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THE ROLE OF GOVERNMENT IN THE ECONOMY FIFTY YEARS AFTER KEYNES

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SUMMARY

J.M. Keynes pointed out the great possibilities open to government in regulating economic life. The problem of great unemployment in his time being possible to resolve in his interpretation, by a governmental increase of effective demand, in the first instance by public works. Although the government today can, by stimulating effective demand, considerably influence economic movement, its role in contemporary economics has changed. The direction of governmental involvement should be directed towards human capital, scientific research, the advancement of the infrastructure, creating the best environment in which the enterprising spirit can flourish, the stability of economic movement, the growth of overall productivity for the factors of production, and for advancing global competition.

INTRODUCTION

The question of the role of the government in the economy has been the subject of many discussions. Keynes's interpretation pointed out great possibilities for the government in regulating economic life. Since the Keynesian 'revolution' the government has been responsible for the overall functioning and the effect of the economic system. It is true that different opinions and discords existed and still exist today about the measures which a government should apply, but all economists agree that the government is responsible for the overall effect of the economy.

This paper will consider the role of the government with regard to the economy fifty years after Keynes. Specifically, the role of the government according to Keynes's interpretation will be considered, in order to try to define then the areas in which the involvement of government in contemporary economics can be revealed. It will also be considered whether this role and directions of action are equal to those in Keynes's interpretation, and what is the specific role of government in the developing countries.

1. THE ROLE OF GOVERNMENT IN KEYNES'S INTERPRETATION

The inevitability of governmental intervention in the economy is usually implied by the expression 'Keynesian economy' and it consequently implies some rules in the running of economic policy. However, Keynes's most important work "General Theory of Employment, Interest and Money" devotes a very small space to the implementation of that theory in the running of the economic policy. The reason is probably that policy ought to be determined for specific circumstances; while theory covers a broad circle of circumstances.[1] Keynes was aware of this and he always believed

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[1] V. Chick, *Macroeconomics After Keynes - A Reconsideration of the General Theory*, The MIT Press, Cambridge, Massachusetts, 1983, p. 316.

Keynes states, in the preface to the General Theory that the main aim of the book is to deal with difficult questions of theory, and only the second-rate intention is to apply this theory to practice. - J.M. Keynes, *The General Theory of Employment, Interest and Money*, Croatian translation - *Opća teorija zaposlenosti, kamate i novca*, CEKADE, Zagreb, 1987, p. 13.

In fact, the General Theory gave less space to a systematic discussion about the questions of economic policy than any other Keynes's book. - A. Leijonhufvud, *On Keynesian Economics and the Economics of* that ideas could and should be adapted to a specific practice.[2] However, *the fact is that the appearance of J.M. Keynes and his macroeconomic theory meant a break with the classical view about the inevitability of balance under the conditions of full employment, and that it opened wide the possibility that the government ran a macroeconomic policy of stabilization.*

The post-war period was marked in the majority of economies by strong governmental legal regulations, the strengthening of the public sector and operations in the open market, which meant a strong role for the government in regulating economic flows. The monetaristic approach has tried to prove, since the seventies, the inevitability of decreasing governmental intervention in the economy through the narrowing of its legal interference, privatisation of the public sector and the elimination of the budget deficit. The fact should be born in mind here that the breaking of illusions about "Keynesianism" was caused by the fact that Keynesian policies were used for a world for which they had never been intended.[3] Just because of that, it is necessary to remember for a moment the problem J.M. Keynes tried to resolve, and consequently the role of the government in his interpretation.

Keynes was working at a time when an emptiness or vacuum appeared in economic thought, that is to say when it was impossible to explain and to resolve the economic imbalance which occurred after the First World War. The central problem he tried to explain and resolve was unemployment, which was high for more than a decade without any sign of its decreasing. The granting of priority to decreasing unemployment, and not to other macroeconomic aims, as the stability of prices and economic growth, defined the role of the government, i.e. a new direction of economic policy. Namely, that government should participate actively in the struggle against unemployment, whereas a monetary policy, under the conditions of high unemployment, is completely ineffective in increasing employment. Thus that the choice is in an expansionist fiscal policy,

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Keynes, Croatian translation - *O kejnezijanskoj ekonomici i ekonomici J.M. Keynesa*, CEKADE, Zagreb, 1983, p. 268.

2 R.Kahn, Selected Essays on Employment and Growth, Cambridge University Press, London, 1972, p. 103.

3 V. Chick, the same work, p. 317.

or more exactly, in government spending or public works, financed by budget deficit, that is to say by new money. How did Keynes come to this solution? We can examine this shortly and simply in two ways.

First, according to quantitative theory, demand for money consists of transactional demand and precautionary demand. Keynes, in his monetary interpretation, adds to this the third element - speculative demand conditioned essentially by the interest rate. Thus the demand for money is divided into active demand, indispensable for transactions and/or precaution and inactive demand intended for speculations. Active demand depends on the level of the overall income of the economy whereas the inactive demand depends on interest rates. At low interest rates, expectations will be linked to the rise of rates and the fall of bond prices which, with the probability that the income from bonds will not be sufficient to abandon the precaution of keeping money in cash, leads to a high speculative demand for money and to a low keeping of bonds (scheme of preference of liquidity). Besides, interest rates would be quite low during periods of depression. Speculators would be unwilling to keep tied up reserves so that their demand for money would absorb every amount on offer. Every increase in the offer of money would be balanced by a corresponding increase in demand, and interest rates would not fall. In such a case a monetary policy would be totally inefficient.[4] From such an interpretation, it follows that a situation is possible when there is unemployment and a surplus of capacity in the economy, and, as a monetary policy cannot resolve that problem, a fiscal policy and public investment become a necessity.

Second, in order to increase employment, it is necessary to increase effective demand and that is possible in two ways - by increasing the inclination to spend (which might be obtained by the redistribution of income) or especially by the increase of investments.[5] Investments can be advanced in two ways - by the increase of a marginal efficiency of capital, which really means the

4 See more in detail - E. Screpanti, S. Zamagni, *An Outline of History of Economic Thought*, Clarendon Press, Oxford, 1995, pp. 268-269.

5 V. Chick, the same work, pp. 317 - 318.

increase of profit expectation, or by a lower interest rate. When demand cannot be increased in the above mentioned ways (for example, when interest rate is low enough, as it was then), the only possibility is to fill the gap between potential output and current demand with government spending. Keynes was very clear regarding the financing of government spending, i.e. public works. The source for that is *new money*. The effect of spending would be an increase of employment and a decrease of the expenses of compensation for unemployment. The demand would be further increased by the effect of multiplicator as well as employment, and, if income would grow sufficiently, taxes might rise as well and the deficit caused by financing would not be as expensive for the government as it might seem. On the other hand, the effect on prices would be minimal at the very low level of output.

Besides, the growth of income can change the expectations of the investors, who might then increase their investments.

The derived estimate that fiscal policy is successful unlike a monetary one, is not given as a general principle because every element in such an approach depends on the actual situation in various economies.

Accordingly, the government comes into play temporarily, when it is necessary. Keynes tries to prove that there are fields of activity in which private initiative is indispensable and in which the government should not interfere, but also there are activities in which the government acts more efficiently than the private sector.

Keynes had already pointed, in his lecture in Germany in 1926, to the indispensability of government intervention, specifying that the technically social services should be separated from those which belong technically to the sphere of action of an individual. The most important agenda of the state are not those belonging to the scope of action of an individual, which he already fulfils, but those functions which are outside that scope, which nobody fulfils and which nobody will fulfil if the government does not take them over. It is important that the government does not do what individuals have already been doing, whether it does better or worse than an individual, but that it does what, at the present, nobody does.[6]

The role of the government expands to the mutual adaptation of the inclination to spend and of the encouragement to invest. Keynes emphasizes in his General Theory that such expanding of the role of government might seem to some as a great straitening of individualism. However, he defends this as the only feasible way of avoiding the destruction of the entire existing system of economic practice, but also as the condition for the successful entrepreneurial activity of the individual.[7] An active role of government does not, by any means, cause an overall suppression of the market mechanism. With the intervention of state authorities to harmonize the inclination to spend, with the attractions of investment, there are no additional reasons for the socialization of economic life.[8]

Keynes emphasizes that the ultimate goal should be the choosing of those variables which central government can control consciously, and govern them, and that, in the kind of society we live in.[9] That means that government intervention is indispensable to save the whole system, and the choice of variables depends on their effectiveness and applicability in the given situation.[10] It is normal to discuss the effectiveness of various variables. So monetarists point out the key role of regulating the money mass, while orthodox Keynesians indicate government spending and the level of investments. These differences are of less importance in reality. As F. Modigliani points out,[11] these differences are of secondary importance and they can be reduced to the emphasis and

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6 J.M. Keynes, *The End of laissez-faire*, Croatian translation - *Kraj laissez-fairea* in J.M. Keynes, *Izabrana djela*, Privredni vjesnik i Matica hrvatska, Zagreb, 1994, p. 79.

7 J.M. Keynes, *Opća teorija ...* p. 214

8 The same work, p. 213.

9 The same work, p. 145.

10 Marx was the intellectual prophet of capitalism as a self-annihilating system, and J.M. Keynes was the engineer of its renewal - R.L. Heilbroner, L.C. Thurow, *Economics Explained*, Croatian translation - *Ekonomija za svakoga*, MATE, Zagreb, 1955, p. 33.

11 F. Modigliani, *The Debate Over Stabilization Policy*, Croatian translation - *Rasprava o stabilizacijskoj politici*, CEKADE, Zagreb, 1991, p. 17.

not to the principle. Basic and most important differences in an attitude towards the need for a stabilization policy and the right role of the government do not come from *analytical differences*, but they can be primarily connected with the differences in *empyrical estimates* of the value of some crucial parameters of the system, and, in the same measure, with differences in *social attitudes and views.*

We have to bear in mind also that Keynes's General Theory was, above all, a tract about the Great depression[12] , and that Keynes did not give general sign-posts for the functioning of the economy, neither did he give the programmes of future development. It is true, he emphasizes, in his essay "Economic Prospects of Our Grand-children" in the periodical "The Nation and Athenaeum" in 1930, that economic problems are not a permanent problem of humanity and that the chances are that it may be resolved in some hundred years[13] (which forecast, after more than sixty years, proved to be unrealistic). But the fundamental thing in his work is the explanation and the solution of the problem which faced humanity at that time, and that is unemployment. His General Theory rests on five key suppositions founded in the world as Keynes looked at it, and we have to note whether our world is significantly different. These suppositions are: 1) unemployment is a rule; 2) there is wide stability of prices; 3) the availability of money is completely inflexible; 4) resources of capital and technique are given; 5) population does not increase significantly; 6) the resources of capital are insufficient.[14]

The role of government fifty years after Keynes has changed essentially. The government does not behave as a temporary agent in action when it is necessary but participates in production on a long-term basis. Beginning with the government which increases effective demand by government spending, i.e. by public works, the role of government in contemporary economies has expanded in several fields.

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12 J.K. Galbraith, *Economics in Perspective - A Critical History*, Croatian translation - *Ekonomija u perspektivi - kritička povijest*, MATE, Zagreb, 1995, p. 197.

13 J.M. Keynes, Izabrana djela..., pp. 87 - 88.

14 V. Chick, the same work, pp. 354 - 355.

2. INVOLVEMENT OF THE GOVERNMENT IN CONTEMPORARY ECONOMIES

The market is not the only and almighty regulating mechanism that obtains optimal results and gives answers to the basic economic questions, how and for whom to produce. *It is able to do this only if some very restrictive preconditions are fulfilled.* These preconditions are necessary for the unity of interests at various levels and for the concordance between individual and social optimum, and they refer to tastes, resources and competition.

Namely, the following preconditions must be fulfilled for the effective action of the market as an automatic regulator of the economic system: the quantity of disposable resources, technology and tastes are given as a constant; demand is the result of real social needs; declining growths dominate in production, i.e. there is no economy of scales: the producers seek to maximalize both the profit and the consumer's usefulness within the limits of disposable income; conditions of total competition reign in the market. These preconditions are generally not fulfilled in reality. Further, there is a *dynamic inefficiency of the market* the result of a lack of harmony between the time of making decisions and the time of obtaining their results so that market information is reliable only on short-term basis.

Besides the above mentioned, there are such situations where the market fails, even in perfect conditions, as the allocator of resources, i.e. there are cases which the market mechanism cannot resolve by definition, and they are known in literature as "*market failures*". Two such cases are the phenomena which prevent the re-establishment of balance (indivisibility of factors and products, and the economy of scales), and another two are the phenomena bringing about unoptimal balance (externalities and public goods).

Precisely due to the above mentioned drawbacks of market mechanism in the allocation of resources in all contemporary economies, a simultaneous acting of the market mechanism and government intervention is necessary. Additional regulation, in tandem with the market, is necessary for the success of economic systems, and therefore the involvement of government is of special importance.

We can speak generally about *three economic functions of government*, and that in advancing efficiency, equity and stability.[15] The government fulfils its function of advancing efficiency seeking to correct market imperfections and failures, whereas, by advancing equity, it seeks to correct great income inequalities which are unacceptable either morally or politically. The government fulfils the function of advancing stability, that is to say curbing inflation and unemployment and increasing economic growth, in the first place by fiscal and monetary policy, where the theory of J.M. Keynes remains one of the fundamental approaches (especially if we keep in mind specific countries in specific circumstances).

The question can be asked: How actively should the government participate in economic life, i.e. in which direction is its involvement most desirable?

The experiences of the seventies and eighties demonstrate that governments that tried to take over key points in their economies have shown a descending trend and a stagnation of growth. Conversely, higher rates of growth were obtained by those countries where the intervention of government in the economy was less, with the outstanding examples of the "four tigers" of East Asia: Hong Kong, Singapore, South

Korea and Taiwan. Consequently, government administration should abandon its function of the production and allocation of goods and services - those activities which are best fulfilled through market competition. Governments should try to create a free market environment in which the government allows free action of the

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15 This division can be found in the introductory set-books from economy - see for example P.A. Samuelson, W.D. Nordhaus, *Economics*, Fifteenth Edition, International Edition, McGraw-Hill, Inc., New York, 1995, pp. 30 - 35.

The traditional role of the government in a market economy revolves around five tasks: providing certain goods and services such as national defense, raising taxes to pay for these services, redistributing income, regulating business, and making and enforcing the law. - W.J. Baumol, A.S. Blinder, *Economics - Principles and Policy*, Sixth Edition, International Edition, The Dryden Press, Fort Worth, 1994, p. 42.

market, intervening efficiently only when and (where) the market proves to be inadequate.[16]

The experience of growth in various countries proves the importance of six factors of growth (accumulation of capital; human capital; research, development and innovations; management and organization; physical and social infrastructure; allocation of output between immediate production sectors), pointing out also the role of stimulating the process of growth by competition and the possibilities for government action, for example in itscare of education and physical and social infrastructure. However, theory and experience show less that public ownership of the means of production is an indispensable or useful element.[17]

Consequently, *the involvement of the government is of special significance in relation to human capital, scientific research, improving the infrastructure (physical and social), creating the best environment for encouraging enterprising spirit, stability of economic movement, growth of the overall factors of productivity and the advancement of global competition.*[18]

Normally, this is a general consideration and claim. The fact is that there are differences in the size of the involvement of government measured by the percentage of the gross domestic product (GDP) in various countries. In some countries, the

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[16] See the interpretation in S. Jurin, *Strategija gospodarskog razvoja Republike Hrvatske*, Ekonomska misao i praksa, Dubrovnik, 1/1992, p. 31 -32.

[17] N. Stern, *The Determinants of Growth*, The Economic Journal, Vol. 101, No. 404, January 1991, p. 131.

[18] In the OECD and EU economies, it is now generally accepted that industrial policy should not get involved in the market mechanism, instead it should increase the market's efficiency through horizontal policies. Horizontal policies are those which seek to increase the quality of important production inputs (education, research and development, telecommunications, etc.). Through such measures, policy makers in these economies seek to improve the general economic environment and produce effects benefiting all market agents. Such a market-oriented industrial policy does not threaten the allocation of resources and reduces state intervention to its lowest possible level. - M. Kesner-Škreb, *Intervencija države u poticanju gospodarske aktivnosti u tržišnim privredama*, Summary of Research Results, Financijska praksa, Zagreb, 5/1995, p. 387.

government is generally occupied with legal structure and some goods and services, such as roads and national defense, difficult to provide in the private sector. On the other hand, the government in some countries is involved in all kinds of activities from the management of air companies, hotels, theatres, radio and television to the production of iron. So the government expenditure (percentage of GDP) in 1991 was in Sweden 62,1 %, Holland 58,6%, Denmark 57,6%, Italy 51,5%, Austria 51,1%, Belgium 50,8%, Greece 49,6%, France 49,4%, Finland 45,0%, United Kingdom 41,6%, Australia 36,9%, the United States 34,2%, Japan 33,0% and Switzerland 31,0%. The share of government expenditure in GNP was significantly less in the countries of East Asia, which witnessed a significant growth during the last decades, and it amounted to 22,2% in Singapore, 21,8% in South Korea, 16,5% in Thailand, and 14,6% in Hong Kong.[19]

However, it is also a fact is also that the process of reprivatisation, both of state enterprises and great public systems (particularly in traffic and communications) has been present, since the eighties, in some developed countries - notably the United States, France, United Kingdom.[20] The experience of these countries shows that private firms are more efficient than public ones, and consequently that the government should abandon the function of production as it is best materialized through market competition.[21] *The government should withdraw from the economy*

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19 According to J.D. Gwartney, R.L. Stroup, *Economics - Private and Public Choice*, Seventh Edition, The Dryden Press, Fort Worth, 1995, p. 137.
It is interesting that the total government spending in the United States in 1929 amounted to 10,1% of GDP, whereas, in the period between 1930 and 1970 it rose significantly, and in 1970 it amounted to 30,8%. Since then the share has continued to rise but at a slower rate and, in 1993, it amounted to 34,4% of GDP.- The same work, p. 115.

20 Since the eighties, almost fifty og the biggest businesses in the United Kingdom have been privatized. See the data for the period between 1979 and 1995 in S.J. Bailey, *Public Sector Economics - Theory, Policy and Practice*, Macmillan, Houndmills, 1995, pp. 291 and 296 - 297.

21 Although, one should bear in mind here, that there are numerous methodological difficulties in comparing the efficiency of nationalized

as the basic allocation mechanism, i.e. the greatest owner and entrepreneur, and the focus of economic policy should be transferred from a short-term regulation of the amount of spending to the structural effects on the side of offer, including the already emphasized help with education and investment in human capital, advancement of the physical and social infrastructure, stimulation of research and innovation, and the creating of the best environment for the development of the enterprising spirit and the stability of economic movement.

3. SPECIFICITIES OF THE ROLE OF THE GOVERNMENT IN DEVELOPING COUNTRIES

The role of government in the economic development of developing countries is the theme of many discussions. Theoretical work after the Second World war pointed out the main role of government in the promotion of industrialization through planning and direct involvement in the process of production (there are such views even today). The justification for such an approach was that market failures in the developing countries were on the increase and that government had to substitute for the market in numerous ways.[22] Much later, opposite views appeared which minimized the role of the state. However, on the basis of theory and experience, it can be proved that the role of the government cannot be minimal. Only, one question arises: In which fields should the direction of its actions be orientated?

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industries and private companies, so that it is not easy to make such judgements. Besides, political, social, industrial and economic conditions relevant for each industry are not directly comparable at the time of enforcing nationalization and at the time of privatisation. Also, the criticism that the monopoly of the public sector is transformed, by privatisation, into a monopoly of the private sector is not not necessarily true, because a change in the market structure cannot occur overnight. The fact is that the effect of privatisation depends on the form of regulation, and on the development of technology and market structures. See the same work, pp 302 - 306.

22 See R. Grabowski, M.P. Shields, *Development Economics*, Blackwell, Cambridge, Massachusetts, 1996, p. 267.

Before we considere this, we should bear in mind that it is the general view of the role of government in the developing countries. The fact is that developing countries differ from each other in many things. 85% of the world population live in the developing countries, and they earn only 22% of the world income. In 1992, gross national product (GNP) per inhabitant in the 37 poorest countries was in average $ 390 only, and in the 23 richest countries $ 22.160, while the average life expectancy in the 10 poorest countries of the world was 48 years, and in the 10 richest ones 77 years. However, there are great differences within the poor countries, so that, for example, GNP per inhabitant in India is $ 310, Bangladesh $ 220, Ethiopia $ 110, and in Mozambique only $ 60.[23] Besides, various countries differ in the level achieved of industrialization, the existence and size of the market, the development of infrastructure, health protection and so on, which largely conditions the direction and the weight of government action in various countries.

Generally speaking, the role of the government cannot be minimal, but it is certain that the main direction of its activity should not be in production but in the fields of health care, education, protection of the poor, infrastructure (physical and social), and in management and organization, i.e. in securing such an environment which will stimulate the spirit of enterprise . These directions of action, as said above, are valid for all contemporary economies as well, only they should have more strength in the developing countries.[24]

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[23] The data are given according J. Sloman, *Economics*, Updated Second Edition, Prentice Hall - Harvester Wheatsheaf, London, 1995, p. 1036 - 1037.
The differences in GNP per inhabitant need not be the main indicator of the situation in various countries. Thus, in China, with $ 470 per inhabitant the life expectancy is 70 years, and the rate of child mortality 31 per thousand, whereas, in Brazil, with $ 2.770 per inhabitant, the life expectancy is 65 years and the rate of child mortality 61 per thousand - according the same work, p. 1036, and G.M. Meier, *Leading Issues in Economic Development*, Sixth Edition, Oxford University Press, New York, 1995, p. 549.

[24] Although the experience data for 1986-1987 show that developing countries show less attention to health care and social security than developed countries (seen as the percentage of the total state

A lack of infrastructure, together with weakness of management and economic organization, influence - probably significantly - a low productivity of the factors in developing countries. It is difficult to expect an efficiency of the factors and businesses in those countries where the supply of electrical energy and water is unreliable, telephone and PTT services weak, and the traffic slow and dangerous. Social infrastructure has a special significance referring more to the way the business is run than to the human capital (in the way of literacy, knowledge etc.). A system without a complete business morality where individuals see the source of profit in various forms of cheating, or where bureaucracy is obstructionist, or where ownership rights have not been clearly defined, can bring about uneconomical allocation of resources, accompanied by expenses and distortions of stimuli which can be serious obstacles to growth. The weaknesses of management, organization and infrastructure can explain exactly the phenomenon of unproductive acting of scarce capital, and why some countries, as India in the sixties and the seventies for example, did not achieve higher rates of growth in the periods when they increased successfully the rate of saving.[25]

In the majority of developing countries, the systems of industrial licences, restrictions on export and import, control of prices, inappropriate legal rules regarding unemployment, the founding of enterprises and ownership rights have weakened the force of competition, slowed down technological progress and the growth of productivity.[26] We have often heard the theory that curbing the market of labour in developing countries brings about the competitive force to export in these countries, and that it is necessary by all means for a successful economic growth and development. However, the experience of the "four tigers" of East Asia shows that the high rates of growth obtained in the eighties were accompanied by an improvement of conditions in the labour

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spending), while more attention is paid to defence and general public services, education, transport and communications, and other services. See data in G.M. Meier, the same work, p. 550.

25 According N. Stern, the same work, p. 128.

26 See J. Weiss, *Economic Policy in Developing Countries - The Reform Agenda*, Prentice Hall - Harvester Wheatsheaf, London, 1995, p. 7.

market. Significant results have been obtained in achieving and maintaining full employment, growth of real wages, improvement of the structure of employment, decreasing income inequalities and lowering the rate of poverty. The economic growth produced by the rise in exports was not based on the curbing of wages, i.e. on the curbing of the labour market but, on the contrary, that growth was accompanied by an improvement of the conditions in the labour market.[27]

On the other hand, we have to bear in mind that the countries which obtained the highest rates of growth were those with the greatest rise of productivity, whereas economic growth was stagnant in the countries with only a small rise in productivity. The question can be asked: What does lead to a rise in productivity? That is surely technological progress. However, technological progress is influenced by: history, culture, the system of education, institutions and applied policies. Technology is quite broad and it is adopted through investment in physical and human capital, and through exchange. Therefore, the investment in human and physical capital + the strengthening of market competition are a significant potential source of local growth. The analyses of research undertaken on the sample of 60 developing countries for the period 1965 - 1987 connect the rise of productivity and output with education and economic policy. It shows that education of labour contributes significantly to the rise of productivity and output, as well as a successful policy of environment. Also, that besides its individual effect on productivity and growth, there is an interactional effect when education and policy are combined. Experience shows that investment in the people, together with increasing quality and quantity, is another kind of infrastructure which comprises the main part of a development programme and which is within the competence of the government: creating the best environment for the rise of productivity and the advancement of enterprising behaviour. *This comprises a list of activities in advancing the development of the market and a competitive micro economy; a clear defining and protection of ownership rights, attraction of*

27 See G.S. Fields, *Changing Labour Market Conditions and Economic Development in Hong Kong, the Republic of Korea, Singapore, and Taiwan, China*, The World Bank Economic Review, Vol. 8, No. 2, September 1994, p. 397 - 403.

capital; openness; a stable macro economy, and improving of management.[28]

And, at the end, the role of the government can be presented graphically, and it is given here to illustrate the dimensions of governmental responsibility which should enable short-term improvements of efficiency and a long-term economic growth with an acceptable level of fairness.[29]

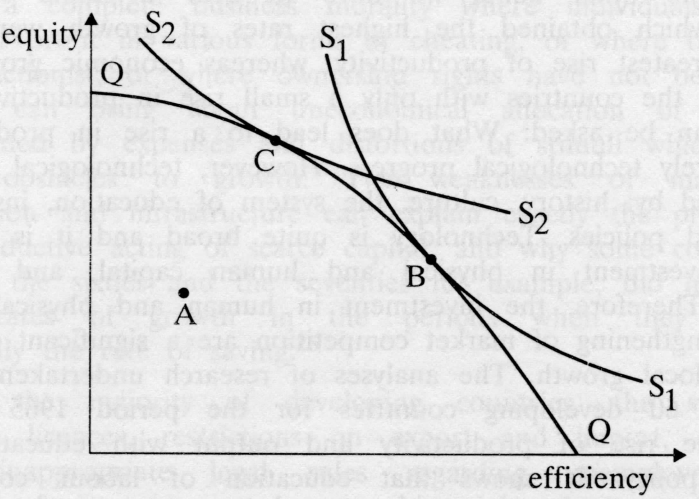

Figure 1.: The role of government - objectives and policy

In figure 1., the points on curve QQ represent a combination of positions for real income (or efficiency) and its distribution (or equity) and reflect an assumed trade-off between efficiency and equity. An economy operating with macro imbalances and micro efficiency will be at a point A that is inefficient in that it is not on the curve - frontier QQ. It will be government's role to improve efficiency by shifting to a point on QQ like B, where for a given level of equity real incomes will be higher (and thus all will be better off). In the longer term, if a government can succeed in putting the economy on a higher growth path, QQ will shift outwards. However, there is also the distributional choice to be

[28] According S. Jurin, the same work, p. 32 - 33.
[29] According J. Weiss, the same work, p. 14 - 15.

considered - that is, society's preference for equity. The curves S_1S_1 and S_2S_2 (which represent social welfare functions) are drawn as trade-offs between equity and efficiency. The curve S_2S_2 is more egalitarian since it is drawn on the assumption that relatively high income or efficiency losses will be sacrificed to improve equity by a relatively small degree. The socially optimal combination of equity and efficiency will be at the point of tangent curves QQ and SS. If social preferences are depicted by S_2S_2 it will be the responsibility of the state to ensure, by intervention, that point C is reached.

CONCLUSION

It is necessary to align the role of the government in the works of J.M. Keynes into his period and in the framework of the problems which he tried to resolve (in the first place unemployment, because J.M. Keynes did not give general sign-posts for the functioning of the economy, especially not for the future. Therefore, the role of the state which increases effective demand by state spending, i.e. by public works, as a temporary agent in situations when it is necessary, has changed in contemporary economies.

It is true, that government also intervenes today in situations when the market proves to be inadequate, and even by stimulating effective demand through government spending. However, its involvement in contemporary economies should be in a different direction. It should withdraw from the economy as a basic allocation mechanism, i.e. as the greatest owner and influence, and its involvement should be of special significance in relation to human capital, scientific research, improving the infrastructure (physical and social), creating the best environment for the flourishing of the enterprising spirit, the stability of economic movement, the rise of overall productivity vis-a-vis production factors, and the improvement of global competition.

Unlike previous views on the role of the government in the developing countries, (which pointed out the indispensability of its role in the promotion of industrialization through planning and direct involvement in the process of production), its role is basically on the same lines as in developed countries, only with a greater weight on various directions of action. It is especially necessary to emphasize its role in management and organization, and in infrastructure and health care, education and protection of the poor. Its activity should not be directed to production but to the securing of such an environment that will stimulate the flourishing of enterprising spirit. It comprises a list of activities on the line of stimulating the development of the market and a competitive micro economy, a clear defining and protection of ownership rights, attraction of capital, openness, a stable macro economy, and improvement of management.

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