Monitoring the State or the Market

Many economists argue that economic analysis should avoid distributional consequences of policies. In democratic countries, however, the political power of individuals inevitably reflects their wealth and income. You cannot have a democracy when income and wealth distributions are greatly uneven. *Monitoring the State or the Market* explains that absolute income equality is not consistent with a market economy, yet neither is large inequality. This study provides a broad survey of major social and economic developments over the past two centuries, beginning with the Industrial Revolution and laissez faire and ending with neoliberalism and market fundamentalism. It explains how each of these periods initially brought moderation and accompanying benefits, demonstrating that some countries, like those in Scandinavia, have demonstrated that it is possible to have low Gini coefficients (low inequality), while preserving economic freedom and prosperity.

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From Laissez Faire to Market Fundamentalism

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Shaftesbury Road, Cambridge CB2 8EA, United Kingdom

One Liberty Plaza, 20th Floor, New York, NY 10006, USA

477 Williamstown Road, Port Melbourne, VIC 3207, Australia

314–321, 3rd Floor, Plot 3, Splendor Forum, Jasola District Centre, New Delhi – 110025, India

103 Penang Road, #05-06/07, Visioncrest Commercial, Singapore 238467

Cambridge University Press is part of Cambridge University Press & Assessment, a department of the University of Cambridge.

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www.cambridge.org
Information on this title: www.cambridge.org/9781009434447

DOI: 10.1017/9781009434430

First published 2024

A catalogue record for this publication is available from the British Library

Library of Congress Cataloging-in-Publication Data

ISBN 978-1-009-43444-7 Hardback
ISBN 978-1-009-43447-8 Paperback

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Preface

This book is largely the result of frustration. The frustration of someone who, for six decades, had been at the center of economic activities and economic thinking and debates, both as an academic, as a high-level supervisor of large groups of highly trained economists, in an important international organization (The International Monetary Fund), and as part of a G7 government (the Italian government). I had also been an active member of a relevant global, academic economic organization, The International Institute of Public Finance (IIPF), of which I had been President in 1990–1994 and am now Honorary President.

When I studied economics, first at the George Washington University in the 1950s. and later at Harvard in the 1960s, I had the good luck of studying under some of the leading economists of the time, several of whom would win the earliest Nobel Prizes in Economics. I learned that the field that I had chosen had the goal of promoting the economic wellbeing of communities and countries. I learned that more economic output (more economic production), when distributed fairly, though not equally, would lead to more general welfare and to happier communities. I also learned that an efficient economy, one in which individuals were guided by basic incentives, would promote self-interest, empathy for others, and community goals.

I had been aware, then, that there were some economists, called conservative, libertarian, or laissez faire economists, who, possibly influenced by the past behaviors of bad and nondemocratic governments, of which there had been many in history, or by the current behavior of socialist governments (such as those that existed in Russia and other "Soviet economies"), believed that government intervention was always bad, and was always accompanied by the danger of becoming a road to serfdom or to inefficiency, as Hayek had stressed in an influential book in the early 1940s, and as von Mises and others have continued to believe.

In the early 1960s these libertarian economists were relatively few, and their influence in the decades after the Great Depression had been limited. Their number and influence would increase in the 1970s, at a time when the economies of advanced countries were running into serious difficulties (inflation and recessions at the same time), while the centrally planned economies of the Soviet Union had also started to run into even greater trouble.

The importance of the libertarian economists, economists who believed in the miraculous work of a free market, one in which economic agents would be free from government guidance and controls, would pay low taxes and would follow the guidelines set by the free markets and by their personal incentives, grew in the late 1970s. These economists had great faith that free economic agents would respect the liberty of others, even in the absence of governments, authorities, and rules that required them to do so, and that they would not abuse the market or the natural environment.

In this free society, speed limits for cars might not be necessary, and neither would regulations that instructed individuals not to pollute or cheat others or that punished them for not respecting established rules. Individual freedom would reign supreme in this free market environment, and prosperity for the whole of society would automatically follow from the greater activity and from "trickle down." Who would not want to live in such a world?

Somehow, I always felt that the libertarian economists who were advocating economic freedom and a world largely free of taxes and regulations, (and, by implication, without essential public goods, because there would be no or little tax to finance them), were living in a dream-land. The world that they imagined possible was obviously very different from the world that had been created in the Soviet Union. But it was also very different from the world of reality as *I* saw it, and as even Adam Smith had seen it three centuries ago when he warned about "cartels" and other abuses of the market.

I was convinced that a world that combined the essential function of a market with a democratic government that closely monitored the market for abuses and inefficiency and paid some attention to equity was a possible, realistic, and preferable world. At least in principle, this was the world that the welfare states had been trying to create after the Second World War.

The question of whether the thinking of the libertarian economists or that of those who were creating the welfare states was right bothered me for decades. This book is an attempt to deal with that question in a way that is as objective as possible when one deals with difficult ideological questions. I hope that this book will not be seen as too one-sided, and that it can contribute to an informed debate, one that is badly needed at this time. I have no illusion that all those who read this book will be convinced by its arguments. But some may, and that would be progress.

The book is divided into three historically based sections, to distinguish different pressures that existed in those periods. Each of those periods have different characteristics and respond to different challenges and circumstances.

Acknowledgments

Several individuals were kind enough to give me some reactions and comments on earlier drafts of this book. They included: Giorgio Brosio, Nuri Erbas, George Iden, Hans-Werner Sinn, and Andres Solimano. Frequent conversions with my son, Alex Tanzi, an economic reporter with Bloomberg Net, were also useful in making me think about some current issues.

As always, I am grateful to my wife, Maria, for her continuing support and encouragement, and for providing me with the gift of the free time that was necessary for this project.