



15 Globalization and Development

A Re-examination of Development Policy

15.1 INTRODUCTION

The nature of policymaking in developing countries has been undergoing a sea change in recent times. This is due in part to the increasing maturity of the discipline of development economics and in part to the changing nature of the global economy. Development economics has advanced rapidly on both the theoretical and empirical fronts. Better interaction with mainstream economic theory, and the increasing availability of data sets that enable us to analyse aspects of the economy that were previously beyond scrutiny, have deeply influenced the study of development. As far as the real world goes, technological advancement and globalization have had a huge impact on the nature of policy-making in developing countries and, more generally, policy-making for development.

This chapter not only investigates the changing face of development policy, but also goes further by raising new analytical issues and urging action in areas that have thus far seen little policy action. The two main themes are labour market policies in a globalizing world and the scope for policy intervention to curb poverty and inequality in a world with increasing mobility of capital and professional labour.

The former has been the subject of very good analysis and heated debate in various fora, such as the ILO and the WTO, so the aim here is to shed some new light with the help of modern theory. Although the problem of inequality and poverty in the context of globalization has been studied, there is still scope for good analysis. This chapter does some spade work on the subject.

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15.2 THE CHANGING GLOBAL SCENARIO

This section discusses the global backdrop against which the subsequent analysis of development policy will be conducted.

15.2.1. Colonizing the Future

Two remarkable developments from the point of view of real-world economics are the recent advances in information technology and globalization. The best historical equivalent to the rise of the information technology (IT) industry was the invention of the wheel in about 3500 BC in Mesopotamia where depictions of the wheel on clay have been discovered and dated at just after that time. While the wheel is at times useful as an end in itself—in fact there is evidence that soon after its invention there were ancillary inventions of toys and games in which the wheel was the central feature—its main value is that it raises the productivity of other activities. Likewise while computers and other IT innovations can serve as ends in themselves, their main advantage is that they facilitate other activities, be it trade, communication, or the simulation of nuclear bombs. The IT industry is currently one of the most profitable industries in the world and will probably remain so for some time. But it is conceivable that eventually it will be just one more industry, its value to the world being that it has made virtually all other industries more efficient and profitable.

Globalization is a close concomitant of the IT industry. It has been facilitated by the cheap and easy modes of communication and trade made possible by the rise of the IT industry. The two main components of globalization are international trade and global capital flows. Both these have grown rapidly. Tables 15.1 and 15.2 provide an overview of the historical trends.

Table 15.1: Merchandise Exports as Percentage of GDP, 1870–1995

	1870	1913	1950	1995
Western Europe	8.8	14.1	8.7	35.8
Asia	1.7	3.4	4.2	12.6
Latin America	9.7	9.0	6.0	9.7
Africa	5.8	20.0	15.1	14.8
World	4.6	7.9	5.5	17.2

Source: Maddison (2001).

Table 15.2: Value of Foreign Capital Stock in Developing Countries, 1870–1998

	1870	1914	1950	1998
Total (\$ billion in 1990 prices)	40.1	235.4	63.2	3030.7
Stock as percentage of GDP	8.6	32.4	4.4	21.7

Source: Maddison (2001).

It is evident that the period between the two World Wars marked a retreat from globalization, but barring this period of aberration the movement has been forward. Exports as a percentage of gross domestic product (GDP), taken as the

average of all countries of the world, rose from 4.6 per cent in 1870 to 17.2 per cent in 1998, with a brief reversal between 1914 and 1950. The same is true of the value of foreign capital stock, both on its own and as a percentage of GDP. Today, however, foreign capital stock as a percentage of GDP is below the level in 1914, but two factors make this less significant than it appears to be. From 1914 to 1998, world GDP experienced enormous growth, so it is not surprising that the stock of foreign capital lagged behind in relative terms, despite its own immense growth. In fact the total stock of foreign capital in all countries in 1998 stood at an astonishing \$3030 billion, which was far higher than ever before. Second, it seems reasonable to presume that, until the early twentieth century, most of the foreign capital flows were from the imperial powers to their respective colonies. In those days it was necessary to establish political control before sending one's money somewhere. Now that this is no longer necessary the world has become much more of a market place. Of course, investing countries still use subtle forms of political control and checks on recipient countries, but that is very different from the control of a colony. One of the main features of globalization is the ability to invest in distant countries with little direct control.

These trends have continued in recent years, as is illustrated in Table 15.3. In the ten-year period covered in the table, all regions saw a rise in capital flows, the overall average rise being approximately 50 per cent. Trade in goods as a percentage of GDP also rose substantially in all regions.

Table 15.3: Globalization Indicators, 1989–99

	<i>Trade in goods as a percentage of goods GDP¹</i>		<i>Gross private capital flows² as a percentage of PPP GDP</i>	
	1989	1999	1989	1999
Low-income countries	41.3	60.0	0.8	1.2
Middle-income countries	69.0	81.5	1.9	4.9
High-income countries	93.5	123.5	2.1	4.9
South Asia	25.6	38.1	0.3	0.6
Sub-Saharan Africa	78.1	95.6	2.1	4.9
Latin America and Caribbean	49.8	74.6	2.2	7.3

Notes: ¹ Excludes services.

² The sum of the capital that flowed into and out of the countries.

Source: World Bank (2001).

Of course, not all regions have merged with the global markets and financial economy with equal rapidity. The fast integration has occurred in most of Asia and parts of Latin America (Kohsaka 2002); Africa has also done well as a percentage of its own GDP. Also, the composition of capital has changed, with a sharper increase in foreign direct investment and portfolio investment than in bank credit and loans. For some countries, such as India, the dominant form of capital market integration has been the flow of foreign capital into the stock markets.

While political instability or war can reverse the trend, it seems reasonable to conclude that the process of globalization, after a period of vacillation caused by

the shock of the two world wars, is firmly on course. Ideas, goods, and money now flow almost instantaneously between distant countries and cities. One implication of this is that inventions spread rapidly, generating interest in faraway places and facilitating further inventions. A ten-year old computer now looks ancient, it seems hard to believe that 10 years ago email did not exist.

Contrast this with innovations in the design of the wheel. Initially (that is, around 3500 BC) it was made of solid disks. It took 1500 years for human beings to realize that it would be more efficient to carve the disk into a ring stretched by spokes. This made it lighter and better able to absorb shocks. It then took another 1400 years to realize that roller bearings would minimize friction and enable the wheel to turn more easily. Not only did inventions occur at great intervals, but ideas took a very long time to spread from one region to another. The Mayans built some of the world's most magnificent stone pyramids but were unaware of the machinery or wheeled vehicles that would have made their work considerably easier.

All these processes went on for hundreds and even thousands of years. The pace has picked up astonishingly in the past few decades, thus changing the nature of the global game faster than most of us can comprehend, creating new opportunities and new tensions, and rapidly altering the efficacy of policy instruments.

In today's world, the struggle is no longer to colonize and control new lands but to 'colonize the future', that is, to lay claims on tomorrow's output (Basu 2000a). Two factors have made this feasible: the ability to take out patents and copyrights and enforce them, and the widespread availability of stocks, shares, and other financial assets. The colonizers of today try to secure a large number of patents and hold huge amounts of shares. When tomorrow comes and the output emerges from factories and offices, part of this output will already have claimants from today (those holding patents and those holding shares) and the remainder will be there to be split between the providers of tomorrow's inputs—labour, raw materials, and so on.

It is worth noting that this colonization of the future is not happening equitably across countries. In 1995, for instance, 235,440 patent applications were filed in the United States, whereas in some of the poorer countries fewer than 100 applications were filed. Hence, the global inequalities of today are likely to be reinforced tomorrow.

15.2.2 Erosion of Global Democracy

Another aspect of globalization and the rise of modern technology is that it has a tendency to erode global democracy. To understand this, observe that it is much easier today for one country to interfere in the affairs of another. In ancient times to influence the policy of another nation, the only option would be to muster an army or sail the high seas to attack. Today, not only have military actions become much more arms-length and effective,¹ but a variety of economic reprisals are possible by the click of a mouse. Of course, coordinating these economic actions is not always easy, because it may involve the participation of firms and corporations that in principle are free agents. Nevertheless, countries have successfully used the threat of cessation of trade or the withholding of capital flows to

influence policy. For example, the US Helms-Burton Act has been used to apply pressure on Cuba not only by curbing US business and trade with that country but also by threatening to cut off business with countries that trade with and invest in it. For instance, the Act has been used to dissuade Mexicans, Italians, and Canadians from doing business with Cuba, which is something they would not have contemplated of their own accord.

Now, if we use a rudimentary definition of democracy, namely, a political system where ordinary citizens have the ability to influence the choice of leaders who influence their lives by exercising their vote, it should be immediately transparent that globalization has a tendency to erode democracy.

Even though it is not possible for people in one country to influence events in another through the democratic electoral process, the leaders of some countries have developed more and more instruments to influence the lives of people elsewhere in the world (a definitional implication of globalization), with a consequent diminution of global democracy (Basu 2002a). This phenomenon has major political and economic implications and calls for thought and institutional innovation.

15.2.3 Globalization and Marginalization

While, on the whole, globalization creates more opportunities than it destroys, it can have the negative effect of marginalizing some people. If this is left unchecked it could lead to political instability and social decay. Not only are marginalization and the consequent rise in poverty undesirable in themselves, but we now have the ability to deal with them effectively. We are at a point in history where it is possible to talk—without inviting the label of idealistic crank—of rooting out poverty from the world altogether. And unlike smallpox there will be no need to keep a small supply of the germs of poverty in stock to counter possible terrorist attacks.

To understand how globalization can lead to marginalization, consider a poor person in a Third World nation, say, India whose livelihood is off-shore fishing. If India were to modernize and become more integrated into the world economy, it might well be that technologically advanced fishing companies would go out to the high seas and bring in larger catches than ever before. The exportation of these catches would make India better off as a whole, but it could diminish the available stock of fish closer to the coast line, resulting in smaller catches by the poor fisherman thereby leaving him worse off. This is an obvious 'resource route' which can result in some people getting marginalized and made worse off by the processes of technological advancement and globalization.

But there is another, more complex, route. Suppose now that the fisherman catches all his fish from a lake. He consumes some of the fish and sells the remainder on the market, which enables him to buy other essentials such as salt, sugar, other foods, and clothing (no one in today's world is totally self-sufficient). At first sight, it may appear that the activities of the deep-sea fishing companies would have no effect on his standard of living, but this is actually unlikely. It is entirely possible that the larger hauls of ocean fish would cause the price of all fish to drop. Hence the fisherman would receive less money for his fish and could buy

fewer essentials.² Hence he would become poorer even though the resources to which he had access remained unchanged. The extent of such 'market-route' marginalization could be very significant, but as economists and statisticians have shown little awareness of the phenomenon, no data is available.

Together, the market and resource routes could create very large constituencies of losers in the globalization process. Apart from its innate unfairness, this could cause large-scale disillusionment, dissent, and ultimately political instability. It is arguable that some of the myriad forms of global dissent that we are seeing today, ranging from terrorism to roadside protests, have their roots in such marginalization. To describe this as a cause of today's global dissent is not to deny that there may be other causes. Economists and social scientists tend to concentrate overly on the proximate causes of global dissent, not realizing that unless the deeper underlying causes are recognized and dealt with we shall perennially be putting out little fires.

Markets can be very good instruments for generating greater productivity and efficiency but they do not have an in-built mechanism to ensure better distribution of the fruits of progress. Hence it is essential to establish institutions to improve the distribution of goods and services and to obliterate poverty.

With this global scenario as back-drop I shall now consider some concrete themes in development policy. The focus will not be just on developing countries but also on the poorest sections of these countries, particularly in terms of the well-being of workers and inequality in general.

15.3 LABOUR MARKET POLICY

Labour market policy is important both because it can influence the performance of the whole economy and because workers are typically the poorest constituents of the economy³ and therefore deserve special attention. Moreover, this is the area in which globalization has changed the terms of debate more dramatically than anywhere else.

Labour markets have always been more closed than the market for goods and services. For reasons mired in politics and sociology, people have generally preferred to stay where they have been born and raised and where they have their cultural roots, which means that the economic incentive for moving had to be substantial for those who decide to migrate. Moreover, nations have tended to erect barriers against immigration that are more formidable than those erected to curtail the importing of goods and services. Hence labour markets are one area in which countries have felt relatively free to have their own laws and regulations, designed according to their own tastes, politics, and cultural prerogatives. Of course, through the import and export of goods, which are ultimately made by labourers, this freedom had its limits. But what has happened in recent times is that this freedom to craft one's own laws has been more severely curbed by the global mobility of capital. Even if workers from country *x* cannot move to the factories of country *y*, globally mobile capital means that the factories of country *y* can now come to the workers of country *x*.

This *de facto* labour mobility has two implications. First, when a developing

country now drafts a new law for its workers, for instance to enhance some workplace right, it has to be sure that this will not drive capital away to another country. Hence countries' legislative freedom is much more limited in today's globalized world.⁴ Second, this *de facto* labour mobility means that industrialized countries are now paying greater attention to working conditions and the labour market in developing countries. This is based on the fear, often misplaced, that the outward flow of capital will result in a loss of jobs in industrialized countries. Child labour is a matter of moral concern to most people, but opposition to it can be used as an instrument of protectionism. In effect, the blending of economics and politics is making the crafting of labour market policy a much contested and intricate matter. To illustrate these points I shall construct a simple model of statutory working hours.

15.3.1 Statutory Limit on Working Hours and International Labour Standards

Statutory limits on working hours is an old topic. It was hotly debated in the United States in the nineteenth and twentieth centuries and in Britain during the industrial revolution, when it was routine for workers and even child labourers to work for fourteen hours a day. As early as 1825, skilled workers in Boston were unionizing and holding strikes to have their working day limited to ten hours. In 1842, the Ten Hour Republican Association distributed campaign leaflets for a statutory limit on working hours and the movement soon gained considerable momentum (Murphy 1992).

The standard argument against a statutory limit proceeded by appealing to the Pareto principle. If a worker voluntarily accepts a work offer that entails fourteen hours of work a day, then, while this may seem unbearably long to us, it must be the case that the money earned by the worker more than compensates him for the hard work. And since the employer makes the offer voluntarily, (s)he must be gaining from this as well. It seems we have a Pareto-improving deal here, so why should we object, especially if the agents involved are adults and therefore able to judge what is in their own best interests? So widely accepted was this argument that, when the first Factories Act came into force in Britain in 1802, it was still impossible to set limits on working hours for adult males, who were supposed to know what was in their own best interests. So the Factories Act of 1802, displaying a rare gender bias which probably helped rather than hurt women, set limits on the number of hours that women and children could work. The limit was twelve hours within the time range of 6 am and 9 pm. An upper limit of twelve hours today would be seen as enabling employers to extract an unreasonable amount of work from individuals, but in the early nineteenth century there were those who worried that the new interventionist Factories Act would encourage sloth in the working class and hurt Britain *vis-à-vis* its trading partners.

The general question of whether all voluntary contracts among adults should be allowed without government intervention has been a hotly debated subject, going back to at least John Stuart Mill's classic works of 1848 and 1856.⁵ I shall here pursue a line that contests this by recognizing the possibility of multiple

equilibria, which is an important feature of developing countries (Hoff and Stiglitz 2001).

Consider a very poor country where many people's incomes are close to the subsistence level. In such an economy, workers' job decisions will reflect their concern for survival. A simple way to model this is to think of workers making their job decision in the way that workers do in developed countries but with an additional eye to subsistence or survival. If their incomes tend to fall below the subsistence level they will work as much as is feasible to ensure that they stay above subsistence. This can be captured by specifying the workers' utility function as follows:

$$U(x, 1 - e) = \begin{cases} x - u(e), & \text{if } x \geq s \\ x - u(1), & \text{if } (x < s), \end{cases} \quad (15.1)$$

where x is the amount of consumption by the workers, e is the amount of work done by them, and s is the subsistence level of consumption. As usual we shall assume that the cost of work, $u(e)$, increases with the amount of work and at an increasing rate. That is, $u'(e) > 0$ and $u''(e) > 0$. Effort, e , is supposed to be an element of $[0, 1]$ and we normalize by setting $u(0) = 0$. That is, there is an upper limit to the amount of work that individuals can possibly do, and this is by definition equal to 1. Thus 1 represents a very large amount of work, say, fifteen hours a day. According to (15.1), until individual workers reach a consumption level of s (the subsistence consumption), consumption is their sole objective—note that $u(1)$ is a constant. They will work as hard as necessary to reach this target, but once they have done so the first line of the utility function takes over and they take an interest in increasing their consumption and their leisure time.

To work out an individual's supply function, suppose that w is the market wage rate and the price of the good being consumed is 1. For the moment, we shall ignore the subsistence factor (i.e., pretend that $s = 0$) and work out the worker's supply. Since the person has no other source of income, x must be equal to ew . Making this substitution in the first line of (15.1) and working out the first-order condition we get

$$w = u'(e) \quad (15.2)$$

If w rises, for Eq. (15.2) to hold, e must rise as well. This follows from the assumption that $u''(e) > 0$. Hence Eq. (15.2) describes an upward-sloping curve. Let us describe the inverse of Eq. (15.2) by $e = e(w)$. What we just proved is that $e'(w) > 0$. Now let us bring in the subsistence requirement, where $s > 0$. Define w^* to be such that $w^*e(w^*) = s$. Therefore for all $w \leq w^*$, $we(w) < s$. Now, solving the full maximization problem of the labourer, that is, with the subsistence constraint taken into account, for $w \geq w^*$ the supply is given by $e(w)$, but for all $w < w^*$ the supply is given by $\min\{1, s/w\}$. The particular form $\min\{1, s/w\}$ simply takes account of the fact that 1 is the technically feasible maximum amount of work. Summing up this in a single equation, we have the following labour supply function, $E(w)$, of the labourer:

$$E(w) = \begin{cases} e(w), & \text{if } w \geq w^* \\ \min(1, s/w), & \text{if } w < w^*. \end{cases} \quad (15.3)$$

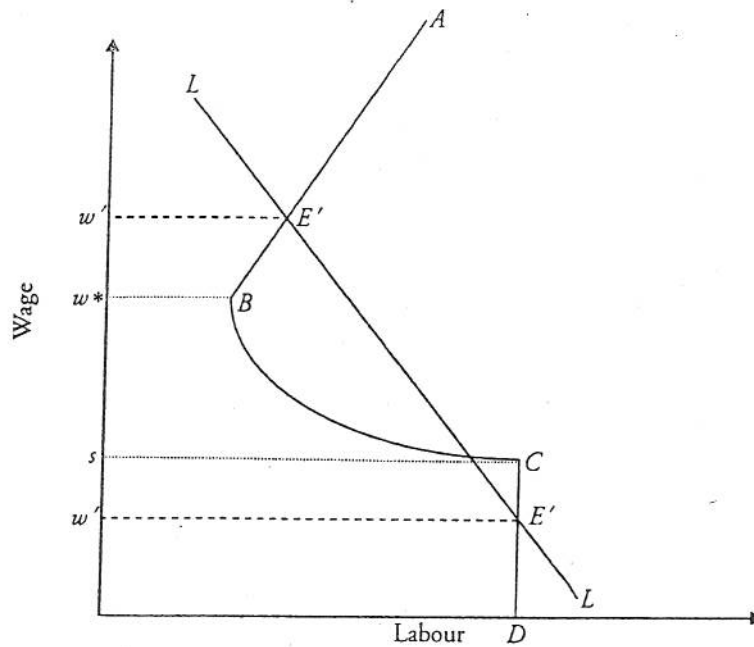


Figure 15.1: Labour Market Equilibrium

This supply curve is illustrated in Figure 15.1 by the line $ABCD$. Since the supply curve has a backward-bending section, clearly there can be multiple labour market equilibria. To complete the story, suppose that there are m identical workers. In this case the aggregate supply curve of labour is an m -fold horizontal aggregation of an individual's supply curve. Without loss of generality, let $ABCD$ in Figure 15.1 represent such a supply curve.

Let us suppose that the country in question has n firms, each endowed with the production function $f(L)$, where L is the amount of labour used by the firm and $f(L)$ is the output produced by it, and for all L , $f'(L) > 0$, and $f''(L) < 0$. Assuming that the price of the good is 1 and the wage is w , a firm will demand L units of labour, where $f'(L) = w$. Using d to denote the inverse of this function, a single firm's demand function for labour is $L = d(w)$. It is easy to check that this is a downward-sloping curve. Aggregating the demand curves of all n firms we have the market demand curve for labour. This is illustrated by the line LL in Figure 15.1. Equilibrium is defined in the usual way—as a wage rate at which aggregate demand equals aggregate supply: $mE(w) = nd(w)$.

In the case illustrated in Figure 15.1 there are three possible equilibria, of which the points marked by E' and E'' are the two stable ones. If the wage rate is low, at w' , workers are forced to work many hours just to survive, and the increased supply of labour in turn keeps the wage low. If wage is high, at w'' , workers are happy to work less and this 'limited' supply reinforces the wage high.

Clearly, workers are better off at the high wage equilibrium, that is, at E'' . Since all agents are price-takers, both equilibria will be Pareto efficient. This is illustrated formally, in the context of child labour, by Basu (2002b). So the difference

between the two equilibria is that at E'' workers are better off and profit-earners are worse off; and vice versa at E' , in a way akin to what Swinnerton and Rogers (1999) have illustrated in the context of child labour.

Suppose now that this economy is stuck at the equilibrium E' . Since workers usually comprise the poorest class in developing countries there is reason for the government to try to move the economy to the superior equilibrium, which in this economy is easy to achieve. The government simply has to announce a statutory limit on the number of hours that a worker can work. This will shift the CD segment of the supply curve to the left. If this shift is sufficient there will be only one remaining point of intersection between the supply and demand curves, namely E'' . Hence, the wage will rise to w'' and the market will settle into that equilibrium.

In this model, the statutory equilibrium law has a very interesting feature. Once it has been imposed for a while it ceases to be necessary, and it can be removed without the economy reverting back to the old equilibrium. Basu and Van (1998) refer to such a legal intervention as a 'benign intervention'. It is a law that is meant to deflect the economy from one equilibrium to another preexisting equilibrium. The law does not hold the economy where the market could not have held it, rather it simply helps to select from the various positions where the market could potentially hold it. Moreover, once the new equilibrium is established the law plays no further role. Since multiple equilibria are germane to developing economies, benign legal intervention has a large role to play in development economics.⁶

Before moving on to the subject of globalization, let us briefly digress to the subject of free contracting and Pareto improvements. It is a staple of economics that, if two consenting adults agree to a contract or an exchange, which has no negative fall-outs on any uninvolved third party, then the contract or exchange results in a Pareto improvement. Hence, economists typically believe that government and politicians should not intervene in such contracts and exchanges. Laws such as rent control legislation are often frowned upon by economists precisely for this reason. If a person is willing to take up a tenancy that requires him or her to pay a low rent but to vacate the dwelling at a day's notice, and if the landlord wants to have such a tenant for the rent agreed upon, there seems to be no obvious reason why the government should disallow such a contract since it will lead to a Pareto improvement. This, however, is a matter of considerable contention and misunderstanding, the debate going back at least to the writings of John Stuart Mill in the early 1800s.

There are three ways in which one can justify a legal ban on certain kinds of voluntary contract among adults while continuing to adhere to the Pareto criterion.⁷ The first is to argue that there is a difference between single acts of exchange or contract and a class of such acts. In particular, it may be the case that each such act can be justified on Paretian grounds but a class of such acts cannot be justified. Parfit (1984) laid the philosophical foundations of this argument and I have tried to formalize this in Basu (2003; see also Genicot 2002).

The second argument is based on the recognition that human beings are often irrational, and systematically so, as the new literature on behavioral economics has made obvious to economists (others already knew it). If people are irrational when

making choices over time, it is possible for some to be systematic losers in certain kinds of market transaction, such as when taking credit. If in today's society a weak person is deprived of his property by someone stronger than him, this is not considered acceptable. But if someone makes a borrower part with her or his property because the latter has failed to repay a loan taken out on terms that reflected the borrower's irrationality and miscalculation we do not raise an eyebrow. The reason for this is the presumption, deeply embedded in traditional economics, that no one miscalculates, no one is irrational. But once we recognize that people are often irrational we can legislate against certain transactions, for instance by putting an interest rate ceiling on credit agreements. It is true that this could prevent some efficiency-raising transactions between smart borrowers and lenders, but it could also prevent some irrational borrowers from being duped. Good policymaking entails intelligently balancing the potential gains and losses.

The third argument based on the proposition that some economies are characterized by multiple equilibria, where each equilibrium can be Pareto optimal. In such a situation, if we are in the vicinity of one equilibrium and we disallow a particular transaction, we may shift the economy to a Pareto suboptimal outcome. But if all transactions in a certain class of transactions are disallowed, we may move to a new Pareto optimal outcome. Hence the new outcome is not Pareto-dominated by the old equilibrium. The model constructed above belongs to this third category. If individual workers and a firm are prohibited from entering a contract in which each individual is required to work, say, fourteen hours a day, this will be Pareto suboptimal. However, if no worker is allowed to work more than a certain amount of hours per day, say ten, it is entirely possible that all workers will be better off by such legislation.⁸ Hence we cannot use the Pareto criterion to rule against such legislation. This argument was not available to those who debated statutory limits on working hours in the nineteenth century or even in the early twentieth century. It is only the advance of economic theory that has enabled us properly to understand the role and consequences of such legislation.

We shall now analyse how globalization can render certain benign laws ineffective. In general, under globalization the labour market legislation adopted by a country can lose much of its force due to the fact that capital is able to escape to another country. This also applies within a country if that country has a federal structure. In the United States there was once a considerable degree of interstate competition in terms of relaxing or not enforcing labour laws in order to attract or retain capital (see Kelley 1905), and this eventually prompted the nationwide imposition of the Fair Labour Standards Act in 1938 (see Bhagwati [1995] and Engerman [2002] for a lucid account of the history of labour standards). India, given its large size and growing regional freedom in terms of the law, including labour laws (Besley and Burgess 2002), can learn lessons from this experience.

To understand the problem that globalization creates in terms of development policy, suppose now that there are many countries, say t , just like the one described above. So what was described in Figure 15.1 refers to country 1 and there are identical countries, 2, 3, ..., t . Let us suppose that each country is caught in the 'bad' equilibrium, namely at E' . In each country there are n firms. But now let us

suppose that these firms are mobile across countries. Each can pick up its capital and move to another country should the need arise. To keep the analysis general, suppose that a firm has to incur a fixed cost of C to shift its operations to another country.⁹

If $C = \infty$, we have the case of a closed economy; and if we have $C = 0$ we have a fully globalized world in which capital can move costlessly among economies. C can be a product of nature and governmental nurture. Some transactions' cost of movement are in the nature of economic life. Certain kinds of capital are typically sunk, and they cannot be uprooted and moved without loss; and even when they can be moved or sold off, transportation costs or advertisement and selling costs may have to be incurred. In addition to such natural costs, the government can enact laws and impose taxes that make movement of capital costly. Hence C can take different values depending on the policy followed, which may in turn be the product of the attitude towards globalization. In reality, C is probably never zero or infinite, but polar cases can shed light on and help us understand the kinds of response we can expect from the market. I have already discussed the case of $C = \infty$, so now turn to $C = 0$.

Suppose that all the economies of the world are caught in the 'bad' equilibrium and therefore wages are equal to w' in each country. Now suppose that the government of a single country wants to nudge its economy towards the better equilibrium. In the case of $C = \infty$, as we have already seen, it could simply impose a statutory limit on working hours—say, ten hours a day. If the limit is severe enough there will be only one point of intersection between the demand and supply curves for labour. Such a case is illustrated in Figure 15.2. Each worker is

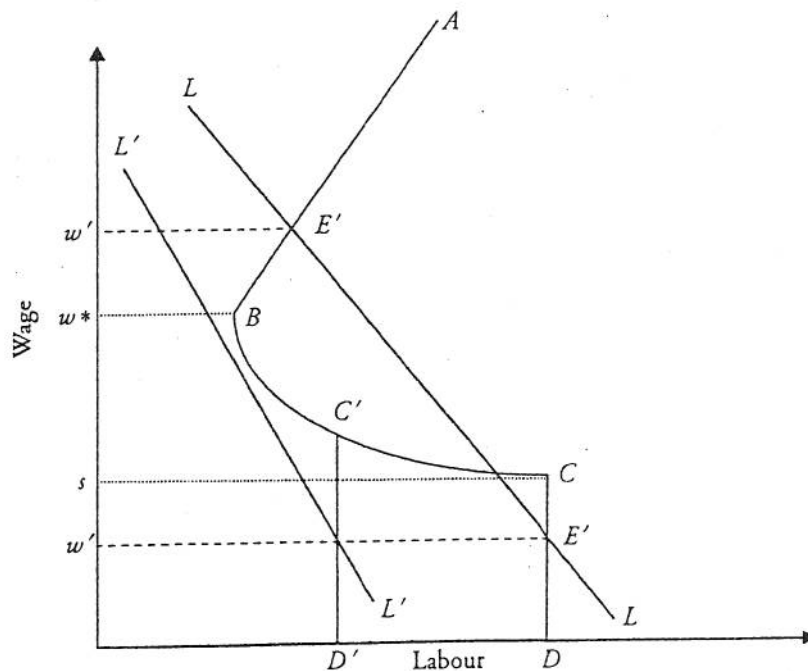


Figure 15.2: Labour Market Equilibrium, Small Nation Case

allowed to work for a maximum of D'/m hours, where D' is as described in Figure 15.2. Then the new supply curve for labour is $A'A''BC'D'$, and if C is so high that no firms leave the country the goal of raising labour standard will be achieved. If, however, C is very low—say, the extreme case of $C = 0$ —as soon as the new law comes into effect and the wage rises, firms will begin to pack up their capital and leave for greener pastures. This will cause the demand curve of labour to move leftwards, which will continue as long as wages elsewhere are lower. Clearly, some of the aims of the government intervention will be defeated. The extent of this will depend on market parameters and how large the country is in comparison with the rest of the world, because as firms move out of this country to other countries, wages elsewhere will rise.

In the extreme case of this country being so small that the flight of firms does not raise wages in the rest of the world, wages here must fall to w' (Figure 15.2). So the new law to improve labour standards in country 1 causes firms to leave, and demand for labour keeps falling in country 1 until it reaches the position of $L'L'$, wages fall to w' and nothing of value is achieved by the country. In reality, $C > 0$, so we would not expect such extreme response, but the theoretical result is nevertheless suggestive. It also explains why international labour standards is so politically charged and highly contested.

The reason why the demand for international standards has arisen is obvious from this model. When capital is free to move between a set of countries, each country's power to impose unilateral labour standards tends to be impaired. One way of restoring this power is for the cluster of relevant nations to coordinate their labour market policies, which is exactly what international labour standards is all about.¹⁰

Before moving on to consider actual policy questions it is important to offer some words of caution about the use of this model. Clearly the model applies to similarly placed countries and we have considered an extreme version of this—a set of identical countries. The model cannot be applied to a set of countries at very different levels of industrialization. The sort of work carried out by children in Ethiopia will be something that no worker in the United States or Japan would have to do. Hence there will be very little movement of firms between Ethiopia and these countries and the banning of child labour in Ethiopia is unlikely to impact seriously on them. The reason why this is important to caution against is that the misunderstanding of this is one of the major factors that has given rise to the chorus for international labour standards in developed nations and created a platform for Northern protectionism.

15.3.2 Labour Market Policy in a Globalized World

When thinking about labour market policy it is worth reminding ourselves that legislative intervention is not the only way to ensure workers' well-being and rights. Ultimately the biggest guarantor of labour standards and well-being is labour demand. If the demand for labour is sufficiently high so that employers have to compete with one another to obtain workers, the workers will be able to get themselves decent wages and have their basic rights ensured. Hence open trade channels that boost demand for labour in developing countries is good policy.

Developed nations can do more to boost workers' welfare by opening their doors to products from the Third World than they can by campaigning for 'social clauses' and chanting slogans. However, at times the market cannot do much to help workers' interests. This can happen when there are multiple equilibria or when the moral status of a set of actions happens to be different from the moral status of individual acts. For certain kinds of labour standard, such as the requirements not to engage in sexual harassment or expose workers to excessive hazards, legislative action and government intervention may be needed (Basu 2003).

While in these matters countries could once enact laws unilaterally, the scope for such action has diminished with globalization. One can also find examples of this within large countries. As mentioned earlier, the United States experienced ruinous interstate competition until 1938, when the enactment of the Fair Labour Standards Act brought all states under a common labour code. In 1904, for instance, the glass industry of New Jersey declared that if it were prevented from the night-time employment of children under the age of sixteen it would shift to Delaware or West Virginia, which imposed no such restrictions. In India, individual states have often competed over labour market policy, which has often led to flights of capital away from states that attempted to implement pro-poor labour market policies (Basu 2002c; Besley and Burgess 2002). Besley and Burgess classify the amendments made by Indian states to the Industrial Disputes Act of 1947 as pro-poor, neutral, or anti-poor. They show that states with more pro-poor amendments have ended up discouraging investment, often hurting the very constituency they meant to help. One lesson of this is that a pro-poor policy may cease to be so when capital is mobile, as is the case in India.

Returning to the subject of international labour policy, as we saw in the previous section, there is a case for concerted international action. However, this does not mean that international labour standards should be enacted and enforced in the way that they are currently being enforced. Ideally they should be formulated, designed and executed by developing countries. The current suggestion that they be designed and enforced by the WTO fails on this score. Despite the fact that the WTO operates on the principle of one-country one-vote and, wherever possible, on consensus, much has been written about the 'greenroom effect' and behind-the-scene attempts by rich countries to set the agenda in advance. As long as power is vested disproportionately in the hands of the industrialized nations, the risk of trade sanctions being used for protectionist purpose cannot be ruled out, nor can the risk of international labour standards being used as an instrument for Northern protection (Bhagwati 1995; Bhagwati and Hudec 1996).

Hence, for now, the matter of labour standards is best left to the ILO, which is unlikely to interfere with trade. The main method used by the ILO is to draft a convention and then to encourage countries to sign it—in this case signing means a commitment on the part of a government to enforce the terms of the convention. Convention 138, for instance, entails a commitment not to allow children below the age of fifteen years to do regular work. A similar effort has been made by the United Nations. Its 'Global Compact' is a voluntary agreement to uphold minimal labour standards, but unlike the ILO's conventions the signatories are not countries

but corporations and multinational companies. Corporations that sign the Global Compact are essentially committing themselves to abjure certain labour market practices that are deemed harmful to workers. Unlike in the case of the WTO—which, if it were to introduce a social clause in its agreements, would use trade sanctions and other forms of punishment as retribution for countries that violated the specified standards—the ILO and the UN work on the basis of self-enforcement by the signatories and rely on the power of publicity and social disapproval.

15.4 GLOBAL INEQUALITY AND POVERTY

Another area where there is growing need for the global coordination of policies is the mitigation of inequality and poverty. As noted above, globalization has a tendency to marginalize sections of the population. Hence, it has created a concomitant need for policies to control inequality. Ironically, however, globalization often makes it hard for countries to control inequality and poverty unilaterally.

Analysts have claimed that inequality is higher today than in medieval times. This is hard to substantiate because there is little historical data on inequality and because the products we consume today are very different from what our forebears consumed. Ghenghiz Khan may have been very rich but he had no way of taking a holiday in Hawaii or visiting the French Riviera for a quick weekend break. If he had a debilitating headache, he would not have been able to swallow an aspirin and get straight back to the business of conquering others. How, then, can Ghenghiz Khan's wealth be compared with that of a billionaire of today? While it would take the best of cliometrics and historical research, not to mention intelligent guesses, to amass inter-temporal inequality data and a lot of abstract theorizing to make sense of it, what we can assert on the basis of cursory research is that (1) the plight of the very poor have remained more or less the way it was during the time of Ghenghiz Khan, (2) inequality today, irrespective of whether or not it is greater than in the past, is astronomically high¹¹ and regional inequality, by all accounts, is higher than ever before, and (3) inequality and poverty are unnecessary today as we have the technology required to provide all human beings with food, housing, basic health facilities, and most other necessities of life.

The reason for the first assertion is simply the knowledge that the very poor today, as in the past, live barely above the subsistence level, that is, they are barely alive. This is because death truncates income distribution at the bottom end. It did so thousands of years ago and it continues to do so today in large parts of Sub-Saharan Africa and some parts of Asia and Latin America. Evidence on regional inequality emerged quite clearly from Maddison's (1979, 2001) research on economic progress over the last 1000 years. Tables 15.4 and 15.5 summarize some of the relevant data.

In the year 1000 AD, while within regions there would have been grave inequalities, since each region had kings and subalterns, across regions there was immense homogeneity, with per capita income standing at just above \$400. The reason for this could be a Malthusian one. With very little in the way of technology, each region supported the size of population that food production

allowed. By 1998, disparity had soared, with the income ratio between the richest and poorest regions being 19 to 1.

Table 15.4: Per capita GDP by Region, 1000–1998 (1990 dollars)

	1000	1820	1950	1998
Western Europe	400	1232	4594	17921
Japan	425	669	1926	26146
Asia (excl. Japan)	450	575	635	2936
Latin America	400	665	2554	5795
Africa	416	418	852	1368
Interregional spread	1.1:1	3:1	15:1	19:1

Source: Madison (2001).

Table 15.5: Per capita GDP, Asian Countries, 1820–1998 (1990 dollars)

	1820	1950	1998
China	600	439	3117
India	533	619	1746
Japan	669	1926	26146
South Korea	–	770	12152
Vietnam	546	658	1677

Source: Madison (2001).

Another interesting feature of the growing regional disparity is that the disparity within regions has grown over time. From Table 15.4 it is clear that a certain amount of global inequality had already emerged by 1820, when the interregional per capita income spread was 3 to 1. However, if we take a region such as Asia (Table 15.5), we find that at that time the disparity within the region was not very high (a spread of 1.3 to 1). By 1998 huge inequalities had emerged, so Asia is now much more heterogeneous than it was in 1820.

In India, regional inequality has been on the rise, since at least the 1960s (see, e.g., Rao, Govinda, and Kalirajan 1999), and one suspects that this process goes quite deep and probably indicates a rise in overall inequality.

Finally, if we compare countries for which we have recent data, we find that inequality is still on the rise. For instance, the income ratio of the richest 10 per cent of the world to the poorest 10 per cent has risen very sharply, from 52 to 1 in 1988 to 64 to 1 in 1993. During this same period the Gini coefficient of the world income distribution, based on household survey data from 91 countries, deteriorated from 62.8 to 66.0 (Milanovic 1996; Thorbecke and Chutotong 2002).

While all this does not tell us unequivocally whether interpersonal inequality is greater or lesser today as part of a secular trend, it does suggest that global inequality is growing. Moreover, because the world as a whole is now a much richer place. It is this that makes today's poverty, even if it were comparable to the poverty of a hundred or two hundred years ago, so intolerable. It is shocking that there are regions in the world where 25 per cent of children aged ten to fourteen are still toiling away as full-time labourers.¹²

If we could skim off a little from the richest segment of the population and make this available to the poorest, there would be no acute poverty in the world. The rich might not even feel the burden, but the poor would certainly feel the benefit. It is possible that many of the rich would be willing to participate in such a project if there were sure ways of directing the funds to the poorest and ensuring that they received adequate medical facilities, food, clothing, and housing.

The problem of global inequality and poverty is not so much an intellectual problem as a problem of determination and commitment, of finding ways to transfer basic necessities, which are now available in abundance, to the needy. This problem relates closely to some of the issues considered earlier in this chapter. Consider, for instance, the subject of international labour standards and environmental standards. These would not have been such major issues if it were not for the fact that the nations of the world have such dramatically different living standards. Hence a level of labour well-being that may appear tolerable to Ethiopians would seem downright degrading to the Swiss, and the level of pollution that Mexicans are required to endure would be totally unacceptable to the Japanese. If there were less global inequality, there would also be less variation in labour and environmental standards across nations. Hence some of the controversies touched on above would be mitigated automatically if we had a more equitable world.

The degree of inequality between, say, the poorest in Burundi and the richest in Switzerland would be considered unacceptable if it were to occur within the same country. If the poorest people of Burundi were to reside in the United States, the latter would find it impossible to ignore their plight or dismiss it as the fault of the Burundians themselves. This is where the subject of global democracy, developed early in this chapter, comes into play. If global democracy were sufficiently developed, then in the world as a whole the inequalities that exist today would be questioned, debated, and no doubt considered intolerable.

There is another sense in which globalization and inequality are intimately related. In today's globalized world, even if a country wants to reduce the extent of inequality in its territory it may not be able to do so because of the ability of professional workers and capital to cross boundaries. Let us formalize this idea a little. Suppose there are two identical countries, 1 and 2. In each country, in the absence of government intervention, there is a high-productivity person (in short, rich) with an income of x (>0) and a low-productivity person (poor) with an income of 0. Now suppose that the government introduces an income tax, with tax rate t that is used to transfer money from the rich person to the poor person. In other words a fraction, t , of the rich person's income is transferred to the poor person. It seems reasonable to argue that the rich person's incentive to work will be affected by the tax. Hence let us assume that the rich person's income, given a tax rate of t , is given by $x(t)$, where

$$x(t) = x - 16t. \quad (15.4)$$

Of course, an expression such as this can only be true within some bounds of t . Instead of complicating the algebra with a formal specification of bounds, we

shall simply be careful to remain within reasonable limits when we consider the examples below.

Since the poor person receives whatever is collected from the rich person as an income subsidy, the poor person's marginal income is unaffected by his or her labour, so I shall assume that the poor person's level of work is unchanged by the subsidy. Hence after the tax system is put in place the rich person's income is $(1-t)x(t)$ and the poor person's income is $tx(t)$. Let us suppose that each country's social welfare, W , is positively related to its per capita income, m , and negatively related to the income gap, g , between the richest and the poorest persons. Since all these variables depend on t , assuming that there is no international migration we can derive these terms as

$$m(t) = [x(t)]/2 \quad (15.5)$$

and

$$g(t) = x(t)(1-t) - x(t)t. \quad (15.6)$$

As this is meant to be a simple illustrative exercise let us assume that social welfare, W , consists of four times the per capita income minus the income gap. Hence

$$W(t) = 4m(t) - g(t) = (1+2t)x(t). \quad (15.7)$$

Assuming from here on that $x = 16$, substituting Eq. (15.4) into the Eq. (15.7) and maximizing it, it is easy to check that the optimal value of t is $1/4$ and $W(1/4) = 18$. Check also that $W(0) = 16$.

So in this model we have a clear policy prescription. If each country could be sure that its tax policy would not cause an out or in migration, then it would fix the tax rate at 25 per cent. This would cause social welfare to rise to 18 from a base line of 16, which occurs when there is no tax.

Now, let us bring in the global aspect of the problem. We shall assume that people will want to work in the country that offers them the higher income, that if both countries offer the same income they will prefer to remain in their own country; and (this is only for simplicity) that both countries only allow high-productivity persons to migrate to their country. In other words, the only people who are able to migrate are high-productivity people. Since both countries are innately identical, taken together the above assumptions mean that high-productivity people will migrate from their own country if and only if the other country charges a lower tax rate.

With these assumptions it is clear that the global optimal occurs when each country sets t at $1/4$. Both countries then achieve a welfare level of 18. Let us now suppose that country 1 sets t at $1/4$ and country 2 sets it at 0. The latter's welfare level is then given by $26 + (2/3)$. To see how this is calculated, note that country 2 will now have two rich people and one poor person, because of migration. So its per capita income will be $[2(16) + 0]/3$ and the income gap will be 16. Applying the welfare function to this we get welfare level as $26 + (2/3)$.

If, on the other hand, country 1 sets t at zero and country 2 sets it at more than zero (for instance $t = 1/4$) then all productive workers will leave country 2 and its

welfare will be given by zero. Clearly it would then be better off to lower t to 0. In short, if we view this as a game between countries, setting t at 0 is the dominant strategy for both countries, although both would be better off if they could set t at $1/4$. In other words, what we have is a classic prisoners' dilemma. The payoff matrix Figure 15.3—in which for simplicity we assume that each country has to choose between setting t_i at 0 or $1/4$, where the subscript i refers to the country in question and the payoffs are the welfare levels of the two countries—sums up this model. It is obvious that no matter what the other country does, it is better for both of them not to tax the rich and to leave income distribution untouched, even though both would be better off if they taxed the rich and transferred some money to the poor.

The model just described, though highly simplistic, drives home the need for global cooperation if countries are interested in improving their income distribution. Globalization means that independent countries do not have quite the independence that countries had in earlier times in terms of exercising their individual policy prerogatives.

While we talk about the need for global coordination for labour market policies, for environmental policies, for trade norms, we seldom talk of global coordination when it comes to discussing countries' policy for achieving greater equity. This chapter, however, has indicated that some of the same problems arise here. The fact that capital and professional worker, migrate from one country to another in response to economic incentives has created a need for international coordination.

There is, however, a need to sound two words of caution. First, the model must not be taken as justification for closing borders against the movement of people or capital. The advantages of the free movement of resources, physical and human, in and out of countries are immense, and the pressure should be kept up on governments to keep the corridors open rather than set up barriers. Second, in the above model there is no conflict between poverty and inequality—the policy that curbs inequality also curtails poverty. But that does not always happen in reality. Some policies can curb poverty only by increasing inequality. At times countries can be so overzealous in controlling inequality that they are unmindful of the fact that this may lead to an increase in poverty.

What should one do if such a conflict arises? I have taken the view elsewhere and would endorse it again, that poverty alleviation should be the priority

		Country 2	
		$t_2 = 0$	$t_2 = 1/4$
Country 1	$t_1 = 0$	16, 16	$26 + (2/3), 0$
	$t_1 = 1/4$	$0, 26 + (2/3)$	18, 18

Figure 15.3: The International Inequality Game

objective. So if there is a conflict between poverty removal and inequality mitigation, we should go for poverty removal. However, there are many situations in which the alleviation of inequality and of poverty are compatible objectives and may even be complementary.

With regard to the objective of reducing poverty, one way of encouraging countries to do so would be to present their economic performance not in terms of their overall per capita incomes, as is the common practice, but according to the per capita incomes of the poorest 20 per cent of each country, or what may be called its 'quintile income'.¹³ The objective of raising quintile incomes would be a good way of combining poverty alleviation with growth. The focus on quintile income would make for a natural Rawlsian focus on the weakest sections of the population. At the same time, a focus on the *relatively* poor, rather than on those below an exogenously defined poverty line, means that one would eventually be interested in everybody. The target of raising poor people above an exogenously given poverty line can be reached, but the aim of raising the living standard of the poorest 20 per cent of a society can never be fulfilled totally, because there will always be a category of the poorest 20 per cent of a population. In a perfectly equitable society, for instance, the objective of raising quintile income would coincide with the objective of raising per capita income. This is the strength of the quintile income target proposed here.

One could legitimately ask whether a focus on quintile income, rather than the more common per capita income, would make that much of a difference. The cross-country view of these measures in Table 15.6 shows the substantial difference between the two. As can be seen, there is not only a large difference in absolute terms (in the 1990s the bottom 20 per cent of people in Peru had a per capita income of less than \$1000, whereas the figure for the country as a whole was more than \$4000; most people in Sierra Leone were poor, but those in the quintile income group were unbelievably poor), but also reference to the quintile measure changes the rankings of countries quite sharply. For example, the United States drops from first place in per capita terms to a position under Norway, Japan, and Sweden. Likewise Bolivia, which ranks higher than India, drops to below India when the quintile measure is used.

Of course, the quintile income is less inclusive than, say, the human development Index, compiled by the UNDP, which takes account of life expectancy and literacy as well as income, but it has the advantage of a sharper focus. It is not claimed here that other measures of standards of living do not matter; rather we merely stress that when looking at a country's economic (or, more narrowly, income) performance we should focus our attention on the bottom of income distribution.

Despite the advantages of, and the moral case for, focussing on quintile incomes, there is a considerable problem with lack of data. In Table 15.6 the data on the share of income that the bottom 20 per cent of each country commanded were collected in different years (shown in parentheses), which reflects the fact that such data are compiled only occasionally. Moreover, it is arguable that the poorest 20 per cent people have a very different consumption pattern from the average person. Hence, ideally, we should use index numbers that are specific to

this class when computing their per capita incomes. Clearly these are data that we will have to strive to collect if we are seriously interested in focussing on the poor.

Table 15.6: Per capita Incomes and Quintile Incomes, Selected Countries

	<i>Per capita GNP, 1999 (US dollars at PPP)</i>	<i>Percentage share of income of bottom quintile (survey years in parenthesis)</i>	<i>Per capita income of poorest 20 % (or quintile income), 1999 (US dollars at PPP)</i>
Sierra Leone	414	1.1 (1989)	23
India	2149	8.1 (1997)	870
Bolivia	2193	5.6 (1990)	614
China	3291	5.9 (1998)	971
Peru	4387	4.4 (1996)	965
Thailand	5599	6.4 (1998)	1792
Mexico	7719	3.6 (1995)	1389
Malaysia	7963	4.5 (1995)	1792
Korea	14637	7.5 (1993)	5489
Sweden	20824	9.6 (1992)	9996
France	21897	7.2 (1995)	7883
Japan	24041	10.6 (1993)	12742
Norway	26522	9.7 (1995)	12863
United States	30600	5.2 (1997)	7956

Source: Compiled from World Bank (2001).

To reiterate what was said above, concern for poverty alleviation should take priority over concern for income inequality. Inequality is something we should strive to minimize, but not be jeopardizing improvement of the income of those in the lower quintile group. To understand this, consider the policy question of whether to extend intellectual property rights over a long duration, say fifteen years. If this were judged to be against the lower-quintile-income-maximization criterion, then we should have to work out precisely what such a policy was likely to do to the poorest 20 per cent. It is, for instance, entirely conceivable that it would make a few people very wealthy, namely those who patent commercially useful ideas. This should not be considered a reason for or against extending the rights to intellectual property, but if such a policy could somehow help to raise the living standard of the poorest people, then it should be considered worthwhile.

Similar issues arise in respect of tax policy. If an overly aggressive tax system were used to divert money from the rich to the poor, it is arguable that this could damage richer people's incentives to such an extent that the poor would end up being hurt when all effects were taken into account, despite the income subsidy they received. This is because their incomes could drop so much (because there was not enough capital to work with or because firms would shut down, causing a drop in demand for labour) that despite the subsidy they would be below the pre-policy intervention level. In such a case the tax would obviously be counter

productive. Note that tax policy is not being evaluated here in terms of general efficiency, as mainstream economics normally does, but in terms of a kind of truncated efficiency where efficiency is judged by its effect on the poorest.

A large number of policies, however, have no obvious effect on the poorest people, and from these we should choose the ones that could minimize inequality. And since the effectiveness of many such policies will crucially depend on what is being practiced in other countries, we return to the subject of the global coordination of equity policies. In practical terms this will require a lot of institutional spade work. As mentioned earlier, for discussions of intercountry trade policy we have the WTO, and for crafting intercountry labour market policy we have the ILO, but there is no forum for coordinating the effort to alleviate poverty and inequality. These issues have been written about and discussed by the World Bank, but inadequate attention has been paid to the intercountry dimension of this problem, which is an increasingly significant omission in a globalizing world.

15.5 CONCLUSION

This chapter has addressed the changing nature of development economics, and in particular the changes brought about by the process of globalization. The focus has been on curtailment of the freedom of individual countries to draft policy. In the ancient world, where the cost of crossing borders and the uncertainties awaiting in distant lands caused most countries to isolate themselves, national governments could pursue the policies they wanted with impunity and with little concern for what other countries were doing. This is no longer the case, and goods, capital and people are flowing in and out of countries at unprecedented levels and at a much lower cost than ever before.

This chapter has argued that one consequence of globalization is the erosion of global democracy. Because powerful nations and the activities of multinationals can have huge effects on the well-being of people in other countries, a retreat of democracy is a natural concomitant of globalization. This has led to the increasing marginalization of some groups and contributed to global political instability. One way of controlling this problem would be to strengthen the democratic working of international organizations, giving much more voice to poorer countries than they currently have.

As an illustration of one area in which globalization has had a major impact on the nature and effectiveness of development policy, this chapter has considered the subject of international labour standards. Models have been constructed to show the need to coordinate policies among developing countries, which will require a democratic forum to help with the coordination. We further argue that global inequality is reaching an intolerable level, and once again this is an area where policies will have to be coordinated across countries if they are to be effective. To this end there is need for international organizations to take the initiative.

Advances in development economics, the availability of large data sets, and the growing sophistication of economic theory have enabled us to understand economic underdevelopment and global poverty much better than ever before. The challenge

is to combine this understanding with political will in order to do away with poverty, which is unacceptable and unnecessary in this generally prosperous world.

NOTES

1. Dreze (2000), drawing on the research of Sivard (1996), reports that the ratio of civilian casualties to military casualties in armed conflicts rose from 1:1 to 5:1 between the beginning and end of the twentieth century.
2. This argument of course hinges on there being more technological advancement in the fishing sector than in other sectors, but this causes only a minimal loss of generality. As long as there is not a perfectly balanced innovation in all sectors, some sectors will see more technological advances than others. One such sector could be 'fishing'.
3. In making this remark I am aware that there are other, more acutely dispossessed people in society. There are the jobless and the homeless, and within households there may be women and girls who are intolerably poor. Needless to say, we need policy instruments to reach out to them. But here, I am not trying to be comprehensive but to consider some major illustrative examples involving the poor in places where globalization is changing the nature of development policy. And it seems reasonable to focus on the case of the working class in poor nations.
4. This is also noted by Kimura (2002), who rightly points out that the competition is not just about wages and workers' compensation but also about the productivity of workers, their education, language skills, and so on.
5. See Mill (1970, 1971). For more contemporary references see Kanbur (2001), Neeman (1999), Satz (2001) and Basu (2002b), Trebilcock (1993). The model constructed here is similar to those in Raynauld and Vidal (1998) and Singh (2002).
6. Once we recognize that social norms are an ingredient in human choice, the role of benign legislation becomes even more important, since a law can help shape human preference and norms; and once these have been formed—even if the law were to be removed—behaviour might well remain unaltered.
7. It could be argued that the Pareto criterion should not be treated as a sacred cow, and that if we eschew the Pareto criterion we can develop justifications for intervention. Such an argument has been advanced by Kanbur (2001), Sen (1970), and others. Kanbur actually looks into a variety of Paretian and non-Paretian justifications for intervening in what he describes as 'obnoxious markets'. Here we shall remain within the Paretian framework.
8. While this sounds obvious, it involves some tricky problems concerning the number of agents involved in an economy. Conventional economics makes very strong assumptions about this, and the only reason why such assumptions are accepted by economists is that they are so used to them (Basu 2002c).
9. A similar analysis pertaining to child labour was conducted in Basu (1999).
10. While the consequences of such coordinated action have not been studied empirically, a recent empirical study of which countries are likely to ratify labour market conventions sheds interesting light on what prompts countries to ratify standards (Chau and Kanbur 2001). There seems to be evidence of a peer-group effect—that is, if the other countries in a country's 'peer group' ratify a convention it is more likely that the latter country will ratify it.

11. Based on *Fortune* magazine data and world development indicators, it seems that in 1998 the 50 richest Hollywood personalities earned as much as the entire population of Burundi (11 million), and that the rise in the value of stocks owned by Bill Gates of Microsoft was equal to the combined income of the entire 60 million people of Ethiopia. Turning to more serious data, the income ratio between the richest 10 per cent of the world and the poorest 10 per cent was 64:1 in 1993 (Thorbecke and Chutotong 2002, based on Milanovic 1996).
12. According to the Census of England and Wales of 1861, 36.9 per cent of boys and 20.5 per cent of girls aged ten to fourteen were regular labourers.
13. The normative basis of using quintile incomes to rank countries and evaluate economic policy is discussed by Michael Lipton, Paul Streeten, and myself in Meier and Stiglitz (2001).

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