

Evolution of Market and State

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May 2007

At the beginning of human civilization, in primitive hunting societies when resources were generally unlimited for a small population, there was no need for skills “specialization”. And so people were food hunters, home builders, warriors and self-administrators, all rolled into one. As population and human wants began to expand, some degree of skills specialization developed and so men learned to trade with each other. The animal and fish hunters traded their excess catch with craftsmen for the latter’s carpentry, hunting weapons, musical instruments and other artistic services. They traded with farmers who practiced the early technologies of agriculture.

Thus, the MARKET for the exchange of goods and services spontaneously arose, naturally invented. There were not too many varieties of each goods and services and hence, there was general homogeneity in product types and qualities. Hence, the presence of money as mode of voluntary exchange was not necessary; barter – goods for goods or services – was possible. The aggregate social surplus was small and communities could not afford, nor was there a need for it, to have a government made up of full-time administrators and enforcers of rules, whether collectively-agreed upon, or imposed from the top.

Later, as population and economic activities expanded, various forms of MARKET IMPERFECTIONS arose, like monopolies and oligopolies. This is natural because under unrestricted market exchange, consumers reward the efficient producers with continued patronage, assuring the latter’s business growth and expansion. Consumers also punish the inefficient producers, those who sell bad quality commodities and services at bad prices, with non-patronage resulting in the latter’s business stagnancy if not bankruptcy. Other sources of market imperfections are “negative externalities” associated with production such as pollution and noise, as well as “positive externalities” wherein potential producers of “public goods” like traffic lights in busy intersections, and peace and order in communities, are not inclined to produce the services because there will be many “free-riders” who will only enjoy the benefits but will not pay or contribute to shoulder the full cost of such “public goods”.

So men invented GOVERNMENT, and hired administrators, regulators and policy-makers to correct many of those market imperfections. The latter of course invented TAXES and various fees to finance the effort of dealing with these complications. Initially it went well. Many disputes among the citizens were peacefully settled; some monopolies were regulated from further inflicting non-competitive behavior. The “externalities”, both negative and positive, were addressed.

Later, governments introduced GOVERNMENT FAILURES and inefficiencies – bureaucratic red tape, corruption, exorbitant tax rates, multiple taxes and fees, excessive trade barriers, state-sponsored monopolies, and so on. The state was used by certain factions of capitalists and businessmen to protect themselves from other factions or batches of capitalists and entrepreneurs, both local and foreign, both existing and emerging. Among such barriers to entry of new competitors are government-legislated franchises and monopolies.

Government also institutionalized PROTECTIONISM of many local businessmen and producers in the form of high import tariffs, import quantitative restrictions, other forms of trade barriers to protect themselves from foreign capitalists and producers. Local businessmen erected barriers (either mandated in the Constitution or through Parliament-enacted laws) against entry of too many foreign inventors that will compete with their monopolistic and oligopolistic market structure. Or government bureaucrats, either by themselves or upon the prodding of the protected businessmen, create a maze of regulatory restrictions that effectively discourage the emergence of too many entrepreneurs, especially from ordinary employees, farmers, or managers. The existence of (a) high unemployment and underemployment rates, (b) high informal or underground economy, are among the major proofs of the success of bureaucratic nightmare.

So men invented non-profit organizations – more commonly referred to as non-government organizations (NGOs), people’s organizations (POs) and other civil society organizations (CSOs) – to reform government and state failures. Initially, it dampened state bureaucrats’ and policy makers’ appetite for more corruption and inefficiencies. But since many non-profit organizations are themselves “allergic” of the market and hate the concept of profit, much less huge profits, they can only demand governance reforms but not governance exit in many areas and sectors that government has already intervened. A “small and limited government” is not within their political horizon because they themselves are advocates of big government (aka “statists”), they themselves want to run the state and its interventionist agencies and corporations someday.

Thus, it became evident that “reforming government” by statist reformers, or by non-competitive capitalists, had become an oxymoron. Bureaucracies and interventions, once created, seldom decline, let alone die. And governments later invented habitual BUDGET DEFICITS (ie, revenues lower than expenditures). Many politicians run for government positions not to rein in government intervention, but to maintain, if not expand and worsen, those state failures.

Early in the last century, some groups went extreme and invented communist parties and socialist parties to turn an already super-imposing state into a “Big Brother” interventionist socialist state, supposedly to “centrally plan” the basic needs of its people. Later, many socialist states could not even plan and produce how many tons of rice and bread, how many million liters of premium gasoline and diesel, how many pairs of jeans and shoes, what varieties of oranges and bananas, will be needed by their people in a month, in a year. Scarcity led to political instability, which later led to the collapse of many socialist governments, from the Soviet Union to Eastern Europe. The remaining socialist states (China, Vietnam, Cambodia, etc.) survive because they have allowed the market system to exist in the economic sphere while maintaining political monopoly.

So now, many former socialist states are back to allowing private and voluntary exchange of goods and services by their citizens. Once the central-planning, chief-allocating, all-encompassing state shrinks, the market and the price system would know where, when, how much, and for whom goods and services will be allocated.

Not all market failures need government intervention

Not all “market failures”, like the absence of exchange by people who supply and demand a particular good or service, or the presence of negative externalities such as resource depletion, will need government intervention. There will always be “market failure” in all sub-sectors or sub-industries given the changing preferences of people who demand ever newer products and services. Or such “market failure” can occur when demand temporarily does not respond to a sudden availability of a new product or service as result of technological innovation, weather and natural events, other factors.

Case 1. Market Failure due to Absence of Supply

Some beautiful waterfalls in a country which have big potential for eco-tourism are not developed. Market failure here springs because while there is big demand by visitors to see beautiful waterfalls, there is no entity that will build the roads to make the place accessible, construct hand rails in dangerous areas, develop picnic grounds and cottages, and so on. Some politicians and anti-market groups can declare this as “market failure” and will move to establish a new government agency called “Waterfalls Development Authority (or Corporation)”, hire personnel, consultants, and politicians-appointed administrators. To do so, government will have to find financing through new tax measures, or raise existing taxes and fees.

There will be many groups of entrepreneurs who will be interested to develop the area, pour their own private resources, to earn money someday. But certain problems exist, like bad peace and order situation due to the presence of rebels and extortionists; problem with neighboring private landowners that will affect the access road to the area. It is also possible that intimidation and extortion is done by the local politicians and police themselves, or by the government's environment ministry or agency in the form of a maze of rules, regulations, and fees to pay, so that the cost of complying with these regulations alone would already cost a big amount of money.

If these problems (especially bureaucracy-created ones) are minimized if not removed, then private entities will compete to develop the area using their own resources, and no burdensome tax hikes or new tax measures will be needed. Applying user-fee principle removes the negative externalities of taxation, where even people who will not get to see those waterfalls are taxed.

There are millions of cases where supply is absent despite existence of demand by other people. There is absence of supply of a mango variety that produces 10 metric tons per tree per year, that is resistant to 95% of all known anthracnose and other mango pests in the world. Demand for this kind of mango variety will be very, very high, so there is another market failure there. But this does not mean that government should come in and put up a Mango Research and Development Authority, pouring vast amounts of money to be taken from the pockets of taxpayers. Time and market dynamics between suppliers and consumers will determine when, where, how and how much such commodity or service will be made available.

Case 2. Market Failure due to Absence of Demand

There are thousands, even millions, of scientific and technical papers languishing in academic libraries around the world, many of which have great engineering, health, agricultural, and other

economic applications and potentials. But there are not enough takers from businessmen and entrepreneurs at the moment. Government need not put up a research and development institute, extend huge amounts of credit, set up a government corporation, or other forms of intervention to each and every promising research proposal. For every intervention that government can think and implement, there is corresponding expropriation from taxpayers' pockets and income; there is corresponding new batch of bureaucracy created that need to be maintained; there is corresponding new batch of rules and regulations that will complicate otherwise simple situations.

During the rainy season, there is absence of enough supply of tomatoes, so that average price in the Philippines can jump from off-season price of P2/kilo to P40 to P50/kilo. During summer, with bumper harvest, there is absence of enough demand so that average price can slump to P2-P5/kilo. Some tomatoes are unsold and left to rot by farmers because the cost of harvesting and transporting them to public markets are higher than both wholesale and retail prices. In this situation, government need not create a Tomato Regulatory Authority or Tomato Development Corporation to stabilize prices and protect tomato farmers during summer, and protect consumers during rainy season. Such will entail additional taxes and fees, bureaucracies, and political intervention in price-setting.

Case 3. Market Failure due to Negative Externalities

Land clearing and conversion, from forest use to agricultural use, creates negative externalities (or side-effects). Soil erosion is exacerbated, streams and rivers are covered with eroded soil and rocks, and marine life is affected. But such land conversion is a natural reaction of people based on emerging prices of agricultural vs. forest products. As population expands, demand for more food production increases, so will the price of agricultural crops, from grains to vegetables and fruits. If people, especially those living in the affected area, do not value highly the forests, then more land conversion will happen, until it reaches a point that people's valuation of forest vegetation is deemed higher than more ricefields, banana and mango plantation, sugarcane and coconut plantation.

But the usual reaction of statist individuals -- those who believe in more government intervention, subsidies and taxation -- is for more government regulation, retain state ownership of vast public forest land. This thinking prevents the emergence and establishment of clear property rights to citizens as individuals, cooperatives, people's organizations, or corporate entities. They gloss over the natural tendency of people that those resources that belong to no one or everyone tend to fall in disrepair, while resources that belong to you, you tend to take care of.

Case 4: Market Failure due to Positive Externalities

Among the so-called "public goods", or commodities and services that benefit the majority if not everyone, are traffic lights, peace and order, justice administration, and clean air. When these services are provided, "free-riders" or people who enjoy the benefits of certain services but are not willing to voluntarily contribute for the maintenance of such services. Hesitance of private enterprises to provide such services stems from the fact that once provided and supplied, it is difficult to collect revenues from the free-riders, and it is almost impossible to exclude other

people who benefit from the services but are not willing to pay the costs of such services.

But it is shown by many private residential villages that many of those considered “public goods” can be privately-provided, and they are able to discourage or eliminate the free-riders. In private villages, subdivisions and residential buildings, the homeowners’ associations act as small government. They administer the provision of basic infrastructure and social services functions that are thought to be the “turf” or domain of government – road and drainage construction and maintenance, garbage collection, street lighting, security and protection of lives and properties, and even occasional immunization and other health care services. They are clear examples that provision of many so-called public goods can be privatized. And the private enterprises are able to collect sufficient revenues to make the service provision sustainable and continuing.

Bottomline: Not all market failures are worth solving, curing, or intervening by government. Buyers and sellers adjust themselves through time given changing patterns in supply and demand conditions. Government “cures” in non-core functions, whether waterfalls development or tomato regulation or tertiary education, often do more harm than good. There is wisdom in this quote, “if market imperfections arise, government can help by doing nothing.” This is because government interventions very often (a) are financed too far and widespread (raising taxes, reducing citizens’ take-home pay), and (b) are done too long (the agency and the bureaucracy stays on even after private players have adjusted to changes in supply-demand situations).