9 State and economic system regulation

From an evolutionary point of view, what role can or should the State play in the economic system? This chapter demonstrates that the State's role extends far beyond the simple task of correcting failures in the functioning of the market – the role to which public intervention is limited in standard microeconomic theory. However, the conditions for the success of this intervention are complex and delicate, and the more realistic framework of the economic system proposed by the evolutionary approach, while providing wider scope for intervention, restricts the degree to which the State can control the evolution of this system. When the neoclassical paradigm – and with it the criterion of Pareto-optimality – are called into question, it becomes much more complicated to define the function that the State should fulfil. The objectives of public intervention no longer appear so clear-cut. The formulation of a set of prescriptive criteria to guide this intervention therefore becomes indispensable.

In this chapter, the State's role is limited to interventions that are more of a microeconomic order (environmental policy, technology policy, management of the labour market, etc.). Policies of a more macroeconomic nature (budgetary and monetary policies, for example) have been deliberately excluded from the analysis. The evolutionary approach undeniably sheds new light on the objectives and conditions for the success of the latter, but this book is devoted to the presentation of an evolutionary microeconomic theory.

9.1 Background and problems

In neoclassical microeconomic theory, the legitimacy of public intervention in the economic system derives from several different sources. Generally, for economists, and more particularly for neo-institutionalists (see chapter 8), it is the State's duty to define the institutions and, on a wider scale, the framework – through the introduction and enforcement of laws – in which individuals and firms carry out their economic activities. The State therefore establishes the rules of the game and ensures their application. Here, its objective is to maximise an intertemporal collective surplus,

possibly under the constraint of equity satisfied by means of tax and redistributive tools. However, this chapter is not concerned with such a wide view of public intervention[40], but with a more specific justification, namely the correction of failures in the market. Such failures correspond to situations in which the free action of market forces does not spontaneously lead to a Pareto optimum, i. e. a situation in which the position of one individual cannot be improved without deterioration in the situation of another. The possibility of decentralised functioning of the economic system is highlighted by the two theorems of welfare economics, which stipulate, firstly, that competitive equilibrium always leads to a Pareto optimum situation and secondly, that a given optimum can always be attained through the competitive market provided that the appropriate modifications have been made to the initial agents' endowments. Consequently, State intervention can only be justified in situations where the market leads to inefficient or inequitable states. Traditionally, *three situations leading to market failures have been identified: (I) the existence of a natural monopoly, (II) the existence of public goods and external effects and (III) the imperfection of information*. We should emphasise from the start that an evolutionary approach in no way calls this point of view into question.

A situation of *natural monopoly* refers to the existence of growing returns in the industry concerned. Considering the size of the market, potential economies of scale justify the existence of a monopoly rather than the presence of many different firms. In this case, the public authorities are encouraged to regulate entry into this market, but also to control the activity of the monopoly so that it does not take undue advantage of its dominant position. Since the 1990s, neoclassical theory has given increasing importance to the role of competition policy, far beyond the simple regulation of natural monopolies, faced with firms using a whole battery of anticompetitive weapons (collusion, barriers to entry, predation), as the new industrial economics has illustrated only too well. In this field, as we shall see later, the evolutionary approach makes it possible to bring the effectiveness of classic antitrust measures into proportion.

The existence of *public goods* also justifies public intervention. A public good possesses two characteristics: non-rivalry or shared consumption (consumption by one individual does not reduce the consumption possibili-

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[40] On the question of the evolutionary analysis of the formation and evolution of laws, and more generally of the political process, see Slembeck (2003) and Pelikan (2003).