, the economic cycle came to a state of slowdown, which was reflected in a decrease in consumer demand and a reduction in investment in the economy.

Most of financial resources were concentrated not in the industry, but in the stock market, which speculative operations rapidly inflated the "bubble".

During the period from the beginning of 1928 to September 1929, the Dow Jones index increased from 190 to 382, i.e. almost twice. The financial authorities failed to put the uncontrolled development of the stock market into the framework. The growth of speculation contributed to the affordable interest rate on the loan. Investors built the pyramids: mortgage the purchased shares to get loans, used this loans to buy new stocks, etc. And as long as prices were rising, this strategy allowed obtaining an income. Some of the shares were essentially not secured by real assets.

The stock market crash of 1929.

October 24 (the "Black Thursday") on the New York stock exchange there was a stock collapse. Within an hour after the opening of trading, stock prices began to fall. To help the economy, a group of banks (headed by Thomas Lamont, Deputy of D. Morgan) decided to support the market and, having collected the amount of about $ 25 million, entered the market as buyers. It delayed the decline for a while, but then everything went downhill. Losses of investors for October-November amounted to about 25-30 billion dollars., i.e. about 30% of GDP.

The fall moved to European markets (London, Paris, Berlin). The chain of non-payments crisis has captured all the economy. In addition to shares, real estate began to depreciate. The economic downturn, the signs of which existed even before the stock market crash, sharply went on increasing.

Government response: promises and results.

The American establishment, which professed the doctrine of non-interference of the state in the market, initially believed that everything would be fine in about 2 months, which was due to the weakness of economic measures of President Hoover. As a result, the crisis continued. Any intervention of the state required an increase in spending and deficit financing of the budget, which strongly contradicted the economic traditions of the time. During this period, the US Government and the FED made another fatal mistake, refusing to actively intervene in the situation. Money supply M25 decreased. The reduction in money supply hit aggregate demand, deflation began, which looked like an overproduction crisis

Economic catastrophe.

The Great depression changed the psychology and worldview of tens of millions of people. The volume of US GNP decreased by 1.85 times, investment fell by 85%. Rapidly growing unemployment, an increase from 3% to 25%, its volume amounted to about 17 million people. About 2.5 million people were left without housing. More than 110,000 companies went bankrupt. There was a sharp drop in real estate prices. The decrease in wages was more than 30%.

The crisis of 1929 showed the inability of traditional approaches to solve socio-economic problems. In search of effective anti-crisis measures, most countries have concluded that it is impossible to get out of the crisis without the intervention of the state. The state became one of the factors of stability and progress in these countries, more and more economic functions were concentrated there, which expanded due to the side methods of economic regulation. Most countries have adopted protectionist policies. The joint efforts of the state and entrepreneurs not only overcame the consequences of the crisis, but also became a kind of guarantor of future stability. The transition to a broad power of state regulation allowed restoring the expanded reproduction of capital, to find new opportunities for building economic and technical potential, to weaken the severity of social conflicts.

Conclusion

After analyzing the concept of market failure, its causes and ideological view on government's role in market economy, government's functions, methods and forms of market regulation, it is possible to make some undoubtable conclusions.

The market as a self-regulating system is not insured from its defeat. Market failure is a situation in which the market is unable to coordinate the processes of economic choice in order of maximization the efficiency of resources used.

Most often, the failure of the market is manifested as inequality in the distribution of income, monopolization of the market, the appearance of external effects, and the inability to ensure the supply of public goods and so on. The state is constantly trying to solve these problems by

[5] Money in circulation

implementing antitrust policy, social insurance, limiting the production of goods with negative external effects and stimulating the production and consumption of economic goods with positive external effects.

Governmental main function can be also described as the maintenance of Pareto optimality. Market itself cannot always find the balance and function on the top of its efficiency. At this points only government can regulate market, implement social policies and compensate losses. It makes vulnerable groups better off without damaging producers.

The reason for huge market failures can also be unregulated activities in the financial sector. The appearance of derivatives changed the structure of economy and brought completely new risks to it. Banking system is compared to the blood system of the economy, as it deals with country's and world's money circulation. Government is needed to look after this system and prevent huge failures in order to keep the economy alive.

Government regulation is necessary to help solve the problems that the market mechanism is unable to provide. It is best seen on the examples of internationals crises, when the whole economic system is on the verge of collapse. Regulations must be carefully and thoughtfully planned by government, otherwise some wrong state's steps can severely harm country's economy.

On how effective and rational the intervention of state institutions in the market systems depends not only on the wellbeing of each individual nation, but also on the fate of the entire human civilization.

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