

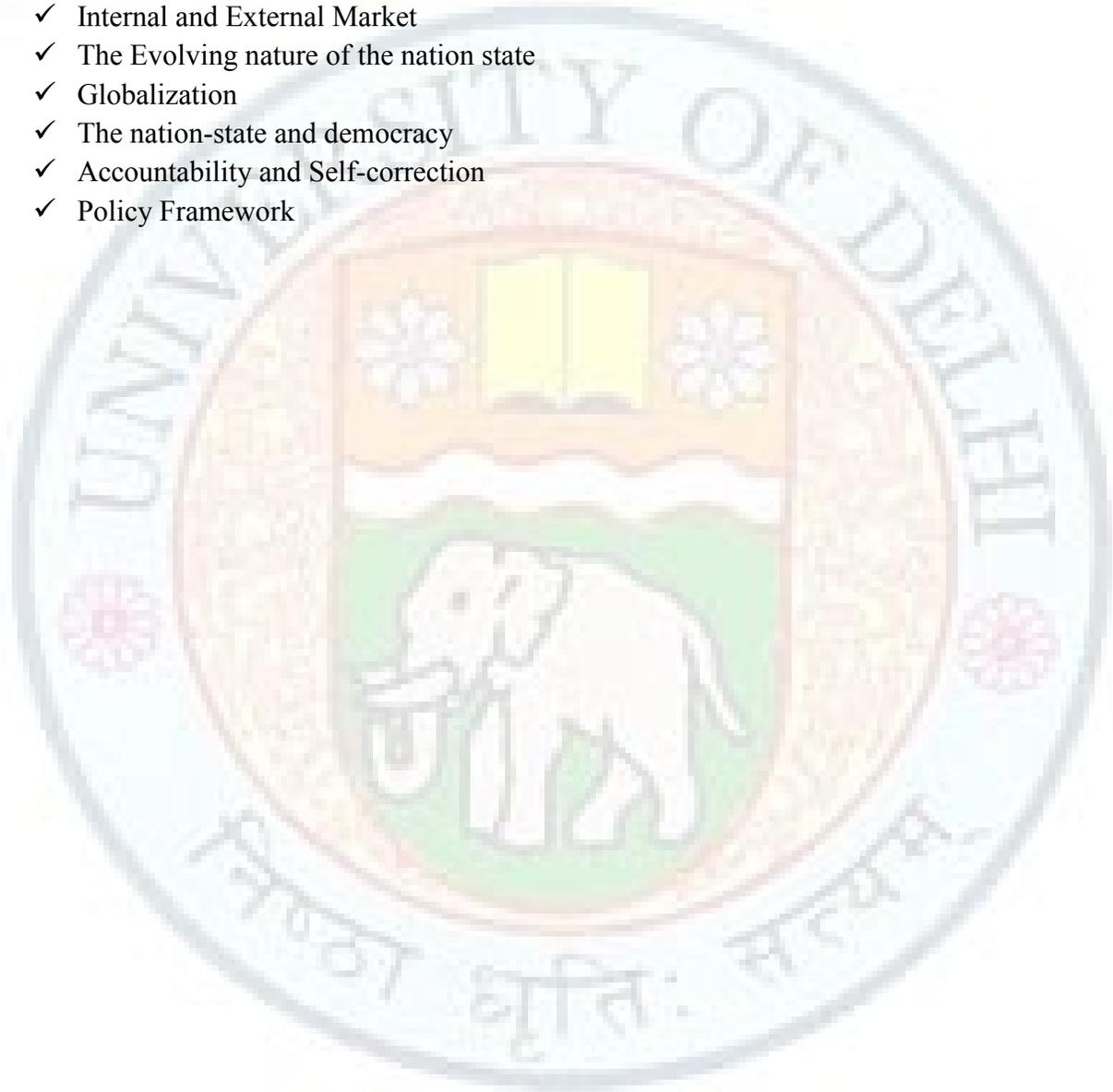
The logo of the University of Delhi is a circular emblem. It features a central shield with a yellow book at the top, flanked by two white floral motifs. Below the book is a green field with a white elephant. The shield is set against a light blue background with the text 'UNIVERSITY OF DELHI' in a circular border. At the bottom, there is a Sanskrit motto: 'सत्यमेव जयते' (Satyameva Jayate).

Lesson: Nationalism Versus Economic Policy In The Age Of Globalization
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Learning Objectives:

After reading this chapter, the reader will be able to understanding the following concepts

- ✓ The rise of nation state
- ✓ Economic nationalism and the market system
- ✓ Legitimacy through Nationalism
- ✓ Internal and External Market
- ✓ The Evolving nature of the nation state
- ✓ Globalization
- ✓ The nation-state and democracy
- ✓ Accountability and Self-correction
- ✓ Policy Framework



NATIONALISM VERSUS ECONOMIC POLICY IN THE AGE OF GLOBALIZATION

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NATIONALISM VERSUS ECONOMIC POLICY IN THE AGE OF GLOBALIZATION

1. Introduction

The nation state according to Amid Bhaduri is based on the ideology of nationalism. The concept of nationalism involves a complex notion which tries to include the state and the society along with the economy. Nationalism demands multiple loyalties which an individual as a member of the society have to commit to the state. The state in turn have to provide and protect the rights and duties of all its citizen. Some of the individuals played the role of producers and others the role of consumers in the economy. There is a need for the balance of various aspects of nationalism which have evolved over a period of time. The market forces seems to dominate this balance in the present era of globalization. This has a strong implications for the nation state. The nation state needs to redefine its economic policy. This chapter will look at the changing role of the state in the present era of globalization.

2. An Intellectual Foundation For The Emergence Of Nation State

There always have been a problem in an attempt to merge the political entity of the state, the historical concept of the nation and the organizational activities of production and exchange of the economy. **The western philosophy** opined that there is a major problem in linking the political entity of the state and the historical concept of the state. The historical or cultural concept of a state viewed the state as an association of individuals on voluntary basis. Thomas Paine treats the rise of the state almost as a ‘necessary evil’.

According to the **classical political philosophy** the society widens the individual’s scope for freedom of action and the state restricts the negative impulses of the individuals. The **modern ‘methodological individualism’** postulates that all social and economic interactions are reducible to the individuals’ self-interest.

Box 1. Intellectual Foundation for emergence of nation state

Western Philosophy, Classical Political Philosophy, Modern methodological individualism, Smithian composite notion of Sympathy

The **Smithian composite notion of ‘sympathy’** embedded a wide range of human moral sentiment in which sympathy is viewed not only as altruism but as complex set of coexisting and conflicting motives of human being. The ‘fellow-feeling’ of the desire to be socially engaged is evaluated rationally for the consequences of such engagement. This leads to the emergence of mutual ‘trust’ and reciprocity which provides the basis for the functioning of commercial society.

The preceding analysis show that both the state and the economy are dependent on each other for their smooth functioning. The societal 'norms' like trust and reciprocity of behavior moderated the behavior of selfish individual. The norms of social behavior are absolutely essential for functioning of the economy to produce, to trade, to exchange goods and services on large scale. It contradicts the Leviathan notion of state whose sole purpose is to restrain individuals' self-seeking behavior in times of conflicts with each other in destructive manner (Hobbes)

The celebrated **Arrow-Debrew model** demonstrates that the actions of selfish individuals in a market which are competitive in nature results in pareto-optimal outcomes. The Smithian proposition which underlies social 'norms' like respect for contracts, trust in exchange etc are necessary for the functioning of market mechanism. By neglecting the role of social norms in formal analysis of microeconomics we exaggerate the role of invented 'auctioneer' for the efficiency of market mechanism. The state could also play an important role in either reinforcing or destroying these norms.

The societal norms can emerge through cooperation of individuals. If the society is more homogeneous in terms of ethnicity, religion, language and shared history, these social norms will apply to individual members with greater intensity. So powerful social norms are usually found in the close- knitted tribal societies. The village headman usually uses his political authority to reinforce these norms. People in Third World countries fighting for independence against imperialist forces may also share the feeling of togetherness. When political freedom is achieved the tendency for togetherness will weaken slowly.

A **commercial society** does not follow rigid and explicit social norms in the interest of trade and commerce thereby bestowing the individual with greater social freedom. But commercial societies create other norms like respect for commercial contracts according to the requirements of trade and commerce. The ideology of nationalism has been used by the nation state to keep together the state, the society and the economy.

According to **Hobbes**, the individual and the state has relatively small space for the civil society to operate. **Hegel** wanted the separation of private sphere from public sphere. The state has moral supremacy

Box 2. Intellectual Background

1. Merger of state, nation and economy always problematic
2. Smithian Composite notion of Sympathy underlies social 'norms' which are necessary for the functioning of market mechanism
3. Commercial society deviates from rigid social norms in the interest of trade and commerce
4. **Hobbes**: individual and state has relatively small space for the civil society to operate
5. **Hegel**: Separation of private from public sphere with the dominance of the latter
6. Nationalism overrides particular loyalties to ethnicity, culture, religion etc

over the private sphere. This overriding authority of the state shaped the idea of nation-state.

The society and its various norms need to be in conformity with the political objective of the state. The state gradually replaces the society over a period of time. The society is capable of generating various social norms but not the ideology of nationalism. People have multiple affinity according to their language, religion, ethnicity, region etc. The concept of nationalism overrides these particular loyalties.

Features of a Nation state

1. The reciprocal arrangement between the state and its citizens formed the basis of a nation state. The citizens are loyal to their state and the nation-state in turn protect the rights of its citizen within the territorial boundaries of the state.
2. The sovereign state determined the rights of its citizen by using the principle of peoples' self-determination. These rights may differ depending on ethnicity, language, religion or culture
3. The Hegelian idea of assigning moral supremacy of the state over private domain become the most convenient ideology for the nation-state. The idea of nationalism is necessary to deal with multiple and often conflicting loyalties in the society.
4. The nation state enforces its laws within its territory. The commercial activities comes under the purview of law and regulation.
5. The national currency remains a 'legal tender' within the nation state. It is also a symbol of commercial trust and signifies the authority of nation state over its economy.
6. The emergence of new commercial norms weakened many societal norms. The nation state extend its control over the society by encouraging newer commercial norms which strengthens the economy but weakens social norms. However complete control over economy is not possible due to various requirements of foreign trade, investment and technology.

Box 3.Features of Nation States

1. Nation state is based on reciprocal arrangement between the state and its citizens
2. Rights of nationals are determined by state based on principle of self-determination of people
3. Domination of Public domain upon private domain
4. Emphasis on territorial integrity of nation-state
5. National currency as symbol of commercial trust and authority of the state
6. Commercial norms weakened social norms
7. State becomes ultimate decision maker within its territory
8. Economically weaker nation states depend on the stronger nation states
9. Economic nationalism is strengthened through trade.
10. Economic nationalism complements territorial nationalism

7. The nation state is the highest decision making authority within its territory. This is based on the concept of sovereignty and the principle of right to self-determination.
8. There is a link between the economic and the political aspects of the authority of the nation state in its national and international context. The political authority of the developing countries is undermined by the role played by foreign trade, investment or finance as they crucially depend on the developed nation states for these factors.

There is possibility of furthering economic nationalism through trade. National governments attached political importance to the 'strength' of their national currency. Earlier the nation states strengthens the commercial norms to weaken social norms. The strengthening of economy was considered as a complement to strengthening the territorial integrity of the nation states. However now, the current phase of globalization challenges the authority of nation states. The spread of trade and commerce on the one hand and the flow of financial and information on the other has transcended economic and territorial boundaries. Therefore a paradoxical situation occurs where the economic nationalism which was once supported by the nation state started to threaten the very existence of nation states.

3. Economic Nationalism And The Market System

The nation state gradually acquired enormous political authority which is encapsulated as the concept of 'sovereignty' of a nation. The nation state becomes the highest authority of power within its territorial domain. The citizens enjoyed the rights which are given by the government. They in turn pledge their loyalty to the state. This reinforces the ideology of patriotism among the population in defenses of the nation of the sovereign nation (Hobsbawm 1990)

3.1. Legitimacy through Nationalism

Every national government seeks legitimacy to retain their political authority. Both democracies and dictatorship appeals to some form of nationalism. The more undemocratic and repressive the national government is the more it needs to appeal to patriotism for legitimizing and holding own to stay in power. They exaggerate the threat from others to instill the feeling of nationalism amongst its population. The ideology of national sovereignty is also important for

Box 4.Economic Nationalism and Market System

1. Sovereign government is the ultimate authority and citizens enjoyed rights given and defended by nation-state
2. National government (both democracies and dictatorship) seeks legitimacy through nationalism
3. Ideology of nationalism overrides diverse culture, religion and social norms
4. Commercially oriented norms weakens social norms
5. Tensions of modernization in building nations are due to opposing tendencies of social and commercial norms.
6. Four components of Belief systems:
Individualism,
Rationality, Invisible hand, Market process

democracies to maintain an advantageous reciprocal arrangement between the state and its citizens.

There are two different directions in which the need for legitimizing the rule of the nation state proceeds. They are:

1. The ideology of nationalism and national interest is used to override the diverse culture, religion and social norms that emerged from interaction on the civil society. This strengthens the grip of political power in the hands of the state. The state reinforces its grip by appealing through cultural or religion nationalism or ethnicity.
2. However an almost opposite tendency exists due to the creation of commercially – oriented norms. The increased spread of trade and commerce, specialization in production and exchange and the rise of a commercial societies leads to a creation of new commercial norms. These norms weaken many earlier social bonds and norms. These contribute to the growth of economic nationalism in which the norms are nominated by their economic content. These commercial norms adapted themselves faster than social norms.

Interestingly both tendencies exist and are responsible for pulling the developing world in opposite directions. Relying on social norms on one hand and commercial norms on the others leads to tensions of ‘modernization’ in ‘building nation’. The tension is further worsened by the faster pace of change in commercial norms and the slower pace of change in social norms. In fact in industrially advanced countries, the commercial norms are well-established and becomes the basis for which other social norms are organized. The distinction between the developed and the developing economies in terms of nationalism is due the relative strength of the two opposing tendencies, both of which strengthens different aspects of nationalism.

3.2. Belief-System Sustaining the Market Culture

The complex system of beliefs leads to the acceptance of market culture and commercial values which in turn drives modern economic nationalism. There are four components of the ‘belief – system’ which sustains the market culture. They are:

1. Individualism.
2. Rationality.
3. The role played by ‘invisible hand’ in guiding market mechanism.
4. The belief in the market process and not merely in the final equilibrium outcome of the market

To explain the above belief-system in more detailed manner, the aggregation of the individual preferences leads to desirable social outcomes. But this individual includes only rational individuals and hence excludes psychopaths and lunatics. The invisible hand of the market is

responsible for aggregating the individual preferences in optimal manner. The motion of optimality applies not only to the final equilibrium outcome but even as a process. Such process is slowly convergent with stable optimal equilibrium outcome.

The belief system which sustain the market can be prove to be fragile. However the recent collapses of central economic planning in USSR and Eastern Europe provides avenues for market as the only viable alternative. However if economic crises like in 1930s occurs frequently, the belief in market economies will gradually fade away. The popularity of market economies will also waned down if the market system marginalizes the majority of its population

4. Economic Nationalism: Internal Market Versus External Market

There are two interrelated ways in which economic nationalism manifest itself. They are:

1. First, the nation-state is dependent to a great extent on the market force in the matters related to international trade, investment or finance. Therefore it will try to benefit as much as possible from the external markets.
2. Second, the nation-state can exercise more control over its internal market than over its external market. Therefore if a nation-state is economically weak in international market, it will depend more on internal markets.

The economic nationalism of a nation-sate will depend on how much importance the nation-sate gave to its internal and external markets. Some nation sate may rely more on internal markets, while others may do the reverse and depend heavily on external markets. Factors like population, stage of economic development influence whether a nation state have to depend more on internal or external markets.

The Keynesian theory of effective demand focused exclusively on the internal market of a closed economy even though it had an intellectual link with mercantilism. Many favor a policy of tariff protection to 'conquer internal market'. The argument for protecting domestic 'infant industries' lead to import substituting development strategy for many developing nations. The doctrine of free trade is perceived as

Box 5. Content of Economic Nationalism

1. Economic nationalism is shaped by amount of importance given to internal and external market.
2. The Keynesian Theory of effective demand focused on internal market
3. Weak nations preferred protectionist policies. There are two drawbacks (a) size of domestic aggregate demand is unknown (b) overstate the danger of economic openness.
4. Free trade doctrine criticized by economically weak and the marginalized.
5. Developing countries accepted globalization as they have limited ability to resist international pressure
6. The economic performance of the state gives legitimacy to the government to stay in power.

the economic strategy of developed nations.

Criticism of protectionism

There are two major dangers in the argument for protecting the domestic market

1. Lots of importance have been given to the supply side of domestic economy. Although the supply of domestic industries is important, the demand side of the economy is equally important. Policy makers tends to ignore the aggregate demand and no efforts have been made to determine the size of the aggregate demand of an economy.
2. The protectionist doctrine put over-emphasis on the dangers related to openness of an economy. A judicious and appropriate integration of domestic market with international market can benefit even a poor nation by increasing the consumers' welfare.

Criticism of free trade doctrine

It has been argued that consumer' welfare can be enhanced through benefits of international competition. However, for this argument to be valid we need to assume that the levels of domestic employment remains unaffected by international competition. The welfare of consumer may decline within a domestic economy if the size of domestic market shrinks due to lower employment opportunities.

There are other problems related to the doctrine of free trade. We need to study not only the gains reaped by stronger nations in international trade. We need to be equally concerned about the loss suffered by some nations as a result of it. This is akin to the rule of majority in democratic governance where the concerned is not only about the wants of the majority but the rights of the minority as well.

The doctrine of free trade should also be seen and justified from the eyes of the marginalized section of the population who are excluded from the labor market. Very often the weaker and the poorer section of the society criticized the market mechanism. Therefore, economic nationalism can either favor or criticized the doctrine of free trade depending upon the benefits and cost of denials the nations received from the operation of international market.

The participation in international market has distributional implication depending upon the economic position of the nation-states. The developing nations cannot afford to resist the pressure of international market mechanism. They are trapped between traditional norms and the commercial norms of international market. They need to accept the commercial norms of international market and undermine the traditional norms to acquire minimal economic strength. In this paradoxical situation, the developing world has no option but to accept globalization.

However the situation is quite different for industrialized nations. They are well accustomed to the norms of a commercial society. The economic nationalism for developed nations will depend

upon their economic performance in comparison with other nations. The government in developed nations will seek legitimacy through the economic performance of their nation state

Globalization

Globalization becomes an uneasy meeting point of opposites. Both the developed and developing world felt the need to globalize though for different reasons. The developing world needs to globalize to assert themselves internally the supremacy of economic norms over traditional norms. However they play a passive role and obey the rules laid down by the developed world.

The developed world needs to globalize because their economic performance depends to a large extent on the external markets. Economic nationalism will depend on the economic performance of their nation state. Sometimes there may be a conflict between the internal economic conditions and external conditions. Thus, consolidation of economic nationalism through globalization operates as a double-edged weapon, which often wounds both the developed and developing world.

The Keynesian theory of demand management has significant political contribution. The government can avoid mass unemployment or economic downturn by managing demand in internal market. When we have more demand, it generates more output and profit. This will in turn increase wages of the workers. So it is model of cooperative capitalism.

According to Kalecki (1944) different set of policies can be used to influence the aggregate demand. Demand can be generated by increasing consumption, investment, government expenditure or exports. The speediest and the most convenient way of demand management by the nation state is to increase government expenditure by deficit financing. This has tremendous consequences for the economic growth of the nation state.

Model of Cooperative Capitalism

The model of Cooperative capitalism has been an accepted norms across all political parties. The state can increase employment by incurring higher expenditure. The welfare role of the state becomes increasingly important. Both the workers and the capitalist gains

Box 6: Globalization

1. Globalization is the meeting point of opposites.
2. Developing nations want to globalize to assert internally while for developed nations external conditions determine their economic performance.
3. Economic nationalism and globalization operates as a Double-Edged Weapon.
4. The Keynesian Theory of Demand Management is a model of Cooperative Capitalism
5. Demand management in internal market can lead economy out of depression
6. Kalecki: Manage demand through three components of aggregate demand
7. Deficit financing is the easiest way of demand management

through expansionary fiscal policy or monetary policy. This has resulted in two or three decades of high economic growth along with near full-employment which is termed as golden age of capitalism.

There are problems with Model of Cooperative Capitalism within a country in the international context. The export surplus of one country is the import surplus of another country. This often resulted in conflicts in global trade. However the intensity of conflict of interest among the trading nation is moderate. The export surplus country will spend some of their increased income on purchasing the goods of import surplus country. Therefore the conflict of interests still remains but it can be moderated by complementary of interest among trading nations.

The application of expansionary fiscal policy to increase demand and hence income has encountered another problem. When income increase as a result of expansionary fiscal policy, it will lead to increase import. This will lead to trade imbalance of that country. Therefore it is not so easy to extend the model of cooperative capitalism in open economies.

There are two ways in which the problem might be moderated by allowing a regime of flexible exchange rate

1. If currency appreciates in export-surplus country and depreciates in import surplus country the balance of trade can be restored provided the trade elasticity's are sufficiently large.
2. If effective exchange rate can be adjusted for inflation rates, then we may get global trade balance. For instance, if inflation is high in export surplus country, its export will become costly abroad and this will reduce global demand. Similar but reverse logical sequence can reduce import in import surplus country.

Limitations of international price mechanism

Very often international price mechanism do not restore global trade balance. There are two main reasons for this: (a) wrong theoretical formulations and (b) economic nationalism. The price mechanism requires the assumption of full employment and satisfaction of Marshall-Lerner Conditions. If both or one of these condition(s) are

Box 7: Model of Cooperative Capitalism

1. The economic role of the state is an accepted norms across all political spectrum.
2. In Cooperative capitalism both sides stand to gain which resulted in golden age of capitalism.
3. There is problem of Cooperative capitalism in international context.
4. Export of one country is import of another country which is the source of conflict.
5. Fiscal policy: An increase in domestic income leads to increase in imports which deteriorate trade balance
6. Flexible Exchange Rate Regime: Currency appreciation of export surplus country and vice-versa can restore trade balance.
7. Limitation of international price mechanism lies both in theoretical formulation and economic nationalism.

not fulfilled then international price mechanism will fail to restore global trade balance.

A part from the theoretical problem, there are various conflicts of interest among the trading nations. The economic nationalism pursued by various nation states may manipulate the functioning of price mechanism. For instance nations which have surplus exports will build reserve of other currencies and engage in 'financial diplomacy' to destroy another country. Britain's acceptance of gold standard in 1925 and its abandonment in 1931 is a classic example to this.

The market mechanisms were also manipulated to suit the interest of imperial nations. In the later phase of the industrial revolution there was extensive bilateral trade between imperialist nations and its colonies. However when several capitalist countries of Europe appear on the scene, Britain become less supportive of the doctrine of free trade. Accordingly, each major imperialist nations retained their sphere of economic influence over their colonial markets.

Historically the imperialist nations played an important role in organizing and defending direct foreign investments and loans. The relationship between stronger and weaker nation often takes the form of 'gun boat diplomacy'. The situation sometimes resulted in open territorial wars. The ugly face of economic nationalism is thus seen in the form of World War I and II.

The economic nationalism redirected itself internally as the nations returned to 'closed' economy model. This did not diminish the relevance of nation state. In fact their legitimate economic role increases over a period of time as the state maintained high level of employment. The emergence of 'welfare state' in industrial nations strengthened this process further. The three decade of unprecedented economic growth after the Second World War assigned the nation state on undisputed economic position. The Keynesian model reconciles two apparently irreconcilable tendencies on the political level. The state reduce the conflict between labor and capital. The economic nationalism of various nation state also leads to some degree of mutuality in international relations. The threat of socialism and cold war acted as a uniting factor for all capitalist market economies. The United States raised expenditure on armaments to sustained aggregate demand and increased welfare programmes to counter the perceived threat of socialism.

5. The Changing Role Of The Nation State In Era Of Globalization

The authority of the nation state reached its peak during the golden age of capitalism. However it began to decline rapidly in the decades after the Second World War. The process of globalization is also responsible for the erosion of nation among others.

There are four different tendencies which eroded and reoriented the authority of the nation state.

1. The re-emergence of the conflict between labor and capital. In many industrial nations, we witnessed high unemployment and low growth rate.

(2) The emergence and domination of multinational corporations in production and in international finance

(3) The increasingly importance of financial capital flows at international level.

(4) Development of communication technology

5.1. Conflict between Labor and Capital

The model of Cooperative Capital helped us in achieving high level of employment. However there are problems associated with it. When workers are in employment for long period of time there is a tendency for workers' 'indiscipline' as the fear of job-loss in the labor market begins to erode. Therefore Kalecki argued that the government and the industry would retreat from demand management in the name of 'balanced budget' and precipitate 'political trade cycle'. The concept of 'political trade cycle' is similar to Marxian theme of maintaining the 'reserve army of the labor' for capitalist development.

The workers may demand money wages higher than the productivity growth of labor. This will results in inflation and a decline in capitalist profit. Thus the nation state have to make a choice between unemployment and inflation. The concept of welfare state which was once sustainable now comes under question in advanced capitalist economies. People resist high taxes to support public expenditure on social spending. A wider middle class fear that inflation might erode their accumulated savings.

Box 8: Nature of Nation State and Globalization

1. Four reasons for erosion of authority of nation state: (a) Capital-Labor Conflict (b) MNCs (c) Financial Capital Flows (d) Communication Technology

2. Capital-Labor Conflict

(a) Keynesian Demand management results in high output, high wage demand and workers indiscipline.

(b) Government will precipitate Political Trade Cycle. This will lead to Unemployment-Inflation trade off.

(c) Welfare state come under question as people don't want to pay higher taxes. Inflation erodes savings.

(d) Keynesian Consensus can break down because demand management can be done through private investment as well.

Breakdown of Keynesian Consensus

The model of Cooperative Capitalism will function if the state play a neutral role in managing aggregate demand to take care of the needs of both labor and capital. However once inflation sets in and conflict between labor and capital begins, the state cannot be assumed to remain neutral. The aggregate demand can be increased by both private sector and the state under Keynesian framework. So reducing corporate taxes or restraining wages is allowed under Cooperative capitalism. This may be politically untenable at times.

It has been argued by under-consumptionist that high wage is beneficial to both the capitalist and the workers. This is because high wages increases consumption which increase the income further. On the opposite side private investment could also be used to increase aggregate demand and hence income. The new conservative view of demand management favors increasing private role in demand management.

5.2. The emergence and domination of Multinational Corporations

The Kalecki-Keynes model of the closed economy become increasing irrelevant in an open economy. The use of 'high wage' policy to induce consumption led growth has its own limitation. The high wage and high price would reduce the price competitiveness of a nation in international market. With the increasing relevance of external market in the era of globalization, the 'high wage' policy would no longer be effective.

There has been tremendous growth of international trade after the Second World War. This is due to the rise of multinational corporations who produce goods at large scale across the globe. Therefore attracting foreign direct investments of the corporations is necessary to improve the trade performance of the nation. The multinational corporations would invest in locations which give highest profits and offers low tax rate and other benefits. This further restricted the nation states in conducting economic policy.

Importance of MNCS:

The importance of multinational corporations are manifold. Some of

Box 9: Emergence of MNCs

1. The Kalecki-Keynes model becomes irrelevant in open economy.
2. High Wage Policy lowers international price competitiveness
3. The tremendous growth in trade is due internationalization of production by MNCs
4. MNCs restricts the nation-state in conducting economic policy. They lower taxes to attract FDI
5. Importance of MNCs
 - (a) Update technologies
 - (b) Finance
 - (c) Commercial Loans
 - (d) Capital inflows

them are:

1. First they are involved in activities like licensing, outsourcing and joint ventures and international marketing. They influence trade performance through these channels. They also updated the technologies in developing nations
2. MNCs undertakes international production activities and engages in finance.
3. If a country has sizeable presence of multinational corporations, it is easy for a domestic firm in a developing nation to obtain international loans.
4. Through MNCs developing nations can attract modern technologies and expect more inflows of international capitals including portfolio investments.

5.3. International Financial Capital Flows

The most dramatic face of contemporary globalization is the internationalization of finance by private players on large and unprecedented scale. The globalization of finance has both opportunities and dangers for the nation state. There are huge opportunities in terms of accessing financial resources. The danger is that the central bank intervention in the market has been drastically reduced. The need to take into account the market sentiments in policy making further curtailed the autonomy of nation state in economic policy making.

There are several reasons for the erosion of the authority of the nation state in economy policy making. They are as follows:

1. The traditional aggregate demand management by fiscal or monetary policy is limited because increased demand can lead to higher import and current account deficit.
2. The sentiments in financial markets favors import liberalization. Therefore the nation state will have to reduce economic activity in domestic economy by artificially boosting exchange rate.
3. Nation state have very little or no autonomy to increase corporate tax rates in domestic economy and to lower interest rates because doing so would result in capital flight.
4. National states have compulsion to indulge in beliefs and prejudices of financial markets. So economic policies

Box 10: International Financial Capital Flows

1. Globalization of finance has both opportunities and dangers
2. The compulsion to be friendly to sentiments of financial market has restrained governments in making independent economic policies
3. Authority of national governments occur as
 - (a) Nation states have less control in managing aggregate demand
 - (b) Import liberalization
 - (c) Fear of capital flight
 - (d) Sentiments of financial markets

Communication Technology

1. Electronic media shapes and influences market sentiments
2. Beliefs like balanced budget, natural rate of unemployment becomes distilled truths.

across nations converge and favor trade liberalization along with investment and finance. This lay down the foundation for neo liberal economic regime.

5.4. Communication Technology

In the present age of globalization, electronic media plays an important role in shaping and influencing financial market sentiments. However the role electronic media has been often ignored by economist. The transfer of funds in huge amount across national boundaries can be carried out at lightning speed and efficiency with the aid of modern communications technology. These market sentiments propagated by the media imposed the most serious constraints on the nation state to conduct economic policies.

Rightly or wrongly the dominant economic theories of our time includes cutting down government spending through balanced budget and accepting a 'natural rate' of unemployment. These theories becomes popular belief as they are continuously propagated by the media. These beliefs then become the 'distilled truths'. When these 'distilled truths' become sufficiently popular in a globally integrated financial market, the national government has no choice but to act according to them.

The theoretical concepts propagated by the media show systematic bias in favor of private capital and discredit the bureaucratic central planning on the other. These make nation state unable or even unwilling to act to tackle poverty, unemployment or environmental degradation.

6. The Role Of Nation-State And Emergence Of Democracy

The once powerful nation state seems to lose its relevance in the era of globalization. The nation state remains local while the MNCs have global reach. However this does not imply the demise of the nation-state. There are two reasons for this:

- ✓ First the state play important economic role for the existence of the market. The state and the market relate to each other in terms of accountability and self-correction.
- ✓ Second the relationship between the nation-state and economic nationalism is evolving and changing over a period of time.

6.1. The State and the Market: Accountability and Self-Correction

The participants in the market economy accept market culture on two important basis:

- ✓ If the participants justified what they receive from the market
- ✓ If the participants justified what the market denied to them.

(1) Accountability

There are important distinctive differences between the roles played by the state and the market. The state is directly accountable to participants while as the market mechanism is not. We see that the majority rule in democracy does not mean that the rights of minority are trampled upon. Similarly, if the market economy marginalizes large section of its population then the state needs to intervene. The intervention by the state will ensure that the market system is legitimized in the eyes of its participants. If the state does not care for the poor and marginalized population, it will be held accountable for supporting a market system which is unjustifiable. This will also discredit the market process itself.

In many economically poor countries, we see massive poverty, illiteracy, diseases and unemployment. Since the state is held accountable to its participants it needs to intervene in such situation. The state also seeks legitimacy of its rule by undertaking various measures to combat poverty, hunger and other social malaises. The state failure is more severe than market failure in such circumstances. Thus accountability is a basis criterion for any democracy.

(2) Self-Corrective Mechanism

The accountability of the state to its participants is no guarantee for a self-correction mechanism. It is possible that the state perform poorly on economic issues and yet improve its image of accountability by appealing to different versions of nations like religious fundamentalism or military might.

The supporters of market argue that there is in-built self-correcting mechanism in market. However this logic is wrong on two counts:

- 1) The self-correcting market mechanism relies heavily on unrealistic assumptions which are not possible in reality. For instance the market cannot automatically correct for the lack of aggregate demand.
- 2) There is little relevance even if equilibrium existed as the speed of adjustment to the equilibrium is too slow

The proponents of liberalization argue that there are future benefits for integrating domestic with international economy. However there is no economic theory which specified how far or close the future is.

Box 11: The Nation-State and Democracy

1. In era of globalization, the state is not heading towards its demise. It has important dynamic economic role to play

2. Accountability:

(a) State is accountable and market is not

(b) State need to intervene to legitimize the market

(c) In developing countries state there is poverty, unemployment, illiteracy etc which the state has to tackle.

3. Self-Corrective Mechanism

(a) Market need not be Self-correcting. Eg lack of aggregate demand.

(b) State corrects itself within specified time period in democracy

4. Globalization has both losers and gainers.

However the government is accountable in a well-specified manner. In democracy the government has to be accountable to be elected in the next election. The government have to acted wisely in a given time framework whereas the market does not. The central planning in USSR and elsewhere collapse as they were neither accountable nor subject to correction within a specified timescale.

6.2. Economic Nationalism and Globalization

The market mechanism and globalization does not weaken various aspect of economic nationalism. There are losers and gainers among the nation states in the process of globalization. The gaining nation states favor globalization which is driven by the multinational corporations in the international capital market.

There is a call for strong central banks whose objective is to maintain exchange rate stability and curtail government expenditure in social spending like poverty alleviation and employment generation. To satisfy the requirements of multinational corporations large regional groupings are formed among nations to develop a more integrated market for trade, investment and finance.

Therefore the two opposing tendencies are being fused together. On the one hand, the nation-state is being constrained and weakened in exercising its authority on economic and political front. On the other hand, the nation-state is being strengthened in ways to suite large corporate interests in trade, investment and finance. Thus, we do not see a diminished of the nation-state but a systematic reorientation which is one of the most important features in the era of globalization.

Box 12: Re-orientation of Nation State: This occurs due to two opposing tendencies

- (a) The nation State weakened in exercising authority
- (b) The nation-State strengthened to suit interest of MNCs

Challenges to national governments and globalization itself

- (a) Global rules of games becoming more sensitive
- (b) National Government need to recognize the gains from globalization

Conclusion: devise ways to reap benefits of globalization without compromising democratic accountability

There are two challenges both to the process of globalization and to economic nationalism of the nation state. They are:

- 1) The global 'rules of the game' especially for MNCs have become more sensitive to the democratic accountability of national governments. The rules include a more transparent code of conduct that discourages corrupt and unfair trade practices.
- 2) Nation state to recognize the gains that can be made from selective, greater international interdependence through trade investment and finance.

The challenge to economic nationalism is to devise ways and means to reap the benefits of the international interdependence without compromising the accountability of nation state.

7. Framework For Sustainable Policy

The contemporary process of globalization is increasingly shifting the balance in favor of external market than for internal market. The states acted passively in the process. The national state help international regime of trade, investment finance and technology for the benefit of MNCs who are accountable to only narrow sectional interest of their managers and shareholders.

In this context, the question is how the nation state can define a plausible economic rule without rooting itself in narrow economic nationalism? The nation states need to shift the global balance by relying more on internal market and less on external market. Such macroeconomic policy can become the guiding principle of all nation states without generating conflicting economic nationalism.

The most beneficial aspects of competition is the increase in productivity. The general living standard and the average per capita GDP can rise if there is an increase in productivity. If productivity of one nation increase it need not decrease the productivity of another nation.

Box 13: Economic Rule in era of globalization

Answer: Rely more on internal and less on external markets

Problem in Keynesian Demand Management

Answer: Fear of Inflation and external payment imbalance

The extent of the division of labor is the source of productivity growth. In external market, increase in productivity can come about through conflicting economic nationalism over international market shares in a zero sum game. However in internal market, the nation state has

an important role to play in expanding the size of the market without generating conflicting economic nationalism.

The demand management by the nation state redefines the role of the nation state from the perspective of the link between productivity gain and the expansion of the international market. There are two problems in demand management namely

- I. The fear of inflation and
- II. The fear of external payments imbalance which may lead to capital flights due to speculation.

Policies

Capital-labor distributive conflict: In democracy, it would be wrong for national government to contain the conflict between labor and capital by reducing employment to the 'natural rate' of unemployment. The government should employ fiscal policies aimed at increasing internal market and raising labor productivity to fight unemployment. So the Keynesian demand management aimed at increasing internal market is a precondition for reducing the conflict between labor and capital. However increasing labor productivity by downsizing would accentuate distributive conflict between capital and labor.

Box 14: Capital-Labor conflict

Wrong policy: reduce employment to natural rate of unemployment.

Correct policy: expansionary fiscal policy and increase labor productivity

External balance: To deal with the problem of external balance, the ideal way is to encourage the formation of international clearing union whereby all members' states accept the debt obligation of the union. This would mean that both deficit and surplus nations received symmetrical treatment.

However the idea has not found any place in policy agenda because it is against the narrow economic nationalism of many nation states. If the policy of internal demand managements of all nation states could be coordinated internationally with respect to their timings, this would surely reduce the constraints in balance of payments that the nation state faces. For instance if all nations expand at the same time, this will increase each other's demand for exports and the net effects of trade surplus or deficit would be smaller. Similarly by reducing the interest rates simultaneously, the danger of capital flights from individual country will decrease.

Therefore we would like to have both clearing union and coordination of demand management at international level. However in the absence of any international agreement, we should discourage

transaction of foreign exchange for speculative purpose through schemes like the Tobin tax. Second, current account convertibility needs to tailor to the requirement of internal demand management by each individual state. Third, international negotiation should be held by the IMF to allow 'stand-still' agreement between private international leaders and the national government when there is speculative attack on its currency.

Box 15: Policies for External Balance

- (1) International Clearing Union and Coordination of demand management
- (2) In absence of clearing arrangement
 - (a) Discourage international speculative foreign exchange transaction
 - (b) Tailor Current account convertibility needs to the internal demand management by the nation state
 - (c) Stand-still agreement

There are two questions which arise due to the absence of international financial reforms:

- 1) What forms of international governance and policy coordination might be feasible in the near future?
- 2) How can democratic national governments empower itself to enhance its accountability without any international agreements?

Developed and developing countries

In developed countries, the way to empower national governments in the eyes of poorer electorates would be to manage internal market rather than leaving it to the forces of global capital. This implies employing internal demand management to deal unemployment and business cycle in advance industrial nations. Regional groupings/union could be counterproductive if it restricts the ability of nation state in managing its internal market.

There are problems like massive poverty, illiteracy and lack of health care facilities in developing countries. So, the government in developing countries should create more employment through public works and simultaneously create productive assets on sustained basis. Pure welfare programmes may run into problems of resource constraints.

In the present intellectual climate of neo-liberalism the policy framework we argue run contrary to conventional wisdom. The conventional wisdom of the 19th century liberalism calls for natural harmony between public and private interest. The neo-liberalism of the late 20th century also favors the harmony between corporate and public interest in the name of globalization. It is high

time that the democratically accountable nation-state face this, both for their own survival, and for the welfare of its citizens.

Box 16: Policies for Developed and Developing Countries

- (1) Advance Industrial Countries: Keynesian demand management in internal market to tackle unemployment and business cycle.
- (2) Developing Countries: employment creation through public works and the creation of productive assets on sustained basis.

Conclusion:

Policy framework should run counter to neo-liberal policies

Sample Questions

1. Globalization does not lead to demise of nation-states but results in its reorientation. Support your answer with valid arguments.
2. Consolidation of economic nationalism through globalization operates as a double-edged weapon which often wound both developing and developed nations which tries to wield it. Discuss
3. The main macroeconomic policy of all nation states in the era of globalization is to shift global balance by relying more on the internal and less on the external market without generating conflicting economic nationalism. Elaborate.

Reference:

Amit Bhadhuri, 2002, 'Nationalism and Economic Policy in the era of globalization' WIDER Working Paper no. 188