

## **Synthesis of Economic Theory Trends as Basis for State Regulation of Economy**

**Mykola M. Kovalenko**, Doctor of Sciences in Public Administration, Associate Professor, Associate Professor of Economic Policy and Finance Department, KRI NAPA, Kharkiv

*Economic theory is comprised of a variety of schools and trends. Depending on the role of the state in the regulation of economy, the author makes their synthesis according to three concepts. The main characteristics and historical examples of applying such concepts (systems of views) as liberalism, socialism, and realism are presented.*

*Keywords: economic theory, state, society, development, state regulation of economy, liberalism, socialism, realism*

Discussions about the need for and specific features of state regulation of economy aiming to create new modes of a boosted economic development or protection against multiple internal and external destructive trends have caused a strife among three major concepts of the state impact on the economy, namely: liberalism (capitalism or market economy), socialism, and realism (national state economy).

Economic liberalism traces its roots in classic theories by English political economists A. Smith and D. Ricardo. Adam Smith developed an idea of an “invisible hand” of the market and its capacity to redistribute resources in the most efficient way without any state interference, attaining the maximum benefit for all. In fact, liberals regard state regulation not only as unnecessary, but even harmful. According to D. Ricardo, the economic freedom of business entities brings about maximum profit, which turns into a source of investment providing incentive for development of all the areas of economic activity.

Advocates of liberalism believe that a rapid growth of production, with which labor supply can not keep up, results in increased wages which in return causes a slow-down of the production growth rate and stimulates labor supply. Under a declining production, a number of consistent and interrelated processes

take place, namely: unemployment springs and grows, real wages drop, labor supply decreases increasing a demand for it, and ultimately, as if by itself, full employment is achieved.

Despite historical changes and global evolution of socio-economic relations, the pivotal ideological concepts remain unalterable. Thus, neoliberalism associated primarily with the names of F. Hayek, L. Mises, and M. Friedman leaves the state nothing but the part of a referee who is to provide favorable conditions for an unrestricted competition. For example, F. Hayek interpreted competition of minds as a process of finding new opportunities to use available resources through upgrading products and technologies, opening up new markets, sources of raw materials or new types of business management. The majority of neoliberals refuse to recognize market failures, alleging that the reason for their actual existence is not limitations of capitalism, but local though continuing interference of the state which impedes a normal market functioning. In their opinion, there has never been a market yet in the true sense of the word [1, p. 219].

Economic liberalism supporters consider economic crises to be a natural phenomenon, which aids the natural selection. Crises let only the fittest businesses and the most capable entrepreneurs survive. Moreover, it is assumed that interference of the state or any other power can but provoke crises occurrence. Standard liberal recommendations are to open borders for goods and capital, cut down public spending, minimize state regulation, and ideally – reduce state intervention to nothing.

This approach is acceptable for those who have accumulated a considerable reserve of strength by the start of the crisis (this refers to both – nations and households). However all crises give rise to unemployment. As to the people whose only source of income is selling their own labor, crises pose an imminent threat to their very survival. Since at the time of crisis the majority of the population find themselves between life and death, the situation causes inevitably a mass human migration, social discontent and conflicts, revolutions, and warfare.

Fair enough, it can be held that an outcome of introducing economic liberalism ideas was World War I, which ended in revolutions in several European countries. And even after that, governments of many countries continued to follow Adam Smith's recommendations, which but again resulted in the Great Depression of 1928–1933, the fascists' coming to power in Germany, World War II and a most horrible devastation of Europe.

Virtually, a forced self-regulation of economic processes that was based on market "laws" made many countries in the 1980s-1990s introduce measures to narrow down the scope of state regulation of economy, in the first place, in banking. Deregulation of pricing (including interest rates) was carried out, and direct control over credit policy of banks and imposed regulation of investment flows was eliminated. New legislative rules were adopted to foster equal competition both for residents and non-residents. The state began to lend support for mergers of bank institutions. In the early 1980s, the European nations started a large cutback in state regulation of monetary and financial flows. In that way the central banks and governments of advanced countries tried to shift from a direct administrative and legal regulation of economic relations in the bank sector to an indirect one.

Approaches, purely liberal in nature, also include: prohibition for the central bank to credit the government for settling budget deficit and financing state target-oriented programs, even strategic ones; prevention of acute fluctuations of the national currency exchange rate; improvement of the balance of payments; placing effective barriers to capital outflow abroad; creating favorable institutional conditions for a capital inflow to the national economy; stimulation of foreign economic activity of the national producers [2, p. 91].

The socialist concept of state influence of the economy originated in the middle of the 19<sup>th</sup> century as an alternative to liberalism. Its core was formed by K.Marx's idea of a socially controlled economy being more effective than a capitalist one and succeeding the latter in an evolutionary manner. That outcome

was claimed to be an impending resultant of capitalism due to a huge concentration of capital, which an unregulated market is unable to control effectively. In that case, economic relations should be organized in a scientifically substantiated, socially regulated and socially planned mode. Then it would provide a structure of an economy without winners or losers, in which an optimum composition of economic entities appears, these entities being supported by the state in a centralized manner in exchange for their fulfillment of certain functions.

Marxism asserts that by eliminating a contradiction between consumption and saving socialism will defeat capitalism, creating more powerful productive forces and consequently, a higher labor productivity. Productive forces are defined as a system of subjective (people) and objective elements that are engaged in “exchange of objects” between humans and the nature in the process of social production. Production relations as a totality of material economic relations among people in the course of social production and social product movement from production to consumption appear as a society’s foundation. Religious, cultural, ideological, legal and all other kinds of relations, according to Marx, belong to the secondary relations, or superstructure.

As D. Nieviedimov [3, pp. 267–268] rightly emphasizes, in fact, productive forces are the same kind of deity in Marxism as Adam Smith’s “invisible hand” of the market. For example, when national industries were ruined in wars, they were always quickly restored, even with mere internal resources, provided the societies preserved their positive ideological unity. Ultimately, countries were not degrading into backward socio-political, and scientific and technological systems. And otherwise, when problems occur in social mentality, as in the USSR of the 1980s or in the post-Soviet space of the 1990s, where factories and plants remained intact physically, serious production problems will follow without fail.

A system of economy created in the USSR and in most socialist countries was characterized by a total state control of all the economic processes and phenomena. A socialist state is not one among many users of a credit and financial

system, but rather owns it. Besides, the state being the owner of the credit and financial system and a multitude of enterprises, neither gains any financial profit nor incurs any losses, when assets are transferred from the balance of one enterprise onto the balance of another one which is accompanied by an appropriate transfer of funds from the second enterprise account to the account of the first enterprise. Market relations were replaced with a planned state system of fund allocation and re-allocation. Distinctive features of the socialist countries' bank systems were as follows: a single-level structure; concentration of banking business within but a few credit institutions; centralization of banking administration on the basis of a planned credit origination, payments, and state foreign exchange monopoly. Thus, a single issuing, treasury, credit, and financial settlement center was created – the State Bank.

A special attention should be paid to the practice of the Soviet Union of the 1930s-1950s where a two-level monetary system existed that has never had any parallel in the world. Its basic principle is that the upper level is non-cash. It was used exclusively for fund transfers between enterprises, industries etc. While the lower cash level was used to pay wages to workers. It is noteworthy that the two levels were separated by a very strong divide. Enterprises were allowed to convert non-cash funds only in the amount needed to pay wages and business trip costs [4, pp.353–355]. That kind of separation was meant to rule out the possibility of misappropriation and corruption. The model proved its worth. Within a short period, the country effected industrialization and got quite powerful.

Of considerable interest is the criticism of Marxism by I.V. Stalin. In his work *Economic Problems of Socialism in the USSR* published in 1952, Stalin expressed his non-acceptance of the Marxist political economy, which made it impossible to manage the economic activity of the society either theoretically or practically: “nowadays, under our social system, most absurdly sound the words about the workforce being a commodity, or about “hiring” workers: as if the working class that owns the means of production hires itself and sells its workforce

to itself. It is equally strange to speak about “necessary” or “extra” work: as if under the present conditions our workers’ labor – dedicated to the society to expand production, develop education, health care, organize defense etc. – were not as necessary for the working class, which now holds power, as the labor spent on covering personal needs of workers and their families” [5, p.28].

I.V. Stalin in his work gives direct instructions to economic theorists to develop a qualitatively new economic theory, which would fit the imperatives of life and a public need for managing the economy: “I think that our economists must do away with the present inconsistency between the old ideas and the new state of things in our socialist country by replacing the old concepts with new that would measure up to the new circumstances. We could stand this inconsistency for some time; however, at last, it is time for us to liquidate it” [5, p. 29]. Regardless of substantial achievements of the Stalinist economy, Stalin himself realized that lack of education in some part of the directorial body and economists hampers attaining the highest efficiency of the planned socialist economy in the USSR, among other things due to their incorporation of market mechanisms for self-regulated use of objective over-plan opportunities. Without elimination of that ignorance (which is hardly possible within the limitations of the acting frameworks of Marxism and liberalism), the task of integrating a societal, demographically driven plan and the market mechanism into a single multi-sector production and consumption system is irresolvable.

A peculiar example of an improved form of the state influence of economy under socialism is provided by modern experience of the People’s Republic of China. In fact China has demonstrated a possibility of a successful symbiosis between liberalism and Marxism which to some extent can be referred to the next concept suggested by us – realism.

First of all, realism, or economic evolutionism by another definition, is based on advances of the school of historical thought, institutionalism, and Keynesianism. The concept of realism traces its origin back to the epoch of the

western continental countries' confrontation (in the first place, with Germany) hegemony of England in the nineteenth century, being based on the economic principles that make it possible to influence countries' level of economic development. The founder of that concept is reputed to be Friedrich List, the author of *The National System of Political Economy* [6]. Within the framework of the historical school, a doctrine of a "national economy" appeared, stating the national distinctiveness of economic systems and laws of their evolution. The existence of universal economic laws was denied on the ground of the lack of comparability between national economies, which have their own distinct lines of development and historical specificity. In this connection, F. List insisted on the need for identifying true national interests and specific laws of every country's economic development in order to determine the role and functions of the state as regards the wakening of national productive forces and creating the most favorable conditions for realization of their economic potential.

List was not a theorist of protectionism, but rather a developmental theorist. Therefore, the scholar was sure that in future, when all countries progressed to a high level, free trade would become a general rule, and gradually the necessary conditions would be created to form a global community of people and an international league of industrialized nations. "A nation that attained a great manufacturing and trading might by way of austerity, having gained that objective, returns successfully to the principle of freedom of trade", wrote F. List. Unlike the classic school of thought, F. List interpreted protectionism not as an obstacle, but rather as "the mightiest driving force of an ultimate consolidation of peoples with a resulting genuine freedom of trade". In this respect, the scholar advocated a considered protectionism, which "fits its level of industrial education", since "any kind of excessiveness does harm to protectionism, because nations can only come to improvement of manufacture by degrees" [6].

The eminent scientist did not reduce state activity to a mere role of a 'night watchman'. According to F. List, under a market economy the state should create

material, institutional, and cultural preconditions for: a country's rapid industrial recovery; formation and development of a single domestic market; accommodation of social interests and directing the nation's efforts to perform long-term strategic tasks. In this context, a special attention should be paid to F. List's substantiation of the need for developing the state sector of economy as an integral component of the national economic complex comprising the "state means of government, their consumption and administration". The scientist believed that "state economizing" was meant to have a stimulating effect on a country's economic progress.

A free market is an environment fit for more developed countries, while other nations are condemned to be their raw-material appendages. In order to prevent falling behind others during potential equalization, according to F. List, it the state should establish special temporary institutions, which would protect a country's national economy and foster its boosted development. A type of those institutions should differ in different countries, being determined by their internal economic traditions, national culture, and geopolitical specificity. Not stifling, but rather preserving historical traditions and culture, using them in economic competition is a consistent idea of modern realism.

A Russian scientist D.I. Mendeleev could be considered one of the pioneers of realism. He had a lead of nearly 90 years of a famous American institutionalist D. North in his understanding the fact that "for the future road to be, whenever possible, evolutionary and progressive, first of all, it should not negate the past" [7, p. 29]; according to D. North "history is relevant" [8, p. 12]. Economic evolutionism (in D.I. Mendeleev's own terminology – 'realism'), the concept of which was elucidated substantively in the scientist's works, found its worthy followers among his contemporaries who further developed that area by founding not only on domestic achievements, but on international thought as well.

D.I. Mendeleev defended a position, according to which real changes take place only gradually, by way of evolution. Evolutionary changes encompass a larger "scope" of economic continuum than revolutionary (discrete) increments: "yes, as far as I am



concerned, there is, although by now relatively small, an impact of any sort of revolutionary mayhem, whether in terms of orders and decrees or in the form of revolutions and pronunciamiento, while the main changes are all of a gradual evolutionary nature, education and industry now coming to the forefront” [9, p. 404].

From the viewpoint of the methodology of historical reality cognition, all socio-economic systems have a principally similar basic structure, “only being in different epochs of evolutionary changes”, that is why D.I. Mendeleev stressed the importance of understanding the primitivism of “any one-sidedness, which is not intrinsic to realism alone that strives to grasp the meaning of reality in its entirety, without one-sided infatuation and to succeed or progress by an exclusively evolutionary way” [10, p. 24]. One-sidedness, narrow opinions and obvious simplification of the methodological framework of the modern neoclassical theory, while facilitating a successful mathematical formalization, cause absolutization of abstract formulae as a reference for economic science results [11, p. 107]. This happens contrary to the institutional theory, which, although often adding complexity (due to more sophisticated, but at the same time more realistic initial conditions), tends to consider economic activity in a consistent and normative manner, approximating maximally to the reality and reflecting its complex and contradictory nature in an objective way.

In compliance with the realism concept, there are no deadlock situations for economic development, as “a historic way out that is suitable for a country, time period, or specific circumstances can be found everywhere” [12, p. 10]. That is why a systemic study of economic reality in its entirety and diversity, from different perspectives and in a multifaceted approach, is an absolute necessity, enabling us “not only to go with the stream, but be aware of its direction and force as well as understand the reason why many factors have changed without any visible catastrophe, and also to be in a position to direct at least part of the impetuous torrent towards the moving turbines – that is for the common good” [12, p. 12].

From D.I. Mendeleev's viewpoint, the crucial functions of the state are control and creation of effective mechanisms for protection of people's right to property, since it "constitutes one of the stems of the entire social system" intended to ensure both people's comprehensive personal fulfillment and organization of their interrelations. In so doing, the state should rely mainly on "the nationwide economic interests (strategic) and not on the fiscal interests of budget replenishment (tactical), shaping its policies accordingly" [12, p. 191], sensing the economic organism's rhythm continuously and responding to its failures in a proper manner.

Realism assigns a special role to protectionism that is treated exclusively in a broad sense as a function of the state aimed to support and protect the entities of the national economic system by means of institutional restrictions for foreign economic agents' production or products of their activity from external systems. From that perspective, protectionism is understood as "manifestation of statehood, which is a component of an evolutionary form of social life of mankind" meaning that "in this regard, there is not and cannot be a state "practice" other than protectionism"; protectionism "is bound to and makes up a general formula, in which levies are but a small part of the whole" [7, p. 86].

Significantly, an outstanding scientist D.I. Mendeleev to the end of his life could not understand people "who make judgments about everything from classical points of view and believe that all the world depends on the political forms of life and not on qualities and traits of people, customs and laws of a nation" [7, p. 61].

Among researchers who are rightly referred to as supporters of the concept of realism, one can mention S.F. Sharapov, who worked on the cusp of the 19<sup>th</sup> and 20<sup>th</sup> centuries in Russia. To his mind, any transformations in the society should be of a smooth evolutionary nature. The scientist thought that the basis for internal ('transcendental') and external ('economic') development of a state is laid by spiritual and moral laws, which in everyday life are expressed in the form of the

appropriate ethical norms, violation of which means, in the ultimate end, infringement of the Devine laws set by God.

S.F. Sharapov was an adherent of a centralized coordinated regulation of a national economy by the state. The ground held by him was that a special approach is necessary to elaborate laws and regulations in economics and finance. In one of his works, the economist wrote that “economic legislation requires, in the first place, an absolute nonpartisan position and quite extensive specialized knowledge. ... Institutions of a parliamentary type are especially unfit here.” [13, p. 321]. Sharapov considered it expedient to create a highest body for the national economy regulation – Economic Council, which would have not only executive but also partially legislative power, taking part in preparation of draft laws of economic and financial nature. The tasks of such an institution should be coordination and strict inspection of the activities of government agencies (ministries), settlement of all disagreements between them, and a competent management of every issue.

Alongside with liberalism, S.F. Sharapov also criticized irreconcilably socialism in its Marxist variety. The scholar described it as a vulgar materialism. He asserted that socialism is the rule of labor, real labor, full of life. However this labor oppresses the labor of the past called capital. Again, a balance between the factors of production is offset. According to Sharapov, neither a parliamentary and stock-exchange state nor a dictatorship of the proletariat can ensure an economic and social harmony.

Later on, one of the theorists who expressed an idea that there are conditions, under which market economy is unable to maintain balance, was J.M.Keynes. He believed that the market makes an economy function at a level much lower than its potential. Polemizing with liberal economists, J. M. Keynes argued that a decrease in prices and wages has a negative impact on the level of production and employment. The matter is that lower prices and wages result in reduced incomes, which in turn cause a further reduction in general spending. While in the context of an individual company a decline in wage rates theoretically

causes an increased demand for labor, within the framework of the society on the whole a general reduction of wages means a decrease of money incomes which leads to a fall in aggregate demand for products and labor.

The scientist emphasized that money is a social institution, a normal functioning of which is within the responsibility of the state. J. M. Keynes proved that monetary and credit policy of the state aimed at stabilization of money turnover, standard of prices, currency exchange and interest rates have become a prerequisite for a developed market economy. The central bank turned from a financial settlements center into an institution, which forms the economic environment of the national economy – its money.

John Keynes created a new theoretical model of state regulation of the national economy. The basic principles of that Keynesian model are as below.

The first principle is a centralized control over regulation of the national economy in the key areas. According to J. Keynes, the state is to exert its administrative influence on a number of spheres of activity that were given to private sector initiative. During crisis the state must interfere actively with the economy by bulk purchasing in the market, supporting entrepreneurial activity with finances, regulating bank interest rates in a rigid manner, and controlling banks.

The second principle is the national economy forecasting and planning. The basis for state regulation is laid by scientific forecasts of a country's socio-economic development – short-term (annual), middle-term (3-5 years), and long-term (10-20 years). The forecasts help attain a country's economic proportionality, which is evaluated by means of national accounts and inter-sectoral balances. The most adequate plan is not imperative (strictly binding), but rather indicative (advisory, guiding). A plan of that kind is drawn on the basis of a number of programs, which presuppose fulfillment of socio-economic tasks. In order to meet the challenge, banks and businesses are involved through state orders. The orders

are provided with resources and have to be very profitable. The state selects enterprises on a competitive basis.

The third principle is the state pursuing the policy of effective demand. J.M. Keynes in his work *General Theory of Employment, Interest, and Money* (1936) set a task of investigating the reasons for production decline and unemployment growth. He saw those reasons in insufficient customer demand for personal items and means of production. The central task of the state, according to Keynes, is ensuring a high effective demand, which leads to growing incomes. The state is supposed to develop two kinds of demand – the demand of people for consumer goods and demand of enterprises for investment goods (means of production). As a result, the effective demand shows itself both in higher employment rates and people's welfare, and in growing profits of businesses [14; 15, pp. 181–182].

It is assumed that the subject of economic theory is relations between people in connection with production, distribution, exchange, and consumption of goods and services. These relations usually entail problems of an effective use of scarce production resources and their efficient management in order to satisfy material, spiritual and social needs of people. Notably, “relations between people” should be regarded as the key words in defining the subject of economic theory. Consequently, what the economy itself is like depends on what basis these relations are built and how, what norms and rules make up their framework in a society. The norms can be divided into four groups: religious, moral, judicial (regulatory and legal), and others.

Therefore, the progress of a society's economic management, the standard and stability of its welfare are the result of establishing and maintaining certain standards of its people's behavior, which subsequently generate relations between people in general and in the economic sphere in particular. Such a concept of economic theory as realism is a deeper, more comprehensive and certainly a more justified form of regulating economic relations by the state. The concept of realism

makes a theoretical basis for the state impact on the economy that could stimulate an all-round development of the society, which sets as a principal idea of its existence, in the first place, attainment of spiritual and moral values. Without doubt, if a state truly strives to extricate itself from the bondage of neocolonial pressure, move to a quite different level of economic development, realism is a more effective alternative than liberalism or socialism.

#### References:

1. Ляшенко В. І. Регулювання розвитку економічних систем: теорія, режими, інститути [Текст] / В. І. Ляшенко. – Донецьк: ДонНТУ, 2006. – 668 с.
2. Розпутенко І. В. Ефективність державного управління / Ю. Бажал, О. Кілієвич, Мертенс О. та ін.; За заг. ред. І. Розпутенка. - К.: Вид-во "К.І.С.", 2002. - 420 с.
3. Неведимов Д. Религия Денег или Лекарство от Рыночной экономики [Електронний ресурс]: Большая онлайн библиотека. – Режим доступу: <http://www.e-reading.club/book.php?book=113920>.
4. Катасонов В.Ю. Экономика Сталина [Текст] / В.Ю. Катасонов. – М. : Институт русской цивилизации, 2014. – 416 с.
5. Сталин И.В. Экономические проблемы социализма в СССР [Текст] / И.В. Сталин. – М.: Государственное Издательство Политической Литературы. – 1952. – 150 с.
6. Лист Фридрих. Национальная система политической экономии [Електронний ресурс]: Электронная библиотека Royallib.com. – Режим доступу: [http://royallib.com/book/list\\_fridrih/natsionalnaya\\_sistema\\_politicheskoy\\_ekonomii.html](http://royallib.com/book/list_fridrih/natsionalnaya_sistema_politicheskoy_ekonomii.html).
7. Менделеев Д.И. Проблемы экономического развития России [Текст] / Д.И. Менделеев. – М.: Издательство социально-экономической литературы, 1960. – 617 с.
8. Норт Д. Институты, институциональные изменения и функционирование экономики [Текст] / Д. Норт. Пер. с англ. А.Н. Нестеренко; предисл. и науч. ред. Б.З. Мильнера.– М.: Фонд экономической

книги “Начала”, 1997. – 180 с. – (Современная институционально-эволюционная теория).

9. Менделеев Д.И. Заветные мысли [Текст] / Д.И. Менделеев. – М.: Мысль, 1995. – 413 с.

10. Менделеев Д.И. Проблемы экономического развития России [Текст] / Д.И. Менделеев. – М.: Издательство социально-экономической литературы, 1960. – 617 с.

11. Маевский В. Взгляд на труды А. Ноткина с позиций сегодняшнего дня (Приложение – Письмо Ноткина А.И. Сталину И.В.) [Текст] / В. Маевский // Вопросы экономики. – 2001. – №3. – С. 105–116.

12. Менделеев Д.И. Заветные мысли [Текст] / Д.И. Менделеев. – М.: Мысль, 1995. – 413 с.

13. Шарапов С.Ф. Избранное [Текст] / С. Ф. Шарапов; [сост., автор вступ. ст., коммент. А. В. Репников]. – М.: Российская политическая энциклопедия (РОССПЭН), 2010. – 744с.

14. Кейнс Дж. М. Общая теория занятости, процента и денег [Текст] / Джон Мейнард Кейнс. – М., 1976. – 453 с.

15. Борисов Е. Ф. Экономическая теория в вопросах и ответах: учебное пособие [Текст] / Е. Ф. Борисов. – М.: Велби, 2005. – 256с.