

# The state-owned company: “State failure” or “market failure”?<sup>☆</sup>

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## Abstract

This article will analyze the activity of state-owned companies and their place in the structure of market relations from the standpoint of contemporary approaches to the study of “state failure” and “market failure”. It will also consider the implications of the systematic embedding of private property rights. In addition to considering the costs of the functions of state-owned companies, the authors address the actual experience of the Russian economy in the present day, the experience of forming state corporations and the risks associated with their operation. Particular attention will be paid to the inhibition of incentives to improve the general institutional environment and, conversely, to the increasing incidence of direct state intervention in matters that affect economic development. We will examine the various ways in which the growth of the public sector, *de jure* and *de facto*, reduces opportunities for implementing private property rights.

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## 1. Introduction

Contemporary economic theory maintains that there is no “universally appropriate” form of property—a form that can be considered superior to all other forms of property and be implemented in any country and in all branches and sectors of the economy, irrespective of specific historical conditions. Even the “pure” forms of property in the overwhelming majority of cases are, in reality, composite. At the same time, comparisons of the efficiency of different forms of property (entrepreneurship) in particular spheres of economic activity do

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not discount and cannot discount, particularly in the circumstances of present-day “globalization”, the effect of mechanisms of central regulation.

The most acute problems of present-day economic development are influenced by the “structural interaction” of private and state-owned companies in different sectors of the economy.<sup>1</sup> The existence of one form of property relations or another in particular spheres of economic activity and the interaction of these forms are, as a rule, the outcome of lengthy processes of evolution. More often than not, these forms have been shaped by the particularities of historical development (“path dependence”), and they bear the imprint of the political and socio-cultural traditions that prevail in any particular society.

For example, A. Greif, in his detailed study of differences in the trading practices of the merchants of Genoa and the Maghreb during the Middle Ages, noted that in the period that followed, private entrepreneurs in the East were deprived of the opportunity to effectively defend themselves against state interference. Their activity was regulated by religious or secular authorities and sometimes, simultaneously, by both. Currently, the institutions of underdeveloped countries bear a resemblance to those of the Maghreb, whereas institutions of the developed West bear a closer resemblance to those of Genoa (see: Greif, 2006. P. 300–301, 396–397). For centuries in the East, huge economic enterprises were managed at the highest level of government, and in these circumstances, the productivity of workers, who in many cases were held in a condition of social subjugation, was low. For structures “of Oriental origin, the fact of being close to government or separate from government has always had great importance. Significantly, in Oriental societies, an unceremonious attitude towards the private property of those who did not stand in close proximity to the government has always been common. Unquestioning submission of the institution of private property and of property owners as a social stratum was the norm” (Vasiliev, 2010. P. 569).

The emergence of political-legal conditions that provide the optimal environment for intensive long-term economic growth has usually been associated with a contraction of the pre-existing (clan-feudal or administrative-command) system of all-pervasive regulation. However, new institutional theorists frequently refer to the “fundamental political dilemma” formulated by B. R. Weingast: “A government strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of its citizens” (Weingast, 1993. P. 287). In some contemporary, post-communist, developing states, the formula “growth in the shadow of expropriation” seems relevant as a description of the dilemmas encountered when constraints are placed upon the institution of private property (Aguilar and Amador, 2011).

Limiting the scope of government activity does not by itself ensure more efficient economic management or guarantee the emergence of market relations. Commenting about the logic of the transition of post-communist countries to a market economy, in his Nobel Prize speech in 1991, R. Coase justly remarked that without the appropriate institutions, no market economy of any significance can exist, adding that the “cultivation” of such institutions always requires time and effort (Coase, 1992. P. 714). This is why measures that augment the role of decentralized (“market-based”) regulation can, in developed countries, often turn out to be successful, whereas similar measures are inapplicable in the same form in countries that are still undergoing the effects of administrative command-type regulation. This circumstance serves to underline the priority that has to be given to the activation of competition mechanisms and the perfection of market institutions.

With regard to the costs incurred by the “failures” of state activity, it is not argued, and it cannot be argued, that every state activity is necessarily unproductive and that, accordingly, the state should be driven out of economic life by private enterprise. Adam Smith, who attached great importance to the “invisible hand” of the market, included amongst the direct

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<sup>1</sup> Unless otherwise indicated, the terms “state-owned company” and “state-owned enterprise” are employed in this article synonymously to describe any economic entity that is more or less controlled by the state. The term “state corporation”, strictly speaking, refers to a small number of entities created in 2007–2008 by special federal laws.

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