

CHAPTER - III

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# ROLE OF THE STATE

### INTRODUCTION

In modern economic development process in both developed and developing economies the role and functions of the state have played a very significant part. Post 1930 depression period in capitalist economies witnessed the emergence of welfare state. In developing nation in early 1950s process of planned economic development led to crucial role being played by state in the process of financing investments and expanding the public sector to develop the heavy industrial base and the necessary socio-economic infrastructure for facilitating industrial and agricultural development. Globalisation and NEP do reduce the role of the state but in developing countries like India, the state still holds the centre place in regulating, planning and supervising private sector along with its social welfare commitments to the weaker section in society. It is again this background that one has to critically examine the changing role of state especially in developing economies as the nature of the role of the state largely determining the public expenditure growth and composition in the Governments budgetary operations.

### CLASSICAL VIEW OF STATE FUNCTIONAL ROLE

All classical economist from Adam Smith to J. S. Mill and others were strong believers in the 'natural law' and had a firm faith in the

allocative efficiency of the free market system which would maximise national production and bring about full employment. So, they propounded the doctrine of laissez-fairs, which limited the role of the state of government in economic activity. Adam Smith's *Wealth of Nations* attacked the fundamental roots of Mercantilist doctrine.

In his book 'Treatise of taxes and contributions', Sir William Petty begins by giving a list of the functions of the state which call for public expenditure – a list which was later to reappear with slight changes in many of the classical writing. In the list of state or government function he includes military and defence functions, the administration of justice, religious and other education care of the impoverished and the in-capacitated and the unemployed and the construction and maintenance of roads, bridges, navigable rivers, ports, etc. which are conducive to the general welfare of the community as a whole.

Adam Smith's views on the appropriate role of the state in economics affairs can be inferred from the economic principles that he propounded in his writings but Smith's did not leave them to be implied and stated them explicitly. Book IV of the 'An Enquiry into the nature and causes of the wealth of nations' system of political Economy and most of this book discussed the mercantile system the most of the book discussed the all system either of preference or of restraint. Therefore, being thus completely taken away. The obvious and simple system of natural liberty established itself on its own accord. Every man as long

as he does not violate the laws of justice is left perfectly free to pursue his own interest his own industry capital into competition with those of all other man, or order of man. The sovereign is completely discharged from a duty in the attempting to perform which he must always be exposed to innumerable delusion and for the proper performance of which no human wisdom could even be significant, the duty of superintending the industry of private people and of directing it towards the employments most suitable to the interest of the society.

According to the system of natural liberty, the sovereign has only three duties to attend to, three duties of great importance indeed but plain and intelligible to common understanding. First the duty of protecting the society from the violence and invasion of other independent societies secondly, the duty of protecting as far as possible, every member of the society from the injustice or oppression of every other member of it and thirdly, duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual or small number of individuals, to erect and maintain, because the profit could never repay the expense to any individual or small number of individuals. Though, it may frequently do much more than repay it to a great society.

Among the government services, which Smith does not believe can be conveniently paid for by those directly concerned is the administration

of justice since obvious abuses can result from such financial arrangements.

J. B. Say propounded the famous 'Laws of Market', which stated that 'supply creates its own demand', that the whole economy was self-adjusting. Hence, minimum of state action and government intervention was suggested. J. B. Say in his own works considers the functions of government in connection with his analysis of public finance unlike Smith.

J. S. Mill's theory of state action is in fact an application of his utilitarianism which is identical to that of J. Bentham 'the admitted functions of government enhance a much wider field than can easily be included within the ring fence of any restrictive definition and it has hardly possible to find any ground of justification, common to them, all except the comprehensive one of general expediency. This statement is supplemented by a declaration in favour of Laissez-Faire "Letting alone in short should be the general practice every departure from it unless required by some great good or a certain evil.

Principles and political economy in the book Mill studied the general functions of government and stated certain reasons for limiting its roles.

1. There is a part of the life of every person who has come to years of discretion within which the individuality of the

person ought to reign uncontrolled either by an other individual or by the public collectively.

2. Every increase of the functions devolving on the government is an increase of its power, both in the form of authority and still a more in the indirect form of influence.
3. The great majority of things are worse done by government than they would be done by private individuals who are interested in them.

It would be wrong to classify the classical economy as die-hard defenders of Laisser-Faire. Their attitude towards Laisser-Faire was relative and conditional. As J. F. Mill put it, "the admitted function of government embrace a much wider field than can easily be included within the ring fence of any restrictive definition and it is hardly possible to find any ground or justification common to them all except the comprehensive one of general expediency.

Thus the basic role assigned to the state or government by the classical economists were defence, justice and provision of basic infrastructure in the form of roads, canals, harbours, light houses and other requirements such as coinage and the post office as well as provision of such matters as the regulation of mortgages and the levying of taxes designed to discourage undesirable leases.

Classical economist viewed a number of areas where state intervention was definitely undesirable notably in price fixation, regulation of industries, taxation of food commodities, restriction on monopolies etc.

### **NEO-CLASSICAL VIEW**

Neo classical economics was the emergence of the welfare theory and its applied utilitarian ideas over the entire range of functions. A. C. Pigou is particularly identified with welfare theory defined it as that composition of production such that no alternative output which could be obtained by means of reallocation among the various industries of the economy resources would leave the community better off than before. Pigou stated that the private market relationship would by itself achieve ideal output, If an only when private market relationship departs from 'ideal output' than state intervention was justified such as

1. When markets were organised on monopolistic rather than competitive lines then there would be misallocation. Hence, a tax on monopoly by state was favoured.
2. In the case of externalities, state subsidies, or even public ownership was favoured e. g. education and transport facilities.
3. Public goods such as radio, telecommunications etc. state provided.

## MODERN VIEW

The depression of the 1930s focused attention on the weaknesses of the classical theory and the myth of Laisser Faire. It proved that self adjusting economy based on private market mechanism failed to operate. In this context, J. M. Keynes's book 'The General Theory of Employment, Interest and Money' provided a scientific base for determining the functions of the government.

The classical theory based on the assumption of full employment, perfect competition etc. The social policy favoured was absence of state control of private enterprises. They further believed that the pricing system was the unconscious planning mechanism. They accepted full employment on the basis of 'Say's Law of Market'. The classical justification of full employment as normal rested on the assumption that income was spent automatically hence all income are spent partly for consumption and partly for investment.

Keynesian attacked the classical idea. He did not demolished their assumption after Keynes it was accepted that neither there could be a shortage of purchasing power in the economy and that wages nor interest rates reached usefully to correct it. A reduction in wages would merely reduce purchasing power that is aggregate demand, in the absence of sufficient demand, even the lowest interest rates would not encourage investment, and stagnation would persist.



The principle of effective demand occupies a pivotal place in Keynesian analysis. Total employment depends on it and it in turn depending upon consumption function and investment function. In the brief, Keynes opined that the state must assume responsibility for stabilizing and expanding, employment and national income. He sought a means of prosperity through monetary expansion, public investment and other form of state activity.

Keynesian analysis revolutionized practical policies and made state participation and intervention the fulcrum of economic policy. It was made the state responsibility to ensure full employment, regulate economic activity and promote social justice.

Later economists following Keynes A. H. Hansen, N. Kaldor, R. G. Musgrave, J. K. Galbraith etc. further expanded and developed Keynes idea. A. H. Hansen in his 'Fiscal Policy and Business Cycles' explained with statistical proof of growth of state activity as regards public works, transport, railway etc. Prof. R. A. Musgrave developed his multiple theory of budget determination. He gave the state the following functions.

1. The service or want satisfying function. ✓
2. Income transfer or distributional function. ✓
3. The stabilisation function.

Thus, we see that the need to provide overall management of the economy has greatly increased the role of the state in the modern

economics system. This has called for an intensification of traditional function and growth of new functions promotional, developmental economic basis.

### **ROLE OF STATE IN DEVELOPING COUNTRY**

In our country, relative importance of the state activities is on the increase take case of India. One way in which the importance of the government activities in our own economy may be judged is by looking at the financial transactions of the government. In a domestic developing country like India, which has adopted planned mixed economy implies that the decision making processes covering economic activities are shared between private and public sector. The constitution of India through its directive principles of state policy require that the state take up necessary welfare measures which would satisfy fundamental human urges since the beginning of the planning period to grow side by side growth and direction of production, channeling of resources etc. are main economic responsibilities of the state has been given a greater weightage.

Accordingly the role of the state expenditure not only in terms of its participation in economic activities but also terms of its protection and regulation in various ways. This, therefore, call for a set of carefully planned monetary and fiscal policies and proper co-ordination between them. Fiscal operations to maintain economic stability is also important fluctuations in economic activities can be cushioned by appropriate taxation and spending policies.

In underdeveloped country however, the fiscal origins of the state have the crucial role to play in mobilization of resources for capital formation and investment, which are important for growth.

We see that no economics is there without a public sector each is a mixed economy with varying proportions of private and public sectors. Therefore, the optimum level of government activity is quite a high one.

Welfare role of the state too is important which bring about redistribution and equity. The state has to provide for public wants and goods, education development of economic infrastructure and social overhead. Welfare scheme like public health, public education, employment guarantee scheme, food and works programmes etc. are obligatory for a modern state to undertake for the upliftment of the poorer sections of the community.

In the process of planned economic development in India the role of the state both central and state government was crucial. The public sector played the major role as far as development of socio-economic infrastructure, development of heavy industry and basic industry base of the economy was concerned. Development of transport system, rail and roads, irrigation, electricity generation etc. Was a state activity, which necessitated rising public expenditure both revenue as well as capital expenditure. In addition, the welfare function necessitated special target oriented programmes aimed mainly at poverty reduction and employment generation. Subsidy food agricultural input and credit also led to growth

of public expenditure. Fiscal policy followed being expanding in nature led to rising public expenditure and growth in deficit financing and debt liabilities of the government both central and states. With in caption of new economic policy stress on reduction of fiscal deficit has led to some degree of expenditure control. By and large expansionary role of state promotion, developmental and welfare role has led to governments increasing public expenditure in India.

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