Market vs. Government Failure

Government and the market are inseparably intertwined. Due to this interconnectedness, it is very difficult in an abstract sense to comparatively evaluate the relative severity of a market failure versus a government failure. In extreme cases for example, a market failure will cause a subsequent government failure. In the reverse, government failure can be a very prominent reason for market failure. The question is much better answered on a case by case basis. In the abstract however, sound government policies can compensate for the societal pains of a severe market downturn. Conversely, a strong market can aid a society in surviving governmental crises. Given the choice between two extremes, it is better to have good government policies. This preference is primarily because in the long run poor government policies doom any possible market successes. In other words, while proper governmental policies do not sufficiently guarantee strong markets, they are necessary for strong markets. The reverse is not necessarily so. While good markets certainly can promote strong government, they are not an absolute necessity. Furthermore, because all markets will inevitably suffer at least short-term downturns, sound government policies are needed to alleviate societal suffering.

The experience of the import-substituting industrialization strategy in Latin America and in other parts of the world is a classic example of government policies that doom long-term market success. While in many cases promoting short-term economic growth, these policies created not only market failures, but also greatly hamper the subsequent policies from achieving success. In almost all cases, ISI developed inefficient
domestic industries, higher prices for domestic consumers, unfairly penalized non-
industry sectors such as agriculture, and created debilitatingly high amounts for foreign
debt. These policies not only lead to market failure and subsequent political instability,
but also have made post-ISI policies exceedingly more difficult to effectively implement.