Democracy, Markets and People in the Context of Globalization

Deepak Nayyar

Markets and globalization may not ensure prosperity for everyone. They may, in fact, exclude a significant proportion of people, particularly the poor, from the development process. This essay identifies the tension between the economics of liberalization and the politics of democracy as the real issue. It analyzes how markets exclude people and countries in the context of globalization and argues that governments play a critical role in fostering inclusion where markets exist, in creating markets where they do not exist, and in ensuring that markets do not accentuate exclusion.

As the twentieth century draws to a close and we approach the next millennium, market economy and political democracy are buzzwords not only in turbulent Eastern Europe that is attempting a transition to capitalism, but also across a wide spectrum of countries in the developing world from Latin America through Africa and Asia. This is partly a consequence of the collapse of planned economies and excessive or inappropriate state intervention in market economies. It is partly attributable to a concern about authoritarian regimes, and even in countries where economic development has been impressive even though there has been no movement toward a democratic polity. Consequently, markets and democracy are perceived as both a virtue and a necessity.

The virtues of a market economy, articulated more than two centuries earlier by Adam Smith, are spelled out in orthodox economic theory. The market economy is efficient as it optimizes production (in terms of resource

This article was prepared as a background paper for the 1997 Copenhagen Seminar for Social Progress of the Royal Danish Ministry of Foreign Affairs.

allocation) and consumption (in terms of utility maximization). It is democratic insofar as it offers an equal opportunity to all. It is libertarian insofar as it gives every person the right to self-determination. For contemporary enthusiasts, private initiative is the means and economic prosperity is the end.

The virtues of a political democracy can be traced to Anglo-Saxon and European thinking about liberalism. Its basic tenets are freedom for individuals, pluralism of values, importance of rights and equality among people. In such political thought, these tenets are sacrosanct and the limits, if any, are enshrined in a social contract where individuals can be coerced by collective decisions only if they have consented to being subjected to the system (Berlin 1969; Sen 1970; Rawls 1971; Sugden 1981).

These virtues of market economy and political democracy, stressed by orthodoxy, have come to occupy center stage in the context of reforms in the contemporary world, particularly in the erstwhile socialist countries. But it is striking that democracy and markets are often considered together as if they were indivisible and of equal importance. This worldview has two limitations.

First, there is an underlying presumption that democracy and markets require one another and almost ensure each other. This is wrong. The existence of a political democracy is neither a necessary nor a sufficient condition for the functioning of a market economy. The East Asian example provides ample support for this proposition. In terms of logic, it implies that the existence of a market economy is neither a necessary nor a sufficient condition for sustaining a political democracy.

Second, the pairing suggests that democracy and markets are at par. This is questionable. The introduction of democracy in a polity is a fundamental issue, whereas the use of markets in an economy is an institutional matter. For its intrinsic value, democracy is an end in itself. Markets, on the other hand, are means, the use (non-use) of which has to be justified by the consequences. In any event, both cannot be posited as fundamental requirements, for if there is a democracy it is up to the people to decide whether or not, or how much, to use markets. In the words of Amartya Sen (1989): 'If democracy is to be an irresistible force, then the market system cannot be an immovable object'.[1]

It is therefore reasonable to suggest that democracy and markets are

distinct from each other. It is also plausible to argue that, even if both are institutions evolved by humankind, democracy and markets are simply not on the same level. Yet orthodoxy believes that, insofar as democracy is about political freedom for individuals and markets are about economic freedom for individuals, the two must together serve the interests of the people. However, there is little basis for this inference either in theory or in practice.

For one, democracies function on the principle of majority rule or some variant thereof. This is clearly preferable to monarchies or oligarchies associated with the rule of an individual or of a few. But democracy can lead to the tyranny of majorities.[2] What is more, in countries characterized by social and economic inequalities that run deep, it is not clear how adult franchise alone can create political equality. We must not forget that universal suffrage is a 20th century phenomenon even in Europe. Indeed, we would do well to remember that it was property rights, rather than equality, which were at the foundation of liberalism. For a long time, it was property that endowed people with a right to vote so that access to political democracy was the privilege of a few and not the right of everyone.

For another, the proposition that markets create equal opportunities for all depends on the critical assumption that the initial distribution of property rights is equal. Thus, any defense of the market on the premise that it is good in terms of actual outcomes must rest on a defense of the initial distribution of property rights. This argument that markets protect the interests of individuals or minorities, which even democracies cannot, is limited,[3] for such individuals or minorities are not guaranteed access to the market as buyers if they have no incomes, or as sellers if they have nothing to sell. It is important to recognize that while democracy may be about the tyranny of majorities, markets are inevitably about the tyranny of minorities.[4]

In practice, we know that the combination of democracy and markets is neither necessary nor sufficient to bring about an improvement in the living conditions of the majority of the people in a society. Consider egalitarian development, which brings about the material well-being of people together with some equality of economic opportunities. We have seen such egalitarian development in planned economies without political democracy, as in the erstwhile socialist countries of Eastern Europe, and in market

economies without political democracy, as in some East Asian and South-east Asian countries. In sharp contrast, markets and democracy together, where these institutions are not sufficiently developed and have not evolved over a long period of time, as in countries of Eastern Europe, have only produced chaos. The outcome is prosperity for a few and misery for the many. Clearly, there are no magic wands. Democracy and markets are both institutions. The outcome depends on how they are used.

The real issue is somewhat different. The essence of the tension between the economics of liberalization and politics of democracy must be recognized. In an economic democracy, people vote with their money in the marketplace. But a political democracy works on the basis of one person-one vote. The distribution of votes, unlike the distribution of incomes or assets, is equal. One adult has one vote in politics, even though a rich man has more votes than a poor man, in terms of purchasing power, in the market. Governments are elected by the people. Even where they are not, the state needs legitimation from the people (most of whom are not rich or are poor). Markets, on the other hand, are driven by demand and not need. For this important reason, among others, successive generations of economic thinkers and social philosophers have stressed the role of the state in bringing the ideals of political democracy and economic democracy closer together. I shall return to this issue later. It is clear, however, that in reconciling economic and political democracy, a sensible compromise must be reached between the economic directions which the market sets on the basis of purchasing power and the priorities which a political system sets on the basis of one person-one vote.

In an economic democracy, people vote with their money.

MARKETS AND EXCLUSION

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'. The same goes for participation in markets. Much the same, I shall argue, is true of globalization. For there is an exclusion in the process.

The term exclusion has recently become a part of the lexicon of economists, although it has been in the jargon of sociology and the vocabulary of

politics in Europe for somewhat longer. The European Commission, for example, uses the phrase social exclusion to describe a situation, as well as to focus on a process, which excludes individuals or groups from livelihood and rights, thus depriving them of sources of well-being that have been assumed, if not taken for granted, in industrial countries (Commission 1993; Rodgers et al. 1995). The essential point is that economic stratification is inevitable in market economies and societies, which systematically integrates some and marginalizes others to distribute the benefits of economic growth in ways which include some and exclude others.

The literature on developing countries has, in contrast, sought to study marginalization or deprivation of majorities through a focus on poverty and inequality. The concept of exclusion may be useful in the context of developing countries if it helps us understand how the march of markets and the spread of globalization affect the common people. Exclusion is inevitable in markets.

Exclusion is inevitable in markets.

Markets exclude people as consumers or buyers if they do not have any income, or sufficient income, which can be translated into purchasing power. In Amartya Sen's terminology (1981), this exclusion is attributable to a lack of entitlements. Such people are obviously excluded from the consumption of goods and services which are sold in the market. But they may also be excluded from the consumption of public goods and services if they live in clusters such as urban slums, or rural settlements, where drinking water, sanitation facilities, roads, electricity or even streetlights are not provided. It is then the location of the poor (and not their income) which deprives them of access to public services which may be (almost) free elsewhere.

Markets exclude people as producers or sellers if they have neither assets nor capabilities. People experience such exclusion if they do not have assets, physical or financial, which can be used (or sold) to yield an income in the form of rent, interest or profits. The prime example of this for the rural poor in the developing world is exclusion from land. Those who are landless are deprived not only of a source of livelihood but also of a status in society. Exclusion, then, is both economic and social. Even those without assets could enter the market as producers or sellers, using their labor,

if they have some capabilities.[5] Such capabilities which are acquired through education, training or experience are different from 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 who cannot find employment are excluded. For the poor, who have nothing to sell but their labor, employment is the only access to income. The people so excluded are underprivileged in both economic and social terms. Open unemployment simply means exclusion from the labor market. But there is also exclusion within the labor market experienced by those who are underemployed in the agricultural sector and by those who are self-employed or in casual employment in the urban informal sector. The segmented labor market means that access to good jobs which are secure and well-paid is exceedingly difficult whereas access to bad jobs which are insecure and poorly paid is easier.

Markets exclude people both as consumers and producers or as buyers and sellers if they do not accept, or conform to, the values of a market system. The most obvious examples of such exclusion are tribal populations or forest communities in market economies. The same can be said, perhaps, for pockets of precapitalist formations in what are essentially capitalist systems. Such exclusion may also take other forms. There may be people who are unable or unwilling to sell their assets or capabilities. For instance, a person may be unable or unwilling to sell an ancestral house in the market. Or, a person may be unable or unwilling to charge fees as an astrologer or a musician because of a belief system that such talents cannot and should not be sold. In other words, people who are excluded because of their set of norms can find some kind of inclusion in the market once they accept a different set of norms. In general, the terms of such inclusion are such that it intensifies insecurity and exploitation at least for some time.

As a concept, exclusion may describe a situation or characterize a process (Cf. Rodgers et al. 1995). In describing a situation, whether it refers to a point in time or to a permanent state, the concept of exclusion is much the same as the concept of poverty. The object is to identify the excluded and the poor respectively. In characterizing a process, the concept of exclusion goes further to focus on how the operation of economic and social forces recreates or accentuates exclusion over time. Such exclusion may be attributable to the logic of markets, which give to those who have and take away

from those who have not, as the process of cumulative causation leads to 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. Or it may be the consequence of strategies of development, as a similar economic performance in the aggregate could lead to egalitarian development, and growth which bypasses the majority of the people in another situation.

Markets take away from those who have not.

It is clear that institutional arrangements which mediate between economic development on the one hand and social development on the other are critical. For these institutional mechanisms may accentuate exclusion or foster inclusion just as they may limit the gains to an affluent minority or spread the gains to the poor majority. The initial distribution of assets and the subsequent distribution of incomes are important determinants of whether the vulnerable sections of the population are marginalized and excluded or are uplifted and included.

It must be recognized that the impact of exclusion from markets happens at different levels: individuals, social groups, regional and national. Individuals are excluded from access to markets if they do not have the requisite entitlements, assets, capabilities or values. Groups in society such as the landless, the illiterate, the handicapped, the lower castes (as in India), women (in some occupations), migrant workers or ethnic groups are sometimes excluded from participation in the economy. This could mean that identifiable social groups are at a disadvantage in their access to markets and may even be subjected to systematic exclusion from livelihood. Regions within countries, particularly those without natural resources, those with a difficult terrain, those at a distance, or those without skilled labor, may be excluded from development. This may take the form of exclusion from infrastructure, from public goods and services, or from economic and social opportunities. Some of these exclusions from the market also exist at the national level. There are many examples of this in poor countries such as exclusions from land, employment, social protection, health care, education and even from basic human needs such as food, clothing and shelter.

It is only to be expected that there is an interaction between exclusion from the market in the economic sphere and the non-economic dimensions of exclusion in the social, political and cultural spheres. The social manifestations of exclusion can be powerful. This is best illustrated with an example from India where the underprivileged in society, such as the scheduled castes or the lower castes, are poor because they have little in the form of entitlements, assets or capabilities. But even where they are better endowed in terms of these attributes, their exclusion from markets, particularly from the market for land and labor in rural India, persists for social rather than economic reasons. At the same time, economic exclusion accentuates social exclusion. The marketization of economies has meant a lesser role for the state, which has diluted social security provisions made available by governments, just as it has meant a weakening of the community and the extended family as institutions which acted as safety nets provided by society.

In the sphere of politics, an economic exclusion from livelihood often creates or accentuates political exclusion from rights. Thus, for the poor in India, the right to vote may exist in principle but in practice it may be taken away by coercion or coaxed away by material incentives at the time of elections. Similarly, the very poor are vulnerable to exploitation and oppression because their civil rights or equality before the law exist in principle but are difficult to protect or preserve in practice. The reason is simple: they do not have the resources to claim or the power to assert their rights. Likewise, cultural exclusion such as that of immigrant groups, minority communities or ethnic groups interacts with economic exclusion from the market. In all this, there is an asymmetry that is worth noting. Economic exclusion exacerbates other forms of exclusion, but economic participation does not eliminate other forms of exclusion which have social, political or cultural roots.

The preceding discussion may suggest that exclusion is bad and inclusion is good. But it is not meant to. Coercive inclusion by markets, in forms such as child labor, tribal populations or immigrant workers can be exploitative. The employment of women as wage labor on terms inferior to those of men, or the employment of migrants from rural areas in the unorganized urban sector at wages lower than those of workers in the organized sector, provide other examples.[6] The basic point is that inclusion which is coercive or on inferior terms is not desirable. For similar reasons, exclusion

is not always bad. To those who do not accept the values of the market system, any voluntary exclusion from markets, on the part of individuals or groups, should be perfectly acceptable.

GLOBALIZATION AND EXCLUSION

THE process of globalization is associated with a simultaneous inclusion that is asymmetrical. It includes a few but excludes the many. It includes the rich but excludes the poor. It includes capital mobility but excludes labor mobility. It includes access to markets but excludes access to technology. And so on. It is not surprising that the spread of globalization is uneven and limited both among people and across countries.

The internationalized segments of the world economy are the most visible. And they call the tune. Yet most economic activities and economic transactions remain within national boundaries. Large numbers of people in subsistence economies exchange through barter and are not even in the market. For the majority of the people in the world, the exchange of goods and services is in local currencies which are not convertible. It is most likely that two-thirds of humankind is untouched by the world economy. The proportion of the world population that is not familiar with telephones or computers is probably as large.

> Globalization includes a few but excludes the many.

Setting aside the industrialized world, there are only 11 developing countries which are an integral part of the process of globalization: Argentina, Brazil and Mexico in Latin America and the Republic of Korea, Hong Kong, Singapore, Taiwan, China, Malaysia, Thailand and Indonesia in Asia. These countries account for two-thirds of total exports from the developing world, absorb two-thirds of investment flows to the developing world and receive an overwhelmingly large proportion of portfolio investment flows to the developing world.[7] Sub-Saharan Africa, West Asia, Central Asia and South Asia are simply not in the picture, apart from many countries in Latin America, Asia and the Pacific which are left out altogether.

There is an exclusion of people and of countries in the process. Globalization has created opportunities for some people, regions and countries

that were not even dreamed of three decades ago. But it has also contributed to increased impoverishment, inequalities and insecurity for many others. It has weakened social support systems and eroded identities and values. The distribution of benefits and costs, both economic and social, is unequal. There are some winners: more in the industrialized world than in the developing world. There are many losers: numerous both in the industrialized world and in the developing world. It is perhaps necessary to identify, in broad categories, the winners and the losers.[8]

If we think of people, the winners are asset-owners, profit-earners, rentiers, the educated, and those with professional, managerial or technical skills whereas those without assets, wage-earners, debtors, the uneducated, semi-skilled or the unskilled are the losers. If we think of firms, those that are large, international, global, risk-takers and technology-leaders are the winners, whereas firms that are small, domestic, local, risk-averse and technology-followers are the losers. If we think of economies, capital-exporters, technology-exporters, net lenders, those with the 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. If we think of countries, North America, Western Europe, Japan, East Asia and parts of Southeast Asia are the winners, whereas Latin America, Africa, West Asia, Central Asia and South Asia are the losers. It needs to be said that this classification is illustrative rather than exhaustive and suggestive rather than definitive, but it does convey the simultaneous inclusion and exclusion that characterize the process of globalization.

We have seen that markets, in themselves, can exclude people both as consumers and producers. This exclusion is often accentuated by the economic impact of globalization within countries, where the brunt is borne by the losers. But that is not all. The problems of exclusion are compounded by the regime of economic policies and marketization of economies associated with globalization.

For one, there is an exclusion from livelihood. This was pronounced in Latin America and Sub-Saharan Africa during the 1980s and Eastern Europe during the 1990s, particularly in countries that were guided by the International Monetary Fund (IMF) stabilization programs and World

Bank structural adjustment programs. But other countries also adopted similar economic policies in conformity with the new orthodoxy which has gathered momentum and influence with the advent of globalization. There is overwhelming evidence that substantial reductions in the government deficit reduce the current account deficit in the balance of payments through a reduction in the level of economic activity—employment and output—rather than by simply reducing the rates of inflation.[9] And in situations where inflation does not slow down, it makes the rich better off as it redistributes incomes from wages to profits, and the poor worse off as it erodes their incomes which are not index-linked.

Inflation redistributes the income of the rich from wages to profits.

For another, there is an exclusion from social services. This is a direct consequence of the retreat of the state in most countries of Latin America, Sub-Saharan Africa, and now, Eastern Europe. As the resources allocated for poverty alleviation, health care, education and welfare programs decline in real terms, the soft options in fiscal adjustment lead to cuts in public expenditure in social sectors, so that there is a squeeze on social consumption. Cuts in subsidies are often at the expense of the poor. So are the increases in user charges for public utilities. The story does not end there: the state withdraws from investment in infrastructure and private investment in infrastructure, whether domestic or foreign, is not forthcoming. The economic, as well as the social costs, are high. Thus, in many cities across the developing world, the infrastructure appears to be in a state of decay. The supply of electricity or water, waste or garbage disposal facilities and public transport systems often break down. The rich attempt to insulate themselves by living in walled, fenced and guarded areas with their own services of water supply or power generation but cannot escape the polluted air, the threat of epidemics or the possibility of robbery or crime outside their protected havens (Cf. Wolfe 1995). The poor simply do without.

Globalization has introduced a new dimension to the exclusion of people from consumption possibilities. Exclusion is no longer simply about the inability to satisfy the most basic human needs for large numbers of people. It is much more complicated. For 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 possibility frontiers 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 incomes cannot buy goods and services in the market. Thus when the paradise of consumerism is unrealizable or unattainable, which is the case for the common people, it only creates frustration or alienation. Some people who experience such exclusion seek shortcuts to the consumerist paradise through drugs, crime or violence. In its ostentatious forms, however, such a consumer paradise for the affluent in poor countries can exist only as long as the majority are excluded. Indeed, the consumption levels attained by the majority of the people in industrialized countries simply cannot be universalized without risking environmental sustainability.

It is important to recognize that globalization is a multidimensional phenomenon. It extends much beyond the economy to polity and society. And the whole is greater than the sum total of its parts. The multiple dimensions—social, cultural, political and environmental—must be considered, even if briefly, for these are other dimensions of exclusion experienced by people.

First, the social dimension. A market economy is seen as a necessary and desirable attribute of globalization. But its creation of a market society may not be a desirable outcome. If the pursuit of material well-being becomes a dominant and, for some, an exclusive objective, the culture of materialism or simply the quest for money might spread to all spheres of life. To use the words of Jacques Baudot: 'A reasonable utilitarianism could then be transformed into a narcissist hedonism'. In such a world, social consumption, public utilities or merit goods would be at a discount. The norms and values which are the foundation of civil society, where individuals have an obligation to society, would be eroded. Social institutions, so essential for the market economy itself, would be weakened.

Second, the cultural dimension. The global spread of cultural impulses is at least as important as that of economic impulses. The culture of the young in metropolitan cities everywhere—North or South, East or West—is globalized: jeans, t-shirts, sneakers, jogging, fastfood, pop music, Hollywood movies, satellite television, or attitudes to sex, divorce,

abortion and homosexuality. There can be little doubt that consumerism is now global. Even corruption, increasingly similar everywhere, has global dimensions. In all this, the communications revolution and the electronic media have played a key role. But appearances are deceptive, for this globalization of culture is only partial. The poor or the excluded, whether in rural hinterlands or urban settlements, have been largely bypassed. This has led to a reaction or backlash, as ethnic identities or cultural chauvinism assert themselves.[10] Such assertion of traditional or indigenous values is often the only thing that poor people can assert, for it brings an identity, continuity and meaning to their lives. The instances are bound to multiply over time if globalization accentuates exclusion, because modernity and tradition do not always mesh together. Global integration sometimes provokes national disintegration, as ethnic, cultural or religious passions fragment societies. The only solution lies in blending modernity with tradition by combining the best of both worlds. In reality, there is a tendency to combine the worst of both worlds.

There can be little doubt that consumerism is now global.

Third, the political dimension. There are critical issues in the realm of politics: national sovereignty and global governance. The reason is simple enough. The momentum of globalization is such that the power of national governments is being reduced (incursions into hitherto sovereign economic or political space) without a corresponding increase in effective international cooperation or supranational government (which could regulate or govern this market-driven process).

In sum, national economies are no longer easily governable while the global economy is almost ungoverned. These are issues I have discussed elsewhere.[11] But globalization can also shape domestic political choices and processes. In a political democracy, it is perfectly possible that the excluded or the poor elect parties or leaders who promise to address their problems and needs. Even when elections have produced such outcomes, however, recent experience suggests that the political leadership conveniently forgets its manifesto promises or rationalizes its compromises by pointing to the reality of globalization and the compulsion of political forces. Questions and criticisms of their own constituencies are set aside by the 'there is no alternative' syndrome even if reality shows that 'this is no alternative'.

Fourth, the environmental dimension. Unsustainable patterns of consumption and production emulating the industrialized countries might mean continued, possibly accelerated, overexploitation and degradation of common property resources. The rational pursuit of self-interest by individuals (utility maximization), firms (profit maximization) and nations (exporting pollution and importing exhaustible resources) could end up with Prisoners' Dilemma outcomes where environmental degradation leaves everybody worse off. The poor or the excluded, who derive little benefit from these market-driven processes, cannot escape the costs of the environmental insecurity so created.

Globalization is creating two worlds.

In sum, there is a real danger that some countries may experience an exclusion from the process of globalization, just as many people within these countries may experience an exclusion from prosperity. Such exclusion from the process of development would increase the economic distance between nations and widen the income disparities between peoples of the world. This would be difficult to sustain in a world where demonstration effects are strong and are reinforced by globalization which creates expectations of, or aspirations for, consumption patterns and life styles.

It would seem that globalization is creating two worlds. For those included, the world is their oyster. For those excluded, there is an ever-widening gap between the aspirations for a consumer paradise and the capacity of economies to satisfy them. Yet, if globalization turns into a secession of the successful, it could have an analogue in terms of a secession of the deprived. For the economic deprivation of the majority is bound to accentuate social divides and political alienation.

CORRECTIVES AND INTERVENTIONS

MARKETS and globalization have a logic of their own which leads to inclusion for some and exclusion for others, affluence for some and poverty for others, or development for some and underdevelopment for others. Is it possible to think of correctives and interventions that would make for a more egalitarian economic development and a more broad-based social development? I shall endeavor to answer this question in terms of two strategic approches.[12] The first approach can be characterized as proactive. It

should seek to develop mechanisms, institutions and policies to ensure that the benefits of development are widely shared. In turn, this requires an integration of social policy into the strategy of economic 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 to those who are excluded. The object is to limit the adverse effects of exclusion. These measures can be described as interventions.

The inclusion of poor people, where markets exist, requires the spread of education and an increase in social consumption. Human resource development is both a means and an end. It is a means of raising levels of productivity and mobilizing labor, frequently the most abundant resource, for the purpose of development. It is an end insofar as it makes a basic contribution to an improvement in quality of life, for people as individuals and for society at large. Thus education is not simply a part of the social infrastructure—it is a priority. Here the role of governments is vital, particularly in primacy education, adult literacy and vocational education, all of which would foster inclusion. Similarly, the role of governments is crucial in ensuring a steady increase in social consumption which is possible only through an increase in the level and the productivity of public expenditure. Social consumption, of course, includes access to basic education. But it is also made up of basic health care which includes safe drinking water, public hygiene, preventive measures, child and mother care, family planning and similar social services. In addition, it should include provision for housing and sanitation. The development of a social infrastructure which provides the poor with access to public services and sustains social consumption is almost entirely dependent on governments everywhere but even more so in the developing world.

The creation of markets, where they do not exist, requires a substantial investment in physical infrastructure, particularly in rural areas and backward regions. There can be little doubt that it is the development of infrastructure in the form of roads, transport, power, irrigation and storage which helps create markets in rural hinterlands.[13] It needs to be stressed that roads which connect rural areas and backward regions to the world outside are essential for the creation of markets.[14] Governments must there-

fore find the resources for stepping up public investment in infrastructure. Power, transport and communications are also the obvious sectors for the economy as a whole. The withdrawal of governments from these sectors, in keeping with the ideology of marketization and globalization, is premature because sufficient private investment is not forthcoming, perhaps because of the high risks, the long gestation lags or the sheer size of the investment needed. In fact, experience from the developing world and even some industrialized countries suggests that the private sector simply does not and cannot make the requisite investment in infrastructure. It is important to learn from this concrete experience, instead of being captivated by slogans about privatization.

In the search for a sustainable solution, what else can be done for the inclusion of people who are excluded by markets? Their integration into 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 with access to the market as consumers or buyers.

How can this be achieved? First, there must be a systematic attempt to make the unemployed employable. This means creating capabilities through education or training of the excluded. 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 labor. Second, the creation of employment opportunities for the unemployed is imperative. This means economic policies that are employment-friendly and a strategy of development that is conducive to employment creation. The object should be to stimulate the demand for labor. Third, wherever 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 labor but are not able to find employment particularly in rural areas. The rural poor who are excluded from land need to be provided with access to land through suitable land reforms.

The poor should be provided with assets.

The design and implementation of interventions are just as important. The object should be to ensure that markets do not accentuate exclusion of

regions, social groups and people. In this, too, the role of governments is crucial. It is important to recognize that economic liberalization tends to widen disparities between regions and people because there is a cumulative causation which creates market-driven virtuous circles and vicious circles. Regions that are better endowed with natural resources, physical infrastructure, skilled labor, and so on, experience a rapid growth. Like magnets, they attract resources and people from elsewhere and the attraction may extend even beyond national boundaries.

By contrast, disadvantaged regions tend to lag and become even more disadvantaged. The same is true for poor people or excluded groups who are disadvantaged because they do not have sufficient income or assets, are unskilled or uneducated, and live in backward regions. The extent of exclusion can be limited by providing public goods and services to such regions, groups or people and by creating economic opportunities for the vulnerable, marginalized and excluded. For the people who remain excluded despite such interventions, it is essential to widen and to strengthen safety nets. The principal examples are poverty alleviation programs or social security for the unemployed which provide incomes to the poor and public distribution systems which provide necessities at subsidized prices to the poor. Such safety nets may need to be extended, at least for a time, to providing shelter for the homeless.

The exclusion of readily identifiable regions and people would require specific interventions. Wherever exclusion coincides with a geographical space—whether urban slums, rural clusters or backward regions—territorial approaches are more appropriate (Cf. Rodgers 1995). The allocation of resources for the development of education, an increase in social consumption and the creation of a physical infrastructure in the identified geographical areas provide obvious solutions. In situations where exclusion takes the form of discrimination against identifiable social groups—say, women refugees, minorities or lower castes—the legislative route may be the most appropriate. 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 favor of vulnerable sections is inevitably needed to redress past discrimination. But even this cannot provide a sustainable solution because affirmative action manages to include some while others remain excluded. And it is not pos-

sible to continue such affirmative action forever. In the ultimate analysis, it is the economic and political empowerment of these social groups that can end their exclusion.

It must be recognized that correctives and interventions depend, to a significant extent, on the level of exclusion. At the level of individuals, the fundamental solution lies in the acquisition of capabilities or assets. At the level of groups, social legislation, affirmative action and in the ultimate analysis, empowerment, are the most appropriate means. At the regional level, the allocation of resources for the development of education, an increase in social consumption and investment in physical infrastructure, combined with a decentralization of decision-making and activation of community groups would contribute to a resolution of the problem. At the national level, there must be an endeavor to regulate markets so that they foster inclusion and do not accentuate exclusion, make social policies an integral part of development strategy, design institutions to mediate between economic and social development, strike a balance between proactive and reactive policies, and facilitate the development of coalitions between people with a common interest in inclusion. At the international level, the state should attempt to reduce the inequalities in the rules of the game, for the institutional framework for globalization is characterized by a striking asymmetry.[15]

The premise of the present regime is that national boundaries should not matter for trade flows and capital flows but should be clearly demarcated for technology flows and labor flows. Yet, if developing countries provide access to their markets, it should be matched with a corresponding access to technology. Similarly, if there is almost complete freedom for capital mobility across national boundaries, the draconian restrictions on labor mobility across national boundaries should at least be reduced if not eliminated. For this purpose, nation-states in the developing world need regional arrangements or strategic alliances among countries that can enter into coalitions on the basis of mutual interest.

THE STATE, MARKETS AND DEMOCRACY

THE marketization and globalization of economies may exclude a significant proportion of people, particularly the poor, from the benefits of development unless governments regulate and supplement markets to make

them people-friendly. This implies a crucial role for the state. The mood of the moment, however, is not receptive to such ideas. There is a disillusionment with the economic role of the state which now extends beyond economists to politicians, opinion-makers and concerned citizens. And skepticism about the state runs deep. In this milieu, there is a tendency to forget that the market is as much a human institution as the state. It is important to remember that the success or failure of either is not exogenous but is shaped in economy, polity and society.

The second half of the 20th century has witnessed a complete swing of the pendulum in thinking about the role of the state in economic development. We appear to have moved from a widespread belief prevalent in the 1950s that the state could do no wrong to a growing conviction, now fashionable in the 1990s, that the state can do nothing right. This dramatic change in thinking can be attributed in part to ideology and in part to reality. The world of competing ideologies, capitalism versus communism, has given way to a world with a single dominant political ideology. Communism has collapsed and capitalism has emerged triumphant. The reality that we observe around us also contributes to this thinking. The market economies of East Asia epitomize success. The erstwhile planned economies of Eastern Europe, in particular the former Soviet Union, represent failure. The success of the market shines when juxtaposed with the failure of the state. However this is an oversimplified perception. The reality is more complex for market failure is also a fact of life. In fact, the term market failure[16] has been in the jargon of economists for some time. It is the term government failure[17] that has entered their lexicon relatively recently.

Market failure is also a fact of life.

It is 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. Both market failure and government failure are facts of life. For neither markets nor governments are perfect. Indeed markets are invariably imperfect and governments are without exception fallible. What is important is to introduce corrective devices against both market and government failure. These failures are seldom absolute. A reasonable degree of correction is possible in either case.

There can be no doubt, however, that it is necessary to redefine the economic role of the state vis-à-vis the market. I believe such a redefinition should be based on two basic propositions. First, the state and the market cannot substitute 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, for the two institutions must adapt to one another in a cooperative manner over time. I also believe that these propositions explain the difference between success and failure. Successful economic development is observed mostly in countries where the state and the market complement and adapt to one another in response to changing circumstances. This proposition is borne out both by the history of capitalism among the early industrializers during the 19th century and by the more recent experience of the late industrializers in the 20th century.

The state and the market must complement each other.

Economic historians tracing the 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.[18] The very extension of the scope of the free market necessitated, at each stage, the imposition of new regulations by the state to ensure the further growth of the market. Thus any characterization of the state and the market in opposition to one another, is a misreading of history. Instead, it is more useful to think of the relationship as being governed by a kind of adaptive principle in which neither the state nor the market becomes destructively dominant to cripple the other institution.

From this perspective, it is instructive to consider the experience of the late industrializers. The belief that markets know best is associated with an unstated presumption that state intervention is not needed or is counterproductive in the process of industrialization. This is ahistorical. Experience from the second half of the 20th century suggests that the guiding and supportive role of the state has been the very foundation of successful development in countries which are latecomers to industrialization. Even among the East Asian countries, which are often cited as success stories that depict the magic of the marketplace, the visible hand of the state is as

much in evidence as the invisible hand of the market. This is the unavoidable inference if we consider, for example, the development of industrial capitalism in Japan after the Meiji Restoration in 1868, or the emergence of market socialism in China after the modernization and reform programs launched in 1978. The economic role of the state has been almost as crucial in Korea, Taiwan and even Singapore.

In the earlier stages of industrialization, state intervention creates the conditions for the development of industrial capitalism. It creates a physical infrastructure through government investment in energy, transport and communication, which reduces the cost of inputs used by the private sector or increases the demand for goods produced by the private sector. It develops human resources through education, which raises private profitability as it lowers the private cost of training workers. It facilitates institutional change through agrarian reform, which increases productivity and incomes in the agricultural sector to foster industrialization through supply-demand linkages. I must emphasize that institutional reform in the agricultural sector, the spread of education in society and, above all, the role of state intervention have been crucial for development among the late industrializers, particularly the success stories in East Asia that are perceived as role models.

In the later stages of industrialization, it is not just the degree but also the nature of state intervention that must change. The role of the state, then, is neither that of a promoter nor that of a catalyst. The role of intervention by the state in the market can be classified conveniently as functional, institutional or strategic.

Functional intervention by the state seeks to correct for market failures insofar as prices give the wrong signals. It can be specific or general. That depends on the nature of the failure of the price mechanism. The debate, in such cases, centers on the availability of alternative market-based solutions or the ability of governments to design and implement correct solutions on the basis of adequate information.

Institutional intervention by the state seeks to govern the market. It does so by setting the rules of the game for the players in the market. In particular, it creates frameworks for regulating markets and creates institutions to monitor the functioning of markets. Some examples would highlight the significance of this form of intervention. A market economy needs

rules of the game to ensure a level playing field and to pre-empt a free-for-all at the same time. Thus trade policy which ushers in import liberalization must be matched by a comprehensive system of antidumping laws for domestic firms to invoke wherever necessary. Industrial deregulation requires corresponding antitrust laws. Financial liberalization requires matching regulatory laws. Consumer protection requires laws that curb restrictive trade practices, ensure quality control and check misinformation in advertising. A market economy needs these institutions to facilitate the function of markets.

Strategic intervention by the state seeks to guide the market. It is linked across activities or sectors in an attempt to attain broader, long-term objectives of development. It is possible to cite different types of examples. Exchange rate policy, for instance, is not simply a tactical matter of getting prices right but may turn out to be a strategic matter. Deliberately undervalued exchange rates, maintained over a period of time, have been known to provide an entry into the world market for differentiated manufactured goods. This is especially true where quality is perceived in terms of established brands but lower prices of unknown brands allow initial access to markets. Thus, a strategically undervalued domestic currency makes the price of domestic manufactured exports cheaper for foreigners to buy, and gradually creates their reputation in competition with established brands. Similarly, restrictions on the use of foreign brand names are not symptomatic of an inward-looking attitude if they are perceived as a strategic means of buying time to develop brand names that become acceptable in world markets, but could never have surfaced in competition with established foreign brands.

In this manner, state intervention may constitute an integral part of any strategy of industrialization that endeavors to strengthen capabilities and develop institutions rather than relying on incentives and markets alone. This is perhaps the most important lesson that emerges from East Asia. Both Japan and Korea put exchange rate policy to such strategic use and, in effect, banned the use of foreign brand names for a period of time as a strategic means of developing their own brand names.[19] Strategic intervention by the state particularly in the realm of industrial policy and technology policy, rather than a blind reliance on markets alone, has been a crucial factor underlying efficiency and dynamism in the later stages of in-

dustrialization, which enabled Japan, then Korea, to join the league of the industrialized nations.[20]

In many developing countries, just as much as in Eastern Europe, perceptions have been so strongly influenced by the counterproductive role of state intervention that the possibilities of a creative interaction between the state and the market are not yet recognized. In theory, it may be possible to remedy market failure by state intervention. In practice, governments may lack the ability or the willingness to intervene efficiently. The experience of excessive state intervention associated with government failures, however, should not lead to the conclusion that minimal state intervention is best or that market failures do not matter. The crux of the problem is to assess the costs of government as well as of market failure, at critical points, so as to minimize the cost to economy and society. And those who never tire of emphasizing the costs of state intervention must also recognize the costs of state inaction at such critical points.

Governments are frequently sectarian in their actions.

In the present context, therefore, we need to reformulate the questions about the economic role of the state. The real question is no longer about the size of the state (how big?) nor the degree of state intervention (how much?). The question is now about the nature of state intervention (what sort?) and the quality of the performance of the state (how good?).

I have argued that it is both necessary and desirable to redefine the role of the state at the present conjuncture. I also believe that the economic role of the state in the developing world will continue to be important for some time to come, even as the scope of the market increases through liberalization. Most would find these arguments persuasive. But many will doubt whether this 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 its 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 people at large. Indeed, governments are frequently sectarian in their actions as they seek to protect or promote the interests of classes, or groups,

they represent. More narrowly, they manipulate on behalf of groups who can exercise influence. The apparatus of governments is often deliberately used to promote the interests of the ruling elite. This does not surprise anyone. What is worse, however, is that governmental systems are sometimes used to further, crudely and openly, the interests of powerful individuals through corruption and nepotism. In extreme situations, the state becomes private property or even family property. The disillusionment with the state, then, is understandable.

Transparency and accountability are essential.

The correctives and interventions suggested here are based on the presumption that the state can be persuaded to act in the interests of its people. This is possible only where political democracy exists in form as well as in substance. For democratic practices and institutions are about checks and balances. However, these cannot be sufficient unless there is transparency and accountability in the system, which must begin with the government but must be extended to political parties.

In a democracy, these principles of transparency and accountability are essential prerequisites if checks and balances are to be transformed into self-correcting mechanisms that provide or invoke the sanction of the people. A simple analogy is the treatment of a very complicated and poorly understood set of diseases afflicting a single patient at the same time. A good doctor, or even a team of doctors, is likely to make mistakes in understanding the complexity of the particular illness which needs to be cured as soon as possible. Democratic systems may not provide the best doctor but they ensure that the doctor will be changed if he fails or does not admit his mistake soon enough.

The emphasis on the principles of transparency and accountability is not so much about morality in public life. Nor does it stem from a desire to preserve the letter, or even the spirit, of Constitutions in political life. It is not that morality and Constitutions are not important in politics. They are. But I attach importance to these principles more because they provide the means of combining sensible economics with feasible politics and reconciling economic democracy with political democracy. The economic priorities of the people will be reflected more and more in the political agenda of

parties if there is transparency in the system. And the political agenda of parties will be reflected more and more in the reality of economic development if there is accountability in the system. Once this two-way process gathers momentum, transparency and accountability will create a commitment to long-term objectives of development in a democracy even though governments are bound to change through elections over time.

The process of development exercises a profound influence on the life of the ordinary people: the proverbial common man. It is far too serious a matter to be left to economists, or even to politicians. Economic development must therefore be embedded in the democratic politics of social consensus. It is neither a matter of technical economics nor a question of managing politics with slogans or illusions.

More than anything else, economic development in a democracy must be recognized as the creation of purposive social organization. This means that people are at the center of economic development not only as its beneficiaries but also as the main actors. For people can impart a sense of purpose to society only when they are enthused by a sense of achievement based on an improvement in their living conditions and a widening of opportunities in their daily existence. Unfortunately, marketization and globalization in the developing world, so far, have provided the enthusiasm and the opportunities to the privileged few who are rich but not to the vast majority who are poor.

NOTES

I would like to thank Satish Jain, with whom I clarified some of my ideas on this subject. The errors that remain are mine.

1. This observation is made in the context of reforms in the erstwhile socialist countries.

2. The principle that the will of the majority should always prevail in a democracy has been a matter of debate for a long time. John Stuart Mill, for example, argues that 'the government of the whole by a mere majority of the people', the principle of majority rule, is undemocratic. This was then developed into an argument for proportional representation (Mill 1946).

3. The argument is that even when a minority group is treated with hostility by the majority (say a group of people with extremist political views who wish to produce a newspaper), the market system offers the minority significant protection (buying newsprint and employing journalists). See Sugden (1981). Similarly, Friedman (1962) points out that Jewish people

were able to survive the hostile environment in medieval Europe largely because they were engaged in commerce and trade. And the economic (self) interest of the population prevailed over religious discrimination.

4. I owe this formulation to my colleague Satish Jain.

5. 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 that enable him or her to use these (capabilities as a producer or as a worker) for which there is not only a price but also a demand in the market. It follows that even persons with capabilities may be excluded from employment if there is no demand for their capabilities in the (labor) 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 command. For example: food can provide nutrition to a healthy person but not to a person with a parasitic disease or a bicycle can provide transportation to an able-bodied person but not to a disabled person. Thus, for Sen (1985) capabilities characterize the combination of functionings a person can achieve, given his personal features and his command over commodities.

6. It is impossible to cite other examples. The basic issue, as Rodgers (1995) suggests, is the terms of inclusion for, in itself, integration is ambiguous because there can be many degrees and facets of inclusion.

7. See Nayyar (1995).

8. Streeten (1996) draws up a balance sheet of globalization based on a rough approximation of what is good and what is bad.

9. For evidence on the impact of structural adjustment on the social sectors, nutrition, health and living standards in developing countries, see Cornia, Jolly & Stewart (1987).

10. This argument is developed by Streeten (1996) who also cites Benjamin Barber's *Jihad vs. McWorld* (1995) on this issue.

11. See Nayyar (1995, 1996a).

12. 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.

13. 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.

14. There is some evidence to suggest that connections provided by roads are critical in the inclusion of poor people and the integration of distant places into markets. In her research on rural India, Bhalla (1997) has shown how economic activities have developed in clusters around arterial roads, integrating small towns into the markets of far-away metropolitan cities.

15. For a more detailed discussion of this issue, see Nayyar (1996a).

16. It is obvious that the word failure is used to describe outcomes that are inefficient or undesirable with reference to some idealized state of economy. Most textbooks in economics elaborate on such failures.

17. Government failure takes many forms and is attributable to many factors. Sometimes, governments make mistakes because they do not have adequate information about a problem. Often, governments do not quite understand the nature of the problem. Without adequate information and necessary understanding, governments are neither able to predict nor able to control the consequences of their actions. Hence, the government intervention may not resolve the problem it intends to. Instead, it may lead to unwanted adverse effects that are unintended. There is also a divergence between the conception and design of intervention by the government. The divergence between the design and implementation of policies is perhaps even greater.

18. See, for instance, Polyani (1994) who examined the complex interaction between state regulation and the growth of the market as an institution.

19. Japanese cameras, television and cars, in an earlier period, or Korean consumer electronics and cars, in more recent years, illustrate the success of this strategy.

20. The preceding discussion on the role of the state in countries that are latecomers to industrialization draws upon Nayyar (1996b).

REFERENCES

Berlin, I. 1969. *Four Essays on Liberty.* Oxford: Clarendon Press. New Delhi: Penguin Books.

Bhalla, S. 1997. The Rise and Fall of Workforce Diversification Process in Rural India. In G Chadha & A Sharma (eds). *Growth, Employment and Poverty: Change and Continuity in Rural India.* New Delhi: Vika.

Commission of the European Communities. 1993. *Towards a Europe of Solidarity: Intensifying the Fight against Social Exclusion and Fostering Integration.* Brussels: European Community.

Cornia, G; R Jolly & F Stewart. 1987. *Adjustment with a Human Face.* Oxford: Clarendon Press.

Friedman, M. 1962. *Capitalism and Freedom.* Chicago: Chicago University Press.

Mill, JS. 1946. *On Liberty (1859) and Considerations on Representative Government (1861).* Oxford: Oxford University Press.

Nayyar, D. 1996a. *Economic Liberalization in India: Analytics, Experience and Lessons.* Calcutta: Orient.

Nayyar, D. 1996b. Globalization: What does it mean for Development? Paper presented at the 1996 Copenhagen Seminar on Conditions for Social Progress: A World Economy for the Benefit of All. Copenhagen, Denmark.

Nayyar, D. 1995. Globalization: The Past in our Present. Presidential Address to the

Indian Economic Association. Chandigarh, December. Reprinted in *Indian Economic Journal,* January – March 1996.

Polyani, K. 1994. *The Great Transformation.* New York: Holt, Rinehart and Winston.

Rawls, J. 1971. *A Theory of Justice.* Oxford: Clarendon Press.

Rodgers, G. 1995. The Design of Policy against Exclusion. In Rodgers et al.

Rodgers, G; C Gore & J Figueriedo (eds). 1995. *Social Exclusion: Rhetoric Reality Responses.* Geneva: International Labor Organization.

Sen, A. 1989. Socialism, Markets and Democracy. Presidential Address to the Indian Economic Association. Trivandrum, December. Reprinted in *Indian Economic Journal,* January-March 1990.

Sen, A. 1985. *Commodities and Capabilities.* Amsterdam: North-Holland.

Sen, A. 1981. *Poverty and Famines: An Essay on Entitlement and Deprivation.* Oxford: Clarendon Press.

Sen, A. 1970. *Collective Choice and Social Welfare.* Amsterdam: North-Holland.

Stiglitz, J. 1989. Markets, Market Failures and Development. *American Economic Review: Paper and Proceedings.*

Streeten, P. 1996. Governance of the Global Economy. Paper presented at the International Conference on Globalization and Citizenship. Geneva, UNRISD, 9-11 December.

Sugden, R. 1981. *The Political Economy of Public Choice: An Introduction to Welfare Economics.* Oxford: Martin Robertson.

Wolfe, M. 1995. Globalization and Social Exclusion: Some Paradoxes. In Rodgers et al.