Cem Somel. 1993. The State and economic activity: problems of economic policy-making. UNCTAD discussion paper 67 (September).

Goals of economic policy

The main goals of economic policy are:

- adequate provision of public and merit goods;
- ensure economic efficiency;
- ensure economic growth;
- improve income distribution; and
- guarantee economic, social and political stability.

Argument for State intervention

Why can't markets alone attain the goals mentioned above? Particularly in earlier stages of development, there are three reasons for State intervention, namely:

- big-push – several activities have to be developed simultaneously to make sure that each one is viable, and this requires the coordination of complementary and competing investment decisions;
- externalities – by definition they are un-traded and even intangible goods, such as knowledge, cost reducing or pollution increasing spillovers into other activities, sectors, firms, such that the social and private marginal benefits diverge;
- provision of finance – this is particularly the case when financial market operation is subject to imperfect information regarding the borrower and the long term viability of new activities.

Theory of economic policy

The fundamental aspects that illuminate the process of economic policy making are:

- what is economic policy – the choice of the instruments of policy (p) to achieve the targets (q), given a set of various parameters (a), namely technologies, markets, resources available, etc. Such that:

$$p = p(q, a) \qquad (1)$$

  Comparatively, economic analysis (x) is the inverse process of industrial policy, as analysis aims at defining targets given the policies and set of parameters, such that:

$$x = q(p, a) \qquad (1)$$

- economic policy should incorporate more instruments than targets, such that the burden is distributed amongst the various instruments;
- the formulation of policy should also include two fundamental aspects: the detail of the implementation procedures and the sustainability and finance of the policy;
- economic policy also involve close monitoring to ensure that targets, policies and implementation mechanism are consistent;
- all policies and regulations have side effects, which should be identified and dealt with. The longer a policy stays the more side effects it is bond to create. Those effects can be negative or positive;

- the formulation and implementation of industrial policy involve various agents, namely: the planners/designers of the policies, the executors and the beneficiaries. Each of these agents is likely to develop different expectations over the policies, understand the policies in slightly different ways, attempt to alter policies and show varying degrees of commitment to policies.

Implementation of economic policy

The following aspects are fundamental in the implementation of policy:

- the details of implementation should be set in the policy papers themselves;
- problems of information (asymmetric or incorrect) should be monitored and dealt with as soon in the process as possible;
- the socio-economic structures and dynamics the policy is intended to act upon change over time, and the more successful the policy the more such initial conditions are bond to change – thus, policy implementation and monitoring should also provide information for policy adjustment and correction;
- implementation should be a learning process, by which all agents learn about the structures and dynamics they are intended to act upon and the adequacy of policies. Monitoring and revision should be a continuous process, and policy formulation and implementation should be as flexible as necessary to incorporate the lessons learned along the process;
- the nature and capacity of the State:
    - what sort of institution the particular State is: rational? Irrational?
    - skills and experience of the State;
    - information required and available;
    - social forces that operate through the State and how they influence and are influence by the State.
- the role of industrialists versus the role of the planners: planners are essential to ensure that linkages take place.

Instruments of policy

The following are some of the fundamental instruments of the State to pursue economic policy:

- taxation: influences savings, income distribution, economic incentives (protection, investment incentives, subsidies) and economic stabilisation;
- wage and trade union policy: affect the wage rate, distribution of income and economic, social and political stability;
- technology policy (licensing, stages of upgrading, etc): influences allocation of investment, the degree of technological capabilities, productive strength and competitiveness, as well as the rates of economic growth, employment and income distribution;
- industrial and trade policy (ISI and EOI): influences technological policies, allocation of investment, the degree of technological capabilities, productive strength and competitiveness, as well as the rates of economic growth, employment and income distribution, and the ability to expand and diversify exports.

Central problems of economic policy

The following are amongst the fundamental questions that economic policy has to respond to:

- can poverty be dealt with properly by fiscal and pricing policies alone, as these are not more than redistribution of income without altering the institutional and socio-economic environment under which poverty may be generated?
- How to finance the State?
    - Long term fiscal deficits (short term for economies with small GDP and limited economic dynamics) put pressure on the State to cut public expenditure. This leads to:
        - Share of current expenditure increases;
        - Share of capital expenditure (usually responsible for crowding-in effects) falls
        - Adjustments towards increasing the share of capital expenditure without increasing total expenditure create unbalances in capacity utilisation;
    - Limited capacity to collect revenue puts further pressures on expenditure reduction. Constraints to revenue collection may be associated to:
        - Inefficiency of tax administration;
        - Degree of economic informality;
        - Collapse of economic activity;
        - Political constraints.