UNIT 6 STATE AND MARKET: INDIAN CONTEXT

Structure

6.0 OBJECTIVES

After reading this unit, you will be able to:

- differentiate between State and Government;
- describe different meanings of Market;

- identify different forms/instruments of State intervention;
- delineate the neoclassical rationale for State intervention in Market for efficiency;
- discuss the rationale for State intervention in Market for equity;
- explain State intervention mandated in the Constitution of India; and
- distinguish between intervention and interference.

6.1 INTRODUCTION

Political economy as evolved in the last few centuries in the West, dealt with the role of State in relation to economic affairs– both of public nature and private nature. As managing the State paraphernalia and making it help run the economy needed resources, fiscal operations of finding ways of mobilising resources and expending them had been an important aspect of a State's economic activities. With evolving complexities, monetary operations were generally parted from treasury functions of the government and entrusted with an independent and specialised agency, mostly within government domain and invariably under a separate law.

Societies and countries could progress because there were in existence certain institutions, which evolved over time practically in all civilised societies with variations and at differing pace. A legal framework ensuring existence of private property, an inheritance system for some assets and protection of contractual obligations has been a ubiquitous feature. It was realised quite early that many of resources are consumed in common and there had to be institutions to resolve issues should they arise in possession or use of such resources. In State-led societies, this task was given to or assumed by the State. State intervened in the economy for improving efficiency, enhancing equity, stabilising its activity level and balancing tradeoffs when they arose.

In the context of development, the expressed aspiration of post-war liberating colonies, led State in many newly independent countries to assume direct charge of running certain industries, besides educational and health facilities, regulating several others to seek efficiency and/or equity and promoting still others like financial institutions. In part, this was a reflection of the apparent success of the planning apparatus in the erstwhile USSR. But the USSR broke up and the constituents pursued market-oriented policies– known as perestroika (reforms) and glasnost (open-ness).

Relationship between State and Market across space and time has not been the same. So-called capitalism where quality and quantity of state invention distinctly differed from so-called socialism but both existed side by side for pretty long time. When most countries allowed market better, individual countries and regions differed not necessarily in proportion to the level of development. Over time, it appears that market dominated state and sought state to be a facilitator rather than a competitor by devising such formal institutions and designing them in such a way that market flourish and help the country grow. However, when crises struck such as the Great Depression of 1930s, the Great Recession of 2008-09 or Covid-19, the market operators sought the help from the State. In other times, either market sought or state sought the partnership between private sector and public sector in many development arenas which were traditionally taken up in public sector for a pretty long time. This partnership had to be in terms of sharing of resources, risk and revenue. Anyway, there have been swings in the relationship between the two, market and state, in terms of domination, competition and cooperation. However, the unit, given the limitation of space, would not devote much time on this aspect.

The focus of this unit is on State intervention in individual markets for improving both the efficiency and equity of outcomes. In addition, State plays paternal role of encouraging or discouraging consumption of certain goods. It also chooses to regulate as well as promote quite a few private activities, including those of economic nature. The unit devotes space to discuss the nature of State and market, the rationale of State intervention in market for efficiency and equity. It also discusses State intervention in the context of India.

6.2 STATE AND MARKET

State and market are two great institutions which humans have evolved over time, among several others, to resolve inter-personal or inter-group issues in people's life that arise from living together. Both are overarching in their scope. Broadly speaking, one is political and the other is economic; but they also seek to intervene in each other's sphere.

State supposedly evolved to perform watch and ward functions, to defend the society from external aggression and internal disturbances while market evolved to benefit from voluntary exchange of goods (and services) which was greatly facilitated with the invention of money as medium of exchange.

However, State has often been intervening in, some would argue even meddling in, the economic spheres of life. Justifications varies from time to time, giving impression that State and market are hand in glove. Property rights and inheritance laws as well as people's entitlements and obligations, which were traditionally evolved have been recognised by the State which either accorded sanction or tweaked them a little here and there. Nevertheless, formal state institutions always alongside informal societal institutions where institutions mean the rules of conduct for individuals and other entities to avoid conflicts should they arise. Generally, there is a tendency for State to assume greater scope by formalising institutions and occasions arise for them.

6.2.1 State and Government

It would be pertinent to point out basic difference between State and government though they may be used interchangeably. State has four essential elements of population, territory, sovereignty, and government. In fact, government works for the State as its agent. People are a collectivity of individuals connected intractably. Territory belongs to the State over which it has sovereignty and jurisdiction; and government is supposed to preserve, protect and defend that territory. While State is sovereign, the government is not. In a democracy, it is often asserted that people are sovereign as they choose the State, rather the government, they would like to be governed by.

Government keeps coming and going as per rules of the State– best codified in the Constitution. While State may appear to be abstract, it is which asserts sovereignty of a community of people. All individuals living in the territory, except those belonging to foreign States, are members of the State as its citizens. In India, there are 130 crore people, with 99.5 per cent being the citizens. While a few Indian citizens may be non-resident, few foreign citizens may be residents in India. In contrast, government is concrete, visible, and active, and involves a subset of people– some as representatives of people and some as employees in their service. For example, in India, there are around 545 MPs in the House of People, over 4000 MLAs in Stare Assemblies and over 30 lakh members in Panchayats and Municipalities, who are direct representatives of the people at some level of government.

Further, the form of government may vary from State to State. Government may be monarchial, aristocratic, dictatorship or democracy. It may have a presidential form or parliamentary one. It may be federal– with several fixed or flexible constituents, or unitary with centralised or decentralised administrative set-up. If federal, it may have several levels or tiers of governments. State exists independently of the form of government while people may choose the form of government.

However, the word State may have several meanings in popular usage. For example, in the Constitution of India, India is a State as well as a Union of States. (So is the case of the US.) Modern government normally has three wings, legislature, executive and judiciary. But the Constitution of India, for legal purposes, defines the State in Art 12, in relation to Fundamental Rights which must be adjudicated by Judiciary, as:

… "the State" includes the Government and Parliament of India and the Government and Legislature of each of the States and all local or other authorities within the territory of India or under the Government of India.

Finally, in the context of intervention, phrases State intervention and government intervention mean one and the same thing. When, however, it comes to failure, the phrase used is government failure– not State failure.

6.2.2 Market: Meaning and Forms

It seems, at some point in antiquity, quite possibly in different periods in different places, humans realised that voluntary exchange between two humans might lead to specialisation– thus to division of labour, and thereby raising production levels and thus bettering the possessions of both the exchangers. The same holds in inter-societal exchanges which might have been rare in the days when a society could still raid on other societies to improve upon its possessions. Once, a society is able to produce enough to maintain a regular army, it evolved as a State to defend itself against other societies. Rules for conduct of human affairs within a society had to be framed. Instruments might have had to be devised. For example, money is an instrument to facilitate exchange or transactions in market.

Size of market depends on the level of specialisation and division of labour, said Adam Smith. He is in fact referring to the size of economy in today's parlance, which is generally measured in terms of Gross Value Added (GVA). Another connotation, as in microeconomics, is a market for a commodity– good or service, or for a factor. Still another connotation is regular market referring to market place or periodic market referring to frequency. Nowadays, it may be real or virtual!

Market expanded as many goods got commoditised or commodified. For example, labour was not directly bought and sold earlier on wages, the labour price per unit of time– notwithstanding existence of slavery wherein a person can be bodily sold; later, it became like any other commodity. Many services like legal advocacy, consultancy, teaching, training, research, marketing, are also now on sale. In management science, market may mean a verb for advertisement.

Normally, we associate market with a place where we carry out purchase and sale of goods. Some are regular and some organised on periodic basis and some on occasions like festivals. There are virtual markets as well, as we are now becoming used to. However, in Economics, for analytical purposes, markets can be classified as asset markets, goods markets, and service markets; goods markets and factor markets; financial market, bond market and money market, etc. They present a platform with certain conditions to facilitate voluntary exchange of goods and services. Based on level of competition, they may be called monopoly, monopolistically competitive or oligopoly. The nature of State intervention invariably depends on the structure of the market. However, State intervention always take the form of influencing either the prices, quantity, or quality standards, or all of them.

If an institution means a set of rules to conduct affairs in a given domain, transactions such as exchange of goods and services, lending or borrowing of money, leasing, or mortgaging of assets (including intellectual property), accepting deposits and loaning them out or conducting other financial services like underwriting risk, all constitute separate markets– some of them may be inter-related.

There are conventions to transact business, some of which are instantaneous, some over time, some with attendant warrantee and conditionalities, some for future dates. For various reasons, the State may find it necessary to intervene by framing laws– rules, regulations, orders, guidelines etc.

6.2.3 Premises of Market

Market presupposes existence of property rights over resources and commodities– ownership of property by individuals, families, businesses, communities, and governments. Non-government ownership is often designated as private. Some properties are said to be common property. Property itself may be tangible or intangible. The former is physical – moveable and immoveable while the latter is mostly financial or intellectual. Market presumes that such property rights are alienable or transferable. So, farming field, town house, government bond, and molecule patent are all alienable. There may be new kind of rights like club membership, right to smoke or right to vote. You may have right to smoke in a railway coach which you may exchange it for consideration with someone who may find it obnoxious but you cannot legally exchange your voting right. So, you may have right to use but not to exchange. Likewise, you cannot pass on your right to smoke or right to vote to your children. They extinguish with your passing away. Government may give land to use but not to sell. Ownership is itself is a bundle of rights and you may possess some of those while others may be possessed by others. You rent in a house and you use; you lease in a piece of land and you cultivate it; you mortgage your financial papers and use borrowed money for some purpose, and you have an intellectual property and permit its use by others. In addition, it also presupposes existence of some rules of inheritance of properties that survive the owner though some of them extinguish with the person.

Chattel (i.e., personal possession not related to real estate) seems to be the first form that came to be accepted as property and slaves appear to be the worst form of property. Both are the cases of means of production as are land, workshops, tools, and equipment. Socialist thinkers believe that means of production which occasion the employment of a sizeable number of workers have to be socially owned whereas capitalist proponents support private ownership. While some believe that private property provides incentive to exert harder, there are some, like Ludwig von Mises, who think that prices cannot be formed in the absence of private property over means (factors) of production.

There is often a distinction made between private property and personal property and another between consumption goods (means of consumption) and capital goods (means of production).

Mutual transfer of properties, including money, in a voluntary exchange is the basis of market. In case, there is a breach of generally acceptable behaviour there exists some mechanism, namely legal redress, to enforce it.

However, market may not exist in certain cases as goods may have peculiar characteristics. Or market may exist but may not yield efficient outcomes. So, private property may be a necessary condition for market to function, but not sufficient. Likewise, rules for succession or inheritance of certain properties are a necessary institution for a society but not sufficient.

Check Your Progress 1

1) Differentiate between State and Government.

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2) State the different meanings of State in political sense.

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3) Explain different nuances of a market.

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4) What are essential premises of market in terms of voluntary exchange?

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6.3 STATE INTERVENTION IN MARKET: INSTRUMENTS AND INSTITUTIONS

State intervenes practically in all spheres– economic, political, and social. In economic sphere, there are general interventions in the economy and there are interventions specific to individual markets. For example, RBI interventions aiming at supply of money which is for the economy as a whole, while interventions by TRAI to influence telecom sector in terms of price, quantum, and quality or standards are specific to the market for telecom services. State devises a variety of methods which are used for intervention and a variety of institutions through which intervention is carried out.

Beside policy formulation, legislation of law, framing of rules, and outlining guidelines, market specific instruments of State interventions can take the shape of production, provision, promotion, protection, restriction (on price, quantum or standards), regulation (on labour or environment), control and sharing information.

Likewise, there are variety of institutions through which interventions are carried out. These institutions are named as agency, association, authority, bureau, boards, committee, commission, corporation, council, foundation, institution, office, organisation, society or trust, which all have somewhat different legal status and organisational complexion. There may be ad hoc task forces, working groups, panels of experts, etc. Similarly, broad sectoral interventions take the shape of plan, scheme, programme, project, campaign, and mission.

For the purpose of elaboration, this unit chooses to classify micro interventions as they are, into four groups in terms of (i) Ownership and Operation, (ii) Regulation and Control, (iii) Promotion and Support, and (iv) Protection.

6.3.1 Ownership and Operation

There may be certain strategic industries/market where State does not trust private owners as it does normally. This is in the case of core defence, police activities or mintage, coinage, and note-issuing, which once upon a time private parties engaged in. There may be sectors where private capital may be shy as it may not have enough capital or venture may be too risky. State may choose to have monopoly over space industry or atomic energy industry or mining of atomic mineral resources. But the Government of the day may ideologically decide to control the commanding heights of the economy or establish a socialistic pattern of society. Or it may find no reason to do business. For example, in India, following Parliament's resolution to establish socialistic pattern of society in December 1955, the Industrial Policy Resolution of April 1956 included a whole set of 17 industries to be exclusively owned and operated by the Government. It included, besides arms and ammunition, atomic energy, and minerals, electricity, railways, ships, aircrafts, coal, iron and steel, etc. If such industries are in private hands, they could be nationalised. The government or its agency, corporation, or company, would own, operate, control, and manage all operations related to production or disposal of the produce. Now, the circle is moving to the other side; instead of nationalisation of private enterprises, privatisation of state enterprises is being contemplated and carried out. As of now the move is towards public private partnership, if not outright privatisation, divest mentor joint ownership and operation.

6.3.2 Regulation and Control

There may be another set of industries essential for developing infrastructure or essential consumer goods, the government could think of regulating or controlling output and/or price. Once, the government compulsorily procured a certain portion of food grains at lower prices and thereafter decided to offer support prices in case market prices fell below that level. Further, once upon a time it was thought textile mills could compete with handloom and khadi which needed to be encouraged for employment and, therefore, their output could be controlled. License to produce was one of the conditions one had to fulfil before starting operations. Many metals, cement, antibiotics, fertilizers, machine tools, sugar, road transport, etc. could be put in that category. There was an Act, called Essential Commodities Act passed in 1955, which permitted the government to control production, supply and distribution of certain commodities like drugs, foodstuffs, fertilizers, etc., under certain circumstances. There are several other regulations put in place to assure, for example, quality of goods and services. Several agencies have now been put in place to certify quality of products by marking as ISI, Hallmark, Agmark, Ecomark, BSIV, etc.

6.3.3 Promotion and Support

Many industries may need financial support or promotion– say, in export. Government creates development finance institutions such as NABARD, SIDBI, NHB or EXIM Bank to support industries and trade. It also floats boards and councils to promote the interests of specific industries.

Needless to say, government generally support supply side of market through S&T/R&D activities, development of general infrastructure – including clusters, estates, market yards and other common facilities. It also supports technical education, training for skills, and extension centres.

6.3.4 Protection

Certain industries may need protection, besides support, from competition with easily substitutable products. There were hundreds of items which were reserved for production by small scale industries (micro and small enterprises). Under WTO obligations, slowly, protection by reservation has been withdrawn. However, there is still Purchase Preference Policy and Price Preference Policy. Under the former, government departments are supposed to give preference for products from small scale industries and under the latter, they could pay up to 15 per cent higher price than the lowest quotation from industry of any scale.

Check Your Progress 2

1) List the various instruments of specific market interventions.

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2) List the institutions and modes of State intervention in market.

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3) Explain the meaning of regulation in the context of intervention in market.

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6.4 STATE INTERVENTION IN MARKET FOR EFFICIENCY

State is supposed to protect life, liberty, and property of the individuals while market is about voluntary exchange of properties– though with quite extended meaning. It is obvious that State emerged after institution of private property had already come into existence. However, according to Marxist literature, State and market are said to be in hand-in-glove.

State is often pressed into service to intervene in the market should its legitimate functioning result in socially undesirable consequences. State is also asked to intervene in the market if the latter is found to be inadequate or incomplete in certain respects. Such a situation is called market failure as it results in higher prices and lower quantities compared to efficient operation of market.

In this section, the rationale of market intervention of State is afforded in terms of production and consumption as well as price, quantity, and quality. The purpose is to improve efficiency or reducing deadweight loss to the society. Let it be clear that these interventions are in white markets which follow all laws of the land. It is possible that some interventions may induce parties to go into black or conduct illegal operations.

6.4.1 Rationale for State Intervention in Market

Neoclassicals provide for clear-cut price formation in market under the condition MR = MC following certain simple assumption. They also highlight instances where markets are not functioning efficiently or may not be complete or may not exist altogether. They called that market failure or, breakdown of competition. Two major sources are (1) existence of externalities with production or consumption of private goods and (2) existence of market power or monopoly power or imperfect competition. Another source of market failure is (3) existence of imperfect and incomplete information. Purists may reduce everything into violation of assumptions of perfect competition (an idealised world) while practical people recognise existence of the extreme case of externalities as (4) existence of public good, as a separate reason. Further, from a society's perspective there are goods which merit consumption and there are goods whose consumption ought to be discouraged. For market, on their own may not be able to enforce this distinction. So, (5) existence of merit and demerit goods is another reason for state intervention.

In the case of perfect competition, marginal revenue (MR) of the producer, often called marginal benefit (MB), is equivalent to marginal social benefit (MSB) as there are no spillovers of benefit. So, MR=MB=MSB. Likewise, marginal cost (MC) is equivalent to marginal social cost (MSC) as no cost is externalised. So, MC=MSC. Usual equilibrium condition of MR=MC (or MB=MC) translates into MSB=MSC and thus efficient voluntary exchange ensures efficient social outcome. There is neither excess production nor shortage. When there is divergence between the two– private and social, this parity breaks down. Market will fail to produce socially efficient output or outcome. In such a situation, an external intervention in the market is required. For long, it has been suggested in neoclassical tradition that the intervention should come from the State. This is the rationale for State intervention. We briefly discuss these five instances of market failure to produce efficient social outcome, leading to State intervention.

6.4.2 Public Goods

There are certain goods which have certain peculiar characteristics such as non-rival consumption and non-excludability. Rival consumption means if I consume more, then less is available to you. If there is a shirt and if I wear it, it is not available to you. If I take away a portion of bread, less is available to you. This is true of any private good. But take the case of viewing a serial on TV, my viewing does not impact your viewing it. Both of us enjoy together with no rivalry. So, is the case with municipality produced street light. Excludability means one can be excluded from consumption if one does not fulfil say certain conditions to enjoy it. In a market, one who is not paying for the good or paying less than the prevailing price, can be excluded. One who is not major may be denied purchase of a cigarette pack or a bottle of liquor even though he is willing to pay. One may not be enrolled for a Ph.D. if he has not done a Master's degree. However, one may not be denied the consumption of streetlight or security by defence forces even when one is not contributing to production of these services. There is no way anybody can be excluded from consuming such goods. Either the prevalent technology does not permit it or cost of excluding is too high. It is often argued that marginal cost of supplying public goods like TV signals is almost zero, it may not be necessary to price them. But its supply does cost, say in terms of high fixed cost, it is suggested that it should be public funded. Then, there exists problem of free-ridership as true preferences for such goods may not get revealed.

Public goods are goods which are non-rival in consumption and non-excludable from consumption whereas private goods which are both rival and excludable. However, it is not true that all goods in existence can be categorised in these two mutually exclusive groups. Goods may be non-rival but still excludable. Few more students may be accommodated in the class as marginal cost of teaching them is zero and consumption is non-rival up to a limit when the class size becomes too large for effective learning to take place. Such goods are often called club goods. There are goods, such as fishing in international water, where fishers are non-excludable, but extraction of fish is rival: more for me and less for you or more today and less tomorrow. So may be the case with oil extraction from two nearby wells with common stock underground. Such goods are often referred to as commons or common goods. Club goods and common goods are also referred to as quasi-public goods or semi-public goods.

For pure private goods, equilibrium condition $MSC = MB_A = MB_B$ where A and B are two consumers, decides the quantum of good that would be produced while in case of pure public goods, equilibrium condition $MSC = MB_A + MB_B$ should decide that quantum. In the case of a private good, marginal benefit curves are horizontally added while in the case of public good, they have to be vertically added. Needless to say, market may not produce any such good. State is therefore called for, for production of public goods.

We may further note that (1) public goods may be national or local or global depending upon their area of outreach and (2) there also exist public bads (global, national and local), like variety of pollutions, which have to be reduced or removed by the State.

6.4.3 Externalities

Most activities related to production of goods, and some involving consumption of goods, also produce bads, which impact others, called third parties– as they are neither producer (first party) nor consumers (second party) who benefit from production of the good. This phenomenon is known as externalities. Sugar or textile or leather factories produce effluents which find way into local water streams impacting those living nearby or depending on them for water. People living in the vicinity suffer from the polluted streams in terms of health hazards and incur expenditure on protection or medical treatment. Some of the production activities do produce benefits which accrue to those who do not pay for those benefits. A classic example is beekeeping. While collecting nectar bees pollinate the trees in the orchard. Free software or basic education are treated in the same category. Thus, we see externalities are negative or positive. The short point is that social cost or social benefit diverge from their private counterpart. Third party cost/benefits are also known as external cost/external benefit (EC/EB). Generally, marginal equilibrium conditions are written as:

For Negative Externality: MSC = MC (MPEC) + MEC while MR=MSB

For Positive Externality: MSB = MR (MPEB) + MEB while MC=MSC

where Marginal Private Economic Cost (MPEC) represents marginal cost and Marginal Private Economic Benefit (MPEB), marginal revenue. MEC and MEB are Marginal External Cost borne and Marginal External Benefit enjoyed by a third party. Since private parties tend to equate marginal (private) cost with marginal (private) benefit, quantum produced may not be socially efficient. While focusing on negative externalities, it was argued by Pigou to adopt 'polluter pays' principle. The suggestion is externalities should be internalised. Since then, many other suggestions have been offered. Allocation of tradable pollution permits is one. Subsidisation sought by private parties to adopt technologies to help reduce pollution is another. Coase had argued for assignment of property rights and private negotiation, but negotiation need to be enforced by State. So, State intervention is needed in such cases as well.

6.4.4 Monopoly Power

When there is only one producer, monopoly is obvious but monopoly power in terms of fixing price is not that obvious. A monopolist dealing in a commodity with an inelastic demand has higher monopoly power than one who is dealing in a commodity with an elastic demand. Elasticity of the demand curve faced by a firm depends on the number of firms in the market as also on substitutes (implying cross elasticity). Oligopolistic and monopolistically competitive firms have thus also some monopoly power. Thus, there is a degree of monopoly with firms not in a fully competitive market. Since for a firm in a fully competitive market, price is equal to marginal cost (P=MC), the divergence between the two, that is excess of P over MC, will determine the monopoly power. Lerner devised an index with formula as

$$\text{Degree of Monopoly Power} = (P - MC)/P,$$

which is zero when P=MC and 1 when marginal cost is zero. Since MC is equal to MR in equilibrium and MR=P(1- (1/e) where e is the measure of elasticity, the degree of monopoly can be shown to be equal to 1/e. Monopoly power is inverse of the elasticity of demand.

There may be good reason to permit monopolies in certain cases. Like in natural monopolies, it benefits the society to harness potential of a technology in terms of economies of scale. However, if producers are few or if a producer controls a good proportion of market, they enjoy market power, which manifests in the form of goods offered at a higher prices. In both cases, State is invited to intervene by regulating prices in addition to quantity and quality so that social outcomes are optimum. Monopoly restricting laws have been enacted in most countries. Competition Commissions are also instituted by the governments in many countries, including in India, to oversee that market power or market dominance is not misused to the disadvantage of consumers.

6.4.5 Information Asymmetries

One of the basic assumptions behind perfect competition is prevalence of full and complete knowledge among buyers and sellers of goods, which is hardly ever the case in reality. With growing economic complexities, though knowledge has increased, so has ignorance or lack of adequate information to make good economic decisions. There is another aspect, information is often asymmetric between the two parties that may be involved in pursuing a transaction. State tries to reduce this asymmetry. There are acts and institutions setting quality standards to take care of– safety in case food articles, quality in case of metals, control of pollution, etc. Samuelson quotes the case of Eben Byers who was a steel mogul in the US. He took drug Radithor sold as an aphrodisiac and cure-all to relieve himself from his ailments. Byers died from its consumption. Later on, it was discovered that Radithor was distilled water laced with radium. State has a role in addressing such informational deficiencies.

6.4.6 Merit and Demerit Goods

There are often goods demanded by some people that may not be considered desirable by the society. State as an important pillar of society is expected to encourage consumption of merit goods. For example, children may not value education and its demand may be low. Competitive market may produce very little education to meet the needs of everyone. State encourages its consumption by subsidising it or making it free of tuition fee. Inoculation, immunisation, vaccination, sponsorship of cultural festivals may all fall in that category. Similarly, there may be goods such as intoxicating drugs tobacco, cigarettes or alcohol, the consumption of which a State may want to discourage. State could discourage consumption through several ways including imposing heavy taxes, restricting or banning the production. Some States in India have prohibited the consumption of alcohol or tobacco. At the moment, Gujarat and Bihar have banned production, imports and consumption of alcohol, while Haryana has lifted the ban imposed earlier.

Check Your Progress 3

1) What are the reasons for State interventions in specific markets?

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2) Explain the rationale of State intervention in the market on account of externalities in production and consumption.

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3) What is meant by a demerit good? How does government intervene in the market for demerit goods?

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6.5 STATE INTERVENTION IN MARKET FOR EQUITY

Market, even if technically efficient, is no guarantee for ensuring equitable outcomes in an economy. This is one reason why people could be against an unhindered play of markets. It is often reported that in market economies the share of better-off sections of the economy improved is proportionately at the expense of the less fortunate. Relative share of the worse-off actually comes down substantially even though, generally speaking, every section becomes better-off in absolute terms. State often redistributes property, puts ceilings on specific kind of property like land, discourages concentration of wealth and through taxation redistributes incomes by supply public goods that are consumed more by the less well off sections of the economy or by subsidising some of their consumption. This helps in addressing the equity concerns in the economy.

This section discusses the market interventions whereby State influences distribution of income among sections that contribute to production. It generally implies intervention in factor markets. However, certain goods, mainly necessities, may require the State to intervene in their specific order to ensure a more equitable access/distribution of such goods perspective. In contrast to intervention for efficiency, intervention for equity might increase deadweight loss of the society.

6.5.1 Goods Markets

Final Consumer Goods

State regulates prices for certain goods, including by the requirement to display maximum retail price for most goods. Many drug prices are notified with ceiling. In India, quite often, Essential Commodity Act is invoked to stabilise prices of onions, potatoes, salt, etc. Some agricultural products attract minimum support prices and procurement is made by some government agency, chiefly Food Corporation of India, at harvest time. At the same time, buffer stock of certain commodities, like wheat and rice, is maintained and it is released in market when prices rise.

Intermediate Inputs and Capital Assets

Irrigation water, power and chemical fertilizers like urea are sold to farmers in India at subsidised rates. In the similar vein, capital assets like milch cattle or pump sets were once subsidised for below poverty line households, with differential subsidy amounts– depending upon the social category the beneficiary belonged to.

6.5.2 Factor Markets

Labour Market

State often imposes Minimum Wage Act to improve wage levels in the labour market. It is generally welcome though quite a few economists find it counterproductive, not without logic, as it might increase unemployment by discouraging use of labour intensive techniques in production. The law is applicable for low level of workers– unskilled, semi-skilled and skilled. Beside price intervention, there are several other interventions seeking job security and income security. However, for most of India's independent history, minimum wages have not been fully enforced in most states. Of late, it has been argued that a floor on wages has been created by the MGNREGA guaranteed wages in many states, including in the backward states where minimum wages were not enforced in reality.

Credit Market

State may use a policy of differential rates of interest for different sectors to ensure adequate flow of credit, interest subvention for equity consideration and even in the context of tax policy. In India, such lending is called priority sector lending and sectors include agriculture, micro enterprises, higher education, affordable housing, etc. where certain floors in terms of credit flows are also enforced.

Entrepreneurship

State encourages private initiative if the promoters have good workable ideas by extending tax benefits, concessional credit and even training. Recent examples are Startup India and Standup India initiatives. Besides, there are interventions at creating skill sets among youth through state intervention or attempting vocational education.

Check Your Progress 4

1) How are interventions for equity different from those for promoting efficiency?

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2) Explain how intervention in the labour market by regulating wages may be counterproductive?

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3) How is intervention for development of entrepreneurial skill helpful in promoting equity considerations in a society?

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6.6 STATE INTERVENTION IN MARKET AND INDIAN CONSTITUTION

Part IV of the Constitution of India embodying the Directive Principles of State Policy, makes it amply clear that these principles, though not enforceable by any court, are fundamental in the governance of the country and that the State is obliged to apply these principles in enacting laws. These are said to be forerunners of the recognition by the UN of the right to development as an inalienable human right. Several Supreme Court judgements allow even tweaking of Fundamental Rights for pursuing Directive Principles provided that tweaking does not touch the basic features of the Constitution.

6.6.1 General Direction

Laws are the basic forms of intervention in the national life, ostensibly for the betterment that a Welfare State should stand for. As Art 38 says, State shall strive to promote the welfare of the people by promoting justice and reducing inequalities as enshrined in the Preamble to the Constitution. Development involves many aspects of life– social, economic, and political; and State may intervene in many of them. Directly relevant for this unit, however, are two clauses of Art 39 that direct the State to secure:

(b) that the ownership and control of the material resources of the community are so distributed as best to sub-serve the common good; and

(c) that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

From these two clauses, it appears that the State accepts the primacy of private ownership of material resources (Clause 39 (b)) and of market price mechanism (Clause 39 (c)) but asserts its interventionist power to correct distribution of material resources as well as to influence price mechanism so as to secure best welfare outcomes. There are several other Articles, all in Part IV, which can be seen as construing market intervention: Right to work (Art 41), Provision of just and human condition of work (Art 42), Living wage for workers (Art 43), and Participation of workers in management of industries (Art 43A). Organisation of agriculture and animal husbandry on modern and scientific lines (Art 48) and Protection and improvement of environment and safeguarding of forests and wild life (Art 48A) can also be accepted to fall in the same category.

6.6.2 Particular Areas

One can well see that there are suggested areas of market intervention– whether regulation or promotion, in the Seventh Schedule under Art 246 that delineates subject-matter of laws to be made by Parliament and by the Legislatures of States. List I (Union List) roughly enumerate them generally under entries 22 through 61, List II (State List) does so under entries 13 through 32, and List III (Concurrent List) lists them under 20 through 38. Many other entries also have relevance for market intervention while some of the entries noted above may not strictly be related with market intervention. Generally, there is separation in intervention between the two level of governments, Union and State. But there may be areas where Union and States are dealing with separate aspects of the same area, like mining or industry or communication. There may be an area where both the governments are competent to legislate, like electricity, but if there is conflict then the Parliamentary Act shall prevail over the Legislative ones. For rough mapping of entries of three lists across sectors, see the Appendix.

It may be noted that market intervention here means influencing production, consumption, and transportation as well as price, quantity, and quality. It should be noted that we have avoided mentioning fiscal and monetary instruments as they indirectly influence the market except those fiscal instruments which may be called sin taxes.

State intervention can be broadly classified as establishment, development, and welfare in economic matters. Development and welfare functions can be partly effected through intervention in market functions– sometimes to promote efficiency but at others to promote equity. However, any efficiency measure will have implications for equity and vice versa.

Check Your Progress 5

1) Which article of the Constitution of India specifically suggest that State has power to intervene in market?

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2) Where are listed areas of legislative intervention in the Constitution of India for Union and the States?

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3) What is the significance of the Concurrent List in the Constitution of India?

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6.7 STATE INTERVENTION AND STATE INTERFERENCE

There is a subtle difference between intervention and interference. Intervention is welcome move by a third party to resolve an issue between two parties, to improve the outcome. Interference is a move that is often resisted, not welcome, by the party which finds it disruptive, making outcome worse. Intervention is considered a positive move while interference is a negative one. What if a move by the State is welcome by one party and rued by the other?

State may not always be right. It is quite possible that State is unnecessarily intervening without good reasons. It is also possible that a State intervention may continue beyond the time it is needed. It is possible that it might become excessive and found to become interference. It is also possible that government has not well understood the situation and may have unnecessarily intervened. Something considered good in 1950s might not be needed in 2000s, suggesting that such moves have outlived their utility. There may be generational shift or ideological shift about the role of State. Their continuance might have counterproductive. Yet, a party may be gaining at the cost of another or the country as a whole.

It may be pointed that 1500 Parliamentary Acts that were found archaic, were repealed in recent years– quite a few of them were economic, impinging upon market functioning.

In India, we often discuss the movement from LPQ (License, Permit and Quota) raj to LPG (Liberalisation, Privatisation and Globalisation) regime. Reforms of 1950s are said to have been relevant during that period. Reforms of 1990s are currently continuing in the same direction. For example, liberalisation means removal of restrictions. So, restrictions are being removed gradually.

There may be several reasons for unnecessary intervention. One of them is rent-seeking nature of politicians and bureaucracy. Another is regulatory capture by industrial biggies whereby regulators get willingly captured by private interests. Still another is pursuit of self-interest by regulators. Similarly, often electorate demand, or political objectives of a ruling party may not be very rational or in the larger interest of the country. There are several others. Scholars of late have asserted that there exists what one can call government failure.

6.8 LET US SUM UP

State is perhaps the most important institution humans have evolved to sustain social living and resolve conflicts that may arise in societal affairs. Market is one of such societal affairs. It intervenes in market in general but also in specific markets to influence level of production, level of prices, quality of products or standards of service, etc. It devises several instruments as well as institutions through which it intervenes. It is to be appreciated that the relationship between State and Market has not been the same across space or time in terms of dominance, competition and cooperation. Despite a tendency of assertion by market, State is called for stabilisation in terms of crises; at other times, market seeks its entry through partnership into the development areas that for a long time were preserve of the State.

Neoclassical economists have over time enumerated the reasons as to when and where State is called upon to intervene in market for specific goods under the assumption that State is most efficacious institution to improve the outcomes. Microeconomic interventions can be undertaken for both purposes– improving efficiency and enhancing equity.

Efficiency interventions generally try to improve welfare (the sum total of producer surplus and consumer surplus and, if relevant, government revenue) and decrease deadweight loss which may be caused by imperfection in competition or presence of externalities. If the operation of a factor market results in further deterioration in the extant inequality, State may intervene to ameliorate the worsening of inequality. There are other interventions directly hitting at distribution but, in this unit, focus has been on those interventions which directly relate to specific markets.

The unit has also broadly touched the direction for intervention in market generally and specific markets through legislation as suggested in the Constitution of India which divides the areas of legislation between the Union and the States. It also hints that State may not always be right in intervening or choosing right kind of institution and instrument.

6.9 TERM- END EXERCISES

1) What do you mean by market failure? What factors can cause a market failure?
2) What do you mean by State or Government intervention? What does an intervention try to impact?
3) Explain neoclassical arguments favouring State intervention in specific market.
4) Show how a factor market may be efficient but not just.
5) Explain the significance of Article 39 (b) of the Constitution of India from the angle of market failure and government intervention.

6.10 KEY WORDS

Demerit Goods : Goods that consumers may like but are actually harmful though they do not appreciate it and therefore their consumption is discouraged, are known as demerit goods.

Externality : Uncompensated effect of an activity on a third party who may neither be a producer nor a consumer of the activity.

Intervention : An action intentionally carried out to sustain an activity or resolve an issue between two parties engaged in an activity.

Market : An arrangement, actual or virtual, facilitating voluntary exchange between two parties.

Market Power : Ability of a firm (or a group of firms) to dictate prices or quantity of goods and services i.e. keep prices above or quantities below the level that would have prevailed under competition.

Merit Goods : Goods that are seen as being useful to consumers, but may not be appreciative and their consumption is generally encouraged by society or government.

Ownership : A bundle of rights over a real, financial, or intellectual property, which can be separated and held by different parties.

Private Goods : Goods that are rival in consumption and consumers can be excluded with ease are called private goods.

Public Goods : Goods that are non-rival in consumption and consumers cannot be excluded altogether are public goods.

Regulation : A directive, law, or rule maintained by an authority to control an activity or process.

State : A human institution of organised political community or body politic.

6.11 REFERENCES

Books on Microeconomics, Public Finance, and Environmental Economics which include relevant chapters, would be good enough for the Unit. www.britannia.com and www.tutor2u.net could be websites among those which can be consulted. Constitution of India contains reasons for intervention in market in Part IV and Part XI– particularly Chapter I. For swings in the relative importance between market and State and changing complexion of the relationship between the World Development Reports of 1996 and 1997 would be an interesting read. However, one can profitably read following books/articles for advanced understanding:

1) Francis M. Bator (1958). The Anatomy of Market Failure, Quarterly Journal of Economics, Vol. 72, No.2. Available on internet.

2) Bernard Salonie (2000). Microeconomics of Market Failure, The MIT Press, Cambridge, Massachusetts.

3) Gordon Tullock et al. (2002). Government Failure: A Primer in Public Choice, Cato Institute, Washington.

4) Clifford Winston (2006). Government Failure versus Market Failure: Microeconomics Policy Research and Government Performance, AEI-Brookings Joint Centre for Regulatory Studies, Washington.

6.12 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) Government is only one component of State, other being People, Territory, and Sovereignty.

2) State word is also used for the constituent units of a State as it has practically all elements of State as defined in Political Science, the difference in some contexts being that 'sovereignty' being replaced by 'autonomy' in their designated spheres. States may be clubbed with Union Territories in certain references in India.

3) Market may mean the whole economy or its size, generally measured in terms of GVA. It may have broad types such as goods market, labour market, etc. But then, it has microeconomic connotation of market for a particular good.

4) Existence of private property or still better alienable property and laws of inheritance.

Check Your Progress 2

1) Production, provision, promotion, protection, restriction (on price, quantum or standards), regulation (on labour or environment), control and sharing information.

2) Agency, association, authority, bureau, board, committee, commission, corporation, council, foundation, institution, office, organisation, society or trust.

3) Price, quantity, and standards.

Check Your Progress 3

1) Existence of public goods, externalities, incomplete information, market power, merit/demerit goods.

2) Social cost is higher than private cost as part of the cost born by some third party. Social benefit is higher than private benefit as some benefit accrues to a third party.

3) Goods that are preferred by consumer but are discouraged for consumption by others in consumer's interest.

Check Your Progress 4

1) Efficiency mimics with equilibrium price and quantity in perfect competition. In markets where it does not obtain equilibrium price is higher but equilibrium

quantity is lower. As a result, there is some deadweight loss. Efficiency interventions try to reduce them. Equity intervention seek to disturb market equilibrium as its outcomes are perceived to be injurious to certain interests—say, labour.

2) Pegging wages at more than equilibrium level is likely to create surplus labour as supply quantity increases while demand quantity decreases. It might result in lower income to wage earners.

3) Enhancement of entrepreneurial skills is likely to improve entrepreneur's income.

Check Your Progress 5

1) Article 39(b).
2) Seventh Schedule of the Constitution under Article 246.
3) Both Parliament and State Legislature can legislate on the subject. Should there be a contradiction, legislation by Parliament shall prevail.

Check Your Progress 6

1) Intervention is welcome while interference is resisted.
2) Rent-seeking, regulatory capture, pursuit of self-interest, and irrational electoral demand.

APPENDIX 6.1

An attempt to map subject areas across three lists of VII Schedule

Subject-matter	Union List	State List	Concurrent List
Land and Property		18	6
Agriculture		14	
Animal Husbandry		15, 16	17
Irrigation		17	
Fisheries	57	21	
Forests and Wild Life			17A, 17B
Mining	6, 53, 54, 55	23	
Industries, Factories, etc.	7, 52, 58, 59	24, 27	18, 33, 36, 37
Industrial Disputes	61		
Trade and Commerce	41, 42	26	33
Banking, Money Lending, etc.	45, 46	30	
Insurance	47		
Communication (Transport)	22, 23, 24, 25, 26,27,28,29,30,	13	31, 32
Electricity			38
Intellectual Property	48		
Trading corporation	43, 44	32	
Gas and Gas Works		25	
Monopoly, Combinations, etc.			21
Trade Unions, Social Security			22, 23, 24
Price Control			34
Economic and Social Planning			20