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# WHO IS THE MASTER? WHO IS THE SERVANT? MARKET OR GOVERNMENT?

## An alternative approach: Towards a coordination system

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## An alternative approach: Towards a coordination system


***S.M. Shafaeddin****



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# WHO IS THE MASTER?
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## An alternative approach: Towards a coordination system

***S.M. Shafaeddin***

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***Abstract***

*The main purpose of this paper is to discuss the limitations of the market and the risks of government failure, and to present an alternative approach on coordination of economic activities by introducing the concept of "coordination system". In such a system, economic activities are coordinated by market, firms and government requiring the availability of "non-price factors" such as infrastructure, institutions and organizations. This approach is practical, country specific and dynamic. It is practical because it is based on the realities of the world economy and the situations of developing countries. It is country specific because the relative role of each coordination mechanism – market, government and enterprises – changes from one country to another, depending on their level of development and other socio-economic characteristics. It is dynamic because in each country the relative role of each mechanism changes over time during the course of economic development of the country.*

## INTRODUCTION

*The market is a very good servant,*
*but a very bad master.*
Sukhamoy Chakravarty

According to the traditional economic theory firms are passive agents and there is no role, or at most a minimum role for the government. On the other hand, the argument that markets fail has traditionally been used in favour of government intervention particularly in the economy of developing countries. This was especially so in the post-Second World War period up to the early 1970s. Traditionalists have responded by arguing that government may also fail.

The opponents of government intervention comprise a spectrum of views. Some believe in no government intervention at all, whether in the flow of trade, in the process of industrialization (Haberler 1950 and Krueger 1978) or in macroeconomic management. Such a belief is based on the assumption that markets are perfectly competitive and spontaneously punish and correct mistakes in the allocation of resources. Others oppose government intervention in trade but do justify other types of intervention. They argue for laissez-passer, but not necessarily laissez-faire (see Corden 1974, Chapter 1).

We shall argue in this paper that the key issue in the trade policy and industrialization of a developing country at any particular period which aims at the expansion of exports of manufactured goods is one, or a combination of the following: (i) To *accelerate* development of the supply capacity in the manufacturing sector; (ii) to make the existing industries efficient and competitive in the internal and international markets; or (iii) to sustain the competitiveness of its manufacturing sector over time through upgrading. The market on its own is inadequate, or fails to attain any of these objectives. The nature and the degree of market failure may vary from country to country, depending on the level of development, industrial base and other socio-economic characteristics of individual countries.

The lower the level of development, *inter alia*, the higher the risk of both market failure and government failure. We shall, however, maintain that the risk of government failure is not an argument against government intervention in trade and industry since the existence of such a risk is not sufficient to prove the certainty of market efficiency. Even when distortionary government intervention has ceased, the market mechanism will fail to produce optimum amount of goods and services over time from a social point of view. On the other hand, the risk of market failure is not an argument in favour of unnecessary, excessive, rigid and prolonged government intervention. Introducing the concept of "coordinating system" we shall argue that the coordination of economic activities takes place through a combination of three coordination mechanisms: market, firm and government. To function efficiently, however, such a combination has to be complemented with institutional, organizational and physical infrastructure. The relative importance of each mechanism changes over time with changes in the level of development, but at each point in time the efficiency of the system is influenced largely by the efficiency of the government.

In the rest of the paper we shall first refer to the key issues in trade and industrialization of developing countries as a background before reviewing the literature on market mechanism, market inadequacy, market failure and government failure. Subsequently, we shall conclude the paper by presenting an alternative approach to co-ordination of economic activities

## A. KEY PROBLEMS OF DEVELOPING COUNTRIES

For the purpose of analysis in this study, we may classify developing countries wishing to expand exports of industrial products into three main groups according to their level of development and industrial capacity. The first group are countries with little or no industrial base and with low level of development in terms of per capita income, and of physical, institutional and organizational infrastructure. This group includes almost all sub-Saharan African countries, as well as a number of low-income Asian and a few Latin American countries. The second consist of those with some industrial base built up through previous import substitution and infrastructural capacities, but with little experience in industrial exports. Most countries in Latin America, the Middle East and North Africa are in this group. In the third group are countries which already figure among the main developing country exporters of manufactured goods among developing countries. These are mainly the NIEs and next-tier NIEs.

Establishing supply capacity requires, *inter alia*, investment, incentives, institutional build-up, organizational development, infrastructural framework, and skilled labour and technological adaptation. At any point in time the burning issue in trade and industrialization of the first group of countries mentioned above is not only to create but also to *accelerate* the development of the