To What Extent is the Free Market Compatible With the 'Strong State'?

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Abstract
Contradictory views persist among neoliberals, social democrats and social liberals regarding relationships between free market and the nation State. In one hand, neoliberals suggest that the development of the free market puts constraints on the role of the state. Yet empirical evidence to support this view is lacking and range of commentators show not only resilience but even the expansion of state spending. Moreover, the article highlights that the State has welcomed globalization for the betterment of the society and subsequently it is restructuring itself to accommodate the changes to be effective on a desired way.
Keywords: Globalization, Strong State, Free Market, State Control and Liberalism

1. Introduction

The concepts of 'free market' and 'globalization' have become very common issues in social, political and economic discourse. In line with these concepts, the relationship between the 'free market' and the 'State' emerged as a conundrum where contradictory views persist around this issue. Initially, the concept of the free market was perceived simply as international trade. With the passage of time, the form, the nature, and the extent of free market have changed significantly; most notably the financial liberalization have significant bearing on the basic concept of free market. The economic liberalization along with the globalisation process has raised debate about the basic 'theory of the State' among the neoliberals, social democrats and social liberals. In one hand, neoliberal rhetoric, policy commentators and academic accounts suggest that the development of the free market through the liberalisation, privatisation, globalisation etc leads to the decline of the nation state. Yet empirical evidence to support this view is lacking and range of commentators show not only resilience but even the expansion of state spending. This paper will briefly clarify the concepts of 'free market', 'globalisation' and the 'strong state'. Afterwards, focus will be on the merits of both the globalisers' and the sceptic's case and consequently we will explore to what extent, actually, are free market and the strong states compatible or contradictory.

2. The Concept of Free Market, Globalisation & The Strong State

In a simple form, 'free market' can be defined as the 'borderless trade' between countries. In a broader sense, it is the outcome of 'economic liberalization' where financial markets will open up along with the borderless international trade. From globalisation perspective, free market is the outcome of the globalisation process; where the term 'globalisation' can be defined as a process or set of processes through which states have become intensely interconnected and interdependent to each other economically, socially, culturally and politically (Pierson, 1996). As the central theme of this paper is set for the relationship between Free Market and the Strong State, it is thus the 'economic liberalization' of the globalization process, which will be the focus of the paper.

Primarily, taking part into the free market economy require some special policy and strategic treatment from individual states; such as having the need to possess their own domestic competencies to promote and participate in the economic liberalization process. The way the various states accommodate themselves within the liberalization process reflects their degree of 'capacity' to afford such participation. From this view, we can define the concept of the Strong State; which is the states with the 'higher capacity' can be termed as the 'strong state' and the states with the 'lower capacity' can be termed as the 'weak state'. For further clarification of the concept of strong or weak state it is important to know what 'state capacity' means.

From the context of 'free market economy' Weiss (1998) defines state capacity as

> 'The ability of policy-making authorities to pursue domestic adjustment strategies that, in cooperation with organized economic groups, upgrade or transform the industrial economy' (Weiss, 1998:5).

At operational level a state's capacity in industrial economy is determined by its institutional sophistication, infrastructural development, capital market sophistication, good governance, reflexive policy formulation in related areas (e.g. investment policy, foreign trade policy etc.) and coordination of industrial change to accommodate international competition. Therefore, from the free market's perspective, it is the degree of 'state capacity' that determines whether a state is strong or weak.

3. Free-Market: Putting Constraints on the Role of The State

The neo-liberal conception of limited government states that the free market and its related features have weakened the role of the states in many circumstances. The neoliberal view also suggests that the Keynesian welfare states are under pressure as the changing international context undermines the national Keynesian strategies. It appears that the traditional 'state capacity' have become insufficient in international context. Similarly, the interventionist states are facing difficulties as economic integration often bypasses the state interventions. Often it is argued that the rise of the transnational organizations, global multilateral bodies and non-governmental organizations have taken away part of the state autonomy. Primarily, these are the major views held by the neoliberals and many policy commentators in the discourse of 'State and power' in international context. Now, some specific policy areas are discussed below to explore how free market is putting constraints on the role of the states.

One of the major influences of the free market forces can be traced in state's freedom in macroeconomic policy choices. According to the globalisers, the options open to policy-makers of the states, in isolation, have been narrowed due to intense interdependencies between countries. As a result, governments are being forced to take *'conservative fiscal policies and market friendly economic strategies'* (Held and McGrew 2003:299); that is the policy options have mostly converged to neoliberalism.

Particularly, in case of the fiscal policy, free market put constraints over states' taxation policy (Genschel, 2002). It is important to realize that the capital mobility makes the tax basis useless and thus *'seriously reduces the nation states' ability to conduct redistribution policies'* (Schulze and Ursprung, 1999: 296). Basically, due to financial openness, government's revenue generation scope has been limited because financial capital can escape higher tax rate by flowing to relatively lower tax based countries. This escaping nature of such tax factor brings distortions to tax policies; that is, tax burden ultimately falls on those factors that cannot escape the national tax policies (e.g. property tax, labor income tax[1], consumption tax etc). In contrast, government imposes relatively relaxed tax policies for mobile factors[2], which otherwise might immigrate to other countries (Schulze and Ursprung, 1999, Held, 2004). This taxing issue is termed as 'taxing dilemma' by Genschel (2002); he mentions that the states are trapped into taxation policy where states are facing constant external pressure to reduce taxes on capital (due to escaping nature of the capital) and internal pressure to reduce employment and consumption taxes because higher tax in employment and consumption may depress employment, encourage shadow economy and also raise question of equity (Genschel, 2002:266). But to run a balanced budget, government has no other option but to tax these relatively immobile factors. In this way taxing dilemma arises for the state, and thus Genschel rests his comment on how free market is putting constraints on the state in policy choices.

Ohmae focused the 'free market' issue from capital mobility perspective. He portrays the modern world as borderless world where territory becomes irrelevant when private capital flows across borders without any government involvement (Ohmae, 1995:3). This movement of capital rests on the basic economics of maximization; that is the capital flows where there are opportunities for higher return. Ohmae criticizes the traditional form of government interventions in the capital market as 'old fashioned tax breaks for investing in this or that location—are becoming irrelevant as decision criteria' (Ohmae, 1995:3). Ohmae suggests that the government should embrace neoliberalism instead of traditional protectionism because it is not possible for any government to protect its domestic market or industries in the long run; government can only protect them with tariffs/quota etc in the short run at the expense of the taxpayers (Ohmae, 1990). Besides, some argue that the protectionism is unfair for the general consumers because protectionism hampers fair-competition which results in relatively higher prices in the domestic market than the price that would have been achieved in an open economy. According to Held, McGrew, Goldblatt and Perraton:

[1] This is applicable more for middle income people. Moreover, compared to capital mobility, labor has remained immobile (Schulze and Ursprung, 1999:302).
[2] Capital, receipts from investment income and on the highest earners (Held, 2004:30).

> 'Today, not only tariffs and quota restrictions, but also policies supporting domestic industry and even domestic laws with respect to business competition and safety standards are subject to growing international scrutiny and regulation' (Held et al., 2000:187).

On the other hand, free market forces gave birth to some large organizations, popularly known as MNCs (Multinational Corporations), which are major constituents of the globalisation process (Held et al, 2000). MNCs flourished in order to reap out the benefit of cheaper factors of production around the globe. It is noticeable that the 'MNCs account for about 25% of world production and 70% of world trade'; moreover, MNCs' 'sales are equivalent to almost 50% of world GDP' (Held, 2004:23). Some argue that, it would be a misconception to think that MNCs only crave for their personal gain, because MNCs also have significant contributions to economic development where they operate.

As Ohmae mentions

> 'True global corporations serve the interests of customers, not governments……They invest, they train, they pay taxes, they build up infrastructure, and they provide good value to customers in all the countries where they do business.' (Ohmae, 1990:195).

It captures the essence of the contributions of the MNCs into the global economies and it also reflects how the power balance is shifting towards the private sector from the public sector. The MNCs have significant market power as in some cases they have established international oligopolies (Held, 2004). Moreover, they are financially strong and a good source of revenue for the government (tax income). The political parties often depend on the MNCs' business donations for their electoral campaigns. In return, MNCs often impose their influences over the government of both the home and the host countries to cater their needs[3].

From another strand, the globalisers advocate that the sovereignty of the states have diluted among national, regional and international institutions. In many cases, the national states are 'hollowed out' as the supra-national organizations have taken away much of their decision making power; which Jessop has termed as 'the loss of the de jure sovereignty of national states' (Jessop, 2003:12). States' central decision making power has spread in every direction—upwards (World Bank, IMF etc.), sideways (regional blocks), and even downwards (local level of governments). The individual states are now part of a global economic process where they can secure domestic welfare of their inhabitants and their institutions through collaborative actions at regional and or transnational level. According to Carnoy and Castels, this interconnectedness and interdependency among all the parties (state, NGOs, multilateral organizations, local governments etc.) has transformed the state as a 'network state' where decision is being made at different levels of this network violating the traditional hierarchical mode of organization (Sakellaropoulos, 2007).

Primarily, the transnational institutions[4] are developed in the name of governance and cooperation of international trade and affairs. The member nations must comply with the policies set by these multilateral bodies in order to take part in international trade in an orderly way. Though these organizations are established to cater global socio-economic integration, they, mostly World Bank and IMF, impose significant controls over social or economic policy issues in less developed countries, especially Africa and Asia. Often the activities of these multilateral organizations are questionable. Some argue that the multilateral organizations do not act on behalf of all its member nations because often they only reflect the interests of few rich nations (Halliday, 2003: 494). In similar vein, Pierson states that, these transnational institutions much of the time acts on behalf of individual nation-states to continue to pursue their own narrowly conceived national interests (Pierson, 1996).

Besides the growth of the transnational organizations, regionalization also flourished at a greater pace to utilize the benefits of economic liberalization[5]. These strategic alliances are the formations of inter-governmental

[3] The large superstores in UK are having too much power on national government due to their huge financial strength (Monbiot, 2001)

[4] IMF: International Monetary Fund, OECD: Organization for Economic Co-Operation and Development, GATT: General Agreement on Tariffs and Trade, WTO: World Trade Organizations, The Bank of International Settlements etc.

[5] NAFTA: North American Free Trade Agreement, EU: European Union, APEC: Asia-Pacific Economic Co-Operation, SEATO: Southeast Asia Treaty Organization, ASEAN: Association of Southeast Asian Nations

networks in search of mutual beneficial results. Generally, various nations join together, usually neighboring nations, to cater the beneficial economic arrangements within themselves and also to form a stronger economic block in order to compete with the relatively larger and the stronger economic power. And in return, the individual member states willingly giveaway a certain part of their autonomy to the regional block. Such as, while forming the EU, individual states willingly surrendered some aspects of sovereignty to the Union and that helped them to establish a stronger economic block in the face of the dominance of the US (Held et al, 2000:74). Similarly, South East Asian nations developed ASEAN, a regional political complex to establish cooperative arrangements within themselves and at the same time to fight with the Western superpowers. In any case, the bottom line is that, both the regionalization and the institutionalization of global affairs, in the name of co-operation and governance, actually disempowering the role of the individual States, especially the role of the smaller or the weaker States.

4. Free Market: Demands More State Participation

It is true that the States are going through a transformation phase but naïve claim of demise of state power due to free market forces is misleading; rather empirical evidence depicts an opposite picture. Unfortunately, globalisers often have mistaken the changing nature of the state as 'diminution of state power'. Moreover, they always exaggerate the concept of internationalization while ignoring the adaptability of the 'state capacity' (Weiss, 1998). Often, a question arises as to what extent the economic globalisation is actually happening in reality. The critical diagnosis of the FDI figures, one of the measurement tools for economic globalisation, can shed light on this issue. Generally, globalisers argue that the MNCs are relocating their production units offshore to utilize relatively cheaper factors of production. From that perspective, economic globalisation can be termed as 'transnationalization of production'. But in reality FDI figures do not support this view. Its been observed that majority of the FDI goes to 'non-productive' assets (e.g. speculative ventures or financial services) and a larger part of manufacturing FDI concentrates on merger and acquisition activities rather than the real investment (Weiss, 1997)[6]. Additionally, the current figures reveal that most of the FDI are directed towards the developed nations, only a minor to developing nations[7]. Therefore, the claim that the MNCs are relocating their production units to those locations where the costs of factors of production are lower is wrong[8]. Besides, most of the assets of the MNCs are located in the OECD countries, not in developing countries. Thus the picture of economic globalisation may not be fully true as the globalisers often misrepresent the facts to people for certain political reasons. In order to understand the actual relationship between free market forces and the Strong State, let us look into some critical roles of the states in international context.

Firstly, it is important to examine the 'State capacity' issue because this factor determines to what extent a State is capable to deal with the free market forces. As it is mentioned in the first section that the strong states have higher level of capacity compare to the weaker states; therefore the weaker states are more vulnerable to external shocks compare to the strong states. The Southeast Asia's financial crisis in 1997 does not show that Thailand could not manage the 'financial liberalization', rather the incidence merely shows that the countries (e.g. Thailand, Malaysia, Indonesia) that collapsed in 1997 had weak capacity; that is those countries did not have such coordinated investment guidelines to cope up with the financial liberalization. Whereas, organized countries, like Korea and Japan, could achieve higher growth in such developmental state as they had organized state-guided strategies (Weiss, 1998). Thus states' successes depend on the 'state-capacity' issue rather than state's compatibility issue in the free market economy.

Secondly, it is important to analyze how the states manage their macroeconomic policy issues in international settings. In case of macroeconomic policy options, there is a constant tension between Keynesian and Neoliberal policies in the age of economic liberalization. As it is argued that the free market has forced nations to be more liberal in macroeconomic policy issues but in reality, both the approaches (Keynesian and Neoliberal) focus on only short-term policy objectives. 'In both cases the instruments of intervention are predetermined; there is little

[6] The large outward flows from Sweden and the UK in the 1980s were mainly for 'portfolio' purchases, involving mergers and acquisitions of existing assets. During the same period M&A ventures expanded dramatically in the United States, rising from 67% to 80% of inward activities. (Weiss, 1997:8-9).

[7] Out of top 50 home-host economy FDI relations in 2005, 41 were among only developed countries and 9 involved developing economies; and United States became the largest FDI recipient in the world (UN, 2007:20).

[8] In 1991 81% of world stock of FDI was located in the high-wage and relatively high tax countries; principally the US, followed by the UK, Germany and Canada. (Weiss, 1997:10).

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room for creative adjustment' (Weiss, 1998:197). Thus there are no such 'real' shifts in macroeconomic policy adjustments from that perspective.

Furthermore, the globalisers' allegation about the welfare retrenchment by the states due to economic integration needs closer examination of the phenomena. Firstly, any retrenchment in welfare should be considered along with expansionary pressure in other part of the welfare sector (Doogan, 2009). Similarly, other domestic factors (e.g. demographic change, recession, technological unemployment etc.) can be responsible for any change in fiscal policy. In addition, Bonoli, George and Taylor pointed out, any retrenchment should not be considered as mere state or corporate withdrawal rather it should be seen as 're*commodofication of welfare systems'* (Doogan, 2009). Often it happens that the political electorates blame the uncontrollable global forces for taking unpopular policies (e.g. fiscal retrenchment).

Besides fiscal policy, states still have significant role to play in maintaining its internal affairs; such as, industrial/technology policies that have significant economic implications. There is a misconception that the international integration demean domestic economy management, but the globalisation process demands more active and creative participation of the state[9]. To succeed in globalisation process, each nation has to have its own 'competitive advantage' that depends entirely on the capacity and role of the state (Dicken, 2003). The principal advocate of this view is Michael Porter who states that the establishment and sustainability of competitive advantage is highly a local process where state is the major player of the process (Dicken, 2003). This view emphasizes that the competitiveness of a nation is defined by productivity which depends on how state utilizes its human, capital and resources (Porter, 2004). Porter (2004) also added that the competitiveness is embedded on a nation's microeconomic fundamentals (e.g. industrial technology, business environment etc.)[10]. And government along with private sector can take appropriate policies (e.g. sophisticated physical infrastructure including transport and communications, laws and regulations etc.) for the advancement of these microeconomic fundamentals. In the international context, as states face new challenges everyday, they develop and implement innovative policies/strategies on a regular basis. Since, the nations are continuously struggling to get larger share of the global economic pie, it can be said that the nations have become 'competition states' where states take strategies, like a firm, in order to gain competitive edge over others (Dicken, 2003).

Not only the internal affairs, states still actively play crucial role in managing external affairs. In case of international trade policies, states are applying creative and innovative policies in order to profit from international trade and also at lower cost. Apparently it may seem that the free market forces have teardown the trade barriers (e.g. tariff) between countries, but in reality the barriers have taken a different form which is known as non-tariff barriers[11] (NTBs), the tools of 'new-protectionism' (Dicken, 2003). These trade barriers are mostly imposed on the import sector as opposed to the export sector where states provide incentives (e.g. tax benefits, subsidies etc). Governments also try to induce, in a guided way, more Foreign Direct Investments (inward investments) in the economy. At the same time government imposes some regulations over the operations of the foreign firms so that it fits with their national interests. State regulations over foreign firms can be in the form of restrictions on the remittances of profits, insistence on involvement of local personnel in managerial positions, compliance with national codes of business conducts, restrictions on the degree of foreign ownership of domestic enterprises etc. (Dicken, 2003).

Another viewpoint for State's importance is that a nation's competencies to sustain in the free market system needs close assistance from The State itself. States act as a 'facilitator' or 'catalyst' in the globalisation process; but, as mentioned earlier, the 'state capacity' varies significantly among strong and weak states. Generally, the weaker States, mostly the developing nations, having poor financial infrastructure and un-sophisticated capital market, need to do careful analysis of their current status before responding to the free market invitation. It is also important to consider that to what degree of openness each State can afford with their existing market and

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[9] Singapore's remarkably high savings rate (approximately 45% of GDP) has been achieved through a system of forced savings which channels compulsory contributions from employers and employees to the Central Provident Fund (CPF) (Weiss, 1997:19).

[10] More than 80% of the variation of GDP per capita across countries is accounted for by microeconomic fundamentals (Porter, 2004:50). Porter's Study also show that there is close relation of a country's BCI (Business Competitive Index) and GDP per capita (Porter, 2004:50).

[11] E.g. voluntary export restraints, rules of origin, special labeling and packaging regulations, health and safety regulations, customs procedures and documentations etc.

financial infrastructure. Globalisation is not an automatic process rather it needs considerable internal preparation to accommodate it. Evidence also suggests that sophisticated internal economic integration can result into successful external economic integration (Held, 2004) and only domestic government can ensure such preparation. As Castells (2000) argues that the economic globalisation was possible for deliberate implementations of government policies. Indeed, the 'free market' demands more responsibilities on the States to look after their own economic activities than ever before. The works of Dani Rodrik is worth mentioning here as his study focuses on the relationship between government and globalisation. He showed that a robust association exists between an economy's exposure to international trade and the size of its government. With the empirical evidence he showed a positive correlation between trade openness and the scope of government[12] exists, (Rodrik, 1998). He justified this empirical evidence by focusing on the State's role responding to external risks; that is government increases expenditure to give social insurance in economies subject to external shocks. Thus, globalisation is not excluding government rather demands more State involvement to accommodate its process.

5. Conclusion

The above discussion explores both the sides of the free market conundrum. In one end we have neoliberal policy rhetoric that suggests that the free market has weakened or restricted the role of the state. Subsequently, specific policy areas have been discussed from globalizer's point of view which assume that the states are encountering several barriers in their ways of managing domestic and foreign policies; such as macroeconomic policies, investment policies, foreign trade policies etc. But the way globalisers perceive the states' policy changes as 'diminution of state power', may not be the case in reality. The proponents of the 'free market' perceive the globalisation process as something external to national economies, acting on domestic policy, but what they fail to see is the globalisation as something in which states are active agents rather than passive victims. The greater role of free market economy does not merely mean that The State's activities are declining because empirical evidence shows that it requires State to increase its involvement to certain policy fields (Pierson, 1996). It is a paradox that the globalisation process does not lead to a simple decline of The State but may seem to necessitate the actual expansion of *de facto* State intervention and regulation in the name of competitiveness and marketization (Cerny, 1997).

In reality, State actors and institutions are themselves promoting new forms of complex globalisation in the attempt to adapt State action to cope more effectively with that they see as global 'realities' (Cerny, 1997). In light of this view, we can say that globalisation is not changing the role of The State; rather The State has welcomed globalisation for the betterment of the society and subsequently it is restructuring itself to accommodate the changes to be effective on a desired way. Empirical evidence also shows that to integrate the nation into the competitive global market, States are playing important roles. It's not the 'state only' or 'just globalisation'; it is the balance between the free market and the State-control to achieve a higher economic growth. Though power balance significantly varies among nations but the end point is--more open economies require more State involvement. To rely on the market, State needs establishment of proper market-functioning institutions and proper laws and regulations to maintain the market disciplines. Thus, all the Nation-States, weak or strong, both implicitly and explicitly are playing important role to achieve everyone's own economic objectives; their significant interventions in the operation of the markets are reshaping the global economic map (Dicken, 1998). In summary we can say that, from a wider perspective, as all the nations are playing their own roles on global market, and by doing that they are actually continuously changing the globalisation sphere. The Free Market itself is created by the utmost efforts of all the States together and henceforth there is no question about the compatibility of the State to Free Market.

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