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STATES, MARKETS AND SOCIETY – NEW RELATIONSHIPS FOR A NEW DEVELOPMENT ERA

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States or Markets – Twenty-Five Years On

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Abstract Pricist approaches to development policy reached their apogee under the influence of neoliberal economists in the post-Reagan/Thatcher years. Their version of state-minimalism was more extreme than that conceived by the very founders of economic liberalism two centuries earlier. Revisiting the themes of a critique published 25 years ago, this article finds that its thesis remains vitally relevant today. It argues, however, that its analytic approach needs to be reset to focus more sharply upon the macro consequences of the neoliberal legacy.

Keywords: development theory, development policy, neoliberalism, structuralism, markets, states.

In 1991 a number of us at the Institute of Development Studies (IDS) came together to produce a book called *States or Markets? Neoliberalism and the Development Policy Debate* (Colclough and Manor 1991). Edited by James Manor and myself, it included contributions by 14 other IDS Fellows, so it was really very much an IDS volume (and a commentary on the state of development studies at that time). The theme of the IDS 50th Anniversary Conference prompts us to look back and ask why we were highlighting this topic, and to what extent the themes of the book are still relevant today. This is the focus of this short article, which deliberately takes a broad sweep – albeit at some risk to the nicety of detail. It begins by asking why, and in what sense, we should counterpose states and markets as alternatives.

The case for liberalism in economics and politics goes back to the Enlightenment. John Locke argued that every person had a right to life, health, liberty and property (Locke 1689). In economics Adam Smith, a century later, showed that, under free competition, the market produces prices as low as is consistent with supplying the product (Smith 1776). He argued that life should be as untrammelled by constitutional legal and administrative constraints as possible, and government action should be limited to ensuring the maintenance of a stable society and marketplace. The relative place of states and markets in determining desired outcomes has been a major fulcrum for policy debate ever since.

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Neoclassical analysis is centrally about how markets would work if perfect competition were to prevail. But much of its power is gained from analysing ways in which output, employment and pricing outcomes vary in the presence of market imperfections – increasing returns to scale, externalities, monopoly and many others. Generally, these imperfections have a negative impact on desired outcomes, so policies to remove them should have positive results. But, as development economists have shown, this is less certain where they are widely prevalent. For example, in low-income countries, laws against monopoly might mean that production could never start. Some environmental protection policies might undermine the chance of industrialising. Ballots presuppose access to full and fair information if they are justly to reflect people's perceptions of their own interests (arguably a lesson that should be close to our minds in the UK in 2016, where lack of such information may have affected the result of the referendum over whether to leave the European Union).

This structuralist tradition in economics showed that selective intervention is needed to achieve development goals, and by the mid-1970s even the World Bank president had announced that development should not be judged by economic growth alone but by the extent to which poverty was reduced in the world (McNamara 1973).

However, during the 1970s the post-war Keynesian consensus on economic policy was breaking down. Fiscal and monetary instruments began to have greater impact on levels of inflation than on output and employment. A series of oil crises fuelled recession in the West and shifts to the right in national and in global politics began to take hold. Reductions in state expenditure and emphasis on the importance of 'getting prices right' became increasingly a unifying message for economic policy reform in the countries of the North.

At about the same time, a major challenge to the development policy orthodoxy came from a group of economists, who sought to reassert the major tenets of economic liberalism in the analysis of development, extending a tradition of economics whose origins were in Chicago and whose pre-eminent exponent had been Harry Johnson. These 'neoliberal' economists (particularly Béla Balassa, Peter Bauer, Anne Krueger, Deepak Lal and Ian Little) advocated a more thoroughgoing rejection of state intervention than even Adam Smith would have allowed. Their central message was that 'imperfect markets are better, in settling matters of resource allocation, than imperfect states' – not that markets were perfect, but that, warts and all, they will allocate resources more efficiently than alternative mechanisms (Bauer 1981: 255–66; Lal 1983: 106; Little 1982).

The intellectual foundations of their position were provided by orthodox neoclassical economic theory. But as *States or Markets?* argued, they differ from careful neoclassical analysts in two very important ways. First, neoliberals concentrate entirely on the costs imposed by ill-advised government interventionism – yet precisely the same methods demonstrate the costs of imperfections which are not policy induced. So, 'hoist by their own petard', where there are serious imperfections in the market, liberalising could actually make matters *worse*.

Second, neoliberals claim more for the long-run impact of short-run optimisation than both classical and other neoclassical writers would presume. Variables with enormous influence upon long-run outcomes – technology, labour supply, capital stock – are relegated to a category which will look after itself. It is not that these things are judged unimportant – rather, they need no separate attention other than that which they will get by consequence of short-run price signals.

In these two respects, neoliberals were incautious – laying themselves open to attack from more careful analysts working within the orthodox tradition – as well as from those providing a more structuralist critique, as in *States or Markets?*, covering agriculture, industry, trade, education, gender, health, international finance, aid and other matters.

As we know, much progress was made during the 1990s and 2000s with moves to get human development more strongly enshrined as the major development paradigm. But orthodoxy remained resilient to these attacks, certainly until the financial crisis, and many neoliberal elements were present in the so-called Washington Consensus policy reforms, summarised well by Dani Rodrik as: 'stabilise, liberalise, privatise' (Rodrik 2006).

To conclude, the macro strategy of neoliberals is: let the market do its work; remove tariffs and let comparative advantage hold sway; trade imbalances should be settled by domestic adjustment rather than by international concessionary finance but where there is reason to provide finance, the private banks will do so. This mantra is not quite so brutally held by the international financial institutions (IFIs), which accept the needs for concessionary financing and to recycle funds from surplus countries. But the costs of such recycling continue to fall mainly on the deficit countries and, as the experience of Greece has shown, there has been only limited progress in getting a wider Keynesian view accepted.

Meanwhile, inequality has risen enormously over the past two generations. Its consequences are patent everywhere from the ballot boxes of the rich industrialised nations to the migrant boats from Africa and Asia. Its impact is felt in the rise of nationalism in countries of both the South and the North and even, partly, in the growth of terrorism. These matters would, I think, be a closer focus for a new 'States or Markets' volume – a continued critique of sectoral strategy, but a new and much sharper focus on the macro consequences of a theory and policy set which assumes that those outside the reach of the market are there mainly because of their own lack of effort, and thus deserve neither rights nor viable opportunities to contribute to it.

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