

WHAT IS ECONOMIC POLICY FOR?

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Abstract

The wrong tracks of forming economic coordination and the ones considered as fortunate all suggest that different rationality types (full of conflicts) inevitably show themselves.

It is evident that for the time being the process in the course of which institutions developing over and below national states (see regions) take over functions from the states has not ended. It is also certain that these changes cannot be overcome by economic policy through definition inventions. But neither its ability to adjust can be doubted!

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Economic policy makers would, by all probability, be pleased to put the clock back to the era of Keynes for no less than two reasons. First, he was the last great theoretician to interpret economy as a whole in the light of the totality of society. Second, the applicability of the theory was, for him, equal to scientific rigour, what is more the practical problem to be solved preceded – in time absolutely! – the ‘General Theory’, to put it adequately. However, the idyllic relation between economics and economic policy is transitory. The new classicist trend of monetarism, the last comprehensive ideology following Keynes, sounded the retreat to state activity, declaring macro-economics perished. However, “governments decided to follow a ‘heterogeneous’ economic policy from that time on” (HORVÁTH–KIRÁLY, 2000, p. 122). In the meantime business world was not lying idle either. The aggregate of phenomena dating from old times and coming spectacularly to the fore in the past twenty years as a reaction to globalization, makes demands with a harsh force on economic policy formerly kept within the bounds of nations. Therefore, is our discipline (called science reluctantly) fighting for its intellectual and functional existence? No, it isn’t. Nevertheless, I think that it’s high time to start at the very beginning – even if certain professional rules are breached in some respects – what is economic policy for?

1. Communal and/or Individual Rationality?

According to the accepted text-book definition ‘economic policy means the views, resolutions, regular decisions, acts of the state, which it applies for influenc-

ing the economy to achieve its social – political goals’ (VERESS, 1999, p. 17). This clear definition is all right if interpreted in terms of instruments, treated as means and if the environment which is difficult to outline is considered the same by the think-tankers of the topic. However, if economic policy in *eo ipso*, or at least in terms of its repository, is put in issue, it is reasonable to put the provocative question (1) why does the state *have* ‘views...’, etc, and (2) why is it the *state* which has ‘views...’ etc., i.e. to question the unsaid presumptions of the definition.

For the sake of transparency let’s answer the question as early as now. As to the first version (1) of the question, the state is engaged in what is enlisted above because through all this it fulfils a duty. The answer to the second version (2) is that it is the state which fulfills the supposed duty under certain conditions.

To survey details, let’s see the example of a simple retail transaction, a model of business cooperation.¹ X (as buyer) declares his demand for the goods Z, which is satisfied by Y (as seller). The compensation – according to routine – is cash payment. What will happen (*sermo fictus*) if any of the parties radically deviates from the traditional procedure? Let’s suppose that the buyer – without any grounds! – does not acknowledge the receipt of the goods (or vice versa: the seller does the same in terms of the money). This extreme conduct, as I revert to this later, may, of course, be managed and is very rare in everyday life. The parties to the agreement reckon with consequences either consciously or in a reflex-like manner. The conditioned conduct exactly reflects that there are laws (in legal sense) even behind the most simple business transactions though this falls into the background sometimes. In the first approach, it can be stated – which is to be examined further – that the duty fulfilled is the contribution to business cooperation with related statutory regulation [ad (1)]. Considering, however, the power of the state in a modern society, the former also reflects the central role of the state [ad (2)].

However, let’s go on with intellectual provocation: is this regulation technique appropriate for cooperation? Yes, it is with certain restrictions. Its operability in the narrow sense can be maintained even in the case of extreme conduct (rarely occurring) – the retail transaction in our example can successfully be completed with the involvement of a notary public –, the problem is implied by related costs, i.e. transaction expenses. However, these costs are not unbearably high in social practice as customs can excellently substitute for the complex power machine.² These communities may be formed independently of the state, what is more, their operation does not imply costs in terms of the society. However, the question of (full) appropriateness arises in this respect, too: to what an extent may the economy rely on this regulatory instrument merely? Experience shows that this

¹The thought experiment follows the logic of situation analysis which tries to deduce certain events preliminarily determined, while it supposes that the operators of the economy are free to act (LANGLOIS–CSONTOS, 1993).

²The coercive force of customs is not slighter than that of regulations if the community forming the medium of the former is characterized by the differentiated system of personal interdependence. Of course, the connection net may imply hierarchic relations as well but this is not a necessary condition for integration (cf. FINLEY, 1985:93, pp. 113–116).

controlling method of cooperation is efficient only in terms of the so-called direct communities.³ Therefore, this also implies costs, however, their resources are different: they generate from the impossibility of expanding the cooperation.⁴

All this may suggest that the community undertook a duty, the regulation of business cooperation in good faith, which is, however, fulfilled with high costs and/or inappropriately. Isn't it more reasonable to choose a spontaneous solution? Isn't it more favourable if the separated parties of cooperation act as they like, undertaking to reckon with costs as a direct part of their calculation? The solution is not unprecedented but the limits of its applicability (proven by history) can be understood: this cooperation form is viable until the 'free rider effect' and/or the need to manage it as a result of the rise in transaction costs jeopardizes the function itself. The extreme outcome of our simple model featuring retail trade gives a good example for this possibility. The repeated and long-standing dysfunctional conduct of the buyer or the seller liquidates the economic bases of supply and demand while the parties – strictly from personal aspects and on the short run which meets spontaneous market conditions – act rationally. Likewise, the community also acts rationally when it sets the limits of business cooperation through its executive power, undertaking to bear direct and indirect costs.

To sum the thought experiment up: the economy is regulated by two types of rationality which contradict to each other, moreover, their operation is subject to different conditions. This statement, however, serves as a basis for *the functional interpretation of economic policy* which, consequently, manifests itself in two types of rationality inferring and at the same time contradicting to each other, that control business cooperation and are the principle/means/practice of enforcing both communal and individual rationality. It is the means and practice that manages the inherent conflict of the two types of rationality; it is a principle that attributes the developing balance to the procedures applied and interprets the prevailing system of intervention as a paradigm and concept of economic policy.

I am aware that my thought experiment exposes rather than proves the definition in the broad sense. By the nature of the discipline I cannot provide exact proof, however, I try to do my utmost to make my statements plausible in a way which is to some extent – as acknowledged above – a bit irregular. The procedure follows the logic of indirect proving. I'll show that even if there were economic policy concepts which (in their original versions) strove for having a single principle (enforcement of only one of the rationality types) they (a) were subjected to strict conditions, (b) through their change the concepts themselves were also necessarily changed and (c) the change in the conditions (in addition to other factors) resulted from the success of the concept logically. That is, as to the two relations between the two types of rationality ('and' or 'or') theoretically possible, the first one can be sustained (and

³Direct communities are characterized by (as compared to intellectual communities) the fact that 'their members personally know one another, they are in direct relation with one another and are situated at a point of social space that can be determined well'. (HANKISS, 1983 pp. 65–66).

⁴See the term and interpretation of 'extended (or expanded in other translation) order' of HAYEK, e.g. HAYEK, 1992.

is to be sustained in my opinion).

The outlining for the purpose of credibility is a historical parabola meaning that the changes in the form of the classic liberal paradigm, i.e. the above economic policy concept, are shown as a linear story – to make the transformation more plausible – though certain phases overlap (at least partly) in time; what is more, junction points are voluntarily emphasized in (and omitted from) this targeted process on the basis of my own aspects. Furthermore, the logical balance is damaged by the omission of the other pole, i.e. the changes in the business policy concepts of the planned economy. However, I am sure that the elimination of these shortcomings would not contribute to the achievement of our goal.

2. Economic Policy Concept of Classic Liberalism

The economic policy concept of classic liberalism will be outlined as one aimed at the enforcement of individual rationality (to be understood with the above restrictions) without any reductions. Its ideal is economic autonomy. It is a platitude of theory history that despite certain pioneers of the 17th century this intellectual horizon is scientifically grounded, however, its version generally known can be traced back to the works of the French physiocrats and the English classicists. Their trains of thoughts (or excerpts) are well-known. However, in their economic policy analyses, the historical conflicts that inspired (or could have inspired) their ideas were not given considerable attention.

As to the physiocrats, they lived to see the perish of the economic prosperity which was generated by the mercantilist concept at the beginning of the 18th century and liquidated by the same at a later date. The strict regulation producing export surplus resulted in joint interests of the social strata able to enforce their will, for the period of the boom, but it was just the high expenses of the state (of course, serving other purposes as well) which led to the status of state bankruptcy the main loser of which was the direct repository of dynamism, i.e. the citizenry. All this paved the way for the criticism by the physiocrats: economy is generated by (agricultural) production rather than exchange; the intervention (known up to that date) of the state is disfunctional.⁵ The only duty of economic policy is to levy the single land tax, otherwise: *laissez faire*.

The substance of the English classicists is the industrial revolution. This promises new energy resources, technologies, transportation, meaning that from the side of knowledge the conditions for mass production do exist. However, both the trading area and the labour market are missing. It is unnecessary to refer to market reducing factors such as the autarchy of micro-regions or physical immobility. The

⁵The English mercantilism cannot be identified with the French one. The difference is significant mainly as regards its import restriction if enforced through concession guaranteeing monopolistic power. However, following their sale the conclusion is similar: 'The government played its role, the government may leave. The hatred for certain monopolists changed into the hatred for the monopoly'. (CSILLAG–LENGYEL, 1985, p. 30).

conflict between technical and technologic opportunities and the boundaries of traditional societies is important in this respect. The *answer* is a new type of order and cooperation i.e. classic liberalism.

From the side of economic logic the preliminaries outlined above provided sufficient motivation for implementing the idea of self-government grounded on individual rationality. For the sake of entirety, however, mention should be made of the fact that the substance of enlightenment – through its criticism, i.e. partly by opposing traditions and partly by its positive program based on natural harmony – did pave the way for the extension of the idea known by us as a consistent economic policy concept. If the ethical theses of utilitarianism emphasized at that time are added to all this, the whole system becomes clear to us: the operators of the economy try to increase their own benefits to the maximum but their decisions are coordinated by the free market in a way facilitating the automatic balancing of manufacturers and consumers. As a direct consequence the economic role of the state is restricted to the protection of private property and the prevention of obstacles in the relation among business operators.⁶

Neglecting the specifications indispensable in other contexts, let me only state that the coordination mechanism based on the principles of classic liberalism proved to be long-standing and successful in terms of its operation. However, the frameworks of the market known today are not by chance entirely different from the above ones. We cannot forget about the start-up conditions which were influencing the economic system in question and which were clearly transitory though they seemed to be stable in terms of nations. In this respect reference should be made to the key role of undifferentiated mass consumption. The social environment characterized by term of ‘era of the masses’ tended to require volume from the demand side (rather than assortment and quality) in exponential progress as a result of the income feedback of increasing employment opportunities. In such a market competition is subject to the scale of economy. Therefore, the concentration and centralization in the countries of paradigms at that time are both an opportunity and pressure. Under the institutional conditions given the process is unavoidable, however, it endangers the resource of success, i.e. the free market: the economic power concentrated in monopolies undermines its own living space, i.e. the (quasi) excellent competition. A new *conflict* is generated which is a strictly logical consequence of an answer given to a former conflict. And the *answer* is a principle and a new economic policy concept partly resulting from this principle. Accordingly, economic thinking recognizes/states that the free market will reproduce the institution of excellent competition as an ideal economic mechanism only under the conditions of certain and temporary conditions; economic policy, in turn, incorporates the conscious forming of the legal/institutional frameworks of the economy

⁶We have to remember that the think-tankers mentioned above did not interpret their economic liberalism inflexibly at all. Quenay, for example, called for a state ruling with a firm hand, which – according to his categories – is able to drive the duality of the ‘natural’ and ‘positive’ order towards the former. The need for public services worded by Smith is even more known. (cf. DOBIAS, 1998, pp. 22–23).

into the duties of economic policy. However, through this, economic liberalism changes to a new form called order-liberalism. The paradigm of social market economy developed from the above at a later date. Finally, state activity – under the conditions of the market economy – ended in the point of global regulation.

3. Changes in the Form of the Liberal Economic Policy Concept

Thus, the first version of the modulation is *order-liberalism*. The experimentalism of circumstances does not belong to the subject of this paper, it is enough to point out that at the time of the ‘Freiburg people’ the *laissez faire* type coordination had already lost its reality; the events of economic history were controlled by non-systematized intervention – without any success. In addition to theoretical considerations this was the experience that made Eucken and his colleagues – the resource of the name of the school – focus on the system. Beyond the standard the interpretation of the practice of economic policy also gained a new dimension. As to the former: the interpretation of economy as a big unit, i.e. the subsystem of society expanded the thinking of the goal (as compared to the classical liberals). According to this stability and justice are elements of welfare as significant as financial richness as a result of which economic policy should extend its regulation in practice while the inherence of the system sets strict limits to intervention. The differentiating between the system policy (or system regulation) replacing spontaneous organization and process policy (or process regulation) results from this duality.⁷ Actually, the former means the constitutionalizing of the economy, the establishment and maintenance of basic conditions which are the legal duties of the strong(!) state. The latter is intervention into actual business processes, which is generally refused by this thinking and allowed by it only restrictedly and upon due consideration of system policy aspects.

The economic policy concept of order-liberalism is summarized the most transparently by the so-called constituting principles⁸ of Eucken. His ideal is excellent competition. He starts from such a model and since in the business environment of his era the conditions for it did not develop spontaneously, he wishes to establish the conditions institutionally. With the exception of the latter he carefully follows the well-known liberal thinking. In the *ex post* type coordination system of market economy price changes indicate modifications in scarcity conditions, i.e. the very subject of the thinking. Therefore, ‘the operability of the price mechanism is the guiding principle of each economic policy action’.⁹ According to the mechanism of the ideal market, price should be a given condition for the operators even through simulation (price control, price forming), if necessary. Therefore, no partial policy breaching this (business activity, tax, etc. policy) can be applied. Last of all, all stipulated rules of game and institutes, i.e. the stability of the value of

⁷See e.g. DOBIAS, i.m., LUCKENBACH (1997), TEICHMANN (1993).

⁸cf. EUCKEN (1975: chapters XII-XIV).

⁹EUCKEN: i.m. 254.

the money, the freedom to enter the market, the private ownership of production means, the freedom to conclude contracts, the obligation to provide guarantee and the constancy of economic policy – resulting from one another and backing one another – are all aimed at this. These considerations inspired the acts on the central bank, the acts on competition determining the functions known this day; this is why monetary policy became a daily duty of the government, etc.

If system policy is restricted to the implementation of the constituting principles – as the order-liberals put it – market changes will result only from the activities of private operators and on these changes limits can be put if the intentions of the manufacturers, manufacturing conditions and consumer preferences are sufficiently known. However, if the state influences processes, the balance of the constructed free market becomes an illusion.

It's, however, a question whether or not order-liberalism is an illusion? Its principles themselves were not implemented in their clear forms but paved the way for an actual and undoubtedly successful economic policy. Therefore the reply is not unambiguous. It can be stated that the constituting character of the train of thoughts (the preference or priority given to system policy), the refusal (or at least restriction) of process regulation in the current sense may be associated with the insufficiency of global demand. While emphasizing again that my way of thinking is a parabola of concept history rather than a par excellence concept history, I may state that the adequate reply to the conflict generated by the classical liberal economic policy, i.e. the free market constructed implied a new *conflict* to be managed at later date as a result of the income structure featuring it. The *social market economy* undertook to give the answer, i.e. the economic policy reviving demand.

Of course, Erhard's program of 'mass purchasing power extending to several strata' is not independent of the then political conditions at all, however, the initiations implying the revival of demand – influencing a less 'wide' but considerable strata of the society – had exemplary preliminaries (e.g. the social security act of Bismarck, regulation of minimal wages, etc.). The intellectual system itself was focusing on practice, refused Utopian¹⁰ solutions and tried to solve prevailing problems step by step, was ready, as a programmed concept, to continuously control itself; at the same time its vision of the economy is very strict, and this is the order-liberal paradigm.¹¹ Accordingly, he is sure that the mechanism of competition is the guarantee for welfare on the long run and that 'the principle of competi-

¹⁰Certain representatives (e.g. RÖPKE) of order-liberalism producing the theoretical framework, inspired by servicing competition unconditionally, were not averse to radical deconcentration and decentralization. However, if we think of certain novels of Huxley, written at that time, the Utopian efforts may be attributed to the spirit of the age rather than the prejudice of the economist.

¹¹Erhard's related thoughts word precisely this fragile equilibrium. Having acknowledged Eucken's constitutive greatness, he states: 'Today his economic system does not produce satisfactory conditions – actual market phenomena are clearly full of difficulties as far as the sense of global relations is concerned.' At the same time he does accept the significance of the orientation: '...reasonable economic policy will at all times require clear theoretical grounds and you must not ... adjust to unfirm ideas ... and to consider the lack of orientedness as a sense of reality.' (ERHARD, 1976, p. 17).

tion, as an indispensable organization principle of the mass society, is operable only if competition is subject to clear general conditions' (MÜLLER-ARMACK, 1956, p. 390). At the same time he consciously restricts the implementation of the principle to the field of industry and trade and is lenient to the oligopolies and monopolies if their operation is necessitated by economic and/or social political goals. The same ambivalence may be found in the practice of economic policy: it sets growth, consumption and distribution policy targets but is reserved concerning the process regulation techniques appropriate for their achievement (with the exception of monetary and credit policy instruments). It's a wholesome paradox that a basically conservative economic policy is summarized the best by a social democratic slogan: 'Soviel Markt wie möglich, soviel Staat wie nötig.'

I disregard hereby as well the analysis of the yields that can be associated by economic history with a logical reply to a logical conflict (not resulting from some errors). For us two related phenomena induced by the need to revive demand are important. The appreciation of the consumer (leading to the so-called consumer society) and the transformation of the structure of the political democracy (dominance of the so-called mass democracy) are in question. Here is the turnover – of course, symbolically understood, protracting in time – which provided economic policy with a new environment in addition to new conditions. During the preceding phase, i.e. in the 'democracy of few' the preferences to be represented (in addition to the voting right linked to money or knowledge capital) are naturally capital oriented; the adequate representation mechanism centralizes private goals in a politically efficient form. In the mass democracy, however, (beyond unrestricted voting rights) preferences are not (cannot be) selected as consumers dominate as far as the preferences to be represented are concerned; the adequate representation mechanism re-defines or defines private goals, i.e. it simplifies them to yes/no alternatives. Namely, while under the conditions of the 'democracy of few' the politician as a person setting macro-economic goals is oriented in his person but is not autonomous, he is autonomous but is not oriented under the circumstances of mass democracy. As a consequence, the time horizon of economic policy may be limited (in concessive sense) or has to be limited (in the sense of living constraints) to an election cycle.¹² And from here comes the need to markedly counter-balance the consequences of the market mechanism which culminates in the concept of *global (process) regulation*.

The targets (or rather the pressures) resulting from the basic situation are as follows: high employment rate, stable prices and constant and proportionate growth serving the first two. The full utilization of the manufacturing potential of the economy and consistent demand are the conditions for the achievement of the above goals. In this sense economic equilibrium may be jeopardized either by insufficient demand ('deflationary gaps') or oversupply ('inflationary gaps'). The former (through the under-utilization of capacities) leads to employment troubles

¹² '... there is no stronger governing position than this ... still the government ... does nothing but tries ... to avoid conflicts ... Power of the state is omnipotent and transparent' – characterizes ORTEGA the power of the masses (1995, p. 43).

while the latter implies an increasing price level. According to the concept the trouble is to be eliminated by the regulation of aggregate demand. It says that the level of government expenditures may directly be set while private consumption and investment as well as the export/import relation may be influenced through direct instruments. The value of the target parameters may be influenced by economic policy through this mechanism.

In this concept two ideas are combined. The first is that of Keynes who disputes the efficiency of market automatism if it requires a high employment level in the society. The second is that of the Freiburg school according to which the economic policy of the state has to be pushed into the background after the economic system has been established. The integration of discretionary process regulation on macro level and self-regulation based on system regulation on micro level was manifested by the German stabilization act. According to this act it is the constitutional obligation of the state to directly regulate the level of certain economic factors.¹³

This is the mark or bounds that cannot be overstepped by the liberal market economy without giving up its identity. Therefore, at this point (in 1967 in historical time) I discontinue the story composed linearly. To sum it up let's remember the changes of the liberal economic policy paradigm from its classic form to global regulation (see *Table 1*).

Table 1. Conflict/reply process of the liberal economic policy concept

CONFLICT (changing circumstances)	traditional society	laissez faire	refusal of process regulation	restricted process regulation	
	technical, technological opportunities	undifferentiated mass consumption concentration centralization	insufficient demand	consumer society political appreciation of the consumer: mass democracy	?
REPLY (economic policy concept)	classic liberalism	order-liberalism	social market economy	global process regulation	

We know what followed. Different economies ‘fed back’ different phases, from *da capo* to reduced adjusting. But – this is the last reference made in this respect – our subject is different. We have to revert to the original question which is connected with the future of the economic policy itself.

¹³cf. DOBIAS, i.m. 43–46.

4. Sursum Corda

The wrong tracks of forming economic coordination and the ones considered as fortunate all suggest that different rationality types (full of conflicts) inevitably show themselves. Therefore, if economic policy is meditated in the functionally extended sense proposed in the starting thesis and cultivated in modern mixed economies without any inducement to make definitions, we have nothing to worry about as regards our discipline. However, the frameworks within which economic policy manifests itself are plastic. Which is the group of people to which communal rationality may be referred in the supra- and multinational space, in the world of integration? How can the institutes representing all this be constructed, operated and checked? What is meditated in this paper is also the subject of scientific argumentation as well as personal feelings and thinking. It is evident that for the time being the process in the course of which institutions developing over and below national states (see regions) take over functions from the states has not ended. It is also certain that these changes cannot be overcome by economic policy through definition inventions. But neither its ability to adjust can be doubted!

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