

Neoliberal Theory of the State

Neoliberalism emerged in the 1970s–80s as a response to the **failures of the post-WWII welfare model**. After World War II, many Western countries followed a welfare model that focused on government spending, public services, and full employment. This system worked well during the 1950s and 1960s, creating strong economies and better living standards.

But in the 1970s, serious problems began to appear, especially in the US and UK. These countries faced **stagflation**—a strange mix of rising prices (inflation) and slow economic growth with high unemployment. A big reason was the **1973 oil crisis**, when OPEC cut oil supplies, making energy expensive and disrupting economies.

Governments kept spending on welfare, but it wasn't helping the economy grow, and debts increased. People began to see the **welfare state as wasteful, slow, and unable** to fix new global problems. As a result, many turned to **neo-liberal ideas** that reduced government control and gave more power to the market.

Neoliberalism reconceptualized the state: **from a provider and regulator to a facilitator and enabler**. It does not reject the state altogether—but believes that **the state's primary role is to protect market conditions**, not to interfere in it.

Stagflation

1. What is Inflation?

Inflation means a general rise in the prices of goods and services over time. It usually happens when demand is higher than supply—more money chases fewer goods—so prices go up.

2. Normal Market Dynamics:

In a healthy economy, inflation rises when people have jobs, businesses grow, and spending increases. This is called **demand-pull inflation** and is seen as a sign of economic strength. Central banks may raise interest rates to cool things down when it gets too hot.

3. But in Stagflation, That's Not What Happens:

Stagflation is when prices rise **without growth**, and unemployment is high. This breaks the usual rule in economics where inflation and unemployment usually move in opposite directions (**Phillips Curve**).

Instead, in stagflation, both problems exist **at the same time**.

The **Phillips Curve** shows a trade-off between inflation and unemployment. It says when unemployment is low, inflation is usually high, and when unemployment is high, inflation tends to be low.

4. The Supply Shock Mechanism (Key Economic Trigger):

The main cause is often a **supply-side shock**—a sudden increase in the cost of essential goods. The most famous case was the **1973 Oil Crisis**, when oil-exporting countries (OPEC) stopped selling oil to the West due to geopolitical tensions.

Oil prices quadrupled, increasing the cost of transport, electricity, and production. When **input costs** go up, businesses raise prices (**cost-push inflation**) but don't hire or invest more, because demand is falling.

People lose jobs, spend less, and the economy slows. This results in **inflation + stagnation = stagflation**.

5. Why Can't Governments Easily Fix It?

- If the government tries to **fight inflation** by raising interest rates or cutting spending, it can make unemployment worse.
 - If it tries to **reduce unemployment** by spending more or cutting taxes, it may raise inflation even more.
- This is why stagflation is one of the toughest economic problems—there's no simple policy tool to fix both issues at once

Key Features of the Neo-liberal State

Market Supremacy over the State

Neoliberalism believes that the **market**, not the **state**, should guide the economy. In neoliberalism, less government and more market freedom is the key to progress.

A. Markets as Rational and Self-Correcting Mechanisms

Neoliberalism believes that **free markets** can organize the economy efficiently on their own. Markets balance supply and demand using **prices**, which act like **signals** showing what people want and what is available.

If the government steps in with things like subsidies or tariffs, it **distorts these price signals**. This can cause waste, wrong use of resources, and even corruption.

Neoliberals think **competition**, not government rules, is the best way to get good quality, innovation, and efficiency.

B. Hayek's Warning: Central Planning Breeds Authoritarianism

Friedrich Hayek, in his famous book *The Road to Serfdom* (1944), argued that too much government control over the economy can harm personal and political freedom.

He believed that **when the state plans everything**—like who gets what and when—it **leads to control and loss of individual choice**.

C. Price Mechanism Over Political Controls

In the neoliberal view, prices are the best way to manage the economy. They are seen as **neutral signals of supply and demand**.

When governments **set prices or give large subsidies**, especially in sectors like food, fuel, or electricity, it can lead to **financial problems, black markets, and inefficiencies**.

Neoliberals believe that **allowing prices to be set by the market** encourages more efficient production and consumption. For example, if petrol prices go up, people may use less petrol or find alternatives on their own, without the need for government action.

D. Indian Economic Shift: Dismantling the License Raj

After independence, India followed a **mixed economy model** based on **Fabian socialism** and **Nehruvian planning**. The government controlled important sectors, issued **industrial licenses**, and managed **foreign exchange**. However, by the late 1980s, the economy faced slow growth, fiscal deficits, and a **balance-of-payments crisis**.

In **1991**, the **Economic Reforms** led by **Manmohan Singh** and **P.V. Narasimha Rao** marked a shift towards **neoliberalism**. The government reduced **licensing**, encouraged **foreign investment**, **deregulated prices**, and **privatized state-run companies**.

Fabian socialism is a political philosophy that advocates gradual, peaceful change toward socialism rather than revolution. It emphasizes reform through **democratic means**, with **state intervention** in the economy to ensure **social justice**.

E. From Command to Competition: The Ideological Shift

Neoliberalism's belief in **market supremacy** leads to a shift in **public policy**, where **welfare** is seen as **market access** rather than direct state support.

Public services like **education, health, and transport** are increasingly offered by **private providers**, with the idea that **competition** will improve quality over state control.

This change also alters the relationship between **citizens** and the state, viewing individuals more as **consumers** or **entrepreneurs** rather than **dependents** or **rights-holders**.

Minimal State Intervention

Neoliberalism redefines the state's role by advocating for a "**minimalist**" **government**. Neoliberals believe the state should **focus on basic functions** like maintaining law and order, protecting property rights, and ensuring macroeconomic stability. Other areas, they argue, should be **left to market forces** and private enterprise.

A. The State as Umpire, Not Player

In neoliberalism, the state is seen as **an umpire, not a player**. Just as an umpire ensures fair play **without participating**, the state should **provide a stable environment**—like rule of law and predictable taxation—while staying out of markets.

B. From Welfare State to Enabling State

In the Keynesian and socialist era, the **welfare state played a central role** in development, with the state **running public sector undertakings (PSUs)** and subsidizing basic needs to ensure equitable growth.

Neoliberalism shifts this focus to an "**enabling state**" that supports markets instead of replacing them. This leads to **reduced subsidies, targeted welfare like cash transfers, and public-private partnerships** rather than full public ownership.

C. Indian Context: Privatization & the Shrinking State

India's privatization of **Air India in 2021** is a clear example of neoliberal minimalism. The government sold the loss-making airline to the **Tata Group**, stating that "**the government has no business being in business.**"

This move was not just a sale but a philosophical shift, where the state acknowledged that running airlines was not its role.

Other examples include **public-private partnerships in railways and highways**, and the **Digital India initiative**, where the government creates platforms but leaves innovation to the private sector.

D. Shrinking Bureaucracy and Fiscal Conservatism

Another dimension of minimal state intervention is **downsizing government expenditure and bureaucracy**.

Neoliberal economists argue that **large bureaucracies lead to inefficiency, corruption, and waste**. Instead, a leaner state apparatus focused on **regulation, dispute resolution, and macroeconomic stability** is preferred.

This also translates into **fiscal conservatism**: avoiding budget deficits, reducing public debt, and limiting welfare schemes that create "dependency."

Tools like **Direct Benefit Transfers (DBT)** in India reflect this shift—**replacing food or fuel subsidies with cash**, which is seen as more efficient and less distortive.

Privatization and Deregulation

One of the core pillars of neoliberalism is the **belief in the superiority of markets over state-led economic models**. Privatization and deregulation emerge as the two key instruments through which this philosophy is operationalized.

The underlying assumption is clear: **markets are efficient, profit-oriented, innovative**, and responsive to demand signals—while the state is **slow, bureaucratic, and politically driven**.

A. The Rationale: Why Privatize and Deregulate?

Neoliberal theorists like **Milton Friedman** and **Friedrich Hayek** argue that **government ownership of enterprises leads to inefficiency**, politicization, and moral hazard.

According to them, when enterprises are **shielded from competition** and profit motives, they become bloated, **underperforming**, and a drain on public resources.

By contrast, **privatization and deregulation are believed to:**

- Improve efficiency and productivity
- Attract private investment and technology
- Reduce fiscal burden on the state

B. Privatization in Practice: The Indian Experience

India embraced privatization in earnest after the **1991 economic reforms**, moving away from Nehruvian socialism.

While the initial steps focused on **disinvestment of minority stakes**, the 2000s saw a shift toward **strategic disinvestment**, where control was also transferred.

Key examples include:

- **Air India Privatization (2021)**: The national carrier was sold to the Tata Group, marking the state's exit from commercial aviation after decades of losses.
- **BPCL Disinvestment (Proposed)**: A major oil PSU is set for privatization to enhance operational efficiency.
- **IPO of LIC (2022)**: A landmark move where India's largest insurer was partially privatized through public listing.

C. Deregulation: Opening the Gates for Market Expansion

Alongside privatization, **deregulation** plays a complementary role. It involves **removing government-imposed barriers** like licensing, quotas, price controls, and entry restrictions—making it easier for private entities to operate.

A landmark example is the **telecom sector**:

- **Before deregulation**: The state-run MTNL and BSNL monopolized services, with high costs and long waiting periods for landline connections.
- **After deregulation**: Entry of private players like Airtel, Reliance Jio, and Vodafone revolutionized telecom. Prices fell, innovation surged, and mobile

penetration exploded—making India the **world’s second-largest smartphone market**.

D. Efficiency vs Equity: The Neoliberal Trade-Off

While privatization and deregulation have undeniably led to **efficiency gains, technological modernization, and fiscal relief for the state**, they have also **deepened socio-economic inequality** in many cases.

In sectors like **healthcare and education**, unregulated private growth has led to:

- **High-cost services** unaffordable for the poor
- **Urban-rural divide** in access and quality
- **Commercialization of essential services**, where profit often overrides social responsibility

For example, private schools charge exorbitant fees while government schools suffer neglect—resulting in **two-tiered systems** that exacerbate inequality.

E. Global Parallels and Neoliberal Push

India's shift aligns with **global trends** set during the **Reagan-Thatcher era**, where large-scale privatizations were seen as key to overcoming the so-called “crisis of the welfare state.”

The **World Bank and IMF** promoted **structural adjustment policies** across the Global South, making privatization and deregulation **preconditions for loans and aid**.

Countries like **Chile, UK, New Zealand**, and later **post-Soviet economies** followed similar paths. However, several of these experiences—especially in Latin America and Africa—also demonstrated that **unregulated privatization without strong institutions often leads to oligarchy, crony capitalism, and public backlash**.

New Public Management (NPM)

Neoliberalism fundamentally **reshaped the internal functioning of the state**, giving rise to a governance doctrine known as **New Public Management (NPM)**.

Developed in the 1980s, NPM introduced **private sector principles into public administration**, especially **managerialism and corporate efficiency** models.

NPM reframed citizens as “**clients**” or “**customers**” of state services, demanding efficiency, transparency, and value for money.

A. Core Features of NPM

NPM isn’t a single policy but a **bundle of managerial reforms**, including:

1. **Decentralization of authority**
2. **Performance-based evaluation** of public employees

3. **Use of market mechanisms** like competition and contracting out
4. **Introduction of information technology** and digital monitoring
5. **Public-private partnerships (PPPs)** for infrastructure and service delivery
6. **Output- and outcome-based budgeting**
7. **Focus on transparency, accountability, and audit culture**

B. NPM in India: The Managerial State in Action

India's administrative landscape has increasingly incorporated NPM principles, especially since the **1991 economic liberalization**. These changes were not only about shrinking the state but about **reforming the way the state operates**.

Key examples include:

- **Public-Private Partnerships (PPPs):** Widely used in roads (e.g., National Highways), airports (e.g., Delhi and Mumbai), and even healthcare (e.g., Ayushman Bharat empanelled hospitals).
- **Digital Governance Dashboards:** Ministries now use real-time data dashboards (e.g., NITI Aayog's Aspirational Districts Programme) to track performance and accountability.
- **Biometric Attendance Systems:** Introduced across departments to ensure discipline among government employees.
- **Direct Benefit Transfer (DBT):** Welfare benefits like LPG subsidy, pensions, and scholarships are now sent directly to beneficiaries, reducing leakages and eliminating middlemen.
- **e-Governance and Digital India:** The mission promotes paperless offices, online service delivery, and digital identity (Aadhaar), all of which are core NPM tools.

D. Advantages of NPM: Efficiency, Transparency, and Accountability

NPM's appeal lies in its promise to **"do more with less."** By introducing business-like methods, it aims to:

- **Improve service delivery** and responsiveness
- **Cut costs** and reduce bureaucratic red tape
- Promote **transparency** and reduce corruption
- Hold departments **accountable** through metrics and targets

In many ways, it represents a shift from **input-based to output-based governance**—measuring not how much is spent, but what is achieved.

E. Criticisms and Limitations of NPM

Despite its transformative vision, NPM is not without serious **critiques and drawbacks**:

1. **Technocratic Bias**: It assumes that managerial tools can replace political wisdom, often sidelining deliberation and democratic participation.
2. **Digital Exclusion**: Reliance on digital platforms can marginalize those lacking access to technology—rural poor, elderly, and women. For instance, many eligible beneficiaries have missed DBT due to Aadhaar-related issues.
3. **Commodification of Services**: Citizens are seen as clients rather than rights-holders, undermining the normative foundations of welfare.
4. **Loss of Accountability**: PPPs blur lines of responsibility, making it difficult to hold private partners accountable for public failures.
5. **Target and Tunnel Vision**: Excessive focus on quantifiable targets often leads to data manipulation or neglect of qualitative aspects.

Thus, critics argue that NPM may **enhance efficiency but weaken equity and democratic values**.

F. Global Context and Comparative Perspectives

Globally, NPM was a part of the **post-Cold War governance wave**, influencing reforms in OECD nations and the Global South alike. In **New Zealand**, it led to radical restructuring of ministries into profit centers.

In the **UK**, Margaret Thatcher's government introduced "agencyfication" and outsourcing of civil services.

In the Global South (e.g., Africa and Latin America), **World Bank and IMF-driven structural adjustment programs** made NPM-inspired reforms a precondition for aid, often leading to fragile and hollowed-out states.

This has led some scholars to argue for a "**post-NPM**" model, emphasizing **citizen-centric governance, collaboration, and resilience over rigidity**.

India & Neoliberalism

1. Crisis as the Catalyst

India's shift to **neoliberalism** in **1991** was not an ideological choice but a practical response to a severe **economic crisis**.

The **Indian Balance of Payments (BoP) crisis** of **1991** was a major financial emergency. India's **foreign exchange reserves** dropped to just **\$1 billion**, enough for only **two weeks of imports**. This was caused by **high oil prices** from the **Gulf War**, a large **fiscal deficit**, and **low exports**.

In **June 1991**, the Indian government, led by **Prime Minister P.V. Narasimha Rao** and **Finance Minister Dr. Manmohan Singh**, sought a **\$1.8 billion loan** from the **IMF** and **World Bank**.

In exchange, India agreed to economic reforms like **opening up the economy**, cutting **tariffs**, **privatizing state-run companies**, and **deregulating industries**. The **devaluation of the rupee** in **July 1991** was a key move to **boost exports** and attract **foreign investment**.

Understanding BOP

The **Balance of Payments (BoP)** is a record of all **economic transactions** between a country and the rest of the world over a specific period.

It includes **imports, exports, investments, loans, and transfers**. The BoP consists of two main accounts: the **current account** (which tracks trade in goods and services) and the **capital account** (which tracks financial transactions like investments and loans).

A **BoP deficit** occurs when a country imports more than it exports, leading to more money leaving the country than coming in. A deficit can lead to **foreign reserve depletion** and **economic instability**.

On the other hand, a **BoP surplus** means more money is coming into the country than leaving. The BoP is important for assessing a country's **economic health** and its ability to meet **international financial obligations**.

Devaluation

Devaluation is when a country **lowers the value** of its currency compared to others. This makes its **exports cheaper** and more attractive to foreign buyers but makes **imports more expensive**.

India has devalued its currency several times, with notable instances in 1947, 1966, and 1991. The most significant devaluation happened in 1991 when the rupee was devalued by around 18-19%.

2. The LPG Model: Liberalization, Privatization, Globalization

Key policy shifts under the LPG model included:

- **Liberalization:**
 - Deregulation of industries
 - Reduction of licensing requirements (end of the “License Raj”)
 - Decontrol of prices in many sectors
- **Privatization:**

- Disinvestment in public sector undertakings (PSUs)
- Encouraging private sector participation in core sectors
- **Globalization:**
 - Reduction of import tariffs
 - Opening up to **Foreign Direct Investment (FDI)** in various sectors
 - Full current account convertibility (1994)

These reforms redefined the **role of the Indian state from provider to enabler**, emphasizing **market logic, competition, and integration with global capitalism**.

3. Transformation of the Indian Economy: Growth and Sectoral Shifts

The 1991 reforms unleashed a **new phase of economic dynamism**, especially in urban, service-driven sectors. Notable developments include:

- **GDP growth acceleration:** India moved from the so-called “Hindu rate of growth” (~3%) to growth rates above 6–8% during much of the 2000s.
- **Expansion of the middle class:** Urban consumption patterns shifted dramatically with rising disposable incomes.
- **Boom in IT and telecom sectors:** India emerged as a **global hub for software services and BPOs**, fueling a digital revolution.
- **Rise in FDI inflows:** Especially in sectors like retail, automotive, and infrastructure.
- **Stock market and financialization:** Emergence of a vibrant equity market and increased household participation in financial instruments.

4. The Costs of Liberalization

Despite impressive macroeconomic indicators, the neoliberal model also **exacerbated structural inequalities** and revealed **cracks in public sector provisioning**.

a. Rising Economic Inequality

Scholars like **Atul Kohli, Jean Drèze, and Prabhat Patnaik** argue that neoliberalism **favored capital over labor**, urban elites over rural poor, and private corporations over public institutions.

- **Rural–urban divide** widened, with most benefits of growth concentrated in urban and peri-urban areas.
- **The Gini coefficient** of income inequality increased steadily post-1991. [The **Gini coefficient** is a number between 0 and 1 that measures how **wealth is**

distributed in a society. A value of **0** means perfect equality (everyone has the same wealth), and **1** means perfect inequality (one person has all the wealth.)]

- **Dalits, Adivasis, and informal workers** remained marginalized from the formal growth process.

b. Shrinking of the Welfare State

The emphasis on fiscal prudence led to **cuts in public spending**, especially in social sectors:

- **Health and primary education** were underfunded, leading to poor human development outcomes.
- **Agricultural neglect** triggered crises in rural India, including farmer suicides and regional disparities.
- **Employment generation** stagnated, leading to the problem of “jobless growth.”

While schemes like **MGNREGA (2005)** and **Right to Education (2009)** were introduced later, they often struggled against the tide of **budget constraints** and **technocratic delivery mechanisms**.

5. The Neoliberal State in Practice: Role Redefined

The Indian state, under neoliberalism, **restructured itself into a market-friendly regulator**:

- It **withdrew from direct production** (e.g., privatization of Air India, telecom).
- It **reoriented welfare** through **targeted schemes** like **Direct Benefit Transfer (DBT)** rather than universal entitlements.
- It **partnered with the private sector** through **Public-Private Partnerships (PPPs)** for infrastructure and service delivery.

This is what political theorists call a “**regulatory state**”—not one that owns or distributes resources, but one that sets rules and facilitates private enterprise.

Critiques and Limitations of Neoliberalism

1. Rising Inequality and Elite Capture

One major criticism of neoliberalism is that it disproportionately benefits the wealthy. By prioritizing **capital** and **deregulation**, the rich accumulate more wealth, while the poor face weaker safety nets.

According to **Oxfam’s 2025 report**, the **top 1%** in India hold over **40%** of the country’s wealth, while the **bottom 50%** control just **3%**. In fact, the **top 10%** in

India possess **77%** of the nation's wealth, and the **richest 1%** have **13 times more wealth** than the poorest half of the population.

Amartya Sen's critique, "**growth without distribution is not true development**," highlights that neoliberalism's focus on **GDP growth** often overlooks deep inequalities in **health, education, and nutrition**.

2. Erosion of Labour Rights and Job Security

To attract investment and increase "labour flexibility," neo-liberal reforms often **undermine labour protections**. The **new Labour Codes (2020)** in India, though aimed at simplifying complex laws, have been criticized for **favoring employers** over workers.

Many workers—especially in the informal sector—face **contractualization, low job security, and lack of collective bargaining power**, weakening the **labour movement**, which was once central to economic justice.

3. Undermining of Public Services

Privatization often reduces public investment in essential sectors like **education, health, and housing**, which are now treated as commodities. **Private hospitals and elite schools** flourish, while **government services** remain underfunded.

During the **COVID-19 second wave**, even middle-class Indians struggled to access basic healthcare, exposing the weaknesses of privatized systems.

Critics argue that the **market-based approach** failed during a humanitarian crisis. As **Noam Chomsky** points out, neoliberalism prioritizes **profit over people**, turning public policy into corporate policy.

4. Market Failures and the Need for Active State

However, critics caution that **too little state intervention can be dangerous**, especially in deeply unequal societies.

They argue that markets alone cannot address **poverty, inequality, or social justice**. For example, while **private hospitals** may offer **excellent services**, they remain **unaffordable for many**.

The COVID-19 pandemic laid bare these weaknesses—**when markets collapsed, it was the state that stepped in** to distribute vaccines, provide food rations, and manage healthcare.

These events have revived interest in **welfare economics, universal healthcare**, and even ideas like **Universal Basic Income (UBI)**—once dismissed as "anti-market."

5. Balancing Act: A Smart, Strategic State

Today, many economists and political thinkers advocate for a “**smart state**”—not a minimal one. This model recognizes the role of **strategic state intervention in correcting market failures**, investing in public goods, and promoting inclusive growth, while **avoiding overreach and inefficiency**.

For instance, countries like South Korea and Singapore have used **state-led industrial policy** and **strategic investment** to become advanced economies—without abandoning markets, but also without fully surrendering to them.

In India, initiatives like the **Production Linked Incentive (PLI) Scheme** show a hybrid approach: the state incentivizes private production in strategic sectors without controlling them.

Conclusion

In conclusion, the neoliberal theory of the state redefines the state's role from being a provider and regulator to a facilitator of market forces. By emphasizing privatization, deregulation, minimal intervention, and managerial efficiency, it promotes a lean, rule-making state rather than a welfare-oriented one.

While this shift has driven economic growth and expanded the private sector—as seen in post-1991 India—it has also raised concerns about rising inequality, exclusion of vulnerable populations, and erosion of public accountability.

Therefore, while the neoliberal model enhances efficiency, its long-term legitimacy depends on how well it balances market dynamism with social justice and inclusive governance.

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