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Globalisation and the Development Agenda

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Globalisation has been heralded over the past quarter century as the gateway to an era of unprecedented prosperity for all world citizens. Its major instrument, economic liberalisation, was presented to the developing world as an alternative to inefficient trade protection and state intervention. In the 1980s and 1990s, the liberalisation agenda gained support in mainstream policymaking circles worldwide, under the active promotion of the IMF and the World Bank through their "structural conditionality", and came to be referred to as the Washington Consensus. In recent years, however, this "consensus" has met with growing criticism, as the promised land of high growth is increasingly seen as a mirage, while the international divergence of income levels and high financial volatility in both the developed and the developing world are increasingly seen as inevitable outcomes of the neo-liberal global order.

As a result of widespread discontent, there is a general call to "civilise" the global economy (Helleiner, 2000) to generate a more inclusive form of globalisation or, in the words of the United Nations Millennium Declaration, "to ensure that globalisation becomes a positive force for all the world's people" (United Nations, 2000). Unfortunately, however, this has led to limited action so far. In many ways, the neo-liberal globalised order continues to deepen, as countervailing processes proceed at a slow pace.

Unfortunately too, the terminology used in the debate has become increasingly obscure. There is much talk about the need to consolidate the "first generation" of reforms (the liberalisation agenda), supplemented

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with a "second generation" or even a "third generation" of reforms aimed at strengthening institutions,[1] equity and social safety nets. In addition, while there is basic agreement on the need for strong macroeconomic frameworks, openness to the international economy, participation by the private sector in the development process, a more efficient state, stronger institutions and active social policies, profound differences of opinion remain as to the exact meanings of all these terms.

The reform fetishism implicit in the concept of generations of reforms is an essential part of the problem since it assumes that development processes are linear and universal in nature. Thus, according to the first of these assumptions, the steps that have been taken during the early stages of the reform process must constitute the foundations upon which the additional parts of the building should be erected. This is surely an inappropriate framework when macroeconomic policies have led to pro-cyclical management practices that increase the risks faced by all economic agents, or when the structural reforms have led to adverse distributive effects. In these cases, the first generation of reforms cannot be trusted to serve as the foundation upon which additional parts of the building can be erected. Rather, the system itself needs to be reformed. It is necessary, to "reform the reforms" (ECLAC, 2000; Ffrench-Davis, 2000).

Against the second implicit assumption, that of universality, it can be argued that there is no single model of economic management that would guarantee macroeconomic stability, nor is there only one way of integrating into the international economy or of designing economic and social institutions. There is no such a thing as a single "market economy". In the terminology of Albert (1991) and Rodrik (1999, 2001), there are different "varieties of capitalism", as the experience of developed and developing countries alike indicates.

This chapter presents an alternative view of the development agenda, with a focus on Latin America. It explores, in a parallel fashion, the need for new global arrangements. It is divided in four sections. The first two look at global and Latin American facts. The third presents the broad strokes of a global agenda, which assigns a critical role to regional institutions. The fourth looks at national development strategies.

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[1] In this chapter, the concept of institutions is used in a more traditional and broader sense than it has had in the more recent literature, to include organisations (e.g. business firms, producer associations and government agencies) as well as policies, constitutional, legal and regulatory provisions, and intangible factors such as traditions and conventions.

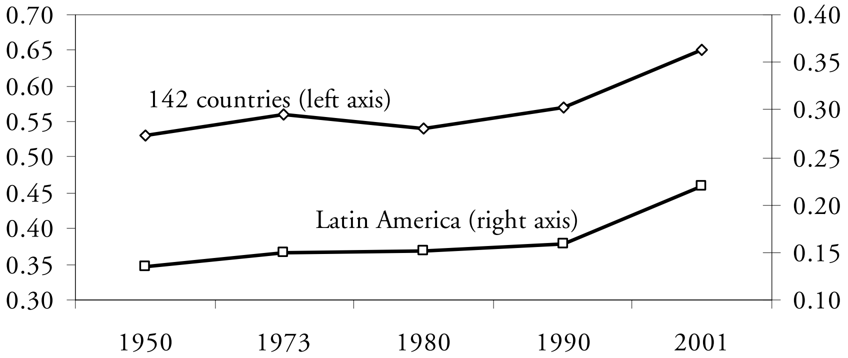
1 Global Historical Disparities

History demonstrates that international "convergence" in income levels, a typical prediction of many orthodox models of economic growth, has been the exception rather than the rule. The only strong case of convergence in per capita income levels occurred among developed countries during the "golden age" of the post-war period, 1950-1973 (Maddison, 1991). The process proceeded steadily until 1990, albeit at a slower pace, and came to a halt in the final decade of the twentieth century. The other historical period in which convergence occurred was the second half of the nineteenth century. O'Rourke and Williamson (1999) have demonstrated that during this period, the United States and Europe witnessed a convergence of wage levels, basically as a result of the mass migration of European labour to the New World. Within Western Europe, a process of wage equalisation also occurred, though it did not encompass countries of the European periphery. Hence, even within the group of now industrialised countries, there was a slight divergence in per capita GDP trends, and this divergence was even greater when a wider group of countries is included.

This subject has been examined thoroughly in the literature on economic growth in the last quarter century. In general, these analyses confirm that there has been a long-term *divergence* of per capita income levels over the past two centuries that was particularly rapid in the nineteenth and the first half of the twentieth centuries, slowed down in 1950-1973 and has renewed since then. Thus, using per capita GDP levels for the 141 countries included in Angus Maddison's historical series (Maddison, 2001), the mean log deviation increased from 0.56 in 1973 to 0.65 in 2001 (Figure 1). However, various studies also indicate that there is some, though not systematic, evidence of "conditional convergence" when other factors that influence the growth of countries are taken into account, including the educational level of the population, infrastructure, macroeconomic stability, and political, social and economic institutions. In light of the evidence of long-term divergence of per capita incomes, any conditional convergence may be read as implying that the factors which determine economic growth according to such analyses are distributed just as unequally as per capita GDP, or even more so. This casts significant doubts on the validity of the concept of "conditional convergence".

The trend towards an amplification of international inequalities in recent decades has been accompanied by a widespread increase in

Figure 1 Latin America: GDP and Aggregate Demand, 1950-2001
(annual growth rates, percentages)



Source: Author estimates based on Maddison (2001) and updates from that author.

inequalities within countries. According to a recent comprehensive analysis of this issue (Cornia, 2004, Part I), 48 out of 73 countries for which information is available experienced a deterioration of income distribution in the last decades of the twentieth century; this is concentrated in 87.5 percent of the population of the 73 countries.

On the contrary, only 9 countries, with 2.7 percent of the total population, lived in nations in which income distribution improved. The remainder lived in countries with stable levels of inequality or ones in which no clear trend could be identified (see Table 1). According to Cornia (2004), inequality tended to increase in most industrialised countries, in Central and Eastern Europe, and in Latin America. Several Asian countries, including China, have also shared in this trend. Only Africa has shown no clear trend of this type due to the opposite distributive trends experienced by different countries.

According to Cornia (2004), this widespread deterioration in income distribution contrasts with the experience of the 1950s and 1960s when several countries experienced the opposite pattern. The estimates by Bourguignon and Morrison (2002) indicate that the only previous period in which such a broad based deterioration in income distribution took place in the world was during the first phase of globalisation from the mid-nineteenth century to the First World War. During the reversal of globalisation that followed in the inter-war period, there was actually an important improvement in income distribution within countries, linked both to the emergence of the welfare state in Western Europe and the United States and to the socialist revolutions in Central and Eastern Europe.

Table 1 Changes in Income Inequality within Countries, 1960s to the 1990s

	Developed countries	Developing countries	Transition economies	Total
A. Number of countries				
Rising inequality	12	16	20	48
Constant	4	10	2	16
Falling inequality	2	7	0	9
Total	18	33	22	73
B. Percentage of population[a]				
Rising inequality	13.3%	66.7%	7.5%	87.5%
Constant	2.3%	7.3%	0.3%	9.8%
Falling inequality	1.8%	0.9%	0.0%	2.7%
Total	17.4%	74.8%	7.7%	100.0%

Note:
[a] Percentage of 73 countries population, that represent 78.5% of world population.
Source: Based on Cornia (2004), Table 2.8 and population data from the United Nations.

These two forces – the divergence of per capita income among countries and the deterioration of income distribution within countries – was counterbalanced at the global level in recent decades by the rapid growth of China and, to a lesser extent, India, the two largest low-income countries. Thus, estimates of the world distribution of income depend on the weight given to this factor and, thus, to the specific methodologies used to compare incomes across countries. Nonetheless, the majority of studies concludes that world income distribution tended to deteriorate in the last decades of the twentieth century,[2] though at a rate that was much slower than that which characterised the first phase of globalisation in the nineteenth and early twentieth centuries. In any case, it is hard to interpret the rapid growth of China and India as the result of the capacity of the global system to favourably redistribute world income.

Thus, convergence in income levels has occurred, but it has done so only among developed countries and only at specific stages in the

[2] Dikhanov and Ward (2001) come to this conclusion for the 1970-1999 period, Bourguignon and Morrisson (2002) for 1970-1992 when using a Theil index (the two other indexes calculated by these authors show no clear trend) and Milanovic (2002) for 1988-1993. The main study that comes to an opposite conclusion is Bhalla (2002).

evolution of the world economy. In Latin America, the stagnation at middle-income levels from 1870 to 1980 was followed by divergence in income levels vis-à-vis the United States in the last two decades of the twentieth century. Furthermore, within this pattern, there have been several experiences of "truncated convergence", such as Argentina after its period of rapid growth from 1880 to 1913, or Brazil and Mexico after their successful period of state-led industrialisation that went on for several decades until cut short by the debt crisis of the 1980s.

The strong renewal of the trend towards income divergence in recent decades also goes against the expectation that economic liberalisation would accelerate convergence by providing ample opportunities for developing countries. Thus, the attempt to draft simplistic links between economic liberalisation and growth has been misguided. The best stylised fact in this regard is that, although freer trade, capital market liberalisation and market incentives do matter, there are no single rules that can be applied to all countries at any point in time, nor to any single country in different time periods. This conclusion comes strongly from comparative analyses of development experiences (see, for example, Helleiner, 1994).

Mixed strategies, on the other hand, have proven optimal under many circumstances. Thus, successful growth of manufacturing exports in the developing world since the mid-1960s was, in general, preceded by periods of import-substitution industrialisation, and the very successful integration of the Asian newly industrialised countries into the world economy was matched by strong state intervention (see, for example, Chenery *et al.*, 1986). Interestingly, Bairoch (1993) came to similar views regarding the relations between protection and economic growth in the period prior to the First World War. He observed that the fastest periods of growth of world trade in those years were not those characterised by the most liberal trade regimes, which led him to conclude that the expansion of world trade resulted from economic growth, rather than the other way around.

The growth and persistence of large inequalities in the world economy make it useful to think of the latter as a system in which opportunities are unevenly distributed between the centre of the world economy and its periphery – or, perhaps more accurately, peripheries. Latin American structuralist thinkers suggested this centre–periphery analysis half a century ago (see, for example, the classic contributions by Prebisch, 1950), and their main thesis still remains valid. Indeed, the best simple manifestation of this fact is that, despite some changes, the world hierarchy of per capita GDP levels has been remarkably stable over the past century, as demonstrated by the fact that about 60 percent of current income disparities in the world can be simply explained by the same disparities existing in 1913. This is also reflected in other crucial features of the world economic order: the very high concentration of the generation of core technology in a few countries, and the equally high concentration there of world finance and the home headquarters of multinational firms.

The major implications of this finding are that while national economic, social and institutional factors obviously do matter, economic opportunities are largely determined by the position within the world hierarchy, indicating that climbing the international ladder is a rather difficult task. Essential international asymmetries help to explain why the international economy is an "unlevel playing field" (see section 3 below). Therefore, unless such asymmetries are systemically addressed, world inequalities would be maintained or may deepen through time.

This means, in turn, that economic development is not a question of going through "stages" within a uniform pattern associated to the rise in income per capita. Development is, rather, the result of structural transformations and the application of appropriate macroeconomic and financial strategies, within the constraints posed by a world hierarchical system and the domestic economic and socio-political institutions, which may be partly determined, in turn, by the particular modalities of insertion into the world economy. This is the essential insight of the Latin American structuralist school, as well as of the literature on "late industrialisation" since Gerschenkron (for a recent restatement, see Amsden, 2001).

2 Recent Latin American Frustrations[3]

In recent decades, Latin America has been a major – perhaps *the* major – showcase of economic liberalisation. The region undertook economic liberalisation with enthusiasm ("ownership") beginning in the mid-1980s (earlier in some countries) and pushed it further than other regions in the developing world. The frustrations with the results

[3] For an extended analysis of these issues, see ECLAC (2000, 2001a, 2001b and 2002), Ocampo and Martin (2003) and Ocampo (2004). For similar analysis relating to the developing countries as a whole, see UNCTAD (1997, 1999 and 2002).

should thus be taken as a serious demonstration of the weaknesses on which the liberalisation agenda was built.

On the positive side, substantial progress was made in controlling inflation. Also, on average (and contrary to widespread perceptions), budget deficits were brought under control in the second half of the 1980s and have remained moderate since then in most countries, though with a moderate slippage since the Asian crisis. Most importantly, the region clearly succeeded in boosting exports and becoming a magnet for FDI. Between 1990 and 2003, and even taking into account the strong slowdown of the early 2000s, the average annual increase in merchandise exports amounted to 7.8 percent in terms of volume, the fastest rate of growth in the region's history. Meanwhile, FDI flows to the region grew at an unprecedented rate too, increasing fivefold between 1990-1994 and 1997-2001; they have, however, experienced a sharp decline in 2002-2003.[4]

The region's success in increasing its share in world markets and attracting FDI has not been reflected, however, in rapid GDP growth. Indeed, the average growth rate in 1990-2003, of 2.6 percent a year, is less than half the record for the period of state-led industrialisation,[5] 1945-1980 (5.5 percent a year). Although there are many reasons – particularly the sweeping changes in the world economy – why it would be a major mistake to resume the policies typical of this earlier historical period, clearly the burden of proof is now on those who characterised state-led industrialisation as a major historical failure and liberalisation as the key to rapid growth. Even some supporters of economic liberalisation now regard the period of state-led industrialisation as a "golden age", and the growth rates achieved during that

[4] Integration into the world economy has followed three basic patterns. In the first, which has been exhibited primarily by Mexico but also by some countries of Central America and the Caribbean, countries joined in the vertical flows of trade in manufactures characteristic of internationally integrated production systems, concentrating their exports in the United States market. In the second, typical of South America, the countries belong to horizontal global production and marketing networks, chiefly for raw materials and natural-resource-based manufactures. This group is also characterised by highly diversified intra-regional trade and by a lower concentration of destination markets. The third pattern is based on the export of services, mainly for tourism, but also financial and transport services, and is the predominant pattern in some countries of the Caribbean and Panama.

[5] This term is preferred to the usual concept of import-substitution industrialisation, for reasons that are explained in Cárdenas, Ocampo and Thorp (2000).

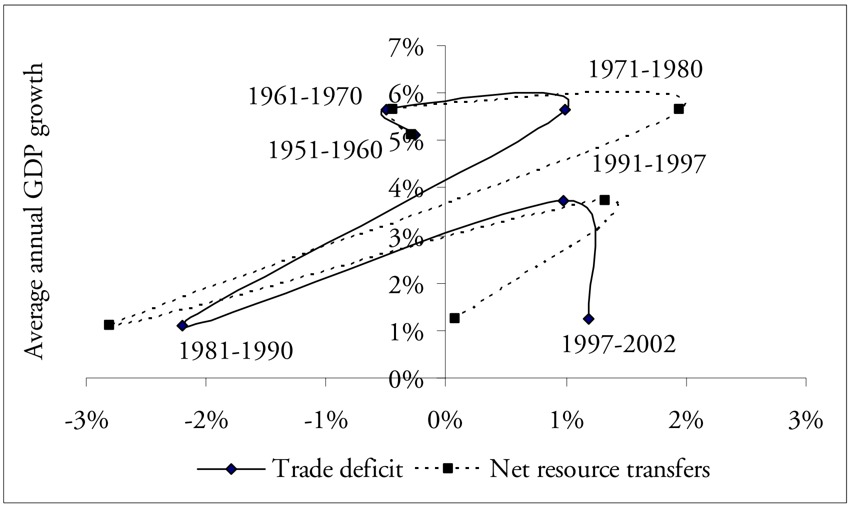
period as a goal for future Latin American performance (Kuczynski and Williamson, 2003, pp. 305 and 29).

A major counterpart of this result is the structural deterioration in the growth/trade balance trade-off, which is equivalent to a weakening of the link between GDP growth and external resource transfers. Figure 2 indicates that this link had already weakened in the 1970s vis-à-vis the 1950s and 1960s (dynamic growth continued only on the basis of a higher trade deficit and increasing resource transfers). It further deteriorated in 1990-1997 with respect to the 1970s (much lower growth was obtained with similar trade deficits and resource transfers) and, once again, in 1998-2002. This reflects a series of adverse trends in the productive structure: (i) a decline in import-substituting industries that has not been counterbalanced by the acceleration of export growth; (ii) the high demand, in dynamic sectors, for imported capital and intermediate goods (a trait of internationally integrated production systems) which, together with the previous factor, has reduced production linkages; and (iii) the weakening of the national innovation systems inherited from the preceding stage of development, as engineering functions and research and development (R&D) that used to be performed by local firms are being transferred out of the region. An opposing trend has been the rapid growth of connectivity, though its counterpart has been the emergence of "domestic digital divides" reflecting the very uneven access of different firms and social sectors to the new technologies.

As a result of these factors, the multiplier effect and the technological externalities generated by the high-growth activities associated with exports and FDI have been weak. Also, the dualism (or structural heterogeneity) characteristic of productive structures in Latin America has become even more marked: there are now many more "world-class" firms, most of which are subsidiaries of transnational corporations. However, at the same time, a growing proportion of employment is being concentrated in low-productivity informal-sector activities, which account for seven out of every ten new jobs created in Latin American urban areas over the past decade. In a sense, the new dynamic activities are "enclaves" of globalised production networks, which have so far proved incapable of inducing rapid overall economic growth.

The structural deterioration in the growth/trade balance trade-off has generated a strong sensitivity to external financing, which has been enhanced by financial liberalisation, pro-cyclical domestic financial systems and equally pro-cyclical macroeconomic policies.

Figure 2 Growth, Trade Balance and Resource Transfers

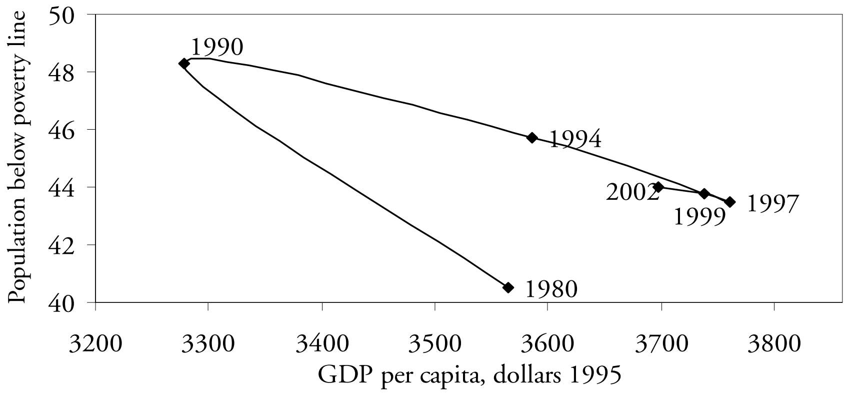


Source: Author estimates based on Maddison (2001) and updates from that author.

In the terms of Stiglitz (2003), the reform process replaced automatic stabilisers with automatic *de*stabilisers. As a result, economic growth has become increasingly sensitive to capital account volatility. Thus, the renewal of the net resource transfer in the early 1990s led to a recovery of economic growth, but capital account and other external shocks have interrupted growth three times in less than a decade (1995, 1998-1999 and 2001-2003). Overall, a period of fair economic growth in 1990-1997, of 3.7 percent a year (which was significantly below the record of 1945-1980, in any case), was followed by a "lost half-decade" – or, rather, a lost sexennial – in 1998-2003. During this recent period, per capita GDP has contracted for Latin America as a whole and for half the countries in the region. Furthermore, all patterns of rapid growth have been interrupted, including those of Chile and the Dominican Republic, the two most dynamic economies in Latin America in the 1990s.

Slow and volatile economic growth and adverse structural patterns have been reflected in weak labour markets. Employment generation has been particularly poor in South America. Rising informality, increasing income gaps between skilled and unskilled labour and, as already indicated, increasing dualism in productive structures are broader regional trends. A major reflection of this is the fact that the poverty/economic growth link experienced a structural deterioration in the 1990s, as Figure 3 indicates. Thus, poverty rates remained significantly higher in 1997 than they had been in 1980, even though the per

Figure 3 Poverty and Per Capita GDP



Source: ECLAC, Social Panorama of Latin America and Statistical Yearbook, various issues.

capita GDP decline that characterised the 1980s had already been reversed. With the further decline in average per capita incomes during the recent "lost half-decade", poverty rates have increased. In turn, this deterioration in the poverty/growth link reflects the fact that about half the countries in the region experienced a deterioration in income distribution during the 1990s, with only few of them experiencing the opposite pattern (ECLAC, 2001b; World Bank, 2004).[6]

These adverse trends defeated the positive effects of rising social spending, which rose from 10.1 percent of GDP in 1990-1991 to 13.8 percent in 2000-2001 – undoubtedly a major pay-off of the widespread return to democracy in the region. They also defeated some major innovations in social policy, particularly improved targeting. The continuous progress towards universal primary education has been accompanied by an increase in the coverage of secondary education (to an average of 70 percent in recent years). This progress notwithstanding, the education gap – in terms of both secondary and higher education coverage and educational attainment – separating Latin America from the developed economies and the emerging economies of Asia has widened. In an equally disturbing trend, the gap in secondary and higher education coverage separating high-income groups from low-income groups has tended to widen in many countries.

[6] Despite this general trend, the World Bank (2004) has argued that there has been an overall improvement in the regional income distribution due entirely to improvements in Brazil, a country that, according to ECLAC did not experience such positive trend.

Social security systems and social safety nets in the region have had to cope not only with the problems created by the segmented and insufficient coverage of the systems developed during state-led industrialisation, but also with the demands generated by population aging and the job and wage instability associated with recent development patterns. Increased levels of macro- and microeconomic risk have thus translated into greater social risks and greater demands for protection being made on underdeveloped social protection systems. Furthermore, in several cases, the principles of universality and solidarity that should characterise social protection systems have been put aside in social security reforms. This fact, together with adverse labour market trends, has been reflected in the frustratingly slow pace of progress in the coverage of these systems.

3 A More Balanced Global Order

3.1 The Basic Asymmetries of the International Economic Order

The strong divergence in the trends of per capita income across countries reflects basic asymmetries of the global order (Ocampo and Martin, 2003). These asymmetries fall into three basic categories. The first is associated with developing countries' greater macroeconomic vulnerability to external shocks, which also strain these countries' very limited means of coping with them. The net effect of this situation is that, whereas industrialised countries have greater manoeuvring room to adopt counter-cyclical policies and elicit a stabilising response from financial markets, the developing economies have almost no such room at all, since financial markets tend to accentuate cyclical variations, and market agents expect national authorities to behave pro-cyclically as well.

The second type of asymmetry is the extreme concentration of technical progress in developed countries. The spread of technical progress from the originating countries to the rest of the world has continued to be "slow and irregular", following Prebisch's half century-old verdict (Prebisch, 1950). This reflects prohibitive entry costs into technological dynamic activities, and even the constraints faced by developing countries in entering mature sectors, where opportunities for these countries are largely restricted to the attraction of multinationals that are already established in those sectors. In turn, the transfer of technology is subject to the payment of innovation rents, which are being afforded increasing protection by the international spread of intellectual property rights. The combined effect of all these factors explains why, at the world level, the production structure has continued to exhibit a high degree of concentration of technical progress in the industrialised countries, which thus maintain their predominant position in the fastest-growing branches of international trade and their hegemony in the formation of major transnational corporations.

A third asymmetry is associated with the contrast between the high degree of capital mobility and the limited international mobility of labour, especially among low-skilled workers. This asymmetry is a distinctive feature of the current stage of globalisation, since it was not observed in the nineteenth and early twentieth century (when all factors of production were highly mobile) or in the first quarter century following the Second World War (when all experienced limited mobility). This element is essential, as asymmetries in the mobility of production factors has a regressive impact, since it works to the benefit of the more mobile factors of production – capital and skilled labour – and to the detriment of the less mobile factors, such as unskilled labour (Rodrik, 1997).

Due to the strong trend towards inequality generated by global asymmetries, "levelling the playing field" through international rules is an inappropriate guide to reform. Attempts to apply the same measures to different situations may only serve to heighten existing inequalities. Thus, the principle of "common but differentiated responsibilities" enshrined in the Rio Declaration on Environment and Development, and the principle of "special and differential treatment" incorporated in the trade agenda, are more appropriate guidelines for building a more equitable global order than the "levelling of the playing field", which has guided efforts to revamp the international economic order in recent years.

This analysis establishes essential elements of international reform vis-à-vis developing countries (Ocampo and Martin, 2003). Correcting the first of these asymmetries implies that international financial institutions should adopt a comprehensive approach for reducing the segmentation and volatility of developing countries' access to international financial markets, and for providing them with more scope for actively using counter-cyclical macroeconomic policies. The latter include adequate surveillance during boom periods aimed at avoiding the accumulation of excessive macroeconomic and financial risks, as well as in adequate financing during crises, thus compensating for sudden stops in external financing. An additional, and equally essential, function is to counteract the concentration of credit at the global level through the provision of financing to those countries and agents that are subject to credit rationing in international private capital markets.

Correcting the second implies that the trading system should facilitate the smooth transfer of raw material production, technological mature industries and standardised services to developing countries, thus avoiding blocking of such transfer through protection or subsidies in the industrialised countries. It should also accelerate the access of developing countries to technology and guarantee developing countries' increasing participation in technology generation and in higher-technology branches of production.

To facilitate these processes, the trading system should give adequate room for the adoption of active domestic productive strategies in developing countries –"policy space", to use the terminology of the recent UNCTAD XI. In light of the problems that these countries currently face to guarantee a dynamic productive transformation, this implies "special and differential" treatment in several areas, but particularly in two critical ones: systems of protection of intellectual property rights that avoid increasing the costs of access to technology by developing countries or limiting the modalities through which the transfer is made, and the use of instruments to promote new export activities ("infant export industries"), which contribute both to the diversification of the export base and to the generation of additional value added in export activities. All of this requires the design of adequate instruments that avoid a sterile competition among countries for footloose industries.

Finally, overcoming the third asymmetry implies that labour migration should be fully included in the international agenda, both through a global agreement on migration policies as well as regional and subregional agreements. Such agreements should include, among others, mechanisms that facilitate migration (such as the recognition of educational achievements and labour market credentials, and the transferability of pension and other social security benefits), and promote the reduction in the costs of remittances.

3.2 Improved Governance Structures

There is now a broad consensus as to the decisive role played by national strategies and governance in determining how successful a country will be in forming strong links with the international community. However, without a suitable international framework, the inequality-generating forces spawned by international asymmetries will hinder national development.

The effort at building strong institutions for a better global order should be based on a network of world, regional and national institutions, rather than being limited to one or a few international institutions. Action at the regional and sub-regional levels plays a critical role as a midway point between the global and national orders for four main reasons: (i) the complementarities between global and regional institutions in a heterogeneous international community; (ii) the unequal size of the actors involved in global processes, which means that the countries' voices will be better heard if expressed as a regional voice; (iii) the greater sense of ownership of regional and sub-regional institutions; and (iv) the fact that the scope for effective economic policy autonomy has shifted in some areas (e.g. macroeconomic and regulatory policies) from the national arena to sub-regional or regional levels. Thus, a system that relies on networks of global and regional institutions is both more efficient and more balanced in terms of power relations.

In Latin America, regional institutions have played a stronger role than in other regions in the developing world. Nonetheless, Latin American integration has been subject to strong tensions in recent years, which can only be solved by a renewed political commitment to and a deepening of current integration processes. This means that beyond trade liberalisation and the design of common trade rules, there is a strong demand for macroeconomic and financial cooperation, harmonisation of regulatory regimes, complementary physical infrastructure, defence of regional commons, and a gradual advance in social and political integration.

Ultimately, however, international institutions would continue to rely on national responsibilities and policies, an essential characteristic of an international system where political processes continue to be built on nation-states. This is particularly valid in relation to the mechanism required to build social cohesion in the face of the strong domestic distributive tensions that characterise the working of the global economy. A basic corollary of this is that global institutions should be firmly respectful of national diversities. Furthermore, respect of diversity is the only principle that is consistent with the promotion of democracy at the world level. Indeed, promoting democracy as a universal value entails ensuring that national processes providing for representation and participation are allowed to influence the definition of economic and social development strategies and to mediate the tensions inherent in the globalisation process. This principle is embodied in the more recent thinking on cooperation for development, which emphasises that its effectiveness will depend on strong national policy "ownership" of the commitments made by developing countries.

It is convenient to recall, in this regard, that successful multilateralism under Bretton Woods was precisely based on a judicious mix of international rules and cooperation, which provided sufficient degrees of freedom for national authorities to pursue their growth and development goals. It was based on strong and effective national authorities, not on weak ones. In this light, the current mix of incomplete international arrangements and weakened national policy effectiveness must be seen as the most inappropriate of all possible mixes.

Lastly, steps taken to restructure the international order should also ensure the participation of developing countries on an equitable basis. Achieving this will require positive action in support of poor and small countries on the part of the international community, as well as requiring an effort on the part of those countries to organise themselves within the framework of regional and sub-regional institutions. Another implication of this principle is that preference should be given to institutional schemes having the largest possible number of active participants. Finally, the adoption of appropriate rules of governance is essential in ensuring the basic rights of developing countries – especially of the smaller ones – in the international order, institutionalising accountability and strengthening auditing functions carried out by institutions that enjoy credibility with all relevant actors. This approach involves placing limits on the power of the countries having the most influence over international institutions. However, this is not necessarily to their detriment, since it will also lead to a greater commitment by developing countries to the global institutional order.

4 National Strategies for Dealing with Globalisation

Any national development strategy in the global era must be founded upon solid social covenants that ensure political stability, non-discretionary legal systems and practices that provide security of contracts and an impartial, relatively efficient state bureaucracy. These broad institutional requirements, which have been correctly emphasised in the recent literature, are essential elements of an appropriate investment climate and, as such, may be regarded as necessary conditions for growth. However, neither of them accounts for the specific forces that drive economic growth, nor do they provide the means for dealing with old and new forms of vulnerability. Thus, the strategies adopted by the developing countries should incorporate at least four additional elements: (i) macroeconomic policies designed to reduce external vulnerability and facilitate productive investment; (ii) active productive development strategies aimed at building systemic competitiveness; (iii) highly active social policies, particularly in the fields of education, employment and social protection; and (iv) specific institutions that generate an appropriate balance between the public and the private interest. There are no universally valid models in any of these areas, and there is, consequently, a great deal of scope for institutional learning and, most importantly, for the exercise of democracy.

4.1 A Broad View of Macroeconomic Stability and the Role of Counter-Cyclical Policies

The consistency that ought to characterise macroeconomic policies should be based on a broad definition of stability that recognises that there is no single correlation between its alternative dimensions and, thus, that significant trade-offs may be involved. Two lessons are particularly important in this regard. The first is that real instability is costly – at least as costly as high inflation and external imbalances. Recessions entail a significant loss of resources that may have long-run effects: firms may sustain irreparable losses of both tangible and intangible assets, and the human capital of the unemployed and the underemployed may be permanently lost. In turn, the uncertainty associated with variability in growth rates encourages "defensive" microeconomic strategies rather than the "offensive" ones that lead to high investment rates and rapid technical change. Volatile growth leads to a high average rate of underutilisation of production capacity, reducing productivity and profits and adversely affecting investment and, thus, long-run growth (Ffrench-Davis, 2000).

The second lesson is that private sector deficits are just as costly as public sector deficits and that risky balance sheets may be as damaging as flow imbalances. When crises lead to a financial meltdown, the associated costs are extremely high. Asset losses may wipe out years of capital accumulation. The socialisation of losses may be the only way to avoid a systemic crisis, but this will affect future fiscal (or quasi-fiscal) performance. Restoring confidence in the financial system takes time, and the financial sector itself becomes risk-averse, a feature that undermines its ability to perform its primary economic functions.

These two lessons are interconnected, as financial boom-bust cycles have become the predominant source of business cycles in the developing world, particularly in emerging economies. The essential task of macroeconomic policy is thus to manage them with appropriate counter-cyclical tools. In particular, managing volatility requires a combination of three policy packages, whose relative importance will vary depending on the structural characteristics and the macroeconomic policy tradition of each country. The first is consistent and flexible macroeconomic policies aimed at preventing public or private agents from accumulating excessive levels of debt and at forestalling imbalances in key macroeconomic prices. The second is a system of strict prudential regulation and supervision, which should be tightened during periods of financial euphoria to counter the mounting risks incurred by financial intermediaries. The third element is liability policies aimed at ensuring that appropriate maturity profiles are maintained with respect to domestic and external public and private sector obligations (Ocampo, 2002b).

Managing counter-cyclical macroeconomic policies is no easy task, as financial markets generate strong incentives for developing countries to overspend during periods of financial euphoria and to overadjust during crises. Moreover, globalisation places objective limits on national autonomy and exacts a high cost for any loss of credibility when national policy instruments are poorly administered. For this reason, it may be necessary to rely on institutions and policy instruments that help to provide credibility, including fiscal stabilisation funds and a clear separation of fiscal and monetary policy management (which may take the form of, but does not necessarily imply central bank independence). The explicit renunciation of policy autonomy (e.g. by adopting a foreign currency) is hardly a solution to this dilemma. Recent events – the Argentine crisis, in particular – leave no doubt as to the fact that macroeconomic authorities' credibility can be strengthened more effectively through prudently managed flexibility than through the adoption of overly rigid rules.

In the long run, economic growth hinges on a combination of sound fiscal systems that provide the necessary resources for the public sector to do its job, a competitive exchange rate, moderate real interest rates and deep financial markets. Macroeconomic policy should be focused on ensuring the first three elements. The objective of financial deepening is to provide suitably priced investment finance with sufficiently long maturities. The liberalisation of financial systems in Latin America has not deepened financial markets or reduced the region's high intermediation costs as much as expected. Consequently, the public sector still has an important role to play in furnishing financial services and promoting the emergence of new agents and segments in capital markets. Meanwhile, efforts to increase public sector saving, the creation of corporate savings incentives and special mechanisms to foster household saving (for retirement, in particular) may be useful means of raising national savings rates.

4.2 Macroeconomic Policies Are Not Enough: The Role of Productive Development Strategies

The idea that the combination of open economies and stable macroeconomics – in the limited sense in which this term has come to be used, i.e. fiscal balances and low inflation – would be sufficient to spur rapid economic growth has not been borne out so far. This has sparked an unresolved debate concerning the underlying reasons for this result. The orthodox interpretation is that markets have not been sufficiently liberalised. This view is contradicted by the longest-lasting episodes of rapid growth in the developing world (i.e. the East Asian or, most recently, the Chinese and Indian "miracles" or, in the past, the periods of rapid growth in Brazil or Mexico), all of which involved a mix of "local heresies" with more orthodox policy prescriptions (Rodrik, 1999; Amsden, 2001). Alternative interpretations emphasise the role of market failures, particularly in the functioning of capital and technology markets, as the explanation for slow growth. Again, this line of reasoning must explain why rapid growth was possible in the past in many developing countries that faced constraints on this account.

A more promising line of reasoning draws upon the different historical variants of structuralism in economic thinking. This view emphasises the fact that economic growth involves a constant transformation of production structures. This process is not an automatic result of a strong macroeconomic performance, nor does it come about in an automatic, harmonious fashion, since the expansion of new sectors involves the accumulation of technological capabilities, and the creation of complementary set of activities and commercial networks, all of which involve learning process and coordination costs (Chang, 1994; Ocampo, 2002a). The transformation of production structures must therefore be an explicit priority of any development strategy. Its core objectives in an open environment such as that characterising the Latin American economies today should be building systemic competitiveness based on three fundamental pillars: (i) the creation of innovation systems to speed up the accumulation of technological capacities; (ii) support for new productive activities and the formation of production linkages; and (iii) the provision of quality infrastructure services. The role of deep financial markets has already been emphasised as an essential complement to an appropriate macroeconomic environment.

This interpretation brings forth a central feature of successful development experiences in the past: a strong industrialisation drive built on solid state/business sector partnerships. On the opposite side, the recent experience of Latin America and some other regions of the developing world indicates that opening markets with "neutral" incentives, arms-length government-business relations and multilateral (Uruguay Round) constraints on traditional development instruments do not provide an adequate substitute for active productive development strategies.

Because of the key role of knowledge, any such strategy must be based on increased public and private investment in education, vocational and business training, and science and technology. The strategy should be implemented through many different forms of collaboration between the state and the private sector, all of which should focus on creating dynamic innovation systems. In view of the intrinsic importance and crosscutting nature of new information and communication technologies, efforts to promote their active use are of vital importance in contemporary innovation systems.

Given existing Latin American conditions, the strategy for diversifying production has three clear-cut priorities: export diversification; broadening the linkages between domestic production and activities catering to the international market; and the integration of small and medium enterprises into production for the international market. Given the strong processes of "creative destruction" characteristic of modern economies, these actions should be matched by explicit policies aimed at restructuring non-competitive activities.

The other core element of systemic competitiveness is the provision of quality infrastructure services. In a number of countries, various public-private partnerships have succeeded in making significant progress in this regard, particularly in telecommunications, port services and maritime transport, and – to a lesser extent and with wider differences across countries – in energy services (electricity and gas). More difficulties have been encountered in bringing about substantial improvements in overland transport infrastructure, filling regulatory gaps in the provision of the corresponding services and increasing the efficiency of state enterprises in areas where the state continues to furnish services directly.

The effective incorporation of the sustainable development agenda places additional demands on production strategies today and, in particular, for the mobilisation of investment in dynamic production sectors that use clean production methods and technologies and achieve competitiveness through the accumulation of capital in the broad sense

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of the term (i.e. human, social, physical and natural capital). The creation of markets for environmental services is the most promising idea in this realm, as it simultaneously generates the economic incentives and the financing required for adopting new technologies.

Progress on all these fronts requires innovative public-private partnerships based on shared strategic visions. An active learning process would necessarily generate different mixes of private and public sector involvement and of horizontal and selective instruments. In any case, these instruments should include a clear link between incentives and results.

4.3 Improved Social Linkages

Social progress may be thought of as the result of three basic factors: a long-term social policy aimed at improving equity and guaranteeing inclusion; economic growth that generates adequate quantities of quality employment and opportunities for small firms; and the reduction of the productivity gaps (dualism) between different economic activities and economic agents. Globalisation has increased tensions in all of these realms, as it has biased the demand for labour towards high skills, generated new tensions between competitiveness and employment, increased dualism in productive structures and created new social risks. Given these tensions, social strategies should focus on three critical areas: education, employment and promotion of small business, and social protection.

Advances in these areas build upon one another. Education is the primary means of halting the inter-generational reproduction of poverty and inequality. It has become all the more important because globalisation has increased the need for human resources capable of engaging in new modes of production, competition and harmonious coexistence. Employment is a key factor in social integration by virtue of its importance in terms of social fulfilment and as a determinant of individuals' opportunities for consumption. As small firms are generating most employment, the environment in which those firms operate has become a major determinant of the quality of employment. The risks faced by the population include those associated with macroeconomic volatility, the adaptation to new technologies and ways of organising work, and reduced employment in many sectors.

In the area of education, efforts should focus on achieving universal coverage, preferably up to the end of secondary school, and on reducing differences in the quality of the education provided to different socio-economic groups. New approaches to learning are also required, involving access to knowledge, networking and the use of information and communications technologies. The modernisation of educational tools is not enough, however. In conjunction with these new tools, it is even more important to develop higher cognitive functions by orienting the learning process towards problem-identification and problem solving, an increased capacity for reflection, creativity, the ability to distinguish between what is relevant and what is not, and planning and research skills, since these functions are vital in an information-saturated world.

Job creation by proactive labour policies is only sustainable when the economic activities concerned are competitive in the long term. The retooling of production activities and increased labour mobility make it necessary to implement aggressive labour training policies that will give workers opportunities to learn how to adapt to new conditions. On the other hand, the central role of small firms (including micro enterprises) and the increasing dualism that characterise productive structures emphasise the need for special policies aimed at guaranteeing the access of these firms to technology, capital and managerial abilities and, as noted in the previous section, at clustering their activities and encouraging their links with larger firms. In addition, labour ministries should adopt policies that help foster self-regulation by social actors (social dialogue) and that devote special attention to the workers who have not gained entry to modern sectors (unemployed and informal-sector workers). To these ends, these ministries' role as policy-setting bodies should be restored.

The development of social protection systems should be guided by the principles of universality, solidarity, efficiency and integrality. Progress cannot be made towards universality unless the sharp inequities in access to services and in their quality are corrected. Solidarity should be ensured through a combination of compulsory contributions, public transfers, and cross-subsidies between different income strata and risk groups. Latin American countries faced enormous demands in this area, as the chronic shortcomings in the coverage of traditional risks are now mixed with the additional burden generated by the new risks associated to the vulnerability in employment and income. Furthermore, the extent of unemployment and, particularly, informal-sector employment limit the feasibility of attaining universal coverage by means of the traditional forms of social protection. Accordingly, emphasis should be placed on complementary insurance mechanisms that are in keeping with the wide range of employment arrangements in use today. These types of arrangements should be designed to promote labour mobility and provide protection against both external and domestic shocks.

The huge disparities in income distribution that characterise the Latin American countries generate considerable demands on social policies. Cross-country evidence indicates that such disparities may have become an essential obstacle to economic growth. This indicates that active social policies are, in a very direct sense, a productive investment. Nonetheless, these policies face the constraints posed by low tax revenues in most countries of the region, as well as traditional high demand on social spending by middle-income groups. Considerable political effort must thus be focused on guaranteeing a fiscal covenant that satisfies the multiple demands that social policy faces in the region, but it is hard to think of any solution that does not involve high tax revenues with a progressive component.

4.4 An Appropriate Balance Between the Public and the Private Interest

Given the tensions that characterise the contemporary world, a new balance between the market and the public interest is an essential component of institution building. This should not be viewed as running counter to the operation of the market. Actions that ensure an adequate supply of public and merit goods, exploit positive and avoid negative externalities among agents, and ensure an equitable distribution of the benefits of development, can serve as market enhancers.

The concept of "public policy" should be understood in a broad sense, as any organised form of action aimed at achieving objectives of collective interest, rather than as a synonym for government actions. This definition of "public" is in keeping with an awareness of the need to open up opportunities for participation by civil society. It is also consistent with the need to overcome a crisis of the state that characterises many countries, and to correct both "market failures" as much as "government failures". This approach emphasises the importance of attaining a high "institutional density" in which a wide range of social actors participate actively, and are accountable to the citizenry – i.e. a high "democratic density".

Institution building, in this sense, recognises that development comprises broad goals, an idea that is implicit in the concepts of sustainable human development or the more recent concept of "development as freedom" (Sen, 1999). These concepts are obviously expressions of longstanding and deeply rooted notions in development thinking. Its major implication is that the economic system must be subordinated to broader social objectives (Polanyi, 1957). This is the only way to confront the strong centrifugal forces that characterise private affairs today. Indeed, in many parts of the developing (and industrialised) world, people are losing their sense of belonging to society, their identification with collective goals and their awareness of the need to develop ties of solidarity. This fact drives home how important it is to foster those bonds in order to "create society". In other words, it means that all sectors of society need to participate more actively in democratic political institutions and that a wide range of mechanisms need to be developed within civil society itself to strengthen relationships of social solidarity and responsibility and, above all, to consolidate a culture based on the sense of a collective identity and a tolerance for diversity.

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