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PUBLIC SECTOR ECONOMICS AND NEW NEOCLASSIC SYNTHESIS

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Abstract

Public sector economics as a **theory of government's functioning in a market economy** unites public sector and the "third sector" (non-government and charitable organizations), i.e. the civil society. Public sector economics is a comparatively new branch of economics originated in the 1960s and it is a compulsory subject in universities which has been taught for several decades in the majority of developed and post-communist countries, but it is not taught in Georgia due to the absence of textbooks.

Public sector economics studies the issues of strengthening socialization of economy, i.e. functioning of socially oriented market economy and in this connection it puts forward the government's new role in economy. Social orientation made market economy politically viable.

The precursors for emergence of the public sector economics originate in the 1940s and are associated with an increase in consumer demand at an inclusive level based on Keynesian revolution which resulted in transformation of uncontrolled, unregulated capitalism into a new quality - socially oriented market economy was realized. In the 1960s the moving of an industrial society into a postindustrial society was preceded by scientific-technical revolution, creation of the system of national accounts of the UN and division of the economy into sectors, at the same time faster growth of service sector compared with real sector.

In modern conditions the market economy has acquired an even more developed form as a social market economy in the developed countries. Therefore, today the following five models of welfare state have been mainly developed in these countries. They are the Continental European or German, Anglo-Saxon or British, Scandinavian or Nordic, Mediterranean or South European and the Conservative/Corporatist or Japanese model.

The ignorance of these requirements is a sign of the backwardness of the country's economy. Therefore, in Georgia public sector economics must be included in university curriculum. The government's consideration of these requirements and students' awareness on governance of the country will play an important role in the formation of a healthy economic system.

Thus, the need to create an economy consistent with international standards objectively determines the study of public sector economics and taking into consideration its requirements in Georgia's economic policy.

Key words:public sector economics, model of orthodox macroeconomical stabilization, gradualism, “the third sector”, non-government organization, charity organization, social market economy, state models of wellbeing, state wealth, externals, natural monopoly, Continental European model, Anglo-Saxon model, Mediterranean model, Conservative-Corporative model.

Introduction

The bloodless revolutionary shifts taking place in the world since the second half of the 20th century especially strengthened the role and importance of economic sciences. A total of 27 countries with a population of 400 million faced a new reality. The refusal of “market socialism” and the formation of a new economic system must have become the basis for the establishment of economic system built on the principles of democratization, justice, raising the level and quality of life in these countries, including Georgia that turned out to be under this wave but unfortunately this did not happen. We did not embark on the path that would lead to the intended goal¹. Today, economic thought paves the way with difficulty in Georgia. The current hard socio-economic situation is not new and one might say it was revealed in the first years of restoration Georgia's independence (not to mention other processes, this is another theme)².

From the very beginning of the restoration of Georgia's independence, it was clear that the trend was directed at backwardness of the economy. As an economist, I became convinced that economic conversion started in the wrong way in the country and there are not only endogenous but also exogenous reasons, imposed from the outside, the overcoming of which took a lot of effort and this process continues today³.

Economic policy fit for orthodox model of economic stabilization appeared to be a kind of shock for Georgia. Unlike China where the construction of a new economic system did not start from scratch by destroying the economy, but on the basis of structural-productivity stabilization known as gradualism leading to the economic revival. Therefore, in Georgia the implementation

¹**Asatiani R.** Post-communist Transition Period in the Georgian Economy. J. “The Caucasus & Globalization”. Vol. 3(2-3), Issue 4, Sweden, Ca&CCPress, 2009.

²**Asatiani R.** Where is Georgia Moving? Conceptual analysis of socio-economic development. Tbilisi, “Siakhle”, p.60; **Asatiani R.** Let's partially overcome “information hunger”. “Bank”, #6 (30), 1993; **Asatiani R.** Service and Market System. Tbilisi, TSU publishing house, 1993, (Georgian).

³**Asatiani R.** Exogenous and endogenous reasons for the failure in economics. “Economics and topical issues of the development of economics”. TSU Paata Gugushvili Institute of Economics. Materials of the International Scientific Conference , 27-28 June, Tbilisi, 2014, (Georgian). **Asatiani R.** Caucasus and Georgian Economy: Past, Present, Prospects. “The Caucasus Region: Economic and Political Developments”. New York, Nova Science Publishers, Inc., 2009.

of economic policy under foreign dictation collapsed as it brought far more problems than solutions. Social issues manifested themselves especially acutely.⁴

This situation put numerous issues under question that had a negative impact on the prestige of Georgia, its international image.

In Georgia in such critical situation it is necessary to work out a scientific paradigm where social requirements will be taken into consideration in the first place. For this, not superficial evaluations are needed but deep analysis based on fundamental concepts approved in the world. This will give an opportunity to get rid of illusions and overspending.

How socio-economic phenomena and processes occurring in Georgia fit the earlier period of the development of capitalism. Against the background of positive changes approved in the world when we could introduce progressive forms of economy and transition to a market economy passing by socially unprotected capitalism, it is a great pity that we found ourselves in a dramatic situation and took the long and difficult road traversed by civilized worlds so painfully.

The formation of socially oriented market economy in Georgia requires new approach and puts forward a new role of the government.

This was the basis for the recently written and published textbook concerning the public sector economics, which was presented a month ago at the Georgian Technical University⁵.

Main Content

Public sector economics is sometimes termed state sector of economy but this is not an exact definition because besides public sector it includes “the third sector” – non-government and charity organizations, i.e. civil society. The subject of its study is just state sector and “the third sector”⁶.

Before dealing with the peculiarities of the functioning public sector economics and its main directions, we consider the prerequisites of the origin of public sector economics as a logical result of objective process and development of the world economy.

What were the objective prerequisites for the emergence of the public sector? The question arises as to how it happened that uncontrolled, unregulated capitalism based on individualistic theories and microeconomic paradigms (capitalism which in the course of 160 years from the

⁴Asatiani R. Study of Public Sector Economics as Necessary Condition of Social Orientation, “Bulletin of the Georgian Academy of Sciences”. Vol. 169, Issue 2, March-April, 2004., p. 199.

⁵Asatiani R. Public Sector Economics. Tbilisi, “Siakhle”, 2017. (Georgian).

⁶Zhiltsov E.N. Economy of the state sector and non-profit organizations. M., "Publishing house of the Moscow University", 1998, (Russian).

last quarter of the 18th century to the forties of the 20th century till the well-known in the world history “Great Depression”, economic system based on prevailing private exploitative relations) has been replaced by a social oriented capitalist system called market economy. But what happened, how the market economy was formed as comparatively high form of the development of capitalism which was based on social orientation of economy, the real implementation of which started since the 1940s and is associated with the use of postulates about macroeconomic regulation considered in John Maynard Keynes’s best-known work “The General Theory of Employment, Interest and Money” and on its basis the issues of strengthening economic socialization of economic policy of the leading (first of all the US) capitalist countries⁷.

Studying the issues of strengthening economic socialization, public sector economics puts forward the government’s new role in the economy. The origin of public sector economics was favored by the development of economic directions and theories, on the one hand, and on the other hand, the boom in technical sphere which later grew into technological boom.

Specifically: An increase in population’s demand at inclusive level since the forties on the basis of the “Keynes’s revolution” that was realized by reduction of taxes and increase in the state social expenditures as well as creation of new jobs caused growing of capitalism into new quality which changed the trajectory of the economic development of the world. The formation of socially oriented economy has become a significant trend of the world development. It was due to the “Keynes’s revolution” namely that in the 1950s scientific-technical revolution took place. It was followed by structural transformation of the economy, rapid growth of the service sector as compared with the rest two sectors – agrarian and industrial was marked. The service sector appeared in cause-reason relationship with the real sector, at same time, later this laid a foundation for the development of information service that can be formed as a separate sector.

Division of economics into sectors was preceded by the creation of the system of national accounts⁸ based on the ISDC obtained as a project in 1948 by the UN for the first time in history in 1953, which beginning from 1958 formed the basis for the study of separate countries and establishment of economic interrelations with the rest of the world.

These progressive phenomena changed the vector of the world’s economic development. **Since the 1960s a new era has begun in the development of mankind, which was also beginning of the establishment of a new world order.**

⁷ Keynes J. *The General Theory of Employment, Interest, and Money. Translated from English. M., Progress, 1978.*

⁸ Asatiani R. *The System of National Accounts and Strategies of Economic Development. “Economics and Business”, #6, 2009. (Georgian).*

The irreversible process of transition of the industrial society into the post-industrial society began. This phenomenon played a great role in the origin of public sector economics. By this transition the attention was focused on the formation of a new society, new *socium*. This circumstance contributed to the promotion of moral values to the forefront. Building of a civil society became the new priority of this period. This process was reflected in the program of economic development approved by the World Summit “Agenda for the twenty-first century” which put forward “new social issue”⁹. It envisages the establishment of new political culture and the rise of democracy, one of the characteristics of which is strengthening of social orientation and development of its basis – public sector economics. Social orientation made the market economy viable and speeded up the development of public sector economics.

Such are those objective prerequisites which laid the foundation to the genesis of public sector economics. Today the development of public sector economics has become a new reference point in intellectual thinking and country’s progress for countries moving along the mentioned path.

What is the new role of the state, what goals and objectives public sector economics sets up?

First of all the government should conduct active social policy. It should not allow the impoverishment of a significant part of its population and for every citizen the public domain should be accessible (free of charge or in the form of subsidies)¹⁰, it should elaborate and protect the laws of economic activity. The government should take effective measures against negative outer effects (externalities)¹¹ manage to overcome them; it is necessary to maintain natural, i.e. state monopolies and not privatize them; the government ought to protect private property and promote its development; the state's prerogative is to fulfill the requirements of the New World Order, first of all, to keep order in the field of competition¹², protection of institutional order (which in the first place envisages the establishment of the property pluralism) and protection of social order¹³; promote the development of fundamental science, conduction of scientific-technological policy, should play a significant role in elaboration and realization of innovative policy; microeconomic regulation in the first place should be based on tax regulation and new

⁹ **Asatiani R.** “New Social Issue” and Fight against Poverty (a report in Russian) “Coll.Works”, v.II. Georgian Academy of Economic Sciences. Tbilisi “Siakhle”, 2001. (Georgian).

¹⁰ **Erhard L.** Prosperity for all. Translated from German. M., 1991;

¹¹ **Asatiani R.** State regulation of Externalities. International Scientific Internet-Conference. 2017, 1 Nov.-28 Dec.

¹² **Asatiani R.** Competition theories and new perspectives of countries focused on competitiveness. Journal. "Caucasus and Globalization", Sweden, Ca&CCPress, 2015.

¹³ **Asatiani R.** New World Order and the current situation of the realization of its principles in Georgia. “Georgia’s Economy”, 2013, #12, (Georgian); **Asatiani R.** New World Order and building of a civil society. “Macro and Micro Economics”, 2003, #4. (Georgian).

budgetary federalism¹⁴; the state should facilitate the strengthening of the socialization of the economy by means of manipulation of taxes, by making progressive taxation, and the monetary credit regulation should not exceed its functioning boundaries so as not to repeat the 2008 World Economic Crisis with speculative trading and money manipulation; the state should promote the development of civil society, at the same time promote the development of small and medium-sized businesses, the formation of the middle class¹⁵. The government ought to ensure economic safety¹⁶, play an active role in the right nature management and ecological and food safety. The government should manage to use the benefits, positive effect of irreversible process of globalization and avoid negative effects which are extremely important in modern open economy.

The following table illustrates main directions of functioning of public sector economics.

Table. **Main directions of functioning of public sector economics**

Elaboration of general strategy of country's economic development	Regulation of external effects, the conduct of effective measures against external effects and their suppression
Creation of the legal basis for economic activity	Preservation of natural monopolies and prevention of their privatization
Prevention of impoverishment of a significant part of the population	Promotion of a small and medium-sized businesses
Production of public wealth and promotion of accessibility to everybody	Effective distribution and use of public finances, progressive tax maneuvers
Elaboration of antimonopoly law and conduction of relevant policy	Conduction of scientific-technological policy
Establishment of economic order and strict observance of laws	Development of civil society
Regulation of foreign economic relations	Prevention of a sharp property inequality and deep politicization
Implementation of positive effects of globalization and suppression of negative effects	Realization of the requirements of new world order
Protection and development of private property	Conduction of social policy
Creation and development of infrastructure	The establishment of institutional order and, first of all, pluralism of property
Macroeconomic stabilization and achievement of high specific weight of the medium stratum in the country	Protection of competition order

¹⁴ **Asatiani R.** Government regulation of inter-budget relations – the task of the first-order problem. “Akhali Ekonomisti” (New Economist), 2012, #4. (Georgian).

¹⁵ **Krugman P.** How did Economists Get it So Wrong? “New York Times”, 2009.

¹⁶ **Asatiani R.** Economic Safety and Public Sector Economics. Coll. works. Modern Economic Tendencies of Sustainable Development. TSU Paata Gugushvili Institute of Economics. vol 10, Tbilisi, 2017, (Georgian).

Budgetary and tax regulation and conduction of fiscal policy	Promotion of fundamental sciences
Monetary regulation in corresponding boundaries and conduction of monetary policy	Promotion of economic security
Introduction of a new fiscal federalism in economic policy	Rational environmental management and Provision of economic security
Conduction of innovative policy	Ensuring food security
Promotion of employment and creation of new jobs	Creation and conduction of state healthcare policy
Creation and conduction of state education policy	Observance of gender equality in administrative bodies in the area of economy

A country that in its economic policy relies on these theoretical postulates taking into account the peculiarities of the national economy creates its own model for the development of the state. Naturally, these requirements should be taken into consideration by Georgia too. There are numerous of such models based on the peculiarities of the national economy in the world today, more precisely, as many as developed countries. As to Georgia, because of incorrectly conducted reforms, we still have a long way to go before reaching the stage of the mature market economy.

These are the main directions of the functioning public sector economics, those levers on which the developed countries firmly stand and which **transformsocially-oriented market economy into social market economy** in these countries, which led to the development of a socially oriented market economy into a socially market economy in these countries, into a more developed form of market economy andconditioned the formation of welfare stateswhich are even called the “sprouts” of socialism¹⁷. There are distinguished five main models of welfare states. They are: Continental-European or German model; 2.Anglo-Saxon or British, 3. Scandinavian or Nordic, 4. Mediterranean or South European; Conservative/Corporatist or Japanese model.

Besides Germany the Continental European model includes Austria, Belgium, the Netherlands, Switzerland, partially France. Besides Great Britain the Anglo-Saxon model includes the US, Canada, Ireland, Australia, New Zealand; Scandinavian model includes Sweden, Denmark, Iceland, Norway, Finland; Mediterranean model includes Greece, Italy, Spain, and the most vivid example of the Conservative-Corporatist model is Japan. The achievement of social welfare at the inclusive level is especially typical for the Scandinavian

¹⁷Yurieva T.V. Social economics. Textbook. M., "Drofa", 2001, (Russian); Economics of the public sector. Eds.Yakobson L.I., Kolosnitsyna M.G .(Russian).

model, its leitmotif, and therefore in the literature much is written about the attractiveness of the Nordic model.

For this model, as well as for the European model, it is noteworthy the redistribution of 50% state finances for social purposes with the help of the budget, active support of the state to attain higher employment rate, strict observance of the laws and the establishment of order throughout the economy, the development of democracy, generic equality and the avoidance of sharp inequality in property.

The Mediterranean model also envisages the redistribution of 50% state finances for social purposes but it doesn't have inclusive character and applies only for less protected population.

Unlike German model, British model provides 40% of GDP redistribution for social purposes and at the same time comparatively passive role of the government in regulation of the employment and high specific weight in support of private companies.

The Japanese model also deserves attention. The government places great responsibility on companies in connection with the socio-economic situation of workers. By creating a long-term recruitment system for employers, the corporation increases the interest of workers' labor results, which is strengthened by redistribution of a certain portion of the shares of the corporation to the employees. Financial support for this model is created by insurance fees by increasing profits.

The Nordic model based on the policy of the "third road" is social-democratic model which is based on progressive taxation with the purpose of abrupt reduction of property inequalities and relies on a society with a high sense of responsibility. Nordic welfare is not so much a result of expenditures allocated by the state as investment obtained on the basis of the society's desire.

It is the effective redistribution and use of the resources accumulated by government, primarily public finance which is the prerogative of the public sector.

In Georgia, in conditions of extremely low aggregate demand, the social polarization is extremely high and the inequality in the property status (the minority of the wealthy and the vast majority of the poor) is well-expressed. The extreme aggravation of demographic processes, actual absence of the middle class (9%), the underdevelopment of small businesses (9.1%), according to 2016, Georgia produces 92% of the GDP of the level of 1990, whereas with a few exceptions, almost all post-Soviet countries overcame the barrier, etc. Therefore, in conditions of such a heavy socio-economic background it is necessary to include public sector economics in university curriculum and taking into account its requirements by the government¹⁸. It will play an important role in the formation of correct, healthy economic thinking.

¹⁸Asatiani R. The Need to Study Public Sector Economics in Georgia's Universities. "Social Economics", 2014, #4.(Georgian).

The disregard of the above requirements to the public sector means failure in overcoming the backwardness.

In order for Georgia to get rid of the syndrome of the outstretched hand, the starting point for the country's revival should be the Keynesian theory of macroeconomic regulation. With certain correlations after overcoming the economic crisis, Georgia's economic policy must rely on a **new neoclassical synthesis** which will reflect the ideas of new Keynesians (J. Stiglitz, A. Akerlof, O. Blanshard, S. Fischer, etc.), with taking into account the existing novelties in the field of technology and raising a country's competitiveness.

New Keynesianism oriented towards traditional Keynesian values is a modified Keynesian theory. New Keynesians have widened the research area; besides macroeconomic issues they started the **analysis of microeconomic issues**. The research focus shifted from analyzing the effective aggregate demand to the microeconomic problems of the principles of individualism; they included into economic analysis separate propositions of institutionalism, microeconomic problems of outsiders. New Keynesians study the impact of monetary policy in short-term period on employment and production. They do not make mechanical connection of Keynesian macroeconomics and Neoclassical microeconomics but they are based on the assertion that economic balance can be possible only by healthy economic policy and to overcome the disequilibrium in economy, with account of achievements of the open economy it is necessary: government regulation, study the influence of the currency market on monetary circulation, take measures to curb the inflation. In the growth and development of the economy New Keynesians attach great importance to the financial sphere. They attach special importance to the study of the issues of "debt-based economy", also to the role of government finances in economic growth and an increase in aggregate supply. They included separate institutional statements in economic analysis.

Conclusion

Today, a viable economic policy is a challenge to modern civilization. Georgia is facing new challenges and therefore, the need to create an economy in accordance with international standards objectively determines the study of public sector economics and taking into account its requirements in economic policy.

In present-day conditions systemic changes occurring in the world, institutional and structural shifts associated with them determine the priority development of economic sciences. No state can solve any problem if it is weak. Economy is a cornerstone of the country's development. If the economic side of life does not cause tension in the society, then all its sides have a space for development and conflict-free coexistence – moral, cultural, educational, national, ethnic, etc., but each failure in the economy strongly affects the development of society. Even if one link in economic development falls, the vector immediately changes the direction and a sharp social differentiation occurs, corruption (including elite corruption), moral degradation, etc. This multifaceted process is organically linked with functioning of public sector economics.

The “New Neoclassical Synthesis” which is still in the process of formation, drawing ideas from both neoclassical synthesis and public sector economics, in our deep conviction, will be a new trend in economic theory created by combination of neoclassical synthesis and main directions of public sector economics and will be relevantly reflected in economic policy. This makes possible to overcome economic crisis in economic sciences so much discussed by prominent economists today.

The formation of socially oriented market economy requires a novel approach to economic development and the state acquires a new role that is confirmed by main directions of public sector economics.

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