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THE EXISTING SYSTEM AND THE MISSING INSTITUTIONS

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1. INTRODUCTION

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.¹

Available evidence suggests that the past twenty five years have witnessed a divergence, rather than convergence, in levels of income between countries and between people. Economic inequalities have increased during the last quarter of a century 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.² And income distribution has worsened. 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, Southeast Asia and South Asia, which experienced a steady decline in the incidence of poverty, constitute the exception. However, the financial meltdown and economic crisis in Southeast Asia has led to a marked deterioration in the situation. In the developing countries, employment creation in the organised sector continues to lag behind the growth in the labour force, so that an increasing proportion of workers are dependent upon low productivity and casual employment in the informal sector. Unemployment in the industrialized countries has increased substantially since the early 1970s and remained at high levels since then, except in the United States, while there has been almost no increase in the real wages of a significant proportion of the workforce in many industrialized countries. Inequality in terms of wages and incomes has registered an increase almost everywhere in the world. In most countries, the share of profits in income is higher while the share of wages is lower than it was in the early 1980s. Over the same period, the rate of growth in the world economy has also registered a discernible slowdown. And the slower growth has been combined with greater instability. It would seem that, in some important respects, the world economy fared better in *the golden age* 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 inequality between skilled and unskilled workers not only in industrialized countries but also in developing countries.³ As a consequence of privatization and deregulation, capital has gained at the expense of labour, almost everywhere, for profit shares have risen while wage shares have fallen.⁴ 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 object of managing inflation has been transformed into a near-obsession by the sensitivity of international financial markets, so that governments have been forced to adopt deflationary macroeconomic policies which have squeezed both growth and employment. The 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 probably contributed to a worsening of income distribution.⁵ 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 for export markets and foreign investment, between countries, 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. But there are many losers. However, the exclusion of countries and of people from development has become much less acceptable with the passage of time.⁶ The proposition that economic growth, or economic efficiency, will ultimately improve the lot of the people is far less credible today than it was fifty years earlier. The democratization of politics, even 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. For the welfare of humankind is the essence of development. As we enter the twenty-first century, therefore, ensuring decent living conditions for people, ordinary people, should be the fundamental objective of the conception and the design for global governance. Such an underlying worldview is an imperative.

This chapter endeavours to draw together the conclusions that emerge from the essays in this volume. In doing so, it does not attempt a summary or a synthesis. Instead, it seeks to develop an overview, for the whole is different from the sum total of the parts. Section II considers the *institutions*, with a focus on the United Nations, the Bretton Woods institutions and the World Trade Organisation, to sketch some contours of reform and change necessary in the existing system. Section III sets out the *issues*, of emerging significance in the contemporary world, to suggest that there are some missing institutions which are needed. The issues selected, global macroeconomic management, international financial architecture, transnational corporations, cross-border movements of people, or international *public goods* and *public bads*, are illustrative rather than exhaustive. Section IV explores some important elements of *governance*, such as structures of representation or decision making in institutions, international rules or norms, evolution or change in institutions, and the role of the nation state, which are critical for any vision about the future.

2. THE EXISTING SYSTEM

2.1 The United Nations

During the second half of the twentieth century, the evolution and the experience of the United Nations system has been strongly influenced by two divides in the world. The East-West divide, which was responsible for the cold war, shaped what the United Nations could or could not do in terms of maintaining peace or ensuring security, which was largely in the realm of politics. The North-South divide, which was associated with decolonization and development, shaped what the United Nations could or could not do in terms of reducing disparities and promoting development, which was largely in the sphere of economics. In both cases, it was conflict, rivalry and limited, even forced, cooperation, which functioned as checks and balances in the system. And, in an almost dialectical sense, these factors provided the driving force, but also slowed things down. The world has experienced a dramatic change during the 1990s. The distinction between East and West has disappeared with the collapse of communism. The distinction between North and South is much more diffused, while the dominance of the Washington consensus has brought divergent perceptions about development closer together. This represents a sea-change. The conflict is much reduced, even if it has not been replaced by harmony. However, the long term implications of a unipolar world in the realm of politics and a new orthodoxy in the sphere of economics are yet to unfold in entirety.

Yet, it is clear that changes in the world, particularly during the past decade, have eroded the legitimacy, the effectiveness and the credibility of the United Nations.⁷ The unipolar world has eliminated the erstwhile *competition between systems*. As competition has

vanished, the urge for cooperation has diminished. This has reduced both the relevance and the role of the United Nations. The dominance of the Washington consensus is just one aspect of the outcome. There are others. Some new nation states remain economically fragile and politically unstable. A few nation states have fractured as they have slipped into ethnic strife or civil war. The legacy of death, displacement and destruction is awesome. There is still no system in place to take care of, let alone prevent, complex humanitarian emergencies. The process of globalization has also given rise to new problems and governance needs. The United Nations system has not quite adjusted to these changed realities. The responsiveness of the United Nations to issues of our times has been limited to global meets such as the Earth Summit or the Social Summit. This is perhaps a form of representation for peoples' concerns. Even if these initiatives have not yielded concrete results, the United Nations has provided a sounding board for new ideas and, at the same time, given them an international visibility. It is, perhaps, a silver lining to the cloud. The moral authority of the United Nations, however, is seriously undermined because its laws or principles are enforced selectively when it suits the interests of the rich and the powerful.

The problem is compounded by the fact that there is a democratic deficit in the United Nations system. It was an integral part of the original design. And it has not diminished with the passage of time. In terms of decision making, the principle of one-country-one-vote has not translated into a democratic mode in a world of unequal partners, just as much as the principle of one-person-one-vote does not make citizens equal in a political democracy. Matters are made worse in the United Nations for two specific reasons. First, the veto clause and the restricted membership of the Security Council are clearly undemocratic. Second, in the General Assembly, any vote on a decision is seen as a failure

while any consensus is seen as a success. The latter, experience shows, can be far from democratic. In terms of representation, the United Nations is essentially an inter-governmental organization. In a more democratic set-up, there should be representation not only for the state but also for civil society. There is some attempt to involve non-governmental organizations and corporate entities but there is no attempt so far to reach out to people at large.

All the same, the United Nations is the core of any international system of governance. Therefore, it is essential to contemplate reform that would make it more credible, more legitimate and more effective.⁸ It must act in accordance with its charter. It must be democratic in achieving representation and making decisions, through participation, transparency and accountability. It must move towards political independence in relation to the powerful geo-political actors. Some institutional changes are obviously desirable. First, it is imperative to enlarge the membership of the Security Council and to circumscribe its veto powers. This structure was created more than half a century earlier. The world has changed since then. These changes have to be recognized rather than ignored or wished away. Second, it is necessary to explore possibilities of alternative modes, at least partial, of independent financing. This would loosen the reins of political control now exercised by the powerful member-states. For the issue of financing is less about money and more about political control. It would also ease the pressures on the United Nations that have been attributable to resource constraints. Some version of the Tobin tax, say on international foreign exchange transactions or stock market transactions, and some charges on the use of the global commons, are possible means of such independent financing. Third, the establishment of a high quality Volunteer Peace Force would be of great benefit. It would depoliticize intervention by the United Nations and

enable it to provide a prompt collective security response wherever humanitarian emergencies arise. Fourth, it is worth thinking about a Global Peoples Assembly, modelled on the European Parliament, which would provide people with opportunities for participation. It would run parallel to the General Assembly. But it would be the voice of global civil society. Fifth, the creation of an Economic Security Council has become essential as a means of governing globalization. It would ensure that the United Nations provides an institutional mechanism for consultations on global economic policies and also, wherever necessary, the international regulatory authority.

2.1 The Bretton Woods institutions

The Bretton Woods institutions were created more than fifty years ago. At the time, their object was to manage the international payments system and to assist in the reconstruction of Europe. There was an underlying worldview about the pursuit of full employment which was shaped by memories of the great depression. This conception also recognized the logic of international collective action in situations where markets did not work and there was a role for government intervention. The world has changed since then. So have the Bretton Woods institutions. But their concerns have become much narrower with the passage of time.

The IMF adapted to the change from a regime of fixed exchange rates to a regime of floating exchange rates, just as it has attempted to cope with the move from capital controls to capital mobility. It had more success with the former than it has had with the latter. The World Bank adapted to the change in its role from reconstruction to development, just as it moved from project lending mostly in infrastructural sectors to

sectoral lending, programme lending and structural adjustment lending. Both the institutions became much more influential and powerful in the process. The influence and the power was directly attributable to the evolution of conditionality. Such conditionality was, ostensibly, a means of ensuring repayment but, in effect, it also performed a surveillance role for international banks. At the same time, it helped shape domestic economic policies in developing countries and transitional economies.

The orthodoxy of the Bretton Woods institutions, however, has not resolved the economic problems of borrowing countries.⁹ Indeed, the solution has often turned out to be worse than the problem. But that is not all. There are two fundamental flaws in the performance of the Bretton Woods institutions. The failure to manage the international financial system, reflected in the instability of exchange rates and the volatility of capital flows which together compound the adjustment problem, is one flaw. The essence of the problem is international capital flows without any international controls. The failure in promoting development, which is reflected in persistent poverty and growing inequalities, is another. The crisis of development has, in fact, been accentuated in the era of globalization. These flaws are, in part, attributable to the *virtual ideology* of the Bretton Woods institutions which does not recognize the importance of public action in coping with market failure. It would seem that the logic of international collective action, which was an integral part of their original design, is forgotten.

As we enter the twenty-first century, therefore, reform and change in the Bretton Woods institutions is an essential element in any design for governing the world economy. Of course, the Bretton Woods twins have much in common in their need for reform and

change. Nevertheless, their roles and functions are different enough, so that it is logical to consider the suggested changes separately for each of the institutions.

2.2.1 The International Monetary Fund

The time has come to redefine the role of the IMF. In terms of governance, this means a constructive role in managing and stabilizing the international financial system, not only through crisis management but also through crisis prevention.¹⁰ The sustainability of the exchange rate, of the current account deficit, of short-term debt and of outstanding portfolio investment, is relevant in thinking about the objectives of a reformed international financial system. However, the pre-occupation with the instability and volatility of capital flows associated with financial crises is so great that there is a tendency to understate the importance of managing exchange rates and current account deficits. The world, it seems, has come a full circle from a time when we thought only about current account macroeconomics to a time when we think only about capital account macroeconomics. But the adjustment problem, and for some countries even the liquidity problem, is not yet *passee*. Therefore, even as it adapts to its new role, the IMF must continue to perform its old role. In doing so, it is necessary to change the structure of governance and the mode of thinking.

Governance in the IMF needs much more representation, transparency and accountability.¹¹ The representation embodied in voting rights that are based on quotas is far too unequal between member countries. The lenders are the principal shareholders in the IMF but the borrowers are the principal contributors to the income of the IMF. There is a clear need to restructure voting rights so as to make them more representative and less unequal. There is almost no transparency in the IMF. Indeed, its operations and

programmes are shrouded in secrecy. The absence of public scrutiny means that there are almost no checks and balances. It is high time that the IMF practices what it preaches about transparency. This calls for a disclosure of information and an independent evaluation of operations. The accountability of the IMF is limited, at best, to finance ministries and central banks which, in turn, have close connections with the financial community. The IMF has almost no accountability to governments in totality, let alone people at large, when things go wrong. Accountability is an imperative without which the IMF could continue to pursue the interests of a subset of the international community, often to the detriment of the general interest of peoples and governments or the collective interest of the world economy.

Thinking in the IMF also needs to change. This is particularly necessary in the sphere of conditionality.¹² Its content leads to overkill. Its coverage extends beyond stabilization and adjustment programmes. And, quite often, it does not work. What is more, where policy reform is driven by the IMF and the World Bank, domestic political constituencies are often forgotten by governments. Such conditionality often subverts the domestic political process so that the question of ownership simply does not arise. Clearly, there is need for a fundamental reform in the practice of conditionality. The IMF also needs to reconsider its thinking in macroeconomics. There is now ample evidence to suggest that its stabilization programmes lead to adjustment through changes in output rather than through changes in prices.¹³ The outcome is beggar-thyself policies where current account deficits are reduced or inflation is restrained through a contraction in output and employment. Last but not least, the IMF should rethink its perspective on capital account liberalization and capital account convertibility. In this sphere, it would be wise for

countries to hasten slowly for, experience has shown, a premature integration into international financial markets is fraught with danger and can put development at risk.¹⁴

2.2.2 The World Bank

More than fifty years after it began life, the World Bank also needs to redefine its role.¹⁵ Its primary task should be to respond to the crisis of development. Its subsidiary task should be to provide scarce capital to countries and to sectors which do not have access to international capital markets. The benefits may be more related to access in bad times than to reduced borrowing costs. The pursuit of these objectives, however, requires a change of mindset. The World Bank should cease to be a moneylender. It should transform itself into an institution more concerned with development. This is easier said than done but it is feasible. The World Bank should focus its activities on development in poor countries and for poor people. This would need reform in its structure of governance and its mode of thinking.

In terms of governance, more representation and more accountability are an imperative. The representation, as in the IMF, is asymmetrical and unequal. A very large proportion of the voting rights are vested in a very small number of industrialized countries as they are the principal shareholders in terms of paid-up capital. In contrast, a large number of developing countries and the transitional economies are vested with a small proportion of the voting rights even though they are the principal stakeholders, interest payments from whom provide most of the income of the World Bank. The need to restructure such a voting system is obvious. It is a necessary condition for change. The accountability also is limited, once again, to finance ministries and central banks. The comprehensive development framework is a step in the right direction but it represents a modest

beginning. Moreover, in the World Bank, there is a difference between what is said and what is done, just as there is a difference between the thinking arm and the operational arm. The Operations Evaluation Department exists but learning from experience is not yet incorporated into management and executive board decisions. The independent evaluation must also begin in borrowing countries to assess projects and programmes supported by the World Bank. This would be the beginning of accountability to governments and to people.

In terms of thinking, there is a need for radical reform in the sphere of conditionality. The story is not very different what it is in the IMF. Conditionality is characterized by over-kill and over-reach. And, quite often, it does not work. There is an obvious need to promote local ownership of country programmes. For this purpose, the World Bank must give up its attempts to micro-manage economies through conditionality. It should, instead, seek to become a partner in development through local participation. For the World Bank, it is perhaps just as important to re-orient its thinking about development which attaches far too much importance to markets and to openness. 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 recognises 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 the time and space, for they depend upon the stage of development and must change over time.¹⁶ And there can be no magic recipe in a world where economies are characterized by specificities in time and space.

The production and dissemination of knowledge about development and about policies or institutions that are most conducive to development is an important function of the World Bank. This function has been distorted, if not subverted, by the Washington Consensus. Its policy prescriptions became increasingly influential as these were adopted by the World Bank, to begin with its research agenda and subsequently in its policy menu. The dominance in ideas soon turned into a propagation of ideology as the World Bank acquire a near-hegemonic status in thinking about development. The time has come to question this knowledge-hegemony. This process can begin the moment developing countries and transitional economies seek to influence and to shape the research agenda of the World Bank. This is neither implausible nor unreasonable because research budgets are supported by the income stream rather than the share capital of the World Bank. It is also important to recognize that over-centralized knowledge systems are like dominant ideologies which do not have the checks and balances to introduce correctives when the need arises. Even in the sphere of knowledge, competition is desirable. Therefore, research about policies and institutions conducive to development must be progressively decentralized to regional institutions and national institutions. And it will not take long to build supportive research capacities.

The Bretton Woods institutions have been the most ardent advocates of economic reforms in recent times. It is time to reform the reformers. There are some critical elements of change which deserve emphasis.¹⁷ The structures of internal governance need to be democratized, in particular through a reform of voting systems. In addition, the Bretton Woods twins should practice what they preach in terms of transparency and accountability. There is also a strong need to rethink conditionality which is often counter-productive. The standardized package of policies, which is inflexible, must be dispensed

with simply because one size does not fit all. Above all, the Bretton Woods institutions must begin to question their belief system about the magic of the market to recognize the importance of public action and public institutions in the process of development.

2.2 The World Trade Organization

The institutional framework of the multilateral trading system has evolved over time. It has been more than half a century since it began life in the GATT. The first twenty-five years, which coincided with *the golden age*, witnessed a surge of trade liberalization among the major industrialized countries. This process was facilitated in politics by US hegemony and in economics by rapid growth associated with full employment. The influence of these factors began to wane in the early 1970s and there was a turn of the tide as the industrialized world resorted to increasing protectionism. The outcome was a steady erosion in the principle of non-discrimination that persisted for two decades. The multilateral trading system came under severe strain in the 1980s, which culminated in the impasse on the Uruguay Round of multilateral trade negotiations.¹⁸ The impasse came to an end at the ministerial meeting in Marrakesh which gave birth to the WTO. The transformation of the GATT into the WTO represented a paradigm shift. The GATT system was simply about negotiating market access at the border for trade in goods. In sharp contrast, the WTO seeks to impose binding multilateral disciplines, with a common enforcement mechanism, on domestic economic policies. The transformation has not been a smooth sail. The journey from the Marrakesh triumph in 1994 to the Seattle fiasco in 1999 spanned just five years. The present state of the multilateral trading system is fluid. And, as an institution, the WTO is still young enough to permit a fundamental debate

about its system of rules and decision making. Therefore, it is worth setting out some guidelines and priorities for reform and change which are in the realm of the feasible.

To begin with, it is essential to situate the institutional role of the WTO in the wider context of development. For trade is a means. It is not an end. Economic development, which improves the living conditions of the people at large, is a fundamental objective. The WTO should, therefore, recognize rather than ignore the differences in levels of income and development between countries. This gap has widened during the second half of the twentieth century. The eradication of poverty and the creation of employment should thus be WTO objectives as much as trade liberalization and trade expansion. In the same mode, it must be recognized that the desirability of outcomes is more important than the procedural uniformity of rules. There are, of course, more specific reform priorities.¹⁹

First, there is need to develop a more democratic and more effective decision making system. In theory, the principle of one-country-one-vote is democratic. In practice, it is not, partly because decisions are based on a so-called consensus rather than a vote. What is more, decision making in the WTO continues the *Green Room* tradition of the GATT in which the main players exercise disproportionate influence behind closed doors while a large number of member countries are spectators outside often presented with a *fait accompli*. Given the large number of member countries and the complex mandate of the WTO, an efficient system of representative decision making, based perhaps on group negotiations or an executive board, would have to be devised.

Second, there is a clear need for greater asymmetry in the rules of the multilateral trading system embodied in the WTO.²⁰ 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.

Third, the agenda for new rules in the WTO need careful scrutiny, for it is shaped by the interests of the industrialized countries while largely neglecting the needs of development. The proposed multilateral agreement on investment should not, in fact, be lodged in the WTO. The issue of labour standards, of course, is simply not in the domain of the WTO. And there is no reason why environmental standards should find a place in the WTO. There is a strong temptation to place issues or lodge agreements on a wide range of matters in the WTO, essentially because it incorporates an enforcement mechanism and provides a legal right to retaliate. Consequently, there is a real danger that the WTO may be turned into an overloaded elevator which is neither functional nor safe.

Fourth, it would be desirable to hasten slowly in creating disciplines for deeper economic integration through the WTO. It is worth contemplating a *standstill* on new issues sought to be placed on the agenda for multilateral negotiations in the WTO.²¹ It is also necessary to reconsider, if not *roll-back* some of the existing agreements in the WTO, such as the unequal agreement on trade related aspects of intellectual property rights, which was signed at a time when most governments and most people did not understand its economic implications.

Fifth, it is necessary to abandon the concept of the *single undertaking* as the binding rule for future negotiations. This concept, which was the basis of the Final Act in the Uruguay Round Agreement, means that member countries are required to agree upon, and abide by,

the entire set of rules and agreements that are multilaterally negotiated within the WTO and to continue to do so in all its future negotiations. Given the vast differences in levels of development between countries, there should be some flexibility for joining in, or opting out of sub-agreements in the WTO. In other words, it should be possible to think of plurilateral agreements wherever there is a lack of unanimity among member countries on proposed disciplines or new issues. This modality is ideal in situations where it is neither feasible nor desirable to subject all countries, irrespective of levels of development, to a uniform discipline modelled on systems in a few industrialized countries and sometimes, as in TRIPs, on the system of one country alone. Of course, member countries should continue to subscribe to a core of principles and practices that can be easily specified.

3. THE MISSING INSTITUTIONS

3.1 Global macroeconomic management

The perspectives on global macroeconomic management have undergone profound changes during the second half of the twentieth century. It began with the Keynesian consensus. Memories of the great depression shaped the quest for full employment in the industrialized countries. The same experience created a focus on expansionary macroeconomic policies, monetary and fiscal, as a means of maintaining full employment. Such an approach provided the basis for macroeconomic management not only within countries but also in the world economy through international collective action.²² This logic of cooperative capitalism was, in effect, the framework for governance of the world economy during *the golden age*. It was followed by the rise of monetarism which became

the dominant mode of thinking. As concerns about inflation became paramount, macroeconomic policies in the industrialized world sought to maintain price stability at the expense of full employment. The transition from the regime of fixed exchange rates to a regime of floating exchange rates did not guarantee external balance. The outcome was reduced degrees of freedom in macro-management for governments, which had to rely on domestic economic policies alone for the simultaneous attainment of internal and external balance. And, coordination of macroeconomic policies among the major industrialized countries, let alone international collective action, became more difficult. The *age of globalization* has created an altogether new world with an explosive growth in international finance as a consequence of the domestic deregulation of financial sectors and the introduction of capital account liberalization. Current account macroeconomics, or open economy macroeconomics, is no longer sufficient to understand the macroeconomic dilemmas of our times. The exchange rate is an asset-price that is determined by expectations about its future rather than fundamentals. Exchange rates and interest rates are interdependent. There is a much greater instability in both. And the volatility is associated with a contagion across markets and borders. In this world, developing countries and transitional economies are more spectators than participants but are not immune from the consequences. It is time to develop a capital account macroeconomics and think about global macroeconomics. And this thinking must not be limited to the external sector of economies. Moreover, the object of macro-management should extend beyond managing inflation to restoring full employment and stimulating investment.

At the turn of the century, it is clear that the problems of global macroeconomic management are, to say the least, complex. Yet, there is virtually no institutional framework for this task, which is left almost entirely to the market. The G-7 does provide

an institutional framework for consultation about, if not coordination of, macroeconomic policies. This is simply not enough, in part because it is driven largely by G-7 (if not just G-1) interests and in part because it needs much wider representation. The newly created G-20 is wider in its membership but narrower in its jurisdiction for its concerns are limited to IMF issues. Clearly, global macro-management cannot be left to the market and it must extend beyond the G-7. There has to be some institutional mechanism for the coordination of macroeconomic policies. It is also necessary to evolve a suitable institutional framework for consultation and surveillance as there is a long list of concerns. It is essential to deal with international volatility and contagion. It is just as important to reflect on the management of exchange rates in a world where there are no fundamentals and there are only conventions. These issues in global macroeconomic management are important not only for the industrialized economies but also for the developing countries and transitional economies.²³ And, in so far as global macroeconomics is not simply about managing financial flows or exchange rates, it is also important to think about the macroeconomic objectives of internal and external balance in the short-term and macroeconomic policies that are conducive to economic growth and productivity increase or employment creation in the long-term.

3.2 International financial architecture

The frequency and intensity of the financial crises, which have ravaged countries across the world, has led to a near-consensus on the need to reform the international financial architecture. There are, however, more fundamental reasons for reform and change. The existing institutional framework for the governance of the international monetary system, embodied in the IMF, was created a long time ago. The world has changed since then, as

fixed exchange rates have been replaced by floating exchange rates and capital controls have given way to capital mobility. This has been juxtaposed with an explosive growth in international 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.²⁴ And the size of international foreign exchange markets is staggering.²⁵ But that is not all. Interdependence and openness, combined with volatility and contagion, have made the governance of international financial markets far more difficult. The conception and design of the architecture should, of course, be concerned with crisis management and crisis prevention. But it should also support the integration of developing countries into the world economy in a manner that promotes rather than hinders development.

The debate on reforming the international financial architecture must start from four basic propositions: (a) the instability of the system reflects information failure; (b) self-insurance for countries is a costly option in the arena of international finance; (c) there is a reluctance to give up national economic sovereignty, even if partial; and (d) no design can be neutral in terms of equilibrium in international relations.²⁶ Taken together, these propositions mean that the design and the implementation are both complex tasks. Nevertheless, it is possible to set out some essential elements of reform.²⁷

First, there is a need for institutional mechanisms that would facilitate consultation, consistency and surveillance of national macroeconomic policies. This would be conducive to international collective action that would address problems arising from market failure and negative externalities which spill over across national boundaries. For the industrialized countries, some global consistency of their macroeconomic policies

would enhance their collective ability to minimize both inflation and unemployment. For the developing countries, collective lines of defence in the face of financial boom-bust cycles could enhance their ability to cope with contagion.

Second, there is a need to increase the supply of emergency financing in times of crisis so that it is made available before rather than after international reserves are depleted. Such financing should also be available to countries facing contagion. The effectiveness of emergency financing may be limited if the negotiation process is too cumbersome or if it is perceived to postpone adjustment which is judged as inevitable. Most important, perhaps, markets may decide that intervening authorities are unable or unwilling to provide finance in quantities required to stabilize speculative pressures. Nevertheless, the very existence of emergency financing could perform a stabilizing role.

Third, there is a need to create an international sanction for standstill provisions, or orderly debt workout procedures, in the realm of international finance. This is essential because capital flight, with its chaotic effects on exchange rates, interest rates and economic activity, does significant damage to debtor countries. It also bad for creditors. Such standstill provisions would play exactly the same role as national bankruptcy procedures play within economies. The preventive suspension of debt service, combined with rescheduling, under an international agreement would ease, if not resolve, the worst problems associated with capital flight.

Fourth, countries should have the freedom to choose an exchange rate regime and should have autonomy in capital account liberalization.²⁸ The need for prudence in capital account liberalization where it has not been introduced, and the need for capital controls

where it has been introduced, is clear enough.²⁹ But there are macroeconomic problems which arise as corollaries. 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 scarce invisible resources in a market economy. The international financial architecture we contemplate may be able to restore some degrees of freedom, if it is based on global agreed but nationally implemented rules in the sphere of capital account liberalization as also exchange rate regimes.

Fifth, there is an emerging consensus that there is a need to improve the institutional framework in which financial markets operate, whether through principles of sound corporate governance or through common minimum standards in prudential regulations, supervision and accounting. There is, in general, broad agreement on the need for regulation and supervision to coordinate financial stability. There is less agreement on a more elaborate institutional framework for governance. It is clear that regulatory power remains trapped within essentially irrelevant national boundaries. In a world of open financial markets, however, national governments cannot effectively regulate the risks to which their economies are exposed. That can only be done by an international institution which has power to regulate, intervene and enforce. The proposed Financial Stability Forum is but a first step. It may, ultimately, be worth thinking about a World Financial Authority that 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.³⁰ Of course, national supervision is of the essence. But it has to be combined with international coordination. Such an authority would have powers of regulation and surveillance. And it would supervise the inspectors.

It would also have the ability to coordinate with central banks and the IMF when interventions may be needed from an international lender of the last resort. This interface between national regulatory structures and international regulatory norms would need an institutional framework.

3.3 Transnational corporations

The last quarter of the twentieth century has been described as the *age of globalization*. This era has also witnessed the phenomenal rise of transnational corporations, which have come to dominate cross-border trade, investment and technology.³¹ The process of globalization is driven by market forces and technical progress, while international trade and international investment constitute the cutting edge of globalization. Transnational corporations, which embody each of these attributes, thus constitute both the driving force and the cutting edge of globalization. Until the mid-1990s, however, the economic activities of transnational corporations, which straddle the world economy, were governed largely by national rules or national policies. The only exception was multilateral rules on trade in goods in the erstwhile GATT. GATT-type rules and principles, with provision for dispute settlement, compensation and retaliation, are sought to be extended beyond trade in goods to international flows of services, technology, investment and information. The introduction of international regimes of discipline on trade in services and trade related intellectual property rights, as also the quest for a multilateral agreement on investment, in the WTO, is closely inter-twined with the interests of transnational corporations who are service-providers, technology-leaders, and capital exporters in the world economy. For them, these new rules of the game represent the final frontier in their global reach to organize production on a world scale without any fetters.³² It would seem that, wherever

cross-border economic transactions are dominated by transnational corporations, governance is moving from national policies and rules to international institutions and rules. This is a consequence of the strong influence exercised by transnational corporations. Their object is to reduce transaction costs and their bottom line is the balance sheet. But the same rules reduce degrees of freedom in formulating strategies of development. Thus, transnational corporations set the rules through their influence in home countries even though these rules are often not in the interests of host countries. And these rules are essentially about what governments can or cannot do. But there are no rules, even contemplated let alone negotiated, on what transnational corporations can or cannot do.

The time has come to consider the creation of an international system of governance for transnational corporations because the economic space of their activities extends way beyond the geographical space of nation states. In sharp contrast to this need, there is a striking asymmetry in the proposal for 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. Similarly, there is a striking asymmetry in the attempt to create a competition policy discipline in the WTO, which is essentially concerned with the interests of foreign firms in host countries. In this context, it is important to emphasize that international regimes of discipline should be concerned not only with the rights but also with the obligations of transnational corporations. There is a need for a discipline on restrictive business practices of transnational corporations. And, in a world where the economic activities of large firms transcend national boundaries, an international regime of anti-trust laws is also necessary. Indeed, an institutional framework for global governance of transnational corporations

would have to incorporate regulatory norms that interface between corporate policies and international obligations.

Such an endeavour would not have to begin from scratch. It is possible to build upon the earlier work in UNCTC and UNCTAD on restrictive business practices and on a code of conduct for transnational corporations. These proposals based on a careful work were reasonably balanced but did not provide for any enforcement mechanism. Similarly, there is much to learn from the European Union experience on competition policy. There is, in addition, considerable work on corporate governance in the OECD and the IFC. The OECD bribery provisions also constitute a code of conduct. Interestingly enough, arbitration practices in the corporate world follow UN systems. And there is a framework for the settlement of disputes between transnational corporations and governments in the ICSID. The United Nations is also attempting to engage the corporate community in terms of a commitment to principles, not so much as a code of conduct but as a frame of reference which would set out the social responsibility of corporate entities in the sphere of labour standards, human rights and environmental concerns. There is a critical issue about taxation of large international firms which is mostly untouched. So far, there is no institutional mechanism for exchange of information. The creation of an institution for this purpose, say a World Tax Authority, is not even on the distant horizon. This patch-work of informal arrangements could provide a starting point. The international system of governance, whenever it is created, would have to be lodged in the UN system, perhaps UNCTAD and UNIDO which are concerned with foreign investment and technology transfer, under the auspices of the proposed Economic Security Council in the United Nations.

3.4 Cross-border movements of people

Over the past fifty years, international labour movements have been significant in absolute terms, even if much less than in the nineteenth century and much smaller as a proportion of total populations. The magnitudes, in terms of the cross-border movements of people and remittances of migrants world-wide, are indeed significant, but are no match for the other manifestations of globalization. In fact, the gathering momentum of globalization has coincided with a discernible slowdown in migration during the last quarter of the twentieth century. But globalization has set in motion forces which are creating a demand for labour mobility across borders as also developing institutions on the supply side to meet this demand. There is a potential conflict between the laws of nations that restrict the movement of people across borders and the economics of globalization that induces the movement of people across borders. And, within limits, markets are adept at circumventing regulations. As we enter the twenty-first century, this process may be reinforced by demographic change and population imbalances, arising in particular from the ageing of industrial societies. However, for the cross-border movement of people, other than refugees, there are no international rules or international institutions, let alone governance. Such cross-border movements are governed entirely by national immigration laws and consular practices. Yet, international migration is a reality. It cannot be wished away. The almost complete absence of international institutions, or rules, in this sphere is a cause for concern. And it is essential to reflect upon this need which has grown with the passage of time. There are two dimensions of governance needs in this sphere. ³³

First, we have to think of actual migrants so as to ensure rights and to eliminate abuse in their countries of residence after they have moved. Among such migrants, it is necessary

to make a distinction between legal migrants and illegal migrants. There are some similarities in the problems faced by them. But there are also important differences. For the former, the essential objective should be to ensure a respect for their rights. For the latter, the fundamental objective should be to eliminate exploitation and abuse. Thus, the institutional solutions would need to be somewhat different.

For migrant workers who have been admitted to their countries of destination in accordance with the laws of the land, there must be some equivalent of the WTO concept of *national treatment*. This, in turn, requires a universal acceptance and ratification of ILO conventions on migrant workers. In this context, it is essential to highlight a striking asymmetry. There is so much emphasis on labour standards, which are sought to be lodged in the WTO. There is so little concern about rights of migrant workers, which are written into obscure ILO conventions. Yet, it should be clear that labour standards and migrants' rights are two sides of the same coin. Both should remain in the ILO where the rights of workers are a fundamental concern.

The cross-border movement of people, attributable to market forces despite immigration laws, is also a reality. But the plight of illegal immigrants, everywhere, is a cause for serious concern. The working conditions are exploitative and the living conditions are abysmal, while the risk of capture and repatriation is ever present. This is not simply a matter of enforcing the law. There is a collusion between intermediaries and employers while governments turn a blind eye to this reality. Such tacit approval of illegal migration to meet labour shortages must be replaced by an explicit recognition of the need for labour imports which should be met through legal channels even if such imports are seasonal or temporary. At the same time, there is a clear need for concerted action to curb the

trafficking in people that is organized by international criminal and smuggling syndicates. Such trafficking in people is a gross violation of human rights which is an example of international *public bads* that need to be regulated through concerted joint action by countries of origin and destination. In this task, there is a critical institutional role for the ILO.

Second, we have to think of potential migrants before they have moved so that the cross-border movement of people is governed at least in part by transparent and uniform multilateral rules rather than by diverse national laws and non-transparent consular practices alone. Thus, it is necessary to develop institutions, or rules, that govern the cross-border movement of guest workers who move temporarily for a limited duration, as also professionals or service providers who move temporarily for a specified purpose. Such labour flows have increased significantly in the recent past and are likely to increase further. It is, therefore, important to develop a set of transparent rules for the temporary movement of guest workers or service providers across national boundaries. In doing so, the equivalent of the *most-favoured-nation* principle, which makes for unconditional non-discrimination, could provide a basic foundation.

The time has come to initiate a preparatory process which would work towards a new institutional framework that would govern cross-border movements of people. At one level, this means rules for those who are already migrants, possibly through a strengthening of ILO conventions on the rights of migrants, with some provision for national obligations to create enforcement mechanisms. At another level, this means a transparent and uniform system, based on rules rather than discretion for those who may wish to move across borders. To begin with, regional arrangements such as the EU, which

build on other forms of economic integration, could yield feasible solutions but regional arrangements are difficult to replicate and do not always constitute building blocks. Sooner rather than later, therefore, it is worth contemplating a multilateral framework for immigration laws and consular practices that governs the cross-border movement 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.

3.5 International 'public goods' and 'public bads'

In markets and societies at the national level, it is the role of governments to provide *public goods* such as road signs, street lights or public parks, as also to regulate *public bads* such as pollution or unfair competition. The logic of markets is exactly the same at the international level. But there is no world government that would provide international *public goods* such as world peace or a sustainable environment, and regulate international *public bads* such as international crime or trade in drugs, arms, people and organs. Yet, the openness, interdependence and integration associated with globalization mean that the functions of governments, in providing *public goods* and regulating *public bads*, will somehow have to be undertaken at the global level.³⁴

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 supra-national government which could regulate this market driven process. In a world where the pursuit of self-interest by nations means uncoordinated action or non-cooperative behaviour, sub-

optimal solutions, which leave everybody worse off, are a likely outcome. International *public bads* would increase while international *public goods* would decrease. Such outcomes can be prevented only by evolving institutional mechanisms for cooperation between nation states which facilitate coordinated action and cooperative behaviour.

The economic characteristics of *public goods*, (non-excludable and non-rival in consumption) are the same, irrespective of whether the *public goods* are local or global. Wherever the benefits of a *public good* transcend national boundaries, it can be described as a *global public good*. The obvious examples are global security, global economic stability, global environment, global health and, of course, knowledge. The provision of such *global public goods* is a central part of the logic for international collective action.³⁵ But the rationale for collective action across countries goes further, for it can address any form of market failure. The provision of *global public goods* requires institutions that ensure a contribution from all countries to meet international obligations. The United Nations was created to provide global security and world peace. The WHO was established to promote global health. Their success is determined by their ability to elicit the requisite cooperation from nation states. The provision of *global public goods* requires the strengthening of existing institutions in some areas and the creation of new institutions in other areas.

There is a common presumption that *global public bads* are simply the analogue of *global public goods*, where negative externalities spill over across national boundaries. The obvious examples are environmental degradation or international crime. And such examples can be multiplied with ease. This presumption, however, is not entirely correct. For *global public bads* also have distributional implications. Chemical factories might

yield profits for producers in one country, but acid rain for residents across the border in another. Deforestation might sustain livelihoods for the poor in one country, but cause floods that hurt people across the border in another. The gainers and the losers, then, are in different countries. Orthodox economics can offer little solace. Prisoners' Dilemma outcomes cannot be mitigated by Coase Theorem solutions, for even in situations where there are no transaction costs, there is complete information and there are well defined property rights, those who gain may not be in a position to, or may not wish to, make compensation payments to those who lose. The regulation of *global public bads* necessarily requires internationally agreed but nationally implemented rules that enforce restraint on the part of economic agents, whether individuals or firms, in all countries. But it also requires funds for the needed compensation payments. Such international rules, even when funds are available, would have to be supported by mechanisms for enforcement and dispute settlement.

The institutional framework for the provision of *global public goods* and the regulation of *global public bads* could extend to public-private partnerships, as for climate change and clean development. In other words, market institutions or commercial mechanisms may be a useful complement for public action. It should also be possible to forge cross-border coalitions between nation states and interest groups in civil society for this purpose. However, such institutional mechanisms would materialise only when the costs and benefits of unilateral self-insurance within countries are compared with the costs and benefits of international collective action across countries. This calculus is necessary both for the provision of *global public goods* and for the regulation of *global public bads*.

4. ISSUES IN GOVERNANCE

4.1 Structures of governance

Governance is largely about rules and institutions that regulate the public realm in civil society. A democratic system seeks to provide for equal participation of the rich and the poor, or of the strong and the weak, individuals as citizens in political processes. And good governance is a process, characterized by communication and consultation, through which disputes are resolved, consensus is built and performance is reviewed, on a continuous basis. In terms of these attributes, the existing arrangements for global governance are, to say the least, undemocratic. Developing countries account for more than 80 per cent of world population and contribute almost 50 per cent of world output. Yet, their influence in multilateral institutions that govern the world economy is at best limited and at worst marginal. What is more, the poorest people and the smallest countries are at particular risk in terms of *de facto* exclusion from the arrangements for global governance.³⁶ In sharp contrast, the industrialized countries exercise a disproportionately large influence in the world not only in the sphere of economics but also in the realm of politics. There is a clear and present danger that, unless correctives are introduced, the emerging arrangements for global governance will simply not attach sufficient importance to the imperative of economic development and the struggle against human poverty.

The endeavour to create more democratic structures of governance in the world economy, as also polity, must begin with the international institutions that exist or are sought to be created. In thinking about these structures of governance, it is useful to make an analytical

distinction between the nature of representation and the decision making process in the system.

In terms of representation, the existing system is not quite democratic. For one, representation is unequal. The principle of one-country-one-vote in international institutions such as the United Nations and the WTO is not the same as the principle of one-person-one-vote in a political democracy, but it is clearly more representative than the principle of one-dollar-one-vote in multilateral institutions such as the IMF or the World Bank. The problem, however, is not confined to unequal weights in representation. It extends to exclusion from representation in arrangements such as the P-5 or the G-7, or even the OECD, which make decisions that are of profound importance for global governance. For another, representation is incomplete. As a rule, most international institutions are inter-governmental organizations. In a more democratic set-up, there should be representation not only for the state but also for civil society. There is some recognition of non-government organizations as observers. There is also some attempt to engage in consultation with corporate entities. But there is no effort to provide representation for other segments of civil society or to reach out to people at large.

In terms of decision making, the existing system is even less democratic. Where some countries have more votes than others, and yet other countries have no votes, the system is obviously undemocratic. In a world of unequal partners, however, even the principle of one-country-one-vote does not ensure a democratic mode of decisions. It is not difficult to understand why. For, in a political democracy, citizens are not equal despite the principle of one-person-one-vote. But that is not all. Much also depends on how decisions are made. If voting rights conform to some principle of equality between countries, voting decisions

based on majority rule are, in theory, democratic. The problem is that voting rights are not equal between countries. Even where they are, international institutions are most reluctant to use voting as a means of decision making. The right of veto in the Security Council of the United Nations is explicitly undemocratic. But decision making by consensus, as in the WTO, can also be undemocratic, if there is bilateral arm-twisting or a consensus is hammered out among a small sub-set of powerful players, while most countries are silent spectators that are in the end a part of the apparent consensus. Of course, the reality is that all countries are not equal partners in the world just as people are not equal citizens in a democracy. The essential corrective, then, is to create institutional mechanisms that give poor countries and poor people a *voice* in the process of global governance. Even if they cannot shape decisions, they have a right to be heard. That is partly what democracy is about. More important, however, democracy is not only about majority rule. It is also about protection of minority rights. The concerns of poor countries and poor people should, therefore, constitute an integral part of any democratic design for global governance.

5. RULES OF THE GAME

The emerging rules of the game for globalization are asymmetrical in terms of construct and inequitable in terms of outcome. This is not surprising in a world of unequal partners. 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 real problem is that such rules are bound to significantly reduce the autonomy of developing countries in the formulation of economic policies in their pursuit of their development.³⁷ 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 technological capabilities. The proposed multilateral agreement on investment, should it materialise, would almost certainly reduce the possibilities of strategic bargaining with transnational firms. Similarly, commitments to structural reform, an integral part of stabilization and adjustment programmes of the IMF and the World Bank, inevitably require industrial deregulation, privatization, trade liberalization and financial deregulation (often combined with capital account liberalization). 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 not be forgotten that such state intervention was crucial for the successful development of the late industrializers during the second half of the twentieth century.³⁸

It is essential to influence and to shape the rules of the game so that poor countries and poor people have degrees of freedom in their pursuit of development. 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 developing

countries, are provided with the time and the space to learn so that they can become competitive players rather than push-over opponents.

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. In other words, rights and obligations should not be strictly symmetrical for member countries. There is a clear need for positive discrimination or affirmative action in favour of countries that are economically poor or politically weak. It is also possible to contemplate 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, wherever these rules constrain autonomy or choices in the pursuit of development.³⁹ Such a provision to opt out of obligations embodied in international rules, without having to forsake rights, would provide countries that are latecomers to development with the requisite degrees of freedom in their national pursuit of development objectives. It is important to recognize that, in democratic situations, *exit* has as much significance as *voice*.

There is, also, the other side of the same coin. The enforcement of rules is asymmetrical. In the Bretton Woods institutions, enforcement is possible through conditionality. Such conditionality, however, is applicable only to developing countries or transitional

economies that borrow from the IMF or the World Bank. In the WTO, enforcement is possible through retaliation. But most developing countries or transitional economies do not have the economic strength, even if they have the legal right, to retaliate. The reality, then, is that countries that are poor or weak conform to the rules whereas countries that are rich or strong can flout the rules. There is no enforcement mechanism, yet, that can be imposed on the powerful players who circumvent the rules. And the hegemonic powers, often, simply ignore the rules. The enforcement of rules, for the rich and the powerful, must therefore be central to any institutional design for global governance.

7. EVOLUTION OF INSTITUTIONS

International organizations are institutional mechanisms for transnational cooperation and collective action. And institutionalization serves to anchor international cooperation. It does so either through formal inter-governmental organizations such as the United Nations and the Bretton Woods institutions or through informal group arrangements among countries such as the G-7, G-15, G-20, G-24 and G-77.⁴⁰ Their obvious function is to produce information for, and facilitate consultation between member countries at lower transaction costs. In an ideal world, they can also create linkages between issues and across space in a long-term perspective. And, in the absence of a world government, it is only such institutions that can create mechanisms, rules and practices for global governance. The adaptation of existing institutions and the creation of new institutions, as circumstances and times change, is thus a critical component of global governance.

In this context, it is important to make three sets of distinctions. First, there is a distinction between rule-setting or rule-making institutions such as the WTO or the IMF and development-oriented institutions such as the UNDP or UNICEF. Second, there is a distinction between treaty-based inter-governmental organizations which constitute the United Nations system and informal consultative groups of countries within, or even outside, the United Nations system. Third, there is a distinction between inter-governmental organizations and non-government or private sector institutions.

The United Nations system and the Bretton Woods institutions are, almost inevitably, the focus of attention, particularly with reference to structures of governance and rules of the game. The process of change in, or the evolution of, these institutions is an important determinant of their effectiveness and relevance. But their trajectories of change can conform to the needs of global governance if, and only if, each of the institutions has an accountability in terms of performing its assigned role and a flexibility in terms of adapting to changed circumstances. Even adaptation and evolution cannot suffice where there are new needs and missing institutions. The creation of new institutions, however, is a difficult task because the process of negotiations between sovereign nation states is complex and slow. In such situations, it is worth contemplating informal arrangements and soft laws whereby practices, conventions, norms or standards evolve over time. Such partial elements of governance, when the time comes, can culminate in an institution.

It is not enough to focus on the existing system and to search for the missing institutions. The past decade has witnessed significant changes on the stage of international economic relations which have gone almost unnoticed but are important for any study of global governance. There is a new set of actors on the stage who, unlike governments, do not

approach problems from the perspective of national interest. These are transnational corporations, international coalitions of NGOs and issue-networks among people across borders. These groups are shaping a whole set of standards, rules and norms. In the private sector, these range from the International Standards Organization to the International Organization of Securities Commissions. There is, of course, the World Economic Forum at Davos. But there is also the International Union for the Conservation of Nature. And there are other examples. This has led to the emergence of coalitions-of-the-willing on important issues. Therefore, the needs of global governance in the twenty-first century extend beyond cooperation among nation states. It is also necessary to recognize the importance of these new actors.

7.1 Role of the nation state

Globalization has reduced the autonomy of the nation state in matters economic, if not political, but there remain degrees of freedom which must be exploited in the pursuit of development.⁴¹ The ideology of globalization seeks to harmonise not only policy regimes but also institutions, including the economic role of the state, across the world. This is a mistake because the role of the state in an economy depends on its 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 nation state not only in the sphere of domestic economic policies but also in the arena of economic and political interaction with the outside world.⁴² In the national context, the state must endeavour to create the pre-conditions for a more equitable development, bargain with transnational corporations 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 minimise the social costs associated with globalization. In the international context, the state should attempt to reduce the asymmetries and the inequalities in the rules of the game and build strategic alliances among countries for the purpose.

The mood of the moment, however, is not quite receptive to such ideas. For there is a disillusionment with the economic role of the state. It now extends much beyond economists to politicians and concerned citizens. And scepticism about the state runs deep. The collapse of communism, it would seem, has reduced the value of compassionate policies and the significance of moral compulsions for the state almost everywhere. Capitalism, even without a human face, has emerged triumphant. At the same time, a market fundamentalism appears to have captured the imagination of opinion makers, particularly in the media, who have an enormous reach and influence in the age of globalization. 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. 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 correctives 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.⁴³

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.⁴⁴ 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 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 promote the interests of the classes, or the groups, whom they represent. The question that arises is whether the state can find a social basis for its re-empowerment so that it can provide for the well-being of its citizens. 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. 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.

It is obvious that the real world does not come close, let alone conform, to this ideal situation. Even so, the role of the nation state is critical for both development and democracy in the world. In a national context, the belief that markets know best and the smaller government is better government is open to serious question. For markets exclude a significant proportion of people, particularly the poor, unless governments regulate and complement them so as to make them people-friendly. Such correctives can only be introduced by the state. The reason is simple enough. Governments are accountable to their people, whereas markets are not. In the international context, where the distribution of economic and political power is so unequal, the nation state is perhaps the only institutional medium through which poor countries or poor people can attempt to influence or shape rules and institutions in a world of unequal partners. Even today, in large part,

only nation states have the authority to set international rules or create international institutions. Thus, developing countries and transitional economies must ensure that their voices are heard in this forum. Groups of countries with mutual interests are more likely to be heard than single countries by themselves. There will always be some conflict of interest, but there will also be areas where it is possible to find common cause and accept trade-offs.

In principle, it is possible to contemplate cooperation among nation states to create rules and norms for the market that transcend national borders, just as the nation state created rules and norms for the market within national boundaries. In practice, however, a recognition of the benefits of such cooperation might not be motivation enough. Cooperation among nation states is far more likely to materialise, much like stable coalitions, if and when the costs of non-cooperation cross the threshold of acceptance. In either case, the nation state is the most important player in this game. Therefore, it is not possible to imagine good governance in the world without nation states, just as it is not possible to have good governance in countries without governments.

NOTES

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¹ 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 periodization facilitates comparison.

² For supporting evidence, see UNCTAD (1997) and UNDP (1999). See also, IMF (1997).

³ Some evidence on the increase in profit shares in industrialized countries and the decrease in wage shares in developing countries is reported in UNCTAD (1997). Stewart (2000) 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.

⁴ For evidence in support of this proposition, see UNCTAD (1997). In addition, see Wood (1994) and Wood (1997). Stewart (2000) also suggests that trade liberalization, associated with globalization, provides an explanation for rising inequality and cites supporting evidence.

⁵ This argument is developed in UNCTAD (1997).

⁶ 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 phenomenal reach of the media in our age has spread the consumerist message far and wide. This creates both expectations and aspirations.

⁷ This erosion is vividly illustrated by the response of the international community to the crises in Iraq and Kosovo during the 1990s. The response to crises before then, whether inside or outside the United Nations system, provides a sharp contrast. At the time of the Korean War, the United Nations provided a critical input. The Cuban crisis was resolved outside the United Nations system essentially through the balance of power in the cold war era. The problem of apartheid in South Africa was addressed through the United Nations.

⁸ For a detailed discussion, see Richard Falk, Chapter 7. See also, Commission on Global Governance (1995) and Ruggie (1993).

⁹ There is an extensive literature on this subject. See, for example, Taylor (1988), Williamson (1990), Cooper (1992), Taylor (1993) and Killick (1995).

¹⁰ See Yilmaz Akyuz and Andrew Cornford, Chapter 5, as also Jose Antonio Ocampo, Chapter 11.

¹¹ See Jong-Il You, Chapter 8 and Joseph Stiglitz, Chapter 9.

¹² For an analysis and evaluation of IMF conditionality, see Dell (1981) and Williamson (1983). See also, Kapur (1997).

¹³ Cf. Taylor (1988) and Cooper (1992).

¹⁴ This argument is outlined in Nayyar (2000) and developed in Nayyar (2001). See also, Helleiner (1998) and Eatwell and Taylor (2000).

¹⁵ See Jong-Il You, Chapter 8 and Joseph Stiglitz, Chapter 9. There is, of course, an extensive literature on this subject. See, for example, Kapur, Lewis and Webb (1997) and Stiglitz (1999).

¹⁶ For an analysis of contending views about openness and intervention, see Nayyar (1997).

¹⁷ For a detailed discussion on reform in the Bretton Woods institutions, see Haq (1995) and Woods (1998). See also, Kenen (1994).

¹⁸ The evolution of the international trading system, outlined here, draws upon earlier work of the author (Nayyar 1996). For an extensive discussion, see Diaz-Alejandro and Helleiner (1982) and Bhagwati (1988). See also, Kenen (1994).

¹⁹ See S. P. Shukla, Chapter 10 and G. K. Helleiner, Chapter 12.

²⁰ This argument is developed, at greater length, in Nayyar (1996) and Nayyar (2000).

²¹ It is worth noting that the phrases *standstill* and *roll-back* were first used during the 1980s with reference to protectionism. These phrases are used here to refer to new issues or new agreements in the WTO. For an analysis of the unequal TRIPs agreement, see Nayyar (1999).

²² See Amit Bhaduri, Chapter 2 and Joseph Stiglitz, Chapter 9.

²³ For a detailed discussion on problems of global macroeconomic management, see Lance Taylor, Chapter 3.

²⁴ 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 (1997). See also, UNDP (1999).

²⁵ Global foreign exchange transactions soared from \$60 billion per day in 1983 to \$1500 billion per day in 1997 (Bank of International Settlements, *Survey of Foreign Exchange Market Activity*, various issues). By comparison, in 1997, world GDP was \$82 billion per day and world exports were \$16 billion per day, while the foreign exchange reserves of all central banks put together were \$1550 billion (Nayyar 2000).

²⁶ Cf. Jose Antonio Ocampo, Chapter 11.

²⁷ See Yilmaz Akyuz and Andrew Cornford, Chapter 5 and Jose Antonio Ocampo, Chapter 11. See also, United Nations (1999).

²⁸ Cf. Lance Taylor, Chapter 3.

²⁹ This argument is developed elsewhere by the author (Nayyar 2001). The problems associated with capital account liberalization are also discussed in Helleiner (1998) and Kenen (1998).

³⁰ For details, see Lance Taylor, Chapter 3, as also Eatwell and Taylor (2000).

³¹ See Sanjaya Lall, Chapter 4.

³² Cf. Nayyar (1988).

³³ See Deepak Nayyar, Chapter 6.

³⁴ See Joseph Stiglitz, Chapter 9 and G. K. Helleiner, Chapter 12.

³⁵ Global public goods are analysed and discussed, at some length, in Kaul, Grunberg and Stern (1999). See also, Kindleberger (1986) and Stiglitz (1995).

³⁶ This proposition is central to the argument developed by G. K. Helleiner in Chapter 12.

³⁷ For a more detailed discussion on rules of the game, and their implications for development, see Nayyar (2000).

³⁸ For a convincing exposition of this view, see Amsden (1989), Wade (1991) and Chang (1996).

³⁹ For an articulation of a similar view, see Rodrik (1997). Such an escape clause mechanism, however, should not be confused with the opt-out clause in the WTO, which also existed in the erstwhile GATT, embodied in Article XXXV. This relates to non-application of the agreement between two contracting parties. It was used extensively by European countries against Japan at the time of its accession to GATT with American support. The point stressed here is embodied in the spirit of Article XXX of the GATT which provides that an amendment, even if approved by a two-thirds majority, does not become applicable until its acceptance by a contracting party. In the WTO (as also in the GATT), of course, there is a provision that on the basis of a three-fourths majority decision (two-thirds majority decision), the member countries (contracting parties) could ask the non-accepting member country (contracting party) to withdraw from the agreement. The important distinction is that between Article II.2 (which provides for binding agreements)

and Article II.3 (which provides for non-binding plurilateral agreements) in the WTO. Latecomers to development should have the flexibility provided for in the latter.

⁴⁰ See Devesh Kapur, Chapter 13.

⁴¹ See Amit Bhaduri, Chapter 2, for a discussion on the nation state in the era of globalization.

⁴² For a detailed discussion, see Nayyar (2000).

⁴³ This set of issues is considered, at some length, in Bhaduri and Nayyar (1996) and Nayyar (1997).

⁴⁴ Economic historians tracing the evolutionary course of the market under early capitalism noted repeatedly that the market could become the organising principle of capitalism only when it was embedded in the regulatory mechanism of the nation state. See, for instance, Polanyi (1944), who examined the complex interaction between state regulation and the growth of the market as an institution. This proposition is 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).

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