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GLOBALIZATION AND DEVELOPMENT STRATEGIES

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GLOBALIZATION AND DEVELOPMENT STRATEGIES*

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* The views expressed in this paper are those of the author and do not necessarily reflect the views of the UNCTAD secretariat.

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Executive Summary

This paper situates the process of globalization in the wider context of development. The implications of globalization for development are considered in retrospect and prospect. The main object, however, is to analyse the implications of globalization for strategies of development. It starts from the premise that development must bring about an improvement in the living conditions of people, but also recognizes that, despite enormous economic progress over the past 50 years, development has been very uneven between, and within, countries. This exclusion of countries and of people from development has become much less acceptable with the passage of time. Globalization, which has gathered momentum during the last quarter of the twentieth century, has created unparalleled opportunities and posed unprecedented challenges for development. Yet, the virtual ideology of our times has transformed globalization from a descriptive into a prescriptive word. The reality that has unfolded so far belies the expectations of the ideologues. The past 25 years have witnessed an increase in economic inequalities as the income gap between rich and poor countries, between rich and poor people within countries, as also between the rich and the poor of the world's population, has widened.

The exclusion of countries and of people from globalization, which is partly attributable to the logic of markets, is a fact of life. The problem may be compounded by the emerging rules of the game for international economic transactions, which are asymmetrical in terms of construct and inequitable in terms of outcome. What is more, these asymmetrical rules, combined with the economic implications of globalization, are bound significantly to reduce the degrees of freedom for developing countries in using economic policies to foster development. Yet no country wishes to be excluded, and not even large countries can afford to opt out. The object of any sensible strategy of development in a world of globalization should be to create economic space for the pursuit of national interests and development objectives. In this task, there is a strategic role for the State – not only in the national context, to adopt policies that maximize the benefits and minimize the costs of economic integration with the outside world, but also in the international context, to shape the rules of the game through regional arrangements or strategic alliances.

Given the reality of globalization, it is also necessary to think of correctives and interventions in national development strategies that would make for a more egalitarian development. These are, in fact, the responsibility of the State because Governments are accountable to their people, whereas markets are not. And political democracy can persuade the State to act in the interests of people. The time has come to evolve a new consensus on development, which should be concerned as much with equity as with efficiency, and as much with social progress as with economic growth. The focus must shift from economies to people and from means to ends. Markets and globalization can be used as means to further the ends of development, which improves the quality of life for people but only if public action remains an integral part of development strategies.

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GLOBALIZATION AND DEVELOPMENT STRATEGIES

*Deepak Nayyar**

INTRODUCTION

This paper endeavours to situate the process of globalization in the wider context of development. In doing so, it explores the implications of globalization for development in retrospect and prospect. The main object, however, is to analyse the implications of globalization for strategies of development, if development is to bring about an improvement in the living conditions of people. Section I sets out the essential meaning of development, in the light of the very uneven development experience and the fundamental change in thinking about development strategies over the past 50 years. Section II outlines the dimensions and characteristics of globalization in our times in order to examine the underlying economic factors, political conjuncture and intellectual rationale. Section III considers the development experience of the world economy during the last quarter of the twentieth century – the age of globalization – which suggests that the exclusion of countries and of people, attributable partly to the logic of markets has become a fact of life. Section IV seeks to focus on the rules of the game for international economic transactions. It explains how the process of globalization, combined with these asymmetrical rules, is bound to reduce degrees of freedom for developing countries to use economic policies to foster development. Section V argues that sensible strategies of development in a world of globalization should create economic space for the pursuit of national interests and development objectives. In this task there is a strategic role for the nation State, both in the national and in the international context, which is elaborated upon. Section VI sets out correctives and interventions in national development strategies that would make for a more egalitarian development. These can be introduced only by the State because, unlike markets, Governments are accountable to their people. It concludes that, as we enter the twenty-first century, the time has come to evolve a new consensus on development, in which the focus must shift from economies to people and from means to ends.

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I. CONCEPTION OF DEVELOPMENT

There is a vast body of literature on economic development which is rich in range and in depth. Yet there is not enough clarity or agreement about the meaning of development, and perceptions have changed over time. There is, however, an irreducible minimum which may be construed as the essential meaning. Development must bring about an improvement in the living conditions of people. It should, therefore, ensure the provision of basic human needs for all: not just food and clothing, but also shelter, health care and education. This simple but powerful proposition is often forgotten in the pursuit of material wealth and the conventional concerns of economics. The early literature on development emphasized economic growth and capital accumulation at a macro level. The contemporary literature on development emphasizes economic efficiency and productivity increases at a micro level. Industrialization has always been seen as an essential attribute of development. The emphasis has simply shifted from the pace of industrialization to the efficiency of industrialization. The underlying presumption is that economic growth and economic efficiency are not only necessary, but also sufficient, for bringing about an improvement in the living conditions of people. From time to time, dissenting voices have questioned the conventional wisdom about economic growth, or increases in per capita income, as a measure of development, and suggested other indicators of development, such as a reduction in poverty, inequality and unemployment, which would measure changes in the quality of life.[1] But these aspects of development have been largely ignored by mainstream economics which has not distinguished between means and ends. Economic growth and efficiency, or for that matter industrialization, are means, while development is an end. Thus, growth and efficiency need to be combined with full employment, poverty eradication, reduced inequality, human development and a sustainable environment in order to achieve development. The purpose of development, after all, is to create a milieu that enables people, ordinary people, to lead a good life.

In conventional terms, the world has made enormous economic progress during the second half of the twentieth century. Over the past 50 years, world GDP has multiplied tenfold, while per capita income has trebled.[2] The growth has been impressive even in the developing world, particularly when compared with the underdevelopment and stagnation of the colonial era during the first half of the century. But such aggregates might conceal more than they reveal, as development has been very uneven between countries and within countries. The pattern of development has been such that it has widened the economic gap between the industrialized world and much of the developing world. It has also increased the economic distance between the newly industrializing countries, and the least developed countries. At the same time, economic disparities between regions and between people within countries have registered an increase. In other words, many parts of the world and a significant proportion of its people, have been largely excluded from development. This may be attributable to the logic of market – which gives to those who have and takes away from those who have not – as the process of cumulative causation leads to

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1 See, for example, Baster (1972), Seers (1972) and Morris (1979). In recent years, this view has been put forward strongly by the UNDP in its *Human Development Reports*.

2 Cf. UNDP (1999), p.25.

market-driven virtuous circles and vicious circles. It may be the outcome of patterns of development, where economic growth is uneven between regions and the distribution of its benefits is unequal between people, so that there is growing affluence for some, combined with persistent poverty for many. It may be the consequence of strategies of development, whereby a similar economic performance in the aggregate could lead to egalitarian development in one situation, and to growth which bypasses the majority of people in another situation.

Uneven development is not without consequences for people. Poverty, inequality and deprivation persist. And there is poverty everywhere. One-eighth of the people in the industrialized world are affected by, or live in, poverty. Almost one third of the people in the developing world, an estimated 1.5 billion, live in poverty and experience absolute deprivation insofar as they cannot meet their basic human needs, such as access to clean water. As many as 840 million people suffer from malnutrition. More than 260 million children who should be in school are not. Nearly 340 million women are not expected to survive to the age of 40. And, as we enter the twenty-first century, more than 850 million adults remain illiterate. Most of them live in the developing world. But, in a functional sense, the number of illiterate people in the industrialized countries, at 100 million, is also large.[3]

It is clear that the development experience of the world economy since 1950 has been uneven and mixed. Attempts to analyse what turned out right and what went wrong have led to both explanation and prescription. This, in turn has meant a fundamental change in thinking about development strategies.[4] In the post-colonial era, which began soon after the end of the Second World War, most underdeveloped countries adopted strategies of development in sharp contrast with their colonial past that had been characterized by open economies and unregulated markets. In the early 50s there was a conscious attempt to limit the degree of openness and of integration into the world economy, in pursuit of a more autonomous development. In addition, the State was assigned a strategic role in development, because the market, by itself, was perceived as insufficient to meet the aspirations of latecomers to industrialization. This approach also represented a consensus in thinking about the most appropriate strategy for industrialization. There were a few voices of dissent, but it was, in effect, the development consensus at the time. By the early 1990s, the pendulum had swung the other way in terms of perceptions about development. Most countries in the developing world, as also in the erstwhile socialist bloc, had begun to reshape their domestic economic policies so as to integrate much more into the world economy and to enlarge the role of the market vis-à-vis the State. This was partly a consequence of internal crisis situations in economy, polity and society. It was also significantly influenced by the profound transformation in the world economic and political situation. The widespread acceptance of this approach, it would seem, represented a new consensus in thinking about development that came to be known as the Washington Consensus. Despite many voices of dissent, it remained the dominant view, in part because it was propagated by the IMF and the World Bank, which exercised enormous influence on economies in crisis. This belief system was

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3 The evidence cited in this paragraph was obtained from UNDP (1999).

4 For an analysis of contending views about openness and intervention, see Nayyar (1997).

somewhat shaken by the financial crisis in Asia. But the Washington Consensus has also lost some of its lustre as development experience during the 1990s has belied expectations. Its prescriptions are now subjected to question;[5] and the questions have not come from the critics alone.[6]

In spite of the shift in paradigm from the development consensus of the 1950s to the Washington Consensus of the 1990s, the degree of openness vis-à-vis the world economy and the degree of intervention by the State in the market have remained the critical issues in the debate on development. But the complexity of the reality is not captured by either consensus. The exclusion of countries and of people from development has become much less acceptable with the passage of time, and the proposition that economic growth, or economic efficiency, will ultimately improve the lot of the people is, obviously, far less credible today. The democratization of polities, even if it is much slower than the marketization of economies, has enhanced the importance of time in the quest for development. Now, almost three fourths of the world's people live in pluralistic societies with democratic regimes. And even authoritarian regimes need more legitimacy from their people. Poverty, or austerity now for prosperity later, is no longer an acceptable trade-off for people who want development here and now. Clearly, the time has come to evolve a new consensus on development where the focus is on people rather than on economies, and on ends rather than means. For the welfare of humankind is the essence of development.

II. CONTOURS OF GLOBALIZATION

Globalization means different things to different people. And the word, *globalization,* is used in two ways, which is a source of some confusion. It is used in a *positive* sense to *describe* a process of increasing integration into the world economy. It is also used in a *normative* sense to *prescribe* a strategy of development based on rapid integration into the world economy.

Even its characterization, however, is by no means uniform. It can be described simply, as the organization and expansion of economic activities across national boundaries. In this elementary sense, the world economy has experienced progressive international economic integration since 1950. However, there has been a marked acceleration in this process of globalization during the last quarter of the twentieth century. There are three economic manifestations of this phenomenon – international trade, international investment and international finance – which also constitute its cutting edge. But there is much more to globalization. More precisely, it can be defined as a process associated with increasing economic openness, growing economic interdependence and deepening economic integration into the world economy.

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[5] The critical literature on the subject is extensive. See, for example, Killick (1984), Cornia, Jelly and Stewart (1987), Taylor (1988), Bhaduri (1992), Cooper (1992), Taylor (1993) and Bhaduri and Nayyar (1996).

[6] See Stiglitz (1998).

Economic *openness* is not simply confined to trade, investment and financial flows. It also extends to flows of services, technology, information and ideas across national boundaries. The cross-border movement of people by contrast, is closely regulated and highly restricted. Furthermore economic *interdependence* is asymmetrical. There is a high degree of interdependence among countries in the industrialized world but considerable dependence of developing countries on the industrialized countries and much less interdependence among countries in the developing world. It is important to note that a situation of interdependence is one where the benefits of linking and the costs of delinking are about the same for both partners; where such benefits and costs are unequal between partners, it implies a situation of dependence. Economic *integration* straddles national boundaries, as liberalization has diluted the significance of borders in economic transactions. It is, in part, an integration of markets (for goods, services, technology, financial assets and even money) on the demand side, and, in part, an integration of production (horizontal and vertical) on the supply side.

The gathering momentum of globalization has brought about profound changes in the world economy. It is worth highlighting the characteristics of these changes.[7] An increasing proportion of world output is being channelled into world trade, while an increasing proportion of world trade is made up of intra-firm trade. Between the early 1970s and the late 1990s, the share of world exports in world GDP rose from one eighth to almost one fifth.[8] The share of intra-firm trade in world trade, which was one fifth in the early 1970s, rose to one third in the early 1990s.[9] International investment flows also registered a rapid increase. Between 1980 and 1996, the stock of foreign direct investment (FDI) in the world as a proportion of world output rose from less than 5 per cent to more than 10 per cent, while world FDI flows as a proportion of world gross fixed capital formation rose from 2 per cent to almost 6 per cent.[10] The growth in international finance has been explosive, so much so that, in terms of magnitude, trade and investment are now dwarfed by finance. The expansion in international banking has been phenomenal, and the international market for financial assets has experienced similar growth. There is also a growing international market for government bonds.[11] The size of international foreign exchange markets is staggering. Global foreign exchange transactions have soared, from $60 billion per day in 1983 to $1,500 billion per day in 1997.[12] By comparison, in 1997, world

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7 For a detailed discussion, as well as more evidence on these characteristics, see Nayyar (1995) and Nayyar (1997).

8 The export-GDP ratios are calculated from data on exports in UNCTAD, *Handbook of International Trade and Development Statistics*, and United Nations *Yearbook of National Accounts Statistics*, various issues.

9 UNCTAD (1994), p.143.

10 UNCTAD (1998b), p.385 and p.399.

11 For evidence on the expansion in international bank lending and the rapid growth in the international market for financial assets, including government bonds, see Nayyar (1995) and Nayyar (1997). See also UNDP (1999), p.25.

12 Bank for International Settlements, *Survey of Foreign Exchange Market Activity*, Basel, various issues.

GDP was $82 billion per day and world exports $16 billion per day, while the foreign exchange reserves of all central banks put together were $1,550 billion.[13]

The origins of globalization need to be analysed in terms of the economic factors underlying the process and the political conjuncture which has enabled it to gather momentum.[14] The economic factors are the dismantling of barriers to international economic transactions, the development of enabling technologies and the transforming nature of industrial organization. The political hegemony characteristic of a unipolar world has strengthened this process, which is driven by the lure of profit and the threat of competition in the market.

Globalization has followed the sequence of deregulation in the world economy. Trade liberalization came first, leading to an unprecedented expansion of international trade beginning in the mid-1950s. The liberalization of regimes for foreign investment came next, leading to a surge in international investment beginning in the late 1960s. Financial liberalization – the deregulation of the domestic financial sector and the introduction of convertibility on capital account – came last. This has been followed by the internationalization of finance at a phenomenal pace since the mid-1980s. The technological revolution in transport and communications has produced jet aircraft, computers and satellites. The synthesis of communications technology, which is concerned with the transmission of information, and computer technology, which is concerned with the processing of information, has created information technology, which is remarkable in both reach and speed. These technological developments have pushed aside geographical barriers. The time needed both to transmit and process information is a fraction of what it was earlier, as is the cost. New forms of industrial organization have also played an important role. The emerging flexible production systems are exercising a strong influence on the strategy and behaviour of firms in the process of globalization. The nature of technical progress, the declining share of wages in production costs and the increasing importance of proximity between producers and consumers are constantly forcing firms to choose between trade and investment in their drive to expand activities across borders.

The politics of hegemony or dominance are conducive to the economics of globalization. The process of globalization, beginning in the early 1970s, has coincided with the political dominance of the United States as the main or even sole superpower. This political dominance has grown stronger with the collapse of communism and the triumph of capitalism. And the political conjuncture has transformed the concept of globalization into a "virtual ideology" of our times. Dominance in the realm of politics, however, is not enough. It has to be combined with an important attribute in the sphere of economics. This is because globalization requires a dominant economic power with a national currency that is accepted as the equivalent of

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[13] The value of world GDP and world exports in 1997, reported by the United Nations, has been converted into an average daily figure for the purpose of comparison. The figure on foreign exchange reserves of central banks is obtained from the IMF *Annual Report 1998*.

[14] This outline of the underlying factors draws upon an earlier work by the author. For more detailed discussion, see Nayyar (1995) and Oman (1994).

international money: as a unit of accounting, a medium of exchange and a store of value. This role is being performed by the United States dollar.

Economic theorizing often follows in the footsteps of political reality. It should come as no surprise, then, that recent years have witnessed the formulation of an intellectual rationale for globalization that is almost prescriptive. It is perceived as a means of ensuring not only efficiency and equity but also growth and development in the world economy. The analytical foundations of this world view are provided by the neo-liberal model. Orthodox neo-classical economics suggests that intervention in markets is inefficient. Neo-liberal political economy argues that Governments are incapable of intervening efficiently. The essence of the neo-liberal model, then, can be stated as follows: First, the Government should be rolled back wherever possible so that it approximates the ideal of a minimalist State. Second, the market is not only a substitute for the State but also the preferred alternative because it performs better. Third, resource allocation and resource utilization must be based on market prices, which should conform as closely as possible to international prices. Fourth, national political objectives, domestic economic concerns, or even national boundaries, should not act as constraints.[15] In conformity with this world view, Governments everywhere, particularly in the developing countries and the former communist countries, are being urged or pushed into pursuing a comprehensive agenda of privatization (to minimize the role of the State) and liberalization (of trade, capital and financial flows). It is suggested that such policy regimes would provide the foundations for a global economic system characterized by free trade, unrestricted capital mobility, open markets and harmonized institutions. And the ideologues believe that such globalization promises economic prosperity for countries that join the system and economic deprivation for countries that do not.[16] It needs to be stressed that this intertwined normative and prescriptive view of globalization is driven in part by ideology and in part by hope but it is not borne out by experience.

III. GLOBALIZATION, DEVELOPMENT AND EXCLUSION

The process of globalization in the world economy has brought about profound changes in the international context. It could have far-reaching implications for development. The reality that has unfolded so far, however, belies the expectations of the ideologues. The development experience of the world economy from the early 1970s to the late 1990s, which could be termed the "age of globalization", provides cause for concern, particularly when it is compared with the period from the late 1940s to the early 1970s, which has been described as the "golden age of capitalism". Any such periodization is obviously arbitrary but it serves an analytical purpose.[17]

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15 In this model, domestic economic concerns mesh with, and are subsumed in, the maximization of international economic welfare and national political objectives melt away in the bargain.

16 See, for example, Sachs and Warner (1995).

17 The quarter century that followed the Second World War was a period of unprecedented prosperity for the world economy. It has, therefore, been described as the *golden age of capitalism*. See, for example, Marglin and Schor (1990) and Maddison (1982). The *age of globalization*, however, is not a phrase that has been used in the literature to describe the world economy during the last quarter of the twentieth century. It is suggested here by the author, as this

Available evidence suggests that during the past 25 years, there has been a divergence, rather than convergence, in levels of income between countries and between people. Economic inequalities have increased as the income gap between rich and poor countries, between rich and poor people within countries, as also between the rich and the poor in the world's population, has widened.[18] The incidence of poverty increased in most countries of Latin America and sub-Saharan Africa during the 1980s and in much of Eastern Europe during the 1990s. Many countries in East Asia, South-East Asia and South Asia, which experienced a steady decline in the incidence of poverty, constitute the exception. However, the recent financial meltdown and economic crisis in South-East Asia has led to a marked deterioration in this situation. In the developing countries, employment creation in the organized sector continues to lag behind growth in the labour force, so that an increasing proportion of workers are dependent upon low-productivity jobs and casual employment in the informal sector. Unemployment in the industrialized countries has increased substantially since the early 1970s and has remained at high levels since then, except in the United States. At the same time, there has been almost no increase in the real wages of a significant proportion of the workforce in many industrialized countries. Inequality in wages and incomes has increased almost everywhere in the world. In most countries, the share of profits in income is higher, while the share of wages is lower, than in the early 1980s.[19] Over the same period, the rate of growth in the world economy has also registered a discernible slowdown accompanied by greater instability. It would seem that, in some important respects, the world economy fared better in the "golden age of capitalism" than it has in the age of globalization.

It is obviously not possible to attribute cause-and-effect simply to the coincidence in time. But it is possible to think of mechanisms through which globalization may have accentuated inequalities. Trade liberalization has led to a growing wage disparity between skilled and unskilled workers, not only in industrialized countries, but also in developing countries.[20] As a consequence of privatization and deregulation, capital has gained at the expense of labour, almost everywhere; as mentioned earlier, profit shares have risen while wage shares have fallen. Structural reforms, which have cut tax rates and brought flexibility to labour markets, have reinforced this trend. The mobility of capital, combined with the immobility of labour, has changed the nature of the employment relationship and has reduced the bargaining power of trade unions. The goal of managing inflation has been transformed into a near-obsession by the sensitivity of international financial markets. As a result, Governments have been forced to adopt deflationary macroeconomic policies which have squeezed both growth and employment. The

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periodization facilitates comparison.

[18] For supporting evidence, see UNCTAD (1997) and UNDP (1999). See also IMF (1997).

[19] Some evidence of the increase in profit shares in industrialized countries and the decrease in wage shares in developing countries is reported in UNCTAD (1997). Stewart (1999) develops a similar argument that globalization may have led to an increase in inequality through an increase in returns to capital as compared with labour.

[20] For evidence in support of this proposition, see UNCTAD (1997). In addition, see Wood (1994) and Wood (1997). Stewart (1999) also suggests that trade liberalization, (associated with globalization) provides an explanation for rising inequality, and she cites supporting evidence.

excess supply of labour has repressed real wages. Financial liberalization, which has meant a rapid expansion of public as well as private debt, has been associated with the emergence of a new rentier class. And the inevitable concentration in the ownership of financial assets has contributed to a worsening of income distribution.[21] Global competition has driven large international firms to consolidate market power through mergers and acquisitions, which has made market structures more oligopolistic than competitive. The competition between countries for export markets and foreign investment has intensified, in what is termed "a race to the bottom", leading to an unequal distribution of gains from trade and investment.

Globalization has, indeed, created opportunities for some people and some countries that were not even dreamed of three decades ago. But it has also introduced new risks, if not threats, for many others. It has been associated with a deepening of poverty and an accentuation of inequalities. The distribution of benefits and costs is unequal. There are some winners – more in the industrialized world than in the developing world – but there are many losers, in the industrialized world and the developing world alike. It is, perhaps, necessary to identify, in broad categories, the winners and the losers.[22]

In terms of people, the asset-owners, profit-earners, rentiers, the educated, the mobile and those with professional, managerial or technical skills are the winners, whereas the asset less, wage-earners, debtors, uneducated, immobile and the semi-skilled or unskilled are the losers. In terms of firms, large, international, global, risk-takers and technology-leaders are the winners, whereas small, domestic, local, risk-averse and technology-followers are the losers. In terms of economies, capital-exporters, technology-exporters, net lenders, those with a strong physical and human infrastructure and those endowed with structural flexibilities are the winners, whereas capital-importers, technology-importers, net borrowers, those with a weak physical and human infrastructure and those characterized by structural rigidities are the losers. It needs to be said that this classification is suggestive rather than definitive as it paints a broad picture of a more nuanced situation. But it does convey the simultaneous, yet asymmetrical, inclusion and exclusion that characterizes the process of globalization. It is not surprising, then, that the spread of globalization is uneven and limited, both among people and across countries.

Over the 25 years since globalization began, the exclusion of people and of countries has become a fact of life. Consider some evidence for 1997.[23] The share in world GDP of the richest 20 per cent of the world's people, living in high-income countries, was 86 per cent, while that of the poorest 20 per cent of the world's people, living in low-income countries, was a mere 1 per

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[21] This argument is developed in UNCTAD (1997).

[22] Cf. Streeten (1996), who draws up a balance sheet of globalization based on a rough approximation of what is good and what is bad.

[23] The evidence cited in this paragraph is from UNDP (1999).

cent. The income gap ratio between the richest and the poorest quintiles was as high as 74 to 1.[24] Similarly, the richest quintile of the world's people in high-income countries accounted for 82 per cent of world exports and 68 per cent of world FDI, whereas the poorest quintile of the world's people in low-income countries accounted for just 1 per cent of world exports and of FDI. The richest quintile of the global population in high-income countries used 74 per cent of the world's telephone lines and constituted 93 per cent of Internet users, compared with 1.5 per cent and 0.2 per cent respectively used by the poorest quintile.

This sharp divide between rich and poor countries is no surprise. But the spread of globalization is just as uneven within the developing world. There are no more than a dozen developing economies which are an integral part of the process of globalization: Argentina, Brazil, Chile and Mexico in Latin America; and in Asia, China, Hong Kong (China), Malaysia, the Republic of Korea, Singapore, Taiwan Province of China, Thailand, and. to some extent, Indonesia. These economies account for 70 per cent of exports from the developing world, absorb almost 80 per cent of investment flows to the developing world and receive more than 90 per cent of portfolio investment flows to the developing world.[25] Sub-Saharan Africa, West Asia, Central Asia and South Asia are simply not in the picture, while many economies in Latin America, Asia and the Pacific are left out altogether.

Joan Robinson once said: "There is only one thing that is worse than being exploited by capitalists. And that is not being exploited by capitalists". Much the same can be said about markets and globalization, which may not ensure prosperity for everyone but may, in fact, exclude a significant proportion of people. Markets exclude people as consumers or buyers of goods and services if they have no incomes, or insufficient incomes, which can be translated into purchasing power. This exclusion is attributable to a lack of *entitlements.*[26] Markets exclude people as producers or consumers if they have neither assets nor capabilities. Assets, physical or financial, can be used (or sold) to yield an income in the form of rent, interest or profits. Even those without assets can enter the market as sellers, using their labour, if they have some capabilities.[27]

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24 This income gap has widened over time. The ratio of the average GNP per capita in the poorest quintile of the world's population to the average GNP per capita in the richest quintile of the world's population rose from 1:31 in 1960 to 1:60 in 1990 and 1:74 in 1997. See UNCTAD (1997) and UNDP (1999).

25 See Nayyar (1995) and UNCTAD (1998b). This concentration of trade and investment flows in a small number of developing countries has increased sharply during the past two decades. It is worth noting that these 12 countries accounted for less than one third of total exports from the developing world during the 1970s.

26 This term was first used by Sen (1981) in his work on poverty and famines.

27 In this paper, I use the word *capabilities* to characterize the mix of natural talents, skills acquired through training, learning from experience and abilities or expertise based on education, embodied in a person and which enable him or her to use their capabilities (as a producer or worker) for which there is not only a price but also a demand in the market. It is essential to note that the same word, *capabilities,* has been used in a very different sense by Amartya Sen, who argues that the well-being of a person depends on what the person succeeds in *doing* with the commodities (and their characteristics) at his/her command. For example, food can provide nutrition for a healthy person but not to a person with a parasite disease; or a bicycle can provide transportation for an able-bodied person but not a disabled person. Thus, for Sen (1985), *capabilities* characterize the combination of functionings people can achieve, given their personal features (conversion of characteristics into functionings) and their command over commodities (entitlements).

Such capabilities, which are acquired through education, training or experience, are different from natural abilities which are endowed. But the distribution of capabilities may be just as unequal if not more so. It is these capabilities which can, in turn, yield an income in the form of wages. Hence, people without capabilities – the poor, who cannot find employment – are excluded. In fact even people with capabilities may be excluded from employment if there is no demand for their capabilities in the (labour) market. And, in the ultimate analysis, such capabilities are defined by the market. That is the problem.

Globalization has introduced a new dimension to the exclusion of people from development.[28] Exclusion is no longer simply about the inability to satisfy the basic human needs of food, clothing, shelter, health care and education for large numbers of people. It is much more complicated, as the consumption patterns and lifestyles of the rich, associated with globalization, have powerful demonstration effects. People everywhere, even the poor and the excluded, are exposed to these consumption possibilities because the electronic media have spread the consumerist message far and wide. This creates both expectations and aspirations. But the simple fact of life is that those who do not have the incomes cannot buy goods and services in the market. Thus, when the paradise of consumerism is unattainable, which is the case for many people, it only creates frustration or alienation. The reaction of people who experience such exclusion differs. Others seek short cuts to the consumerist paradise through drugs, crime or violence. Others seek refuge in ethnic identities, cultural chauvinism or religious fundamentalism.[29] Such assertions of traditional or indigenous values are often the only way that poor people can bring an identity and meaning to their lives. Outcomes do not always take such extreme forms. Nevertheless, globalization inevitably tends to erode social stability.[30] Thus, economic integration into the outside world may accentuate social tensions or provoke social fragmentation within countries.

IV. RULES OF THE GAME

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[28] The term *exclusion* has recently become part of the lexicon of economists recently, although it has been in the jargon of sociologists and politics in Europe for somewhat longer. The European Commission, for example, uses the phrase *social exclusion* to describe a situation, and also to focus on a process, which excludes individuals or groups from livelihoods and rights, thus depriving them of sources of well-being that have been assumed, if not taken for granted, in the industrialized countries. The essential point is that economic stratification is inevitable in market economies and societies, which systematically integrate some and marginalize others to distribute the benefits of economic growth in ways which include some and exclude others. See Commission of the European Communities (1993). For an extensive discussion on social exclusion, ranging from conceptual issues through country studies to policy issues, see Rodgers, Gore and Figueredo (1995).

[29] This argument is developed by Streeten (1996) who also cites Benjamin Barber, *Jihad vs McWorld*, New York, Random House, 1995, on this issue.

[30] The hypothesis that there are actual or potential sources of tension between global markets and social stability is developed, at some length, by Rodrik (1997).

The process of globalization has moved new players to centre-stage. There are two main sets of economic players in this game: transnational corporations (TNCs), which dominate investment, production and trade in the world economy, and international banks or financial intermediaries, which control the world of finance. It would seem that the present conjuncture represents the final frontier in the global reach of capitalism to organize production, trade, investment and finance on a world scale, unfettered, except of course, for tight controls on labour mobility. TNCs and international banks or financial intermediaries wish to set the new rules of the game, which would enable them to manage the risks associated with globalization. In this task, the States of the industrialized world provide the much-needed political clout and support. The multilateral framework of the World Trade Organization (WTO), the IMF and the World Bank is, perhaps, the most important medium.

In a world of unequal partners, it is not surprising that the rules of the game are asymmetrical in terms of construct and inequitable in terms of outcome. The strong have the power to make the rules and the authority to implement them. In contrast, the weak can neither set nor invoke the rules. The problem, however, takes different forms.

First, there are different rules in different spheres. The rules of the game for the international trading system, being progressively set in the WTO, provide the most obvious example. There are striking asymmetries.[31] National boundaries should not matter for trade and capital flows but should be clearly demarcated for technology flows and labour flows. It follows that developing countries would provide access to their markets without a corresponding access to technology and would accept capital mobility without a corresponding provision for labour mobility. This implies more openness in some spheres but less in others. The contrast between the free movement of capital and the unfree movement of labour across national boundaries lies at the heart of the inequality in the rules of the game.

Second, there are rules for some but not for others. In the WTO, for instance, major trading countries resort to a unilateral exercise of power, ignoring the rules, because small countries do not have the economic strength, even if they have the legal right, to retaliate. The conditions imposed by the IMF and the World Bank, however, provide the more appropriate example. There are no rules for surplus countries, or even deficit countries, in the industrialized world, which do not borrow from the multilateral financial institutions. But the IMF and the World Bank set rules for borrowers in the developing world and in the transitional economies. The conditionality is meant, in principle, to ensure repayment, but in practice it imposes conditions to serve the interests of international banks which lend to these countries. The Bretton Woods institutions then, act as watchdogs for moneylenders in international capital markets and have been doing so for some time. But there is more to it now. The IMF's programmes of stabilization and the World Bank's programmes of structural adjustment in developing countries and in transitional economies, impose conditions that stipulate structural reform of policy regimes. The objective is to increase the degree of openness and to reduce the role of the State in these

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[31] The asymmetry in the rules of the game for the international trading system, emphasized here, is examined in Nayyar (1996).

economies so that market forces can shape economic decisions. In this manner, the Bretton Woods institutions seek to harmonize policies and institutions across countries, which is in consonance with the needs of globalization.

Third, the agenda for new rules is partisan, but the implicit agenda is just as important as the explicit. The attempt to create a multilateral agreement on investment in the WTO, which seeks free access and national treatment for foreign investors, with provisions to enforce commitments and obligations towards foreign investors, provides the most obvious example. Surely, these rights of foreign investors must be matched by some obligations on their part. For example, a discipline on restrictive business practices of TNCs, the importance of conformity with anti-trust laws in home countries, or a level playing field for domestic firms in host countries should also be in the picture.

The process of globalization, combined with these asymmetrical rules is bound significantly to reduce the autonomy of developing countries in the formulation of economic policies in their pursuit of development. As stated earlier, this is attributable, in part, to the asymmetrical rules and, in part, to the economic implications of globalization. The existing (and prospective) rules of the WTO regime allow few exceptions and provide little flexibility to countries that are latecomers to industrialization. In comparison, there was more room for manoeuvre in the erstwhile GATT, *inter alia*, because of special and differential treatment for developing countries. The new regime is much stricter in terms of the law and its implementation. The rules on trade in the new regime will make the selective protection, or strategic promotion, of domestic firms vis-à-vis foreign competition much more difficult. The tight system for the protection of intellectual property rights might pre-empt or stifle the development of domestic technological capabilities. The proposed multilateral agreement on investment, should it materialize, would almost certainly reduce the possibilities of strategic bargaining with transnational firms. Similarly, commitments to structural reform, an integral part of the stabilization and adjustment programmes of the IMF and the World Bank, inevitably require industrial deregulation, privatization, trade liberalization and financial deregulation. And it is not clear how or why a rules-based regime is better than one based on discretion. For, taken together, such rules and conditions are bound to curb the use of industrial policy, technology policy, trade policy and financial policy as strategic forms of intervention to foster industrialization. It must be recognized that such state intervention was crucial for the successful development of the late industrializers during the second half of the twentieth century.[32]

The constraints implicit in the economics of globalization are most vividly illustrated by the vulnerability associated with rapid or premature integration into international financial markets. This often begins with a reliance on portfolio investment, on capital flows that can be withdrawn on demand, to finance current account deficits in the balance of payments. An economy needs high interest rates together with a strong exchange rate regime to sustain portfolio investment or other similar capital flows in terms of both profitability and confidence. But this erodes the competitiveness of exports over time and enlarges the trade deficit. It is important to

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[32] For a convincing exposition of this view, see Amsden (1989), Wade (1991) and Chang (1996).

recognize the macroeconomic implications. Larger trade deficits and current account deficits require larger portfolio investment (or short-term capital) inflows which, beyond a certain point, undermine confidence and create adverse expectations even if the Government keeps the exchange rate pegged. But when a stifling of exports does ultimately force an exchange rate depreciation, confidence may simply collapse and lead to capital flight. It is possible to think of many variations around this theme but the essential story-line is the same.[33] And the outcome is the same when capital flight precipitates a currency crisis. These problems did indeed surface, to begin with, in Latin America, and subsequently, in South-East and East Asia.[34] Russia and Brazil were the most recent casualties. The frequency and intensity of such financial crises has only increased with the passage of time. And it is no coincidence that the most advanced among the developing countries, which are more integrated into the global economy, have been ravaged by such crises.[35]

The problem is, in fact, even deeper and larger. Exchange rates can no longer be used as a strategic device to provide an entry into the world market for manufactured goods, just as interest rates can no longer be used as a strategic instrument for guiding the allocation of scarce investible resources in a market economy. What is more, countries which are integrated into the world financial system, by using an autonomous management of demand are constrained to maintain levels of output and employment. Expansionary fiscal and monetary policies – large government deficits to stimulate aggregate demand, or low interest rates to encourage domestic investment – can no longer be used because of an overwhelming fear that such measures could lead to speculative capital flight and a run on the national currency.

The lesson is clear. For developing countries, it would be prudent to reconsider the question of financial liberalization and to resist the pressures for capital account convertibility, because premature integration into international financial markets is fraught with danger and can put development at risk.

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33 Cf. Nayyar (1997).

34 For a systematic analysis of, and evidence on, the financial crises in South-East and East Asia, as elsewhere, see UNCTAD (1998a).

35 This experience exposed deep flaws in the international financial architecture. The response of the multilateral financial institutions, in particular the IMF, to these financial crises was both inadequate and inappropriate. In some instances, the approach was counterproductive for it accentuated, rather than alleviated, the crises (cf. UNCTAD 1998a).

V. THE STATE AND DEVELOPMENT IN THE CONTEXT OF GLOBALIZATION

As the twentieth century draws to a close, the facts of life in the world economy are clear. Globalization is the name of the game from which no country wishes to be excluded. Not even large countries can afford to opt out. The choice, then, is between a market-driven, passive insertion into the world economy and a selective, strategic integration. The sensible choice would be to opt for the latter. But is it possible to contemplate correctives that would make this market-driven process more people-friendly so that the outcome is globalization with a human face? The object of such a design should be to provide more countries with opportunities to improve their development prospects and more people within these countries with opportunities to improve their living conditions.

Globalization has reduced the economic autonomy, if not political, of the State but there remain degrees of freedom which must be exploited in the pursuit of development. The ideology of globalization seeks to harmonize not only policy regimes but also institutions, including the economic role of the State, around the world. This is a mistake because the role of the State in an economy depends on level of income and stage of development. The object of any sensible strategy of development in a world of liberalization and globalization should be to create economic space for the pursuit of national interests and development objectives. In this task, there is a strategic role for the State not only in the sphere of domestic economic policies but also in the arena of economic and political interaction with the outside world.[36] In the national context, the State must endeavour to create the pre-conditions for more equitable development, bargain with international capital to improve the distribution of gains from cross-border economic transactions, practice prudence in the macro-management of the economy so as to reduce vulnerability, and intervene to minimize the social costs associated with globalization. In the international context, the State should attempt to reduce the asymmetries and inequalities in the rules of the game and build strategic alliances among developing countries for this purpose.

Consider the national context. First, in countries that are latecomers to industrialization, the State must create the conditions for the development of industrial capitalism. In the earlier stages of industrialization, it means creating a physical infrastructure through government investment, investing in the development of human resources through education and catalysing institutional change, for example, through agrarian reform. In the later stages of industrialization, it means using strategic industrial policy for the development of technological and managerial capabilities at the micro-level, establishing institutions that would facilitate, regulate and govern the functioning of markets, and evolving strategic interventions interlinked across activities to guide the market in the pursuit of long-term development objectives. It must be emphasized that the benefits of integration into the world economy will accrue only to those countries that have laid these requisite foundations. Indeed, creating the pre-conditions and using strategic interventions are essential for internalizing (maximizing) the benefits, and externalizing (minimizing) the costs, of globalization.

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[36] For a more detailed analysis of the role of the State in the world of globalization, see Nayyar (1997). The discussion that follows in this chapter draws upon, and builds on, earlier work by the author.

Second, in the search for foreign investment, the State must resist the temptation to offer incentives and concessions. Indeed, wherever possible, it must bargain with large TNCs. Such an approach would not only improve the distribution of gains from economic transactions with TNCs, but also ensure that their activities are conducive to development. The reason is simple. TNCs are in the business of profit, while Governments are in the business of development. For large countries, this means strategic negotiations in the sphere of trade and investment, for example, to improve terms of trade, obtain market access for exports, facilitate transfer of technology or establish manufacturing capacities in components or downstream activities. But this can be done only by Governments and not by individuals or firms. For small countries, it means a conscious decision to opt out of "a race to the bottom". Hence, Governments must possess the minimal determination to stand firm or to negotiate, rather than surrender from a perceived position of weakness or to make concessions without reciprocity in keeping with the rhetoric of unilateral liberalization.

Third, the State must ensure prudent macro-management of the economy, particularly in the sphere of government finances, for two reasons. For one, it saves Governments from being forced into stabilization and adjustment programmes that come with high conditionality, which, in turn, reduces degrees of freedom in the pursuit of development objectives. For another, it reduces vulnerability and the problems associated with a rapid integration into international financial markets through portfolio investment or capital account convertibility. The bottom line is that such prudence can enable a country to avoid some of the costs of integration and, at the same time, to capture some of the benefits by retaining the freedom to create the necessary conditions.

Fourth, from the perspective of social progress and human development, State intervention is an important means of minimizing the social costs or negative externalities associated with the process of globalization, such as unbridled consumerism, industrial pollution, environmental degradation, sex tourism, lax labour laws and so on. The necessity for such intervention is greater in a developing country where poverty is widespread, environmental concerns are minimal and the rights of the citizens are not assured – all more so as the process of globalization often relocates the production of goods and services, in whole or in part, to avoid laws and regulations in the industrialized world or in the home countries of TNCs.

In the international context, States must endeavour to influence the rules of the game so that the outcome is more equitable. It need hardly be said that the nature of the solution depends upon the nature of the problem. Where there are different rules in different spheres, it is necessary to make the rules symmetrical across spheres. Where there are rules for some but not for others, it is necessary to ensure that the rules are uniformly applicable to all. Where the agenda for new rules is partisan, it is imperative to redress the balance in the agenda. But that is not all. Rules that are fair are necessary but not sufficient. For a game is not simply about rules. It is also about players. And if one of the teams or one of the players does not have adequate training and preparation it will simply be crushed by the other. In other words, the rules must be such that newcomers or latecomers to the game – for example, the developing countries – are provided with the time and the space to learn so that they can become competitive players rather than pushover opponents.

There is a clear need for greater symmetry in the rules of the multilateral trading system embodied in the WTO. If developing countries provide access to their markets, it should be matched by some corresponding access to technology. If there is almost complete freedom for capital mobility, the draconian restrictions on labour mobility should at least be reduced. Similarly, the rules of the multilateral financial institutions, implicit in the conditionalities of the IMF and the World Bank, which are applicable only to deficit countries or borrowing countries, should be reshaped so that the standardized package of policies, which is inflexible, is not imposed on countries, irrespective of time and space, particularly where some of its elements are not consistent with national development objectives in the long term.

In addition, the agenda for the new rules needs careful scrutiny, for it is shaped by the interests of industrialized countries, while largely reflecting the needs of development. For instance, if the proposed multilateral agreement on investment is so concerned about the rights of TNCs, some attention should also be paid to their possible obligations. In any case, such an agreement should not be lodged in the WTO. The issue of labour standards, of course, is simply not in the domain of the WTO. And, insofar as a game is not only about fair rules but also about competitive players, it is essential to reconsider the existing provisions of the unequal agreement on Trade-related Aspects of Intellectual Property Rights (TRIPs), which was signed at a time when most Governments and most people did not understand its economic implications. Such a reconsideration should endeavour to strike a balance between the interests of technology-leaders and technology-exporters in the industrialized world, which are the focus of attention, and the interests of technology-followers and technology-importers in the developing world, which have been neglected.

But that is not all. There are some spheres where there are no rules, such as international financial markets or cross-border movements of people, which are not even on the agenda. The time has come to introduce some rules that govern speculative financial flows in search of capital gains that are composed mostly of short-term capital movements, sensitive to exchange rates and interest rates. It is also perhaps necessary to think about a new international financial architecture in which a world financial authority would manage systemic risk associated with international financial liberalization, coordinate national action against market failure or abuse, and act as a regulator in international financial markets.[37] Similarly, it is worth contemplating a multilateral framework for consular practices and immigration laws that would govern cross-border movements of people. This would be akin to multilateral frameworks that already exist, or are sought to be created, for the governance of national laws, or rules, concerning the movement of goods, services, technology, investment and information across national boundaries.[38] The aim

[37] The rationale for international regulation of global financial markets, possibly through such a world financial authority, is developed at some length by Eatwell and Taylor (forthcoming 2000).

[38] For an elaboration of this idea, as well as a more detailed discussion on its rationale, see Nayyar (1999).

should be to create a transparent and non-discriminatory system, based on rules rather than discretion, for people who wish to move, temporarily or permanently, across borders.

In this context, it is important to stress that, for countries at vastly different levels of development, there should be some flexibility, instead of complete rigidity, in the application of uniform rules. We should be concerned with the desirability of the outcomes and not with the procedural uniformity of rules. It is, in principle, possible to formulate general rules where application is a function of country-specific or time-specific circumstances, without resorting to exceptions. This implies a set of multilateral rules in which every country has the same rights but the obligations are a function of its level or stage of development.[39]

In sum, there is need to reduce asymmetries and inequalities in the rules of the game need to be reduced. How is this to be done? In the multilateral institutions, whether the WTO, the IMF or the World Bank, developing countries and transitional economies must ensure that their voices are heard. This is easier said than done, but groups of countries with mutual interests are more likely to be heard than single countries by themselves. For this purpose, it is essential to find common causes in a world where there are many conflicts and contradictions. There are two means of creating such country groupings: through regional and subregional economic initiatives, or through strategic alliances between countries across regions. These must be based on a coincidence of mutual interests. Unless they constitute an integral part of the pursuit of national interest, such alliances or arrangements cannot sustain themselves, let alone provide a real solution. This is, perhaps, the most important lesson that we must learn from the failed quest for a new international economic order during the 1970s. An appeal to the enlightened self-interest of the rich, which was the spirit of the North-South dialogue, or the rhetoric of solidarity among the poor, which was the spirit of South-South cooperation, cannot suffice. The impetus can come only from material interests in the sphere of economics and national interests in the realm of politics. There will always be conflict and contradiction, but there will also be areas where it is possible to find common cause and accept trade-offs. Regional arrangements or strategic alliances among developing countries, which provide an institutional mechanism for this purpose, can also help in preventing a race to the bottom and in acquiring more bargaining power in the international context.

It needs to be said that governing globalization is, perhaps, just as important as reducing asymmetries in the rules. The momentum of globalization is such that the power of national Governments is being reduced, through incursions into hitherto sovereign economic and political space, without a corresponding increase in effective international cooperation or supranational government which could regulate this market-driven process. In other words, national economies are much less governable, while the global economy is largely ungoverned. In a world where the pursuit of self-interest by nations means uncoordinated action or non-cooperative behaviour, sub-

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[39] It is possible to come up with a weaker version of this formulation. The conditions under which countries can depart from, or even opt out of, multilateral rules can be specified. This would be the equivalent of an escape clause mechanism, which is provided for in the WTO, and also existed in the erstwhile GATT. For an articulation of this view, see Rodrik (1997).

optimal solutions which leave everybody worse off are a likely outcome. International *public bads* such as environmental degradation, arms trade or drug traffic, would increase, while international *public goods* such as a sustainable environment or world peace, decrease. Such outcomes can be prevented only through institutional mechanisms for co-operation. This requires more than rules. It needs a consensus, as the regulation of *public bads* requires self-restraint while the promotion of *public goods* requires a contribution from all countries. Global governance, then, is not so much about world government as it is about institutions and practices combined with rules that facilitate cooperation among sovereign nation States.

VI. DEVELOPMENT STRATEGIES IN THE NATIONAL CONTEXT

Markets and globalization have a logic of their own, which leads to inclusion for some and exclusion for others, or affluence for some and poverty for others. Given this reality, is it possible to think of correctives and interventions, in national development strategies, that would make for more egalitarian economic development and broader based social development? The answer to this question can be contemplated in terms of two strategic approaches.[40] The first approach can be characterized as *proactive*. It should seek to develop mechanisms and policies to ensure that the benefits of development are widely shared. In turn, this requires the integration of social policy into the strategy of economic development. It also requires the creation of institutions to mediate between economic and social development. The object is to pre-empt exclusion. Such measures can be described as *correctives*. The second approach can be characterized as *reactive*. It should attempt to curb the degree of exclusion and at the same time provide social safety nets by those who are excluded. The object is to limit the adverse effects of exclusion. These measures can be described as *interventions*. It need hardly be stressed that there is a critical role for Governments, in both spheres, particularly in the developing world.

The formulation of correctives requires careful design and implementation. The object should be to foster inclusion where markets exist and to create markets where they do not exist. The inclusion of poor people, where markets exist, requires the spread of education and an increase in social consumption. Human resource development, of course, is both a means and an end. And the role of Governments is vital, particularly in primary education, adult literacy and vocational education, all of which foster inclusion. Similarly, the development of a social infrastructure, which in the developing world provides the poor with access to shelter, health care, clean water and sanitation and ensures a steady increase in social consumption, is almost entirely dependent on Governments. The creation of markets, where they are missing, requires substantial investment in physical infrastructure, particularly in the rural areas and backward regions.[41] For example, roads which connect hinterlands to the outside world are essential for the creation of

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[40] Rodgers (1995) makes a distinction between two basic strategic alternatives – reactive and proactive – in a detailed discussion on the design of policy against exclusion. The implications of these alternatives for social integration are obviously different.

[41] It is now widely accepted that substantial public investment in rural infrastructure was an important factor underlying the sharp decline in rural poverty in Indonesia between the mid-1970s and the early 1990s.

markets.[42] Governments must therefore find the resources for stepping up public investment in infrastructure, especially power, transport and communications. The withdrawal of Governments from these sectors, in keeping with the ideology of marketization and globalization, is premature because sufficient private investment, whether domestic or foreign, is simply not forthcoming.

The integration of people who are excluded by markets into an economy and society requires one fundamental corrective. Such people must acquire either capabilities or assets which would give them access to the market as producers or sellers which, in turn, would yield an income so as to provide them access to the market as consumers or buyers. How can this be achieved?[43] First, there must be a systematic attempt to make the unemployed employable. This means creating capabilities through education or training. These capabilities must, of course, be related to the needs of the market. The object should be to create a market responsiveness in the supply of labour. Second, the creation of employment opportunities for the unemployed is imperative, and this in turn means economic policies that are employment-friendly and a strategy of development that is conducive to employment creation. The aim should be to stimulate the demand for labour. Third, whenever possible, the poor should be provided with assets, so that they can enter the market as producers and earn an income on a sustainable basis. This is essential for those who have nothing to sell except their labour but are not able to find employment. An obvious example is land reform, which provides land to the landless rural poor.

The design and implementation of interventions is just as important. The object should be to ensure that markets do not accentuate exclusion. In this, too, the role of Governments is crucial. For markets tend to widen disparities between regions and people, through a process of cumulative causation. Better endowed regions experience rapid growth. Like magnets they attract resources and people from elsewhere until congestion or pollution halts the process. In contrast, disadvantaged regions tend to lag behind. The same is true of poor people or excluded groups, who are disadvantaged because they do not have sufficient income or assets, are not skilled or educated, and live in backward regions. The extent of exclusion can be limited by providing public goods and services to such regions, groups or people. For the people who remain excluded despite such interventions, it is essential to widen and strengthen such safety nets as anti-poverty programmes and social security.[44]

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[42] There is some evidence to suggest that *connectivity* provided by roads is critical in the inclusion of poor people and the integration of distant places into markets. In research on rural India, Bhalla (1997) has shown how economic activities have developed in clusters around arterial roads, running from the north to the south over long distances in the country, integrating rural settlements and small towns into the markets of far away metropolitan cities.

[43] In an analysis of development strategies that are likely to produce egalitarian outcomes, Stewart (1999) emphasizes similar factors: education and training, employment creation, asset distribution and government intervention.

[44] Institutions where exclusion takes the form of discrimination against identifiable social groups (such as women, refugees or minorities), social legislation is necessary. But it may not be sufficient because it is difficult to implement and to enforce a law of equal opportunities. If such exclusion has a history, affirmative action in favour of vulnerable sections in inevitably needed to redress past discrimination. However, it is not possible to continue such affirmative action in perpetuity. In the ultimate analysis, therefore, it is the economic and political empowerment of these social groups that can end their exclusion. For this, political democracy is an imperative.

It is clear that markets may exclude a significant proportion of people, particularly the poor, from the benefits of development unless governments regulate and complement them so as to make them people-friendly. This implies a crucial role for the State. The mood of the moment, however, is not quite receptive to such ideas owing to disillusionment with the economic role of the State in the recent past. That disillusionment now extends much beyond economists to politicians, opinion makers and concerned citizens, and scepticism about the State runs deep. In this milieu, there is a tendency to forget that markets are good servants but bad masters and that the market is as much of a human institution as the State. It is important to remember that the success or failure of either is not exogenous but is shaped by economy, polity and society. It is just as important to recognize that the juxtaposition of government failure and market failure, or judgements about which is worse – as if there were a choice to be made – is misleading because it diverts us into a false debate.[45] Both market failure and Government failure are facts of life.

For neither markets nor Governments are, or can ever be, perfect. Indeed, markets are invariably imperfect and Governments are, without exception, fallible. The important thing is to introduce corrective devices against both market failure and government failure. In fact, as institutions, markets and Governments can provide some mutual checks and balances vis-à-vis each other.

There can be no doubt, however, that it is necessary to redefine the economic role of the State vis-à-vis the market. Such a redefinition should be based on two basic propositions.[46] First, the State and the market cannot be substitutes for each other but must complement each other. Second, the relationship between the State and the market cannot be specified once and for all in any dogmatic manner, as the two institutions must adapt to one another in a cooperative mode over time. These propositions explain the difference between success and failure at development. The real question is no longer about the size of the State or the degree of State intervention. The question now is bout the nature of State intervention and the quality of the performance of the State.[47]

The dominant ideology of our times seeks to create a world in which the retreat of the State from the economy is matched only by the advance of the market. Globalization, also, is a market-driven process. In the absence of correctives, however, it may erode the social stability of institutions and the political legitimacy of Governments in countries that are part of the process. Such correctives can only be introduced by the State and are, in fact, its responsibility. The reason is simple. Governments are accountable to their people, whereas markets are not.

Even so, the changed international context attributable to globalization has important implications for strategies of development, and these must be recognized. An increase in the

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[45] For a more detailed discussion, see Bhaduri and Nayyar (1996) and Nayyar (1997).

[46] Cf. Bhaduri and Nayyar (1996).

[47] For a discussion on the economic role of the State, see Stiglitz et al (1989) and Killick (1990). See also Bhaduri and Nayyar (1996).

degree of openness of economies is inevitable, while the degree of freedom for States is bound to diminish. But it would be a mistake to consider this necessity as a virtue. Simplified prescriptions, which emphasize more openness and less intervention and which advocate a rapid integration into the world economy, combined with a minimalist State that simply vacates space for the market, are not validated by either theory or history. Economic theory recognizes, and economic history reveals the complexity of the development process. The degree of openness and the nature of intervention are strategic choices in the pursuit of development, which cannot be defined and should not be prescribed, irrespective of time and space, for they depend upon the stage of development, and must change over time. And there can be no magic recipes in a world where economies are characterized by specificities in time and space. It is clear, however, that to succeed development needs an adaptive interaction between the State and the market.

It follows that the role of the State in the process of development will continue to be important for some time to come, even as the scope of the market increases through liberalization in the wider context of globalization.[48] Most would find this argument persuasive. Yet many would doubt whether such a redefined economic role of the State is feasible in terms of politics. The willingness and the ability of the state to perform such a role depends on the nature of the State which, in turn, is shaped by the underlying politics. If we look at the world around us, it is obvious that States are not Plato's guardians. Thus, Governments do not always act in the interests of the people at large. Indeed, Governments are frequently sectarian in their actions, as they seek to protect or to promote the interests of the classes, or groups, whom they represent.

The State can be persuaded to act in the interests of its people only where political democracy exists, not just in form but in substance. For it is only democratic political systems, with supporting institutions and practices, that can provide checks and balances.[49] And it is possible for people to be at the centre of development, not only as its beneficiaries but also as the main actors, in a democracy which empowers people to participate in decisions that shape their lives.

As we approach the twenty-first century, it is time to reflect on a new agenda for development. In this reflection, the concern for efficiency must be balanced with a concern for equity, just as the concern for economic growth must be balanced with a concern for social progress. It is also time to evolve a new consensus on development in which the focus is on people rather than economies. Such a consensus must be built on a sense of proportion which does not reopen old ideological battles in terms of either-or choices, and on a depth of

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[48] Economic historians tracing evolutionary course of the market under early capitalism noted repeatedly that the market could become the organizing principle of capitalism only when it was embedded in the regulatory mechanism of the nation State. See, for instance, Polyani (1944), who examined the complex interaction between state regulation and the growth of the market as an institution. This proposition is also borne out by the experience of countries that were latecomers to industrialization. For a discussion, see Bhaduri and Nayyar (1996). See also Wade (1991), Chang (1996) and Nayyar (1997).

[49] This argument is developed, at some length, in Bhaduri and Nayyar (1996) and Nayyar (1998).

understanding which recognizes the complexity and diversity of development. This thinking should not be limited to the sphere of economics. It must extend to the realm of politics.

Substantive democracy, which makes Governments politically accountable to the people, must be an integral part of the new agenda for, and the new consensus on, development. In such a world, ensuring decent living conditions for people, ordinary people, would naturally emerge as a fundamental objective. The distinction between ends and means would remain critical. And, in the pursuit of development, the importance of public action cannot be stressed enough. It must be an integral part of development strategies, which should not be forgotten in the enthusiasm for markets and globalization.

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