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CONTENTS

ABSTRACT

The *raison d'etre* of the nation-state is the ideology of nationalism. Yet, nationalism is a complex notion which encompasses the society, the state and the economy. It comprises of a complex nexus of multiple loyalties of an individual as a member of the society, duties and rights of the citizen in a reciprocal political arrangement with the state, and the role of the individual as a producer and consumer in the economy. While the balance among these different aspects of nationalism evolved historically, in the present area of globalization this balance seems to be shifting in favour of global market forces. Its consequences for the nation-state, and the new role that it needs to define for itself, especially in terms of economic policy, is the theme of this paper.

1. AN INTELLECTUAL BACKGROUND TO THE RISE OF THE NATION-STATE

The three-way merger of the state as a political entity, the nation as a historical or cultural concept, and the economy as an organization of production and exchange activities has always been problematic. Through several centuries in Western political philosophy, the relationship between the political authority of the state and the historical formation of the society, viewed as the voluntary association of individuals, posed a major problem. Coinciding almost exactly with the date of publication of Adam Smith's *Wealth of Nations* (1776), Thomas Paine gave one of the clearest, if somewhat dramatic expression of the view which tended to treat the state almost as a 'necessary evil'.

> Society is produced by our wants and government by our wickedness; the former promotes our happiness positively by uniting our affections, the latter negatively by restraining our vices (Paine 1776: 66).

To the modern proponents of the 'minimalist state', this might sound like an echo from the distant past of their theories. Nevertheless, this would be a misinterpretation. In the classical political philosophy, the counterposing of the society as widening the individual's freedom of action against the role of the state needed for restricting the scope of the individual's negative impulses, had a more subtle intellectual basis. Indeed, the shaping of Adam Smith's political economy—his journey from the *Theory of Moral Sentiments* (1759) to the *Wealth of Nations* (1776)—illustrates well this point.

Unless we postulate over-simplistically, in line with modern 'methodological individualism', that all social as well as economic interactions are reducible only to the self-interest of the individual, the notion of the society can be embedded in a wider range of human moral sentiments, that is, the Smithian composite notion of 'sympathy'. Sympathy, in his view, is not just altruism, but a complex range of coexisting, often conflicting human motives. In particular, it combines 'fellow-feeling' which involves the desire to be socially engaged, with a 'rational' evaluation of the consequences of such engagements. An important social outcome of this is the emergence of mutual 'trust' and reciprocity without which no commercial society can function.

The consequence that follows from this analysis provides a necessary clue to our understanding of the role of the state. It is not altruism vs. egoism, or community feeling vs. selfishness which is the relevant issue. Neither the society nor the economy can function exclusively on the basis of either. Selfishness is moderated invariably by social 'norms' like trust and reciprocity of behaviour, which may even be the outcome of longer-term enlightened self-interest. They are absolutely essential for production with specialization, trade and exchange on an extensive scale. Thus norms for social behaviour having their origin in the Smithian notion of 'sympathy' go beyond narrow selfishness, but do not necessarily contradict enlightened self-interest; instead, self-restraint may be imposed in enlightened self-interest. This raises doubt about the popular view of a Leviathan state whose main purpose is to restrain self-seeking individuals in times of destructive conflict with each other (Hobbes 1957: especially chapters 14 and 15).

Viewed in the context of our preceding discussion, a central misleading feature of modern economic theory is not so much in the act of commission, as in the act of omission. The celebrated Arrow-Debreu model purports to demonstrate rigorously the Smithian proposition that the unintended outcome with (Pareto) optimal properties result through entirely selfish actions of individuals in a (competitive) market. What could be misleading about this analysis is not the string of unrealistic assumptions needed to establish the optimal properties of the market mechanism; but the implicit neglect of the complementary Smithian proposition that market exchange is sustained by the underlying social 'norms' resulting from sympathy, e.g. trust in exchange, respect for contracts, etc. By leaving out the role of social norms in our formal analysis of exchange and production, we tend to exaggerate on the one hand, the efficiency of an abstract market mechanism based on an invented 'auctioneer'. On the other, we tend to neglect the roles which the state could play in either reinforcing or destroying these norms which are essential for the functioning of the market economy.

Within the framework of methodological individualism, some writers have tried recently to incorporate the notion of social norms as the informal constraints which the otherwise selfish individual faces (e.g., North 1990 chapter 5). Some others have seen these social norms as the emergence and evolution of cooperation which individuals learn in their enlightened, longer-term self-interest, especially in situations of repeated games of short-term conflictive interests (e.g., Axelrod 1984). In addition to the self-imposed restraint, either perceived by the individual as informal constraints or learnt as cooperative behaviour through repeated experience in social interactions, there is, however, a wider set of cultural constraints or norms that may be imposed by the norms of the society. They originate in different spheres like religion, language or a common historical memory of a people. Juridical interpretations of such norms, in which the state plays an important role, may either reinforce or weaken them over time. The conflict between the church and the state in Europe, the curbing of the absolute power of the monarch during the European Enlightenment, the attempt even in recent times to establish the authority of the state either by adopting an official religion or by emphasizing its secular character bear testimony to the complexity of this process that evolves continuously through time.

However, there is perhaps a general feature in this evolution. Broadly speaking, the more homogeneous a society is, say in terms of language, religion, ethnicity and a shared history, the stronger is likely to be the intensity with which social norms apply to the individual members. It is not by accident that close-knit tribal societies have more powerful social norms, which typically tend to be reinforced by the political authority of a tribal or village headman. Obversely social norms may reinforce a feeling of togetherness against a common enemy that operated in many liberation struggles against colonial powers. However, they tend to weaken after political freedom is achieved. Commercial societies, often in the interest of trade and commerce, deviate from such rigid and explicit social norms, bestowing apparently the individual with greater social freedom. At the same time, however, a commercial society creates other norms reinforced continuously by the needs of trade and commerce, like respect for commercial contracts. The modern 'nation-state', which tries to fuse together the state, the society and the economy under the over-riding norm or ideology of 'nationalism' needs to be understood in this context.

In terms of starkly schematized intellectual history, Hobbes saw relatively little space between the individual and the state for the operation of the civil society. Hegel's philosophy of the state-craft (*staatswissenschaft*) can be seen as the culmination of this intellectual tradition. By separating the private from the public sphere, and by assigning moral supremacy to the latter, the Hegelian view celebrated the authority of the state which is engaged in the public sphere over the society which is engaged in the private sphere (Knox 1964).

Hegel's metaphysical justification of the moral supremacy of the state with its over-riding authority over the private sphere became a powerful idea in the shaping of the nation-state. This was especially feasible in situations where the (civil) society and its diverse norms could be compatible with the political objectives of the state. Thus, somewhat imperceptibly over almost the last two centuries, the political concept of the 'nation' has come into use to replace gradually the concept of the (civil) society. As pointed out already, the society generates its formal and informal norms of behaviour for social interaction, but it is hardly the natural place to forge any collective ideology like 'nationalism'. Multiple affinity or loyalty to groups, in terms of ethnicity, language, religion or culture, is more easily understandable than 'nationalism' as an abstract construction which over-rides these particular loyalties. This is given a tangible form in terms of loyalty to the geographical territory controlled by the state.

Territorial loyalty, however, is only a surface phenomenon; its content derives from the fact that the state is meant to assign and protect the 'rights' of its 'nationals' within that territory. The nation-state is, therefore, based on a reciprocal arrangement. Nationals accept territorial loyalty as over-riding, while the nation-state protects their rights within that territory. However, in this reciprocal arrangement, the rights which the nationals of a particular territory enjoy is determined by the sovereign state according to the vague principle of 'self-determination of a people'. National sovereignty, therefore, leaves ambiguous the question of what these rights are or should be. In particular, it leaves open the question of how a sovereign state should deal with the multiple loyalties of its nationals in terms of ethnicity, language, religion or culture which often make conflicting demands. The Hegelian requirement of placing the civil society with its multiple loyalties as the 'private' domain, and therefore, under the political authority of the state which belongs to the 'public' domain, becomes a particularly convenient ideology for the nation-state in this context. Like Voltaire's God, the idea of loyalty to the nation, had to be invented, to suit the requirements of the nation-state in dealing with multiple loyalties in the civil society.

The emphasis on the territorial integrity of the nation-state meant that its laws and regulations applied also to the commercial activities carried out within its territory. Most importantly, national currency as a 'legal tender' within its territory became the symbol not merely of commercial trust, but also of the authority of the state over the economy. Nevertheless, these newer commercial norms and arrangements, often encouraged by the state, weakened at the same time many traditional social norms. As a result, the nation-state consolidated itself by extending its control over the civil society through the economy. Nevertheless, the requirements of foreign trade, investment and technology never allowed this control over the economy to be complete. The Aristotelian doctrine that, the optimum size of the state is determined according to the level of self-sufficiency (Aristotle 1912, Book 7), was reinterpreted centuries later by Machiavelli as self-sufficiency in arms and the ability of the state of defend itself (Meinecke 1957). In our century, it came to be redefined as the right to self-determination and sovereignty of a 'nation', which permits the state to become the ultimate decision maker within its territory. And yet, with respect to national sovereignty, foreign trade, investment or finance can play a contradictory role. It may undermine the political authority of the economically weaker nation-states by making them crucially dependent on foreign trade, investment and finance; contrariwise, it may enhance the political authority of the economically stronger states in so far as the weaker nation-states are crucially dependent on them. This links inextricably the economic with the political aspect of the authority of the nation-state.

The policies of mercantilism recognized this possibility of furthering economic nationalism through trade. Closer to our time the political importance attached by national governments to the 'strength' of their national currency might reflect a similar sentiment. The current phase of globalization is important in the evolution of the nation-state precisely from this angle. Economic globalization challenges the political authority which the nation-state had attained by undermining gradually many of the norms of the traditional civil society. The political authority of the nation-state was consolidated in the process of expansion of commerce, as its laws and jurisdiction extended over the national economy. This strengthened economic nationalism as a complement to territorial nationalism. A paradoxical turn in history now confronts most nation-states, as the further spread of trade, commerce, finance and information obliterates many economic boundaries among nations. The same commercial logic, almost ironically, tends to undermine today the economic authority of the nation-state which it once helped to consolidate.

2. ECONOMIC NATIONALISM AND THE MARKET SYSTEM

The enormous political authority which the nation-state has acquired gradually is capsuled conveniently in popular imagination as the 'sovereignty' of a nation. Viewed from above, each government is the ultimate source of authority and arbiter of disputes among its people. And, viewed from below, the nation, as a body of citizens, enjoys rights, which are given and defended by the state. In turn, this gives the population a stake in 'their country' to reinforce the ideology of patriotism, in defence of the nation of a sovereign nation (Hobsbawm 1990).

Within each nation-state, however, the political authority of the national government seeks legitimacy in one form or another. The more repressive and undemocratic a national government denying rights to its citizens, the more it needs to appeal to some version of 'nationalism' or patriotism for legitimizing its exercise of power over its people. Thus, the ideology of national sovereignty becomes important not only for democracies but also for dictatorships; paradoxically both need nationalism.

The need for legitimacy and the search for a legitimizing ideology for the exercise of authority by the nation-state proceeds in two somewhat different directions. As argued in the last section, the umbrella ideology of nationalism and national interest is an intellectual construction which is meant to over-ride the diverse cultural, religious and social norms that evolve from interactions in the civil society. Thus, one obvious way to legitimize the ideology of nationalism and the authority of the nation-state is through an appeal to reinforce particular loyalties. Cultural or religious nationalism, or nationalism based on the ethnicity of a 'common' people, provides examples of this tendency in recent history.

At the same time, however, an almost opposite tendency is also in operation. Increasing specialization in production and exchange, the expansion of trade and commerce, and the spread of a commercial society, weaken many earlier social bonds and norms, while creating new commercially-oriented norms. Aided by the nation-state, this contributes to the growth of economic nationalism, that is, a process of convergence of 'norms' dominated by their economic content. These market-oriented norms like respect for contract also seem capable of adapting themselves faster to new requirement and circumstances, compared to traditional social norms that tend to change more slowly.

In many newly formed nation-states of the developing world, both tendencies operate and pull the emerging nation-state often in opposite directions. The tensions of 'modernization' in the 'building of a nation' arises largely from these opposing tendencies of relying on the traditional cultural, social, and religious norms on the one hand, and the requirements of strengthening economic nationalism driven by the logic of a commercial society on the other. What appears as relapse into tribalism, or drive for ethnic purity, or religious fundamentalism usually means the triumph of the former tendency over the latter. The tension is further accentuated by the discrepancy between the faster pace of change in the market-oriented, and the slower pace of change in traditional social norms. In contrast to this, in industrially advanced countries, the norms of the commercial society are far more well-established; indeed, they tend to become the organizing principle of various other social norms. From this point of view, the distinction in terms of nationalism between the 'developed' and the 'developing' economies is largely a matter of the relative strength of the two opposing tendencies, both of which rely on strengthening different aspects of nationalism. However, it is only the sustained success of capitalism in the course of the rise of the nation-state that inclines us towards that particular version of nationalism which has a dominant economic content, that is, 'economic nationalism' for short. Nevertheless, this economic nationalism is still embedded in the particular historical and cultural contexts of different societies. And, the power of economic nationalism is often at it height, not when it opposes other social or cultural norms, but moulds them to reinforce the requirements of a commercial society.

The acceptance of the commercial values by the individual and the dominance of the 'market culture' which drives modern economic nationalism is the outcome of a complex system of beliefs, economic arguments and historical experiences. Recent analytical works have helped to clarify the 'belief–system' which sustains the market culture. Four important components may be distinguished for expositional convenience (Schotter 1989):

i) Individualism;

ii) Rationality;

iii) The 'invisible hand' as the guiding principle the market mechanism;

iv) And finally, belief in the market process, and not merely in the ultimate equilibrium outcome of the market (e.g. Pareto-optimal outcome in a competitive market).

To elaborate, social outcomes are believed to be an expression of aggregated individual preferences implying 'individualism'. But this aggregation procedure includes only 'rational' individuals, e.g., those considered lunatics or psychopaths are excluded by the criterion of 'rationality'. The principle of the 'invisible hand', postulated by Adam

Smith, and articulated rigorously by the so-called fundamental theorem of welfare economics, suggests that the aggregation of the preferences of self-interested rational individuals is done optimally by the market. Finally, this is believed to be optimal, not simply as the ultimate equilibrium outcome, but even as a process. Note that such a process may be stable with optimal equilibrium outcome, but only very slowly convergent. In contrast, another process may not have strictly optimal outcome, but may achieve more rapidly some reasonably satisfying configuration. It is far from clear that the former, slowly convergent process would be more desirable to a rational participant in the market. Nevertheless, belief in the market culture might require this as a condition of rationality (cf. Hurwicz 1989). In a simpler allegory, the 'rational' bellboy brought up in the market culture needs to believe that he too has as fair a chance as anyone else of becoming the chairman of the corporation, provided he sticks resolutely to the routine market-based process 'long enough'!

Even if the fragility of the belief system underlying the market culture can be demonstrated analytically, there is a danger in overdoing this. Because, subjected to analytical scrutiny, almost all belief systems would turn out to be questionable. And yet, a belief system persists by the force of experience and in the absence of an alternative, plausible belief system. It is called into question only when experience shows it to be disastrously wrong. Thus, the recent experiences of the collapse of centrally planned economic system strengthened the belief in the market as the only viable alternative. Nevertheless, the belief in the market system would not have spread so widely, if the market economies were to face frequently economic disasters like the great depression of the 1930s. Similarly, a market system which marginalizes over time an increasing proportion of the population steadily is unlikely to sustain itself, except by default until a plausible, alternative belief system is created.

3. THE CONTENT OF ECONOMIC NATIONALISM: THE INTERNAL AND THE EXTERNAL MARKET

Economic nationalism tends to manifest itself in two interrelated ways. First, because the nation-state depends to a large extent on the market forces in matters of international trade, investment and finance, it naturally tries either to adapt or mould those external market forces to its advantage. The age-old debate between the free traders and the mercantilists is an expression of this. However, at the same time, by its very nature the nation-state exerts far greater control on the internal market defined within the national boundaries than on the external market. This gives rise to the second aspect; the nation-state, particularly if it is a weak player in the international economic scene, has a tendency to rely more heavily on the internal rather than on the external market.

The relative importance attached to the internal and the external market in the policies pursued by the nation-state provides a useful indicator of how economic nationalism is shaped under different circumstances. Since the relative importance of the internal and the external market depends both on the size of a country and the stage of its development, relying heavily on the internal market is not a feasible option for many countries. However, Keynes' theory of effective demand (Keynes 1936) was set almost self - consciously in the context of a closed economy without foreign trade, focusing almost exclusively on the internal market. And yet, it had an intellectual link with mercantilism, which Keynes himself recognized. Mercantilism was largely a product of economic nationalism of the emerging nation-state of an earlier time. One of its most articulate, early proponents, Friedrich List (1841) discussed the problem of industrial development of his country, Germany, in an age when Germany was still fragmented politically, and faced Great Britain as the hegemonic economic power of the day. List argued in favour of a policy of tariff protection with at least temporary deviation from free trade to 'conquer the internal market'. Free trade might still be the longer-term national goal, but only when the weaker nation catches up more or less to the same level of economic and industrial development. This argument for protecting domestic 'infant industries' provided the intellectual justification in more recent times for an import-substituting, inward-looking strategy for industrial development of the economically weaker nations. They invariably perceived the free trade doctrine as the weapon of the stronger nations, against whom protection of the domestic market was the only option. Fallows (1993) stresses that all the US presidents whose effigies decorate today's dollar notes supported such protectionist policies. He quotes Abraham Lincoln in the context of the conflicting views of the Northern and the Southern States on tariff: 'I do not know much about tariff. But, I know this much. When you buy manufactured goods abroad, we get the goods and the foreigner gets the money. When we buy the manufactured goods at home, we get both the goods and the money' (Fallows 1993: 82). At that time, the average import tariff in the newly industrializing United States was around 30 per cent.

The argument for protecting the domestic market runs two serious dangers. First, it is logically incomplete in so far as it points to the importance of supplying to the domestic market from domestic industries, but, fails to examine what determines the size of aggregate domestic demand. As is well known, Keynes' theory made its most important contribution precisely here. It logically completes an important aspect the mercantilist-free trade debate. Until the Keynesian formulation of effective demand, economists and policy makers alike might have debated over the virtues and vices of protecting the domestic market, but neither side had any precise idea about what determined its size.

There is a second danger of the protectionist doctrine in so far as it tends to overstate the danger of economic openness. While in its more extreme version conventional theory argues for indiscriminate free trade and passive insertion into the world economy, more judicious and selective integration with the world economy can be of advantage to even a poor nation, as experience has shown repeatedly. Conventional trade theory highlights the problems of consumers' welfare, which is enhanced through control over cost and quality. These controls are most effectively managed through the discipline of international competition. While this argument is valid in many circumstances, it is misleadingly incomplete, because it fails to recognize that consumers' welfare may or may not be enhanced through competition among the producers, particularly if the market size shrinks. Thus, unless we assume full employment, it is not clear why international competition will leave the levels of domestic employment unaffected. If the size of the domestic market and economic activity decline as foreign producers capture a larger share of the market, the level of consumers' welfare within the nation-state may decline due to lower employment. Moreover, with serious unemployment, efficient utilization of economic resources is not possible. Consequently the conventional support for free trade in enhancing consumers' welfare by allocating resources more efficiently is open to question, unless we assume the level of domestic employment to be unaffected.

The problem with the free trade doctrine in particular, and with the free market mechanism in general, however, lies deeper. Each individual nation-state tries to mould the international market mechanism in its favour, not because what it receives, but, because what is denied to it by the international market mechanism. The international market mechanism is not merely about what the individual nation-state receives, but what is denied to it. In this respect, it is similar to 'majority rule' in a democracy which is not merely about what the majority wants, but what is denied to the minority (Schotter 1989). The enhancing of the market mechanism through free trade appears to be justified in the eyes of the domestic participants only when the denials, including marginalization and exclusion from the labour market are accepted by them as justified. It is at this more fundamental level that the market mechanism is criticized by those who are economically weaker, and feel threatened with marginalization, exclusion or other forms of denial by the market. This applies to individuals, groups and regions within a nation-state or to the state itself. Consequently, economic nationalism can either favour or turn against free trade depending on the benefit the nation receives, and the cost of denials by the international market mechanism.

The distributional implications of participating in the international market with or without free trade has been a familiar theme through centuries, almost since the birth of political economy. The power of a nation to settle international disputes or denials in its favour depends largely on its economic position. For developing countries their ability to resist international pressure is limited by their economic weakness. Moreover, often torn between tradition and modernization, between social, religious and cultural norms on the one hand and the norms of an encroaching international commercial society on the other, they face a paradoxical situation. Without accepting largely the norms of the commercial world, and undermining the cohesion of the traditional society, they cannot often hope to acquire the minimal economic strength needed to assert their nationalism. It is this paradoxical choice which many developing countries try to make the best of, by surrendering to 'impersonal' market forces. In this sense, globalization is not imposed but accepted by them.

For the industrialized nations, the situation is less paradoxical. With the logic of a commercial society historically well-entrenched, reliance on the market becomes more a matter of routine which usually entails the acceptance of a form of nationalism with a dominant economic content. It is the relative economic performance vis-à-vis other nations which increasingly defines the 'nationalism' of an industrially developed country. Accordingly, the legitimacy of the government in power also depends usually on the relative economic performance of the country.

'Globalization' in this context becomes an uneasy meeting point of opposites. The developing nation-state feels the compulsion to globalize to assert internally within the country the supremacy of economic over social norms to strengthen some form of economic nationalism. Externally vis-à-vis other nation-states, however, its economic nationalism suffers in so far as it is economically less powerful, and is compelled to play more or less passively by the rules set by the more powerful industrial nations. The tension is less intense, but no less real, for the industrially developed nation. Its relative economic performance depends crucially on external conditions in many ways. However, while economic performance is the main vehicle of expressing its nationalism, within the domestic economy, internal economic compulsions may become incompatible with better external economic performance. Thus, consolidation of economic nationalism through globalization operates as a double-edged weapon which often wounds the nation-state, developing or developed, which tries to wield it. The danger is usually greater for developing nation-states; but it is also real for advanced industrial nations.

The political significance of the Keynesian theory of demand management can be appreciated in this context. The theory showed how mass unemployment and acute economic depression could be avoided through the management of demand in the internal market by the national government. It was a model of cooperative capitalism, because, output expansion through higher demand results in more profit as well as more wage income without necessarily generating distributive conflicts. That the size of the internal market is governed largely by the purchasing power of the working population had been a well-known economic doctrine long before Keynes. According to this under-consumptionist doctrine, a high wage and a more equal distribution of income are favourable not only to the workers, but even to the capitalists, in so far as it maintains high demand in the internal market. Keynes distanced himself from this narrow under-consumptionist position by pointing out that either consumption or investment could be raised to increase aggregate demand, to avoid disastrous economic depressions with mass unemployment. Contrasting his views from those of early under-consumptionists like Malthus and Sismondi, he writes:

> Practically I only differ from these schools of thought in thinking that they may lay a little too much emphasis on increased consumption at a time when there is still much social advantage to be obtained from increased investment. Theoretically, however, they are open to the criticism of neglecting the fact that there are *two* ways to expand output (Keynes 1936: 325; emphasis in original).

Kalecki (1944) pointed out more precisely the entire range of possibilities for managing demand by the national government. Each of the three major components of aggregate demand—private consumption, private investment or government expenditure—could be manipulated through a different set of policies to influence the level of aggregate demand. To these 'three ways to full employment', must be added also the possibility of generating demand through a larger export surplus in an economy open to foreign trade.

Of all these different routes to demand management, by far the speediest and the most convenient way for the national government is to increase the level of government expenditure through deficit financing. Understandably, governments of very different political persuasion took repeated recourse to this method for averting serious unemployment. Thus, the share of government spending in GDP in major OECD countries rose from about 18 per cent before the outbreak of the Second World War to 27 per cent in 1950, and to 37 per cent in 1973 (Maddison 1991; see also Tanzi 1998 for an alternative set of calculations). However, more important than the actual method of demand management was the intellectual confidence that governments acquired to fight economic depression. Keynesianism brought about this dramatic change in the climate of opinion, as more or less continuous full employment came to be viewed as an achievable goal under capitalism. Thus, following the publication of the Beveridge Report in 1942, the maintenance of 'a high level of employment' was recognized by 1944 as a primary objective of the British government.

Its implications for the growth in the economic stature of the nation-state was tremendous. The economic role of the state in maintaining high employment through high state expenditure became the accepted norm for the conduct of economic policy across a wide political spectrum. It also meant an expanding role for the welfare state. This was rooted in the consensus view that cooperative capitalism among the contending classes is practicable, because both sides stand to gain through the expansionist fiscal and monetary policies of the state in maintaining high demand. More than two decades of sustained near-full employment with high growth seemed to reinforce this view. It was the golden age of capitalism. Perhaps, it was also the golden age for the nation-state in its conduct of economic policy.

When the Keynesian theory of aggregate demand is extended to incorporate the influence of international trade, its limit becomes immediately obvious. Considered in isolation, a country with an export surplus would experience an expansion in its market and economic activity, just as a country with an import surplus would experience a contraction. However, since one country's export surplus is another country's import surplus in the global balance of trade, this immediately points to a source of conflict of interests among the trading nations. The model of cooperative capitalism within the nation-state as the main political attraction of the Keynesian theory, seems to run into serious difficulty in the international context.

The conflict of interests among the trading nations is, however, more moderate than might appear at first sight. Because, the export surplus nation with its higher level of income would spend a part of that higher income on imports, that is, on export from the import surplus nation. This, in turn, would stimulate to some extent the external demand in the import surplus nation. The net effect of an export surplus would still be an expansion in income, but the expansion would be moderated by higher imports induced by higher income through the so-called 'foreign trade multiplier'. Obversely, the import surplus nation would experience a more moderate net contraction in income, as it experiences higher exports due to higher induced imports by its export surplus trading partner. Schematically speaking, conflict of interests still remains the dominant theme among trading nations, but it tends to be moderated by an undercurrent of complementarity of interests among them through mutual dependence on trade (Bhaduri 1986: Ch. 5).

Management of demand by the nation-state through fiscal expansion runs into a similar difficulty. As the country expands its demand and income, more import is induced by the higher income which, in turn, leads to a deterioration of the trade balance. As a result, the model of cooperative capitalism in an economy closed to foreign trade does not extend easily to open economies. Despite the mutual interdependence that trade creates, conflict of interests among nation-states engaged in trade seems unavoidable.

The problem might seem to be moderated by the international market mechanism in two different ways, especially in a regime of flexible exchange rates. If the export surplus country experiences an appreciation of its currency while the import surplus country undergoes depreciation, there might be a tendency for the balance in trade to be restored through the international exchange rate mechanism, provided the 'trade elasticities' are sufficiently large (that is, the Marshall-Lerner condition is satisfied for both the countries). The effective exchange rate, adjusted for the comparative rates of inflation in the two countries, might also set in motion a similar equilibrating mechanism. Thus, as demand expands in the export surplus country, if it experiences a higher rate of inflation at home, its exports become more expensive to foreign buyers to reduce the initial export surplus. An obverse sequence of events reduces the import surplus of the deficit country. Its analogy with the equilibrating discipline of the Gold Standard, first postulated by David Hume (1740), should be apparent. A trade surplus was supposed to lead to an inflow of gold, which in turn would result in a corresponding expansion of the domestic money supply linked to the gold stock. Under the Quantity Theory of Money, this was expected to raise the price level of all domestic, including exported goods, and reduce its international price competitiveness until the trade surplus got more or less wiped out.

The reliance on any automatic international price mechanism to restore trade balance often runs contrary to experience. The fault lies with both the theoretical formulation, and neglect of economic nationalism that permeates international economic relations. Theoretically, the postulate that an increase in demand resulting from an export surplus would necessarily lead to an increase in the domestic price rather than output is open to question. It is indeed one of the fundamental propositions of Keynesian economics that higher demand may cause output to expand with the price level relatively stable in situations of substantial unemployment or excess capacity. Therefore, the efficacy of the price mechanism would require the assumption of full employment, or at least the implicit assumption that output is constrained by supply, and not by demand so that the effect of higher demand would be felt on higher price and not on higher output level. Moreover, the price mechanism would fail to do its job if the trade elasticities are sufficiently low (violating the Marshall-Lerner condition). And such low trade elasticies are a common feature of many least developed countries which depend on essential imported items, but have only some primary products to export in the international market.

However, these theoretical problems are only one side of the story, and not always the most important side. Since, as we already argued, trade among nations almost invariably involves some conflict of interests, the working of the price mechanism may be manipulated in the interest of economic nationalism. Thus, an export-surplus country may accumulate reserves of other currencies and engage in 'financial diplomacy' to bring down the international economic position of another country, especially in the earlier regime of non-floating exchange rates. Britain's return to the Gold Standard in 1925, and abandonment of it in 1931 illustrates how such financial diplomacy used to be played out among the major nation-states, each governed by its economic nationalism. Britain returned prematurely to the Gold Standard in 1925, pegging the pound at the old pre-war rate of gold parity. However, since the competitive position of Britain in world trade had declined considerably in the meantime, between 1926 and 1930 both the United States and France ran large trade surpluses, and the Bank of France also began to convert steadily the payments surplus into sterling claims for a final show-down with Britain over the British attempt to reinstate internationally the sterling. The impending 'run' on the small gold reserve of the Bank of England began in early 1931, when France brought matters to a head by converting her accumulated sterling claims into gold. Britain was forced to abandon the Gold Standard in the summer of 1931.

A more blatant case in history was the manipulation of the market mechanism to suit imperial trading interests. In the later phase of the industrial revolution (from around 1880), enforced trade irrespective of international competition on a bilateral basis between the imperialist metropolis and the colonial periphery, began surfacing on an extensive scale. With several capitalist countries of Europe emerging as rival industrial powers, the doctrine of free trade became less acceptable to the economic nationalism of Britain. A pattern evolved gradually in which each major imperialist country of Europe tried to retain and expand its share of the captive formal or informal colonial market, which was more or less its exclusive sphere of economic influence (Klieman 1976; Hobsbawm 1972). The conflict among the imperialist nation-states to expand or retain their spheres of influence led not merely to trade rivalry, but ultimately to open war. It might be added that the 'financial diplomacy' of the inter-war period was a step forward compared to the 'imperialist war' of the earlier phase.

Historically, in those periods of intense economic nationalism, the imperialist nation-states played a major role, both as a vehicle of organizing direct foreign investment and as a defender of foreign investments and loans. It was a twilight zone between formal and overt imperialism, often taking the form of 'gunboat diplomacy' which characterized the economic relations between the stronger and the weaker nation-state. The stronger nation-states themselves went through phases. It degenerated at times to open territorial wars over spheres of influence, especially until the First World War and gave way later to 'financial diplomacy' in various forms. On the whole, it was an ugly face of economic nationalism.

The return to the 'closed' economy emphasized by the Keynesian theory redirected internally economic nationalism, but it did not reduce the importance of the nation-state. As a matter of fact, with national governments engaged in maintaining a high level of employment at home through demand management, the legitimate economic role of the nation-state got enhanced over time. The emergence of the 'welfare state' as a widely accepted ideology in the advanced industrial nations strengthened further this process. Following the Second World War, almost three decades of unprecedented economic growth with near-full employment assigned to the nation-state on undisputed economic position. On the political level, it seemed to reconcile two apparently irreconcilable tendencies. On the one hand, the Keynesian model of cooperative capitalism contained within limits the conflict between capital and labour, as the state managed aggregate demand usually to the advantage of both. On the other, by giving economic nationalism an internal orientation, by focusing on the internal market and the welfare state, it reconciled to a large extent the economic nationalism of the individual nation-state with some degree of mutualism in international relations.

For a more complete understanding, it needs to be emphasized that the cold war also contributed to this process in a somewhat paradoxical way. The threat of socialism acted as a cementing factor to unite ideologically the capitalist market economies (Hobsbawm 1994). Rising expenditure on armament especially in the United States helped in sustaining aggregate demand. It is even arguable that the perceived threat of socialism stimulated welfare programmes to moderate the intensity of capital labour conflict within the capitalist nation-state. It was in many ways an exceptionally favourable configuration for the nation-state. The subsequent limitations of the nation-state, emerged as conditions become less favourable.

4. THE EVOLVING NATURE OF THE NATION-STATE AND GLOBALIZATION

The gradual erosion in the authority of the nation-state from its past height achieved during its golden age in the decades following the Second World War, is attributable to several intertwined tendencies. They impose serious limitations on the economic role of the state. Although they coincide in time with the current phase of 'globalization', it would be a misleading over-simplification to suggest that these tendencies are generated entirely by the world economy globalizing at a rapid pace. Because some of these tendencies are the consequence of the economically active role which the nation-state played in the past; others are attributable to the process of globalization. For expositional clarity, it may be useful to distinguish these tendencies under four different heads, while bearing in mind that they interact with each other in the process of eroding and reorienting the authority of the nation-state. They are:

i) The resurfacing of capital-labour conflict, especially in an era of sluggish growth and high unemployment in several industrially advanced nations;

ii) The consolidation of multinational corporations in production related activities as well as in the field of international finance;

iii) The overwhelming quantitative importance of international financial capital flows, mostly from private sources; and,

iv) Finally, technological development especially in communication technology.

Each of these tendencies requires some elaboration which follows.

4.1 Capital-labour conflict: unemployment and inflation

It is perhaps not too misleading to evoke the image of the biological evolutionary process to understand the economy. Economic policy that deals successfully with the immediate problems of the economic environment, is likely to change that environment by its very success. Somewhat like the grand algorithm of natural selection, successful adaptation at each round of evolution might call for a different type of adaptation at the next round, precisely because adaptation was successful enough in the preceding round to change the environment! This analogy applies with some force to the Keynesian theory of demand management. Its sustained success in dealing with the problem of unemployment in a framework of cooperative capitalism generated new problems.

The problem was not altogether unforeseen. Already in 1943, Kalecki expressed his scepticism about the political sustainability of long periods of full employment (Kalecki 1971). As he saw it, a shift of power in favour of the workers generated through long periods of sustained full employment would create new problems of workers' 'indiscipline', as the fear of job-loss as an enforcement device in the labour market begins to erode. This problem of shift in the balance of power between the classes would arise despite the fact that high employment and capacity utilization might be good for both profit- and wage-earners. As a consequence, Kalecki argued, the government supported by captains of industry would retreat from time to time from demand management, perhaps in the name of 'sound' public finance and balancing the budget, to precipitate 'political trade cycles' in order to impose discipline on the workers.

The idea of 'political trade cycles' is an astute variation on the classical Marxian theme of the maintenance of the 'reserve army of the labour' as an integral feature of capitalist development. However, the precise economic consequences of workers' indiscipline in the political trade cycle were left somewhat vague. Marx had postulated that the presence of a 'reserve army' of labour would prevent real wages from rising. That prediction, literally interpreted, had turned out to be false. Nevertheless, its implication that cooperative capitalism has a inherent tendency to degenerate into conflictive capitalism over the distribution of income under conditions of low unemployment and increased bargaining power of the worker, cannot be so readily dismissed. Thus, workers' indiscipline can take the particular form of demand for higher money wages, out of line with labour productivity growth, to threaten the economy with inflation, and a squeeze on profits. This idea got a sharper quantitative focus in Phillips' (1958) statistical analysis which showed that money wages generally tend to rise faster at lower levels of unemployment. This presents an awkward choice between the two economic objectives of maintaining a higher level employment, and a reasonable degree of price stability—the 'unemployment-inflation trade-off', as it came to be known in policy debates. The first crack in the model of cooperative capitalism had appeared.

The terms of the policy debate changed dramatically, when 'monetarist' economists led initially by Friedman (1968) denied the very possibility of any trade-off in the longer run between the rates of inflation and unemployment. Economic models were constructed to demonstrate that the economic policies of the state would necessarily be ineffective in the long run to reduce unemployment below its 'natural rate' or the related concept of the 'non-accelerating inflation rate of unemployment' (NAIRU). It again became respectable in 'new classical' economics to argue that all unemployment is 'voluntary', that is, the outcome of intertemporal leisure-income choice by the individual workers (e.g., Barro 1993; Lucas 1981; Phelps 1970; Sheffrin 1996).

The interesting political question is, what made these various models, all of which had the common unifying thrust against the expanding economic role of the state, so widely acceptable politically at this juncture of history?

At the most obvious level, constructs like the 'natural rate' or 'the non-accelerating inflation rate of unemployment' (NAIRU) played on the fear of inflation triggered off by higher wage claims at sustained near-full employment. In essence, they justified the need for maintaining a 'reserve army' of labour under capitalism, an old idea recycled in new theoretical terms.

It should be remembered that three decades of near continuous full employment, the welfare state and sustained growth had largely transformed advanced capitalist economies into property, owing democracies with extensive rentier interests. This transformation was sustained by the growing presence of the state in economic life; government expenditure as a share of GDP in the industrial countries increased from about 22 per cent in 1937 to 28 per cent in 1960 to 46 per cent in 1996 (Tanzi 1998: Table 1). It was financed partly by taxes; but also by the issue of interest-bearing government securities, which helped in strengthening rentier interests on the one hand, and the need to raise taxes to finance the growing interest payments on the other. Both the resistance to paying higher taxes, and the fear that inflation would hurt rentier interests in particular, combined to undermine the attractiveness of still higher public expenditure to fight unemployment in this transformed social structure of advanced capitalism. It was not only the 'captains of industry' who wanted to discipline organized labour through maintaining a 'natural rate' of unemployment. A wider middle class with rentier interests supported them, fearing that inflation triggered off by excessive wage claims may erode the value of their accumulated savings.

There is, however, a more subtle political reason for the breakdown of the Keynesian consensus. The wide acceptability of the Keynesian theory is accounted for partly by its political ambiguity. Its vision of cooperative capitalism presupposed a neutral state which will manage aggregate demand to reconcile the interests of capital and labour. However, once their distributive conflict begins to fuel a process of inflation driven by conflicting claims, the neutral stance of the state may become increasingly untenable; indeed, even traditional fiscal instruments like a progressive direct tax structure may contribute to, instead of abating, the inflationary process by involving the state as one of the parties in the conflicting claims (Bhaduri 1986: Ch. 6; Jackson, Turner and Wilkinson 1975; Rowthorn 1980).

The policy of demand management is also politically ambiguous, in so far as either the state or private business can be relied upon to undertake the necessary investment for expanding aggregate demand. Since the stimulation of private investment is an alternative route to managing demand, measures aimed at achieving this, e.g., reduced taxes on corporate profits or restraint on wages become justifiable in the Keynesian framework. These measures constitute the case for a politically conservative style of demand management based on profit, and private investment driven economic expansion within the Keynesian intellectual tradition. Moreover, in so far as such private investment-led economic expansion also creates sufficient jobs with a relatively slow rise in real wages in relation to the growth in labour productivity, private profitability is increased; at the same time, however, the working class might also gain in terms of higher real wage and expanding employment opportunities.

The original under-consumptionist thesis of wage-led and consumption driven economic expansion, which argued essentially that 'high wage' is beneficial to both the classes, finds its anti-thesis in this case of profit and private investment driven economic expansion. Ironically, both can be interpreted as models of cooperative capitalism. And, both are based on the Keynesian theory which assigns centrality to aggregate demand in determining output and employment (Bhaduri and Marglin 1990). Keynesianism in this wider sense also leaves ambiguous the economic basis of social democratic politics or the necessity of the welfare state, by accommodating different forms of cooperative capitalism. Helmut Schmidt, as the social democratic chancellor of the - then West Germany articulated this conservative alternative by pointing out, 'The profits of the enterprises today are the investment of tomorrow, and the investment of tomorrow are the employment of day after' (*Le Monde*, 6 July 1976). It symbolized complete reliance of private industry, and its willingness to investment to solve the problem of unemployment, rather than creating jobs through direct expansion of public investment. The economic role of the nation-state was thus circumscribed by the need to maintain, above all, a favourable climate for private investment. This view was also an intellectual watershed. It marks the beginning of a new conservative era in advanced capitalist countries, when it becomes increasingly difficult to distinguish social democratic from conservative policies, in so far as the economic role of the state becomes directed towards strengthening the role of private business. According to this new conservative view of demand management, if cooperation between capital and labour is at all to be attained, it is better attained through the agency of private business, but not through direct state intervention, as the earlier version of social democracy had advocated.

4.2 The rise and consolidation of multinational corporations

At the level of the relevance of theory, there can be little doubt that the Kalecki-Keynes model of the closed economy became increasingly obsolete as world trade, particularly among the industrialized countries, began to grow rapidly in the post-war years. In an economy significantly open to foreign trade, arguments in favour of mass consumption-led growth through a 'high wage' policy become less compelling. Because, in so far as higher wages through higher prices also lead to lower international price competitiveness, aggregate demand may actually decline through adverse trade balance. Therefore, with increased relative importance of the external compared to the internal market under globalization, policies aimed at promoting aggregate demand through 'high wage' policies are less likely to be effective. A basic tenet of welfare capitalism thus becomes questionable. In contrast, in an open economy conservative policies in favour of a 'low wage' policy directed at propelling economic expansion led by profit, private investment and trade surplus seem more likely to succeed (Bhaduri and Marglin 1990).

International trade has grown at roughly double the rate of world GDP on an average, since the Second World War. This growth is linked intimately with the internationalization of production by the multinational corporations; some 40 per cent of the volume of trade in manufacturing is accounted for by intra-firm trade among the subsidiaries of these corporations. As a result, attracting direct foreign investments of the corporations assumes a special significance for improving the trade performance of nations. Since foot-loose corporate investments would tend to choose the most profitable locations, a 'race to the bottom' follows among the nations by reducing competitively corporate tax rates, and offering other tax breaks. This reinforces further the limitations on the nation-state in conducting economic policy, by reducing the collection of tax revenue on the one hand, and by promoting policies for an attractive investment climate for the multinationals on the other.

Nevertheless, the quantitative importance of foreign direct investment (FDI) in terms of its share either in fixed capital formation, or the accumulated stock of FDI as a share of GDP, is not overwhelmingly large. For all economies, its share in fixed capital formation roughly doubled from 4.4 to 8.7 per cent on a four-year average between 1981-85 and 1991-95 (UNCTAD 1997: table B5), and as a ratio of GDP the accumulated FDI stock increased over the same period from about 11 to 20 per cent (UNCTAD 1997: table B6). Even for the more 'open' industrializing economies, the figures are not very different, the former share was about 10.7 per cent in south east Asia and 10 per cent in Latin America in 1991-95, but highest at 13.6 per cent in Europe (UNCTAD 1997: table B5).

It raises an interesting puzzle: Why are multinationals perceived to be so important, if their presence in terms of FDI is not proportionately large? The answer to this question lies, perhaps, in two parts. First, multinational corporations are involved increasingly in activities like licensing, outsourcing and joint ventures, including international marketing, which are not captured in the measures of FDI. They become important in influencing the trade performance of the nation-state through these channels, and in updating technologies in newly industrializing nations. Moreover, multinational corporations are engaged increasingly not only in international production activities, but also in finance. It is often easier for a domestic firm in a developing country to raise commercial loans internationally through joint ventures, and to obtain a better internationally approved credit-rating, if it is linked to a well-known multinational. Even the credit-rating as well as the Bretton Woods institutions usually tend to use the attitudes of the multinationals to the host country as an index of its economic health and market-friendliness. Thus, the cost of noncompliance by the nation-state to the requirements of the multinationals—the 'enforcement cost' imposed by the international corporations on the conduct of economic activities by the nation-state, tends to be large, and indirectly magnified by the nexus between international trade and investment on the one hand, and international credit-worthiness on the other (Crotty, Epstein and Kelly 1998).

In the second place, multinational investment is also assigned somewhat disproportionate importance by national governments because it is growing at a relatively faster rate in recent years. Through this fast growing route, developing countries hope to attract both modern technologies, and an increasing share of other forms of international capital inflow, including portfolio investments. On the other side, in making their investment location decisions multinational corporations are involved in a guessing game about the 'investment climate', not only vis-à-vis the potential host country but also by watching the behaviour of other multinationals. Like in so many other situations of marked uncertainty and incomplete information, this tends to generate behaviour governed by the 'herd instinct', and looking for safety in the crowd. As a result, well-publicized refusal by one multinational can set off a chain reaction of refusals by many other multinationals. Strategic negotiations by setting one multinational against another become all the more difficult for the national government in these circumstances. It feels circumscribed, paradoxically not because of 'coordination failure' but, because of too much informal coordination among multinational corporations, banks and Bretton Woods institutions!

4.3 International financial capital flows

As is widely recognized nowadays, the most dramatic face of contemporary globalization is presented neither by international trade nor by investment. It is in the field of internationalization of finance by private players on a scale altogether unprecedented in history. Global turnover in foreign exchange trading, excluding trade in derivatives, rose from the average daily figure of 18.3 billion dollars in 1977 to 1.23 trillion dollars in 1995, a figure which increases to about 1.30 trillion dollars per day including foreign exchange options and related derivatives. During the same period 1977-95, the ratio of global foreign exchange turnover to the value of global exports rose from 3.5 to 64, while official reserves declined from 15 days of daily foreign exchange turnover to less than that of a day (Felix 1998: also tables 1A and 1B).

Given the astronomically vast magnitudes, all nation-states tend to view this process of globalization of finance as enormous, opportunities mixed with equally serious dangers, reminding one of an old Buddhist proverb: 'It is the same key that opens to gate to heaven or hell'. So long as the nation-state can play on the right side of the international financial market, its opportunities for getting finance are enormous; but placed on the wrong side of the same market the danger is equally serious, as the financial power of any national government or central bank to intervene is pitifully limited. The resulting compulsion to be friendly to the day-to-day sentiments of the international financial market has curtailed, more than anything else, the traditional autonomy of the nation-state in conducting economic policies.

The erosion of authority of the nation-state in the face of globalized finance occurs in several ways. Of these the following four are probably most important. First, the national governments have far less control in managing aggregate demand, because fiscal or monetary policies aimed at expanding demand spill over partly into higher imports and current account deficit. The fear on the part of the national governments that this might destabilize the financial markets triggering off massive speculative capital flights, has an almost paralytic effect on expansionary fiscal and monetary policies.

Second, import liberalization in developing countries, sustained, at least temporarily, by international capital inflows can often result in higher trade deficit which contracts aggregate demand and output (Bhaduri and Skarstein 1996). And, the obverse of this contractionary output adjustment is the lack of price, or exchange rate adjustment in such cases. If the global financial market sentiments are in favour of import liberalization, which seems to be the usual case, many national governments in developing countries would have to accept contractionary pressures on domestic economic activity with an artificially boosted exchange rate in a liberal trade regime.

Third, national governments would have little autonomy to increase domestic corporate tax rates for raising additional revenue, just as they would have little freedom in lowering interest rates. The more integrated the international financial markets, the greater is the danger that a comparatively higher tax rate or lower interest rate would induce disproportionately large capital flights that might become explosive as speculation feeds on speculation.

Finally, and over-riding the preceding considerations, national governments in both developing and developed countries have a strong compulsion to pander to the widely held sentiments, beliefs and prejudices of the globalized financial markets. Like the self-fulfilling prophesies in 'sun-spot' theories, if the financial market holds, rationally or irrationally, that fiscal or government budget deficit is 'bad' or current or capital account liberalization is 'good', the governments would have a strong compulsion to indulge those market sentiments. This single factor, more than anything else, has probably been the most important reason for the 'convergence' of economic policies across nations, and in driving the global economy towards rapid liberalization of trade, investment and finance. Without gross exaggeration, it is probably on the basis of such convergence that the foundations of the neoliberal economic regime is being laid.

4.4 Communication technology

Economists seldom try to analyse the social processes that generate widely held economic beliefs and sentiments that govern the financial markets. They marvel at the lightening speed and efficiency with which vast funds can be transferred across national borders with the aid of modern communication technology, but seldom turn their attention to the tremendous power of the electronic media in shaping and influencing the sentiments that drive transactions in financial markets. And yet, it is these sentiments which impose the most serious constraints on the conduct of national macroeconomic policies.

Nevertheless, the media itself is not in the business of formulating the theories and hypotheses around which the sentiments in the market crystallize. They merely package attractively and propagate views, while the theories underlying them originate mostly in individual creative thinking, often in the academia (Enzensberger 1988). In the inimitable and oft-repeated words of Keynes:

> The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back (Keynes 1936: 383).

If anything, these words are more true in our media age.

Rightly or wrongly, the dominant economic theories of our time, since the disintegration of the Keynesian consensus around early 1970s, believe in the efficiency and wisdom of the market, and in the inefficiencies of the government. Thus, restraining government spending through balanced budget, or by putting an upper ceiling on fiscal deficit and public debt, accepting a 'natural rate' of unemployment etc. are ideas that originate in particular models and theories, which are propagated by the media to become popular beliefs. From finance ministers to ordinary participants and practical men in the financial market, these beliefs become the 'distilled truths' continuously served by the media. This was also the case in the past. The real difference today is that those 'distilled truths', when they become sufficiently popular in a globally integrated financial market, force national governments to act according to those beliefs. This social process, enormously strengthened by the advances in communication technology, makes national governments unable or even unwilling to act with determination in the face of poverty, unemployment or environmental degradation. The particular theories propagated in recent times by the media also show a rather systematic bias in favour of private capital, against a sufficiently active role by the state in defence of the economically weaker sections of the society. This bias is not accidental; it reflects a shift in favour of the interest of corporate capital on the one hand, and the discrediting of bureaucratic central planning on the other. And, the 'free' media, often a part of the corporate world, tends to propagate as theories, beliefs that are especially convenient to these powerful interests.

5. THE NATION-STATE AND DEMOCRACY: ACCOUNTABILITY, SELF-CORRECTION AND ECONOMIC NATIONALISM

As markets are become globally integrated, its major actors, the multinational corporations have global reach, while the nation-state remains local by its very nature. It is understandable why so many contemporary observers find the nation-state to be an anachronism in this global setting. Like the pre-historic dinosaur, the once powerful national state seems to have almost outlived its time as an institution.

The view that the nation-state is moving inextricably towards its demise during the present era of globalization is misleadingly over-simplistic for two reasons. First, it misunderstands the economic role that the state plays with respect to the market. Second, it fails to see the way in which the relationship between the nation-state and economic nationalism is evolving over time. The first aspect is discussed quite extensively in debates over the relative roles of the state and the market. It is best understood in terms of how the state and the market relate to one another in terms of the extent of accountability and self-correction embodied in the two institutions. The second aspect as to how economic nationalism is affected by, and affects globalization in turn, has received relatively little attention from economists and political commentators.

5.1 The state and the market: accountability and self-correction

It has been repeatedly emphasized in the course of our argument that the acceptance of the 'market culture' depends on the participants seeing as justified, not merely what they receive but also what is denied to them by the market. And yet, the most important feature of the market mechanism is that, it is not directly accountable to the participants; in contrast the state is. In a political democracy, the majority cannot trample on the rights of the minority, simply in the name of majority rule. And, in this sense the notion of democratic legitimacy and accountability involves not just majority rule, but extends also to the protection of rights for the minority. A similar argument applies to the functioning of the market economy. If its functioning marginalizes and denies almost everything to a significant minority, the state as the accountable institution may have to intervene, if only for the sake of legitimizing the market. Otherwise, the political authority of the state itself would be in question for supporting an unjustifiable market system which deprives the significant minority of almost everything. And, if there is one thing to be learnt from the unfolding experiences of the post-Soviet reform, it is precisely this. A state which pays little attention to the economic sufferings and marginalization of a significant proportion of its population, not only discredits itself but also the market process through which such marginalization occurs.

The problem is distressingly acute in many economically poor countries because, in the more extreme cases, not merely a minority, but even the majority may be denied the very minimum of economic life through extensive poverty, unemployment, illiteracy and lack of health care. The staggering magnitudes of the problem on a global scale can be judged from the facts that, of some 4.4. billion people in developing countries, almost three-fifths live without basic sanitation, one-third without safe drinking water, a quarter lack minimum housing facilities and one-fifth live beyond the reach of any modern health services. And at least one-fifth of the children are condemned to illiteracy, as they do not get as far as grade five in school (UNDP 1998).

Because the state is accountable but the market is not, the state seeking legitimacy should feel compelled to act under such circumstances. There has been a great deal of discussion in recent years about the extent of state versus market failures. Theories like public choice and rent-seeking have rightly drawn our attention to the fact that, in many circumstances the failures of the state can be even more severe than the failures of the market mechanism. However, they ignore the basic issue: being accountable, the state has compulsions to act which are absent in the workings of the market mechanism. And, this accountability is a basic criterion for any democracy.

However, accountability is no guarantee for a self-corrective mechanism. A state might continue to perform very poorly on the economic front, and yet try to improve its 'image' of accountability by taking recourse to cruder forms of nationalism like religious fundamentalism or increased military might. In contrast, proponents of the market mechanism would argue that the market has an in-built self-correcting mechanism, an argument flawed on two counts. First, the self-correction of the market mechanism is based upon a string of unrealistic assumptions which need not hold in practice, especially the fact that the lack of adequate aggregate demand is not subject to automatic self-correction. What conventional theory claims to show is the efficient allocative equilibrium properties of a well-functioning market (e.g., the so-called 'fundamental theorem' of welfare economics), when full employment of resources is ensured by adequate aggregate demand. Second, even granting such allocatively efficient equilibrium, the speed of adjustment to the equilibrium may be too slow to be of practical relevance (see Section II). While the proponents of liberalization in favour of the market might claim that liberalization and integration with the global market is necessary 'now' to reap benefits in the 'future', there is nothing in economic theory to establish how close or distant that 'future' might be!

In contrast, the accountability of the government, at least in a democracy, has a well-specified time scale. Its failure to correct gross mistakes becomes accountable in times of election. The government has to act, wisely or unwisely, because of that definite time constraint; but the market does not. As a matter of fact, the collapse of bureaucratic central planning was largely due to the fact that it was neither accountable nor subject to correction within a specified time scale. Similarly, dictatorial rules, even apparently benevolent ones that try to legitimize themselves in the eyes of the population, are dictatorial precisely because they accept no definite time constraint. A dictator can promise a better 'future' without committing himself to when that future would come. And, in this respect, the trajectory of a competitive market towards the desired 'optimum' may represent something like a dictatorial promise! In contrast, the time-constrained political accountability of the nation-state may force it to act in a manner not necessarily replicated by the market. From this perspective, a fundamental issue, therefore, is not whether state actions are 'market-friendly', but whether they conform to the time-constrained accountability criterion of a democracy.

5.2 Economic nationalism and globalization

It is a political myth of our time that both the market and globalization would weaken many aspects of narrow economic nationalism. Since like the market, globalization creates its losers and gainers among the nation-states, the losers would naturally have a tendency to create a defence mechanism against globalization by taking recourse to different aspects of nationalism. Thus, the tension between tradition and modernization may be heightened through the reinvention of the 'nation' in terms of ethnic purity or homogeneity in terms of religion, language or a shared history. That these tendencies have actually surfaced far too frequently in the recent political history of many developing countries might not be just an accident, but partly the result of being confronted with global market forces.

Even for the nations that expect to be gainers from the current process of globalization, there is a paradoxical element. These nation-states are geared increasingly towards serving the demands and requirements of a process of globalization which is driven not primarily by their political authority but by the multinational corporations and powerful anonymous private traders in the international capital market. Viewed from this angle, the nation-state does not merely face today more severe constraints in the conduct of independent economic policies (Section IV). In a more subtle fashion which typically escapes the attention of most commentators on the subject, the economic activities of the nation-state are being reoriented, and many of its economic institutions are being strengthened systematically in the interest of globalization. The point may be illustrated with only a few selected examples.

There is a growing tendency for stronger national central banks to emerge as independent decision makers to establish the supremacy of monetary over fiscal policies. Its main objective is to maintain the stability of the exchange rate and the value of the currency by curtailing government expenditure, rather than fighting unemployment or alleviation of poverty. In a parallel vein, many countries are centralizing institutions and strengthening regulations for facilitating international transactions in financial assets, but are underplaying at the sometime the need for strengthening other institutions and regulations needed for improving corporate tax collection or their socioeconomic infrastructure. Even the larger regional groupings that are being formed among countries often have a central motivation of developing a more integrated market for trade, investment and finance in the interest of large corporations which produce and trade across national boundaries. In other words, two opposing tendencies are tending to be fused together. The nation-state is apparently being constrained and weakened on the one hand in exercising its economic and political authority. On the other, however, the nation-state is being strengthened in certain respects in so far as it suits large corporate interests in trade, investment and finance. In this sense, it is not the demise, but a systematic reorientation of the nation-state that we may be witnessing as one of the most striking features of the current process of globalization. Nevertheless, it is a politically dangerous trend. The reason, as we have argued, is that it creates a growing hiatus between the democratic governments of the nation-states that have to be accountable for their performance within the electoral time-frames, and the multinationals as central actors in globalizing markets who are not accountable to the wider body of ordinary citizens of any nation.

Viewed from this perspective, the emerging challenge both to the process of globalization, and to the nation-state and its nationalism can be appreciated in a different light. On the one hand, global 'rules of the game', especially for multinational business, have to become more sensitive to the democratic accountability of national governments; indeed, they may even play a part in enhancing this accountability by following a more transparent code of conduct that discourages corrupt and unfair trade and business practices in dealing with especially weaker national governments. On the other hand, national governments need to recognize the gains that can be made from selective, greater international interdependence through trade, investment and finance. In particular, the dynamic sources of gains that are attainable through international learning about technology, taste and quality and are typically carried by the vehicles of international trade and investment should not be minimized. The challenge to national governments in general, and to their economic nationalism in particular, is to devise ways and means by which they can take advantage of the international interdependence in various ways without compromising their democratic accountability.

6. TOWARDS A POLICY FRAMEWORK

The drift of the preceding argument seems to be leading to a puzzle at first sight. How can the nation-state define a practicable economic role for itself in the global setting without rooting itself in narrow economic nationalism? Our central thesis leading to an answer lies in the recognition that an intelligent policy of shifting the balance globally, by relying more on the internal and less on the external market by all nations can become the guiding principle of macroeconomic policy without generating conflictive economic nationalism. The contemporary process of globalization, in so far as it is propelled by the multinational corporations, is shifting increasingly the balance in an opposite direction, from the internal to the external market. The nation-states are acting as passive or even complying agents in this process, with the result that economic nationalism is degenerating into mere competition among nation-states. Nation-states today help in setting up an international regime of trade, investment, finance and technology transfer in the name of globalization, more in the interest of multinational corporations who are accountable at best only to the narrow sectional interest of their managers and shareholders. It has been rightly pointed out in this context that the concept of competition applies to companies, not to nation-states. The most beneficial and important objective of competition is to enhance productivity. This very reasonable objective can be pursued independently of a competitive international trade policy. Because, an increase in productivity raises the general living standard, and the average per capita GDP with or without trade; because quantitatively trade plays a relatively inconsequential part in this (Krugman 1996). Only because of the competition among corporations that, we have come to the surprising view that even this reasonable objective of raising productivity is only a part of trade policy which is related to the external, but not to the internal market. And yet, increased productivity of one nation need not by any means imply decreased productivity of another. It is not a zero sum game, once taken out of the context of competition in international trade.

The extent of division of labour as a source of productivity growth, Adam Smith had observed, is limited by the size of the market. If the market is primarily the external market, increase in productivity can materialize mostly through conflictive economic nationalism, over international market shares in a zero sum game. However, if the market is internal, the nation-state has a paramount role to play in expanding the size rather than the share of the market, without necessarily generating conflictive forces of economic nationalism. It is from this perspective that the importance of demand management by the nation-state needs to be recognized again and the constraints on it re-examined. There are two types of constraints normally perceived on demand management—the fear of inflation, generated mostly by domestic capital—labour relations (e.g., 'natural rate' of unemployment, NAIRU etc.), and the fear of external payments imbalance that might deteriorate unmanageably into speculative capital flights on a massive scale (Section IV).

For a democratically accountable national government, the way to contain capital-labour distributive conflict as the main source of inflation cannot be to precipitate unemployment in the name of a 'natural rate' of unemployment. Expansionary fiscal policies aimed at increasing the internal market on the one hand, and raising labour productivity on the other, are still the valid ways to fight unemployment. Rising labour productivity which usually goes with expanding market and output also provides more room to accommodate the distributive conflict between labour and capital, as the size of the cake to share expands. An institutionalization of 'incomes policy' has a far greater chance of success in an expanding economy with rising labour productivity. In this sense, demand management focused on expanding internal market is a precondition for a less conflictive capital-labour relation. To emphasize the difference, one only has to contrast this with some recent corporate strategy of 'downsizing' of firms by shedding labour to raise labour productivity at the microlevel. It generally increases the market share of the successful corporation by reducing its unit cost, but tends to reduce the overall size of the market through a reduction in employment and purchasing power. And, if the size of the market is not reduced due to 'capturing external markets', the size of one nation's market is expanded only at the cost of another. Thus, increasing labour productivity through downsizing would tend to accentuate distributive conflict between capital and labour, and trade conflict among nations, precisely because its focus is on market share and the external market, rather than on the internal market. This cannot be the route which nation-states should follow either to raise labour productivity or to achieve a more harmonious process of globalization, as it would unleash forces of conflictive economic nationalism.

The ideal way to deal with the problem of external balance would have been to proceed along an International Clearing Union arrangement, by which all member states would accept the debt obligation of the Clearing Union ('banker', as the Keynes' Plan of 1942 called it). The logic is obvious—'No depositor in a local bank suffers because of balances, which he leaves idle, are used to finance the business of someone else' (UNO 1948; quoted from article 12 of the 'proposals by British experts for an International Clearing Union dated 18 April 1943). This implies symmetrical treatment of surplus and deficit nations. The proposal was unacceptable, not because its logic is faulty, but because it runs against narrow economic nationalism—the use of trade surplus and the privilege of the use of the national currency to dominate other nations. It must be pointed out also that, trying to institute an International Clearing Union is no more difficult in principle than trying to set up, say a world trade organization or complex rules for international protection of intellectual property rights. The real difference is the latter is in the interest of dominant nations and their corporations, the former is not.

Plans relating to wide ranging international financial reforms such as the International Clearing Union are not even on the current international political agenda for discussion. This raises two questions in turn whose practical relevance cannot be over-emphasized in the present context. First, are there other forms of international governance and policy coordination that might be more feasible in the foreseeable future? Second, without feasible agreements in the sphere of international governance in the near future, can the nation-state find a way to empower itself in a way which will enhance its democratic accountability to its people, especially the economically weaker and more vulnerable sections? These two questions are usually separately addressed, somewhat like the 'first-best', and the 'second-best' alternative. And yet, a main thrust of our economic policy perspective with its repeated emphasis on the importance of the internal market has been to question implicitly the usefulness of any such dichotomy. It does not seem particularly useful in actual decision-making to separate the 'best' alternative that might be achievable in the unforeseeable long run from the 'next-best' alternative that might be worth attempting in the foreseeable short run. We should look for ways by which policies pursued in the short run are not only compatible, but reinforce the process of change in favour of the longer-term objectives.

It has been the main thrust of our argument that for countries with sufficiently large size, a determined effort to manage their internal markets more effectively rather than leaving it to the forces of global capital, would be a way to empower their national governments politically in the eyes of their electorate, especially the economically weaker section of the electorate.

This implies, taking recourse to internal demand management to deal directly with problems like unemployment and business cycles in advanced industrial countries. It is also the main route to the re-empowerment of the welfare state. To the extent larger regional groupings such as free trade areas facilitate rather than hinder progress along this route, especially to overcome the problem of size, they are a step in the desirable direction. However, if regional groupings or unions impose rules whose main purpose is to strengthen currencies or to help corporate of business (like a bureaucratic limit to budget deficit or national debt) but restrict the ability of the nation-state in managing demand in the internal market, they should be considered counter-productive.

The problems are somewhat different in developing countries where issues like poverty, basic education and health care are naturally far more pressing. Yet, it is worth emphasizing that employment expansion through public works and the simultaneous creation of productive assets is the best way known to deal with these problems on a more sustained basis. Pure welfare programmes, however desirable, soon run into problems of resource constraints, unless the resource base can be expanded simultaneously through these programmes. Thus demand management, but with a view to productive employment creation, should also be a focus of policy formulation in developing countries.

The strain on the balance of payments of an individual country or a group of countries would tend to be lower, if policies of internal demand management could be internationally or at least regionally, coordinated, especially with respect to their timings. When all countries expand simultaneously to raise each other's demand for exports, the net effect on trade deficit and surpluses are likely to be smaller, even if they are unevenly distributed among countries. Similarly, simultaneous lowering of interest rates in support of expansionary monetary policies reduce the danger of capital flights from an individual country.

It should be recognized that proposals for international monetary reform along the lines of a Clearing Union assume even greater importance in a world without any coordination in international demand management. Because, the Clearing Union was essentially devised to allow countries to pursue unilaterally policies of demand management without hitting against the crippling constraint of the balance of payments. Although in an ideal world, one would like to see both a Clearing Union arrangement and coordination of demand management, fortunately international agreement or even debate, discussion and negotiations can begin separately on either front (e.g. in the United Nations). For instance in the absence of any international agreement or even debate on any Clearing Union-type arrangements, countries may be allowed to impose capital controls in the interest of demand management. At the same time attempts should be made to discourage international speculative foreign exchange transactions through schemes like the Tobin Tax (Tobin 1978) which is a variation on the 'government transfer tax on all transactions in the stock exchange' as suggested originally by Keynes (1936: 160). A first step in this direction will be for the IMF to recognize that capital or even current account convertibility is not an objective in itself. It needs to be suspended when it contradicts the more pressing requirement of demand management by the nation-state. Similarly, international negotiations may be initiated by the

IMF to permit 'stand-still' agreements between private international lenders and the nation-state in case of a speculative attack on its currency to provide more room for demand management and investment for development through the expansion of the internal market.

In the present intellectual climate of neoliberalism at the turn of the twentieth century, the policy framework and perspective in favour of which we argue may seem to run contrary to conventional wisdom. Yet, conventional wisdom usually reflects not the truth but the mood and the dominant interests of the time. A natural harmony between public and private interest was the earlier conventional wisdom. It was the very cornerstone of nineteenth century liberalism. Harmony between public and corporate interest in the name of globalization seems to have become the cornerstone of the late twentieth century neoliberalism. And yet, it is a contrived harmony, a harmony not meant to enhance the welfare of the people, but mostly to extend the global reach of the multinational corporations. It is time, this fact is faced by at least the democratically accountable nation-states, both for their own survival, and for the welfare of their ordinary citizens.

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