Authors:
Vito Tanzi
International Institute of Public Finance, Munich, Germany

THE ELUSIVE SEARCH FOR HARMONY BETWEEN THE ROLE OF THE STATE AND THAT OF THE MARKET*

Abstract

Since the creation of modern states, states that were democratic and used market economies, there has been the question of what should be the economic role of governments. During the many years when the prevailing ideology was "laissez faire", the answer was that governments had very few basic responsibilities and available economic resourced should be directed exclusively toward increasing output, without any attention to the distribution of income. After the years of the Great Depression and the Second World War, views started to change and welfare states that paid attention to income distribution and to the well being of all the populations came into existence. After the decade off the 1970s there was a tentative return of policies to more laissez faire. The result was uneven income distributions in many countries. The paper stresses the difficulty in reaching harmony between the role of the state and that of the market.

Keywords: Laissez Faire; Use of Economic Resources; Income Distribution; Harmony; Ideological Changes
JEL Classification: B10; B20; D60; H10; I30; P10

Riassunto

La difficile armonia tra funzione dello stato e funzione del mercato

Dalla creazione degli stati moderni, stati con carattere democratico, che funzionavano con economie di mercato, c'è stata la questione della responsabilità economica che avevano i governi di questi stati. Durante gli anni quando l'ideologia del "laissez faire" era dominante, fino agli anni Venti, la risposta era che i governi avevano poche responsabilità e le risorse disponibili ad un paese dovevano essere usate efficientemente, senza preoccupazione per la distribuzione dei redditi. Con la Grande Depressione degli anni Trenta l'ideologia cominciò a cambiare e gli stati sociali, che davano molta importanza alla distribuzione del reddito, furono creati. Negli anni

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Ottanta ci fu un tentativo di ritorno all'ideologia di laissez faire. L'articolo conclude che solo in pochi anni, e per poco tempo, c'è stata armonia su quello che doveva fare il mercato e quello che doveva fare lo stato nell'economia dei paesi.

1. Introduction

This article focuses on the long run and covers three, somewhat distinct, though partly overlapping, periods. The first is the period from the mid 19th century until the late 1920s. The second is the period from the Great Depression until around 1980. The third is the post -1980 period, until the arrival of the Great Recession in 2009. The period after the Great Recession has taken characteristics of its own, including the impact of the pandemics and of recent governmental actions that have been playing distinctly different roles, roles at times close to what was needed, at other times far from it.

The article deals with what may be the most important question in economics: the economic role that the government, or the state, should play in democratic countries which operate with market economies. How and why that role has changed over time? How closely has it matched what the market needed, and the citizens expected the governments to do? Why did the government role become increasingly larger and more complex? The key assumption is that, at any one time, there should be some balance, or some harmony, between what the market requires from the government and what many citizens expect the government to do. This equilibrium is often broken, leading to difficulties.

The views of economists have oscillated over the years, between seeing the government as the enemy of the market, to seeing it as a substitute for it. Some economists, at times, have even seen the government as a solution for all the social and economic problems, as some did in centrally planned economies. In a market economy, the government should ideally correct the market failures and should be seen as a necessary input into the work of the market and as a complement to it, not as a substitute of it.

At some times, the market might be so efficient as to require little government's intervention, at other times more. There should be harmony between what the citizens expect from the market and what they expect from the government. In the real world, this harmony seems to exist only in brief periods, if ever. When the right balance is broken, as it has often happened, the role of the government or the operation of the market, or both, should change.

Often the needed changes come late and may, in turn, create their own difficulties for the future. Or, the changes go further than needed. This has happened several times in the past, when major disequilibria were created, between the actual, or positive, role of the state and the expected, normative role. It also happened when the market was expected to perform miracles, thus excessively reducing the government role.

2. The period before the Great Depression

The economic role of the state has attracted the attention of philosophers, political scientists and economists for centuries. In the 19th Century there were two main and somewhat conflicting schools of thought: *laissez faire* and *socialism.*
Laissez-faire has often been attributed, not entirely correctly, to Adam Smith's "The Wealth of Nations". In that book, Smith wanted the government to play a role that was different from the one that it had been playing in his time, a role that he called *mercantilism*. *Socialism* had several branches and many advocates. Its two most important branches were: *Catholic socialism* and *Marxist socialism*.

Catholicism had always stressed the virtue of poverty, charity, and sharing, and the associated notion that private ownership of wealth conveyed social obligations on the part of those who owned it. This aspect had been stressed in the Rerum Novarum, the important, economically focused, Encyclical Letter, issued by Pope Leone XIII, in 1891. For Catholic socialists this aspect was consistent with a market economy and with the ownership of private property, and it could justify some inequality in income or wealth distribution, as long as that inequality was accompanied by acts of charity.

Marxist socialism, the version largely connected with the writings of Karl Marx and his associates, left no or very little role for the market, or for private property. It called for the socialization of all the means of production and for the centralization of economic decisions. Therefore, it would eliminate both the market and private property, and would aim for equality in the standards of living. For it, economic justice required economic equality.

Both kinds of socialism required some changes to what the role of the state was at that time, given the great inequality in income and wealth that existed. Marxist socialism required far more radical changes. The Marxist view had its first, real-life, experiment in Russia, after Lenin's Bolshevik Revolution, in 1917; and, in later years, in the Republics of the Soviet Union, in China, with Mao's Revolution, and in some other places. The results from those experiments are well-known. As socialist economies became more developed and more complex, Marxism proved to be an unrealistic option, in its pure form. The original idealism, that had existed among those who had endorsed it, was progressively replaced by corruption and inefficiency, and a new class, with implicit privileges, emerged in the socialist countries. Recent versions of it, that have given an important role to the market and to personal incentives, in China, Vietnam and elsewhere, have been far more successful economically, but they have largely abandoned the original objective of equality.

Laissez faire requires a little more attention because of its greater relevance for recent years, that saw some return to "market fundamentalism", and because there has been some misunderstanding about the role that *laissez faire* had played in countries in the 19^{th} Century. Many modern economists have failed to understand that *laissez faire* was not a completely free choice on the part of the governments, and it was never practiced in its pure version. See Tanzi (2018b).

The term **laissez faire** did not originate with Adam Smith, but in France, when, Colbert, the powerful finance minister of the King of France, in a meeting with French merchants, asked them what the government could do to help them in their activities. One of them, by the name of Legendre, replied that the best help that the government could provide to them was simply to stay out of their way, and "**nous laissez faire"**, to "let us do our business" without interference. Clearly, the merchants had seen the government's role at that time as an obstacle to their activities, because **mercantilism** had been a common government practice.

Mercantilism was an extreme version of what some, today, call "crony capitalism". Governments intervened in many economic activities, by creating monopolies for some privileged individuals, or by providing other competitive advantages for others. *Laissez faire* had, thus, little to do with the level of taxes, or with that of public spending, but much to do with the arbitrary use of regulations by governments. This use of regulations continues to be a problem today, in several countries.

It is important to stress also that, until the late 19th Century, governments would not have been able to play a modern economic role, one requiring significantly higher public spending, even if they had wanted to do so, because they could not have had the financial resources required by that role. They could not have been able to raise high tax revenue and to hire the competent public employees needed to supervise and monitor modern economic policies. See Tanzi (2018b.

Public debt was not as easily available as it is today, and recourse to it by a government was considered very bad policy (see Tanzi, 2016 and 2019). Because of the above reasons, *laissez faire* was seen by economists as an alternative *modus operandi* that was better than mercantilism. However, it was not, necessarily, the ideology that all governments would have chosen, if they had faced different financial and political realities.

Until the beginning of the 20th Century, the tax level of the now-advanced countries remained low, generally under ten percent of GDP. That level was barely sufficient to cover the government's needs: (a) to sustain the high standard of living of sovereigns, (b) to pay expenses for defense, (and, occasionally, for wars), for administration, justice, and essential infrastructure, and (c) for other public goods. For data, see Leroy-Beaulieu (1888), and Tanzi and Schuknecht (2000).

Why were tax levels so low? It was not necessarily because of explicit policy choices. They were low for objective reasons, and *laissez faire* may not have been one of the main reasons, even though, given the reality of the times, classical economists and governments had a bias for low taxes. The reasons for the low tax levels were several.

First, few citizens had the right to vote. Those who did were often males, property owners and individuals capable of paying the "poll taxes". These taxpayers who were the voters would not have been happy to support policies that required them to pay higher taxes. The widening of voting rights, especially during the first half of the 20th Century, and the extension of the right to vote to women, increased the support for higher tax levels in the new century.

Second, the "ecology of taxation" at that time (Tanzi, 2018b) would have made it difficult for governments to collect higher taxes, even if they had wanted to. In the second half of the 19th Century, and especially in the first half of the 20th Century, the Industrial Revolution would create large enterprises that concentrated much income and sales in few places. This created conditions that would make it easier for governments to collect higher revenue from income and sales taxes. These two tax bases would provide a large share of most of the countries' tax revenue in modern times. Without the industrial revolution it would not have been possible to collect these taxes.

Third, higher tax revenue and better schools made it possible for governments to hire more and better-trained, public employees, employees who could have Max Weber's ideal, bureaucratic traits. These bureaucrats were better able to monitor the more complex modern policies. The governments would not have been able to do so during much of the 19th Century. Higher tax revenue and better trained and paid bureaucrats made it possible, for governments, to satisfy the new, emerging, collective needs, and to reduce the wide gap, or the conflict, that had developed between the *desired* and *needed* role and the *actual* role of the state, in the early part of the 20th Century.

Industrialization, new technologies, and the growing urbanization created new needs for governmental intervention that had not existed in the past. Industrialized, urbanized, and democratic societies demand and need more public intervention (both higher public spending and regulations) than do more primitive, informal, and rural societies.

The second half of the 19th Century had experienced many reforms, and some historians – for example, Woodward, [1938] 1962 – had called that period *the age of reform*. However, the reforms had been mainly related to demands by industrial workers against the owners of the private enterprises, and not against governments. Most of the 19th Century's reforms had been directed at changing the relationships between the owners of the enterprises (the employers), that had all the economic power, and the dependent workers, who had had none. The reforms had aimed at: (a) improving working conditions; (b) raising wages; (c) reducing working hours; (d) demanding vacation time; (e) raising the age when children could work; (f) creating the rights of workers to organize and strike; and (g) reducing accidents in the places of work. There had been the beginning of some shift of power from employers to workers (see Loria, 1903). In addition to the above reforms, there had been pressures on governments to broaden the right to vote. Therefore, most of the 19th Century's reforms had not been directed towards creating economic claims, or entitlements, *against the state*, as they would in the 20th century, but *against private employers*.

True *laissez faire* had never existed in practice. Or, better, it had never been a genuine, free choice for governments. Classical economists, who at that time had little trust in governments, had advocated *laissez faire* as a lesser evil to the realistic alternative of mercantilism and bad government. The attitude of economists at that time had led some observers (as for example, August Strindberg, a Swedish dramatist) to argue that

"economics [had become] the science by which the economic elite remained the economic elite".

The most important Italian economist around the middle of the19th Century, Francesco Ferrara, who was a true believer in the evil of state intervention and in the virtue of the free market, in 1853 would write that the use of import duties, by the US government at that time, was a sin "as great as slavery". The USA committed this first sin for much of the *laissez faire* period, and so did several other countries, including Italy and France. The USA ended slavery (the second sin) in 1865.

Countries had used import duties as protective devises, as development tools, or simply to raise needed public revenue. Furthermore, governments often intervened with regulations and other policies, to assist specific industries (cotton, petroleum, steel etc.). So, they were not immune to lobbying by vested interests. *Laissez faire* was often used as an excuse for not intervening in some areas, but it was not necessarily the desired policy. By the beginning of the 20th Century, the gap between the actual role of government and the needed, and increasingly desired, role had become wide. This would lead to inevitable pressures to reduce it (see Porter, 1992).

3. From laissez faire to welfare states

By the turn of the 19th Century, the industrial revolution had advanced enough to radically transform the social and the economic environment that had existed in the past. The change had made the need for new policies and for a larger government role increasingly felt. Significant reforms would come mainly in the 1930s, pushed by the Great Depression, and especially after

World War II. The policy changes would progressively close the wide gap that had developed, between the *desired* and *needed,* and the *actual, positive* role of the state. They would also bring changes in the private sector; first through regulations, and then through higher taxes.

The years around end of the 19th Century had witnessed:

(a) The Bismarck's welfare reforms in Germany, that had provided, for the first time, minimum pensions to dependent workers.

(b) The influential writings by the German economist Adolph Wagner, who had argued that the economic role of the state was bound to grow, and that governments ought to play a role in making income distributions more equal.

(c) The previously mentioned Papal Encyclical Letter, Rerum Novarum.

(d) Rising concerns about the very uneven income and wealth distributions, that had been leading to major strikes by workers. In 1912, that concerns had led the Italian statistician Corrado Gini to propose the use of a statistic, the Gini index or coefficient, that would provide an objective measure of how uneven the income distribution of a country actually was.

(e) The introduction, in 1913, of the income tax, in the USA.

(f) The fast rise of labor unions, and the beginning of major and, at times, violent strikes.

(g) There would be other important developments, including, the First World War, and, in 1917, the Bolshevik Revolution in Russia. The Russian Revolution would have a great impact on economists who had had some socialist sympathies, of whom there were some or many in various countries.

The world that had existed until the 19th Century was being challenged by these developments, and a new world was slowly coming into existence. The new world would require a different and larger government role. Keynes would recognize the need for change, in a small book, published in 1926, called "The End of Laissez Faire". A few years later President F.D. Roosevelt would recognize this need in the USA, by introducing the policies of the *New Deal.* Those policies included social programs and important regulations of market activities.

The Great Depression accelerated the changes, also, by raising questions about the claimed virtue of the *laissez faire* ideology of well-behaved economies, when unemployment had reached 25 percent of the labor force in the USA and 30 percent in some other countries, and outputs had collapsed. Keynes would propose a counter-cyclical fiscal policy, significantly contributing to the change in the future role of the government. *Redistribution* of income and *stabilization* of the economy which had played no role in the past would become integral parts of the governments' operations. These changes would bring the role of government more in line with popular expectations, and presumably more in line with market needs. They would begin to close the gap between desired and actual roles of governments.

By the end of World War II: (a) many advanced countries were facing more friendly *tax ecologies*; (b) most citizens (including women) had acquired the right to vote; (c) advanced countries had become more urbanized; and (d) the attitudes of many, though by no means all, economists, had changed and had become more welcoming toward a larger and potentially more beneficial role that governments could play, in promoting the welfare of most citizens, and in stabilizing the economies. Proposals for changes in policies had been suggested, in the UK in the Beveridge Report of 1942, and, in the USA, in a "fire chat" by Roosevelt in 1944. Eisenhower's presidential acceptance speech, in 1950, would make many references to a new role that the government could play. These were all indications of the ideological shift that had taken place, and that was being increasingly recognized, even in conservative circles. Eisenhower was a republican.

The age of the "Keynesian Revolution" and that of the beginning of full-fledged welfare states had arrived. By this time the structures of the economies had changed, making it easier, for governments that wished to, to collect higher tax levels and to create the bureaucratic apparatuses needed to implement and monitor more complex government programs (see Fogel, 2000). If could be argued that, at this time, the *normative* and the *positive* roles of the government were coming closer, at least in the eyes of many citizens, and that the harmony of government and market roles had significantly increased.

In the decades that followed, between the 1940s and the 1970s, the levels of taxes and of public spending would grow significantly in most advanced countries. The share of taxes into GDP would rise from an average of around 13 percent, at the beginning of the century, to reach 30, or, in several countries, including Italy, to exceed 40 percent of GDP. The use of regulations – not just to control the profits of monopolies, as in the time of "big business" in late 19th century, but to reduce new forms of negative externalities that were created by the actions of individuals and enterprises, and potential abuses – increased correspondingly, and so did the power and the role of labor unions.

The new urbanized setting in which many people now lived, and the growth of large cities, in countries with deepening industrial activities, made more evident than it had been in the past that some negative externalities (pollution, traffic congestion, non-hygienic behavior, excessive noises, and others) needed to be controlled, and that only the government could do it.

The Great Depression had left deep scars in several countries, caused by the losses of incomes experienced by many unemployed workers and their families, at a time when there had been no formal “safety nets”. This experience had increased the popular support for social programs, and for progressive taxes to pay for them. The “personal income tax” with its progressive features had become important and had come to be considered by many an “ideal tax”. The new social programs, introduced in those years, financed by progressive tax systems, led to significant improvement in the income distributions in the following decades. Policies were also introduced that protected employment and “workers’ rights”. By the late 1960s these policies had created some significant market rigidities that with time would intensify and attract negative comments and reactions.

In those years there would be a kind of bifurcation of the road taken by the governments of advanced countries. Some would choose to raise the tax levels enough to finance some *universal* social programs (programs that were accessible, free or at highly subsidized rates, by all or by most citizens, regardless of income levels). Several European countries (especially the Scandinavian countries and a few others) chose this “universal” route. Other countries, especially the USA and some other Anglo-Saxon countries, chose a more “means-tested” route, a route that allowed access to government programs only to citizens that met certain, specified income or other criteria.

The universal programs tended to be administratively and politically simpler. However, they were more costly, and they required higher tax levels. The means-tested programs were less expensive but were more complex to administer. They required specific political decisions, and more administrative resources, to determine and to control accessibility to them.

The countries that relied on universal programs, generally, kept their tax systems less complex and more broad-based. For them the main objective of taxation remained that of generating high revenue, while respecting some broad criteria of equity. The countries that relied on the means-tested programs chose more complex tax system, in order to achieve, through the tax structures, particular social or economic objectives. These countries made less use of value added taxes and relied more on complex income taxes, using "tax expenditures", "tax incentives", "special deductions", and other features, aimed at achieving various social objectives, through the tax systems, rather than through public spending. This inevitably led to greater tax complexity, that over the years became a serious and growing problem.

Tax complexity tends to grow with time. In the USA, for example, the tax code and the related regulations now require tens of thousands of pages, compared with only about 500 pages until World War II. "Compliance costs" and taxpayers' complaints, about the complexity of taxes, have risen significantly. US taxpayers feel burdened by the taxes, even though the tax level in the USA has not changed much over the past half century and for high-income taxpayers, it has even fallen significantly. In other Anglo-Saxon countries the tax level changed less than in several European countries, but the complaints about high taxes intensified, because of the increased complexity of the tax systems.

Access by citizens to means-tested programs tend to grow with time, because of political pressures, bureaucratic maneuvers to make the programs more accessible, and increasing abuses and corruption. Means-tested programs create "poverty traps" because some individuals lose the public subsidies, if they became employed and thus create dependency by some on the public programs, reducing economic efficiency. By the 1970s taxes had generally become heavier, more progressive, and generally more complex in many countries, creating possible disincentive effects for working taxpayers, and some market inefficiency. The labor market had become over regulated and over protected. This led to growing concerns by economists, and to growing opposition to the high and progressive tax rates, and to the social programs that had required the high taxes. These reactions were especially strong in the Anglo-Saxon countries, that had used more means-tested programs.

By the late 1960s, the potential disincentive effects of high taxes and welfare programs, together with growing concerns about inefficiency of governments, and reported abuses of means-tested programs, and concerns about the role that labor unions were playing in particular areas (public schools, public enterprises and others), were being highly publicized by conservative economists and had started to influence the public opinion. This would lead to the election of some very conservative policymakers in influential countries, especially the UK and the USA. Clearly the equilibrium that had existed between the role of the market and that of the government in the earlier years was seen as having been broken. This would require adjustment, aiming at less government and more market.

4. A RETURN TO LAISSEZ FAIRE?

In the decade of the 1970s, conservative economists (Friedman, Hayek, Buchanan, Lucas and others), became more influential and attracted more attention and followers to their anti-government views. The *Chicago School,* the *School of Public Choice*, and the *Austrian School* became influential players at that time and created strong academic and political oppositions to high tax rates and to welfare programs.

Their influence seemed to be particularly strong in countries where the social programs were means-tested, and where the taxes had had high marginal rates, and "tax expenditures" had created significant complexity. The government started to be seen, by some important political figures (Reagan, Thatcher, and others), as an enemy of the market and of the capitalistic system. It became a Leviathan monster to be controlled, while the market came to be promoted as an efficient instrument that was to be admired and fully used. The difficulties that the countries of the Soviet Union were encountering in those years provided a convenient contrast.

Concepts such as "Laffer Curve", "Ricardian Equivalence", "Rational Expectations", "Efficient Market", "Excess Burden" and others attracted large followings, among academic economists and even among some politicians in those years. The above-mentioned economists earned Nobel Prizes in Economics in those years. The political winds had clearly changed direction: from those that had blown in favor of a larger government role in earlier years, to those that favored a larger market role. The new winds created skeptical attitudes toward the large role that the government had assumed in previous decades. The ground was ready for the pro-market, supply-side revolution that followed in several countries.

The supply-side revolution played a role in the election of highly conservative policymakers in several countries (UK, USA, Canada, Australia, New Zealand and some others). "Market fundamentalism" became a popular ideology. It could in part be seen as a return to the *laissez faire* ideology of a century earlier, but it had become a free choice. In the 1980s and 1990s many economists came to believe that the market, unassisted, could solve many problems, if allowed to, if there were no impediments by governments. High tax rates and regulations came under attacks. The government role started to be reduced, and much of the world became less regulated and more globalized. However, public spending resisted the reduction and this would lead to a gradual increase in public debt over the following years.

The economic results generated by the work of the freer market – in terms of income generation and distribution, and in terms of the assignment of values to economic activities – acquired an almost ethical justification (see Sandel, 2012). The scope of the market was expanded, by economists, such as Gary Becker and others, to encroach on, or to replace, some values that in the past had been based on traditional, community norms. Many came to believe, that market outcomes were always right, and should not be challenged. This would in time justify very high incomes for some individuals, at a time when the marginal tax rates on those incomes were being sharply reduced.

A period of privatization followed in many areas, (pensions, schools, jails, infrastructures, fighting wars, and even in the resolutions of some disputes between employees and enterprises). Important changes in the tax systems (such as dramatic reductions in marginal tax rates, changes in the "architecture" of the income tax, which gave preferential treatment to incomes from capital sources, and some others) were made, in the late 1980s and later. In important sectors (such as the financial market and the labor market) regulations were sharply reduced. Labor unions lost much of the powers they had had, and the managers of enterprises acquired more power and much higher incomes.

The supply-side revolution had been expected by its supporters to generate miracles, in terms of economic efficiency and growth, without making the income distributions less equitable. "Trickle down" effects would assure that everyone would benefit from the new policies. Unfortunately, growth did not pick up as significantly as expected, and the growth that occurred did not benefit a large share of the workers. The income distributions of many countries, and especially that of the USA, became much less equal. Much of the income growth benefitted only a few. The expected "trickle down" did not raise the wages of average workers, that, for many, remained unchanged for decades.

The supply-side revolution had come at a time when both the operations of the market and the activities of governments (including in the social programs and in the writing of laws and regulations) had been becoming increasingly complex. The growing complexity had been creating more opportunities for clever but less scrupulous individuals, and for lobbyists representing special interests, to exploit to their advantage both the operations of the complex market and those of the governments. Opportunities had been created for some to extract "rents". This new environment would, in time, lead to the financial crisis of 2008 and to the Great Recession of 2009 (see Tanzi, 2013). An increasing number of observers had started to define the capitalistic system, as it was operating, as "crony" or "casino" capitalism (see Sinn, 2010).

With the impact of new technological developments, and with globalized economic activities, the free market had changed in important and not always positive ways. It had come to resemble less and less the cozy and efficient market, that had been described and idealized by Hayek and by the Austrian School, and by Friedman and the Chicago School. In many exchanges, it had come to be characterized by "lemons", using George Akerlof's (1970) terminology. "Lemons" are market exchanges in which symmetry in the information, available to both sides of the exchanges, is missing.

The presence of "lemons", in many exchanges, between sellers and buyers, has significantly increased over the years. Therefore, an increasing share of the market exchanges are no longer welfare improving. "Termites" have entered in both the operations of the market and in those of the government. The economic sectors in which asymmetry in information can easily exist have been growing as shares of the countries' GDPs. These sectors include finance, that has become very complex and global; insurance; private health; house and car repairs; provision of various services, including tourism and legal services; exchanges of goods across frontiers; and others.

Many products and services have become too complex to be easily understood by normal citizens, and many products (including the growing share of "fakes" in the market) are no longer bought from nearby known suppliers, as they had been in the past, when economic activities had been mostly local, and exchanges had been mostly among acquaintances. Many of the products consumed in modern globalized economies are now imported from far-away places and from unknown producers, and they are produced under unknown conditions.

The asymmetries have reduced or nullified many of the benefits that are expected from market exchanges. *Ex ante*, it has become more difficult for an individual to know precisely the real value of what he or she is getting from an exchange, or from a contract, as happened in many of the financial transactions that led to the "sub-prime crisis" in 2008. Often the terms of formal contacts are buried in fine prints, and the contracts are written in "legalese", a language that only few can read and understand.

The asymmetry in information has worked its way into many operations of the public sector, including the drafting of laws, the interpretations of regulations and others. New laws have become thousands of pages long and, because of their length and their complexity, they are often approved by legislators and by policymakers who, in many cases, have not even read them (see Tanzi, 2011). Therefore, the *termites* (including the work of lobbies) can more easily penetrate the writing of the laws and of the regulations, and/or change their interpretations.

The existing laws have grown in numbers (in many countries they have reached many thousands) and in complexity. This development has created an almost impenetrable legal jungle for most citizens, one that can be easily exploited by clever representatives of special interest groups. The result has been a less transparent form of the mercantilism than had prevailed during Adam Smith's times. Privileged or clever individuals have been the major beneficiaries of some of the governments' activities.

5. Income distribution

During the 1980s and 1990s marginal tax rates on income taxes were dramatically reduced in many countries, especially the rates for the highest incomes. This happened at a time when the incomes received by these individuals were increasing rapidly (see Piketty, 2002). Furthermore, in an increasing number of cases, the incomes had taken characteristics of "rents" (i.e. partly unearned compensations) than truly *earned* and *deserved* incomes (see Tanzi, 2018a, Ch. 30). This development has contributed to the growing skepticism that has developed among many citizens about the ethics and the fairness of the market economy. This has helped promote populist movements, that have intensified in recent years.

The decades after the 1970s experienced what could be defined as a perfect storm. It was a storm that, in several countries, and especially in the USA, led to income distributions that became as uneven as they had been in the 1920s. The share of total national income received by those at the top 1 percent, or even at the top 0.1 percent, of the income distributions increased dramatically, giving these individuals great market and, increasingly, more power over policies. This happened at a time when the incomes of most workers had stagnated. This development could hardly be called utilitarian.

"Perfect storms" have several elements that can combine in unanticipated ways to contribute to the storms' power. Some of these elements are mentioned below, without much elaboration. Some were the direct consequence of the market fundamentalism that had influenced the role of the state, in the 1980s and later years.

The first element of the storm was the role played by the expanding and government-protected concept of intellectual property. Over the years, technological developments and public policies had created new possibilities, for some of those who could establish claims to intellectual property, to extract large profits from, unregulated, but government protected, monopolies. In many cases, the same genuine effort by an individual, an effort that in the past would have earned that individual a modest income, led to very large incomes (see Tanzi, 2018a, Ch. 30 for examples). These incomes had thus become largely "rents", in an economic sense.

The change was in part due to government policies that protected intellectual property rights and that assigned time-limited monopoly power over some output. Combined with technological developments, such as the internet, that had been largely financed by governments, it became possible for some owners of intellectual property to sell their output to a huge number of buyers around the world and to extract huge incomes or profits, that were little or hardly taxed. Many of the largest enterprises in the world, today, have these characteristics.

The second element of the storm was the novel view, promoted by some economists in the 1970s and 1980s, that large financial incentives can have a great impact on the performance and the productivity of individuals, especially of those who manage corporation. Money, and not pride or reputation, is supposed to drive performances. This somewhat novel view came to justify the asking for, and the giving of, huge bonuses and large compensations for CEOs and individuals. The new view promoted and encouraged the squeezing of the wages of normal, dependent workers, a process facilitated by globalization and by the weakening of labor unions. For average workers, financial incentives, or higher wages, were not assumed to stimulate productivity, only for the managers and other lucky individuals.

The average compensation of managers rose from the five times the average wages of workers that the first Nobel Prize in Economics, Ian Tinbergen, had considered desirable in the 1950s, and from the 20 times the level assumed desirable by Peter Drucker, the famed, management expert in the 1960s, to levels that at times reached or exceeded 500 times. In Starbucks and Chipotle, today, the CEOs get 1500 and 2000 times, respectively, the average salaries of their workers. The CEO of Apple gets about 1500 times the compensation of the Apple dependent.

There was no longer any embarrassment on the part of managers to ask for and to obtain compensations from docile Boards, that, in some cases, have reached hundred times that of the cash salary of the US president. Some managers have got these high compensations even when the performance of the enterprises that they managed was far from admirable, as happened in Boeing, after two of its advanced planes crashed within a few months. If the market was assumed to be always right, and if its outcome should not be questioned, these compensations were not to be challenged.

The third element of the storm was the already reported changes in the tax systems that occurred in many countries, in the 1980s and the 1990s. In those years the marginal tax rates, the rates that are important for very high incomes, were dramatically reduced (in the USA from 70 to 28 percent) and taxes on capital income were also slashed. Additionally, the growing complexity in tax systems, combined with the effects of globalization, created new opportunities for high net-worth individuals and for corporations to evade or avoid paying taxes. Some of the most profitable corporations now pay very little taxes.

Other factors, such as deregulation, especially in the financial market, the weakening of labor unions, technological developments and some others, have also played some roles in changing the social and the economic landscape in the past four decades. Clearly, the harmony that had in part existed, in the mid 1960s, between the desired role of the state and that of the market, was compromised.

6. CONCLUDING QUESTION

The final question to be asked is whether a market economy, in countries that are still democratic, can retain its legitimacy and its freedom when the income distribution becomes so uneven, and when it creates a new class of privileged individuals who increasingly feel that they are different from the rest, and that can influence public policy. This was the situation that had existed in the world in the years before the Great Depression.

In 1926, Lord Keynes had called for new knowledge to deal with that situation. New knowledge is clearly needed at this time to suggest what to do. This knowledge would aim at bringing again some harmony between the desired role of the state and the results that the market delivers. In the view of many people such harmony does not seem to exist any longer in many countries. Without that harmony, the world risks moving in unanticipated and not desirable directions, as several political scientists have been predicting.

The new harmony would need a government less exposed to lobbies, with less complex policies, including simpler taxes, with the capacity to regulate efficiently and equitably the work of the market, and with policies that do not eliminate the role of the market, but make the sharing of the national pie more equitable.

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