Development Strategy: Balancing Market and Government Failure

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Abstract

This paper describes the evolution of development economics thinking after World War II as one of a constantly shifting balance between addressing market failures and government failures. The pendulum has swung from statist "big push", through market-oriented "Washington Consensus", to a more balanced approach between state and market that also includes the role of civil society as a third player. The paper interprets these swings as not just technical responses to real-world problems with either approach, but as the result of political forces and institutional incentives. Looking ahead, the paper sees development thinking in the future being dominated by two issues that go beyond the "market-versus-state" dichotomy: sub-national pockets of poverty, and global

public goods. The paper concludes by noting that development economics thinking proceeds in evolutionary rather than revolutionary steps, with each shift building on the experience of the previous phase.

Keywords: market failure, government failure, Washington consensus, civil society, politics, global public goods, sub-national government

Introduction

"Markets versus the State" has long been one of the central themes of the development economics discourse. Broadly speaking, development strategies lie on a continuum, with more regulation of economic activity, less integration into the world economy, greater role for public provision of social services, more redistribution, etc., at one end; and the opposite at the other end. A policy package, or development strategy, will reveal its orientation by where it lands on this stretch between state- and market-oriented approaches. Those who come down on the more statist end stress "market failure," while those who come down on the market end stress "government failure."

In this paper we examine the evolution of development economics thinking in the post-Second World War period as a constantly shifting balance between emphasis on market failure and emphasis on government failure. The swing of this pendulum can be traced back to the pre-war period, and well before. Development thinking in any phase was influenced by the experience of the immediate past—successes or failures. The dominant strand of thinking was in turn challenged by new experiences and new realities. The next section of the paper identifies three

main phases in post-1945 thinking: the immediate post-war period, where statist strategies reigned supreme, the era of the Washington Consensus in the 1980s and 1990s, which represented a market oriented reaction to this orthodoxy, and the current phase, where the pendulum has swung back in the direction of the statist dominance of the 1940s and 1950s.

However, the current phase of thinking has elements that take us beyond the simple "market versus state" pendulum swings, important as they are. The following section takes up a strand of development economics thinking that has come to the fore in the last two decades: namely, the shift from a technocratic perspective on the balance between market and government failure to the political economy of policy making and strategy. Which policies get chosen, and how they get implemented, reflect the balance of political power in a country, and we will not fully understand choice of strategy without understanding these basic forces. Indeed, to the extent that government failure is the result of these political forces, we cannot understand a key component of the old debate either.

The "state" in the development economics discourse has been the nation state, and most of the discourse on economic strategy in the balance between market and state has centered on the

nation state, its policies, and its strategies. But the nation state in the conventional sense is now facing two challenges, one global and the other local.

The final section introduces the issues that arise as we look out from the nation state in these two directions—the need for cross-national coordination to address externalities across countries and international public goods, and the need to address growing sub-national disparities within nation states, disparities which could undermine the legitimacy of the state in the "market versus state" debate.

The paper concludes by asking whether there are in fact revolutions in development strategy and thinking, or whether evolution is more likely to be the order of the day.

The evolution of development thinking and outcomes since 1945

Development thinking pre–1945

The focus of this paper is on development economics in the post-Second World War era. There was of course thinking and writing about economic development before 1945. One can go right back to the classics, such as Ricardo's analysis of the joint determination of accumulation and income distribution, an analysis that was refreshed in the immediate post-war era by Arthur Lewis (1954). Or one can find in the neoclassical analysis of Alfred Marshall "the hope that poverty and ignorance may gradually be extinguished, derives indeed much support from the steady progress of the working classes during the nineteenth century." (Marshall 1961: 3)

But it is in the early part of the twentieth century, especially in the inter-war period, that one begins to see a focus in the rich countries on the problems of poor countries or, in many cases, poor colonies of rich empires. The economic reports of the League of Nations, including on territories with mandates and other areas, began a discussion of low incomes and investment

needed to raise them. The colonial powers themselves could be said to be taking a "developmental interest" in their colonies, although the interests of the metropole were always central:

> "From about the turn of the century, the UK Government began to take a slightly more active interest in colonial economies, and a variety of committees studied education, the use of natural resources, and similar topics in selected colonies. . . . In 1929, for the first time, provision was made for assisting colonial governments to develop their economies by means of grants and loans for what is now called 'infrastructure;' for improving transport, research, power and water supplies, land surveys, and so on. Education was excluded, and a strong subsidiary aim of the new Colonial Development Act of 1929 was to promote employment in Britain by stimulating the colonial economies and their demand for British exports. Funds therefore had to be spent on British products as far as possible." (Little and Clifford 1965: 31)

In 1943, in the middle of the Second World War, the Colonial Economic Advisory Committee (CEAC) was set up by the Colonial Office, and none other than Arthur Lewis, a 28-year-old lecturer at the London School of Economics, was recruited to be its secretary (Mine 2006). The

exchanges between Lewis and Sydney Caine, head of the Economic Division of the Colonial Office, are instructive, and the debates seem very modern. As Lewis wrote of Caine in a confidential memorandum in 1944, just prior to resigning from the CEAC:

> "He is a religious devotee of laissez-faire, and his headship of the Economic Department at this juncture is fatal. . . . [His approach] is fatal not only in the decisions he makes, especially on secondary industry, on marketing and on co-operative organisation, but also in the appointments he recommends to important jobs in the Colonies, for which he chooses almost invariably people as laissez-faire as himself." (Quoted in Mine 2006: 335)

Of course the debates between Caine and Lewis reflected wider debates on market versus state. If there is any surprise it might be that the laissez faire view persisted so strongly in the inner reaches of government into the mid-1940s, being reminiscent of the "Treasury view" that Keynes battled in the 1920s and 1930s. The generally accepted consensus is that this view was discredited by the economic disasters of the interwar period, and a more interventionist, state-led view of economic policy in general, and development policy in particular, was dominant by the time the war ended.

A global perspective on the balance between market and state

The discipline of economics in general, and the sub-discipline of development economics in particular, emerged from the Second World War with a deep concern about market failures as a hurdle to rapid development and growth. The classic paper by Rosenstein-Rodan (1944) highlighted these concerns, focusing on lack of development as the result of coordination failure, and the need for state intervention to coordinate the "big push." We have already referred to the thinking of the young Arthur Lewis in the 1940s, which eventually crystallized into his Nobel Prize-winning paper (1954) on development with surplus labor. A slew of other publications, such as Myrdal's (1968) monumental *Asian Drama*, testify to this mindset in development economics thinking.

Policy reflected this thinking nationally and internationally. Surprising as it may seem now, the World Bank's assistance in the 1950s and 1960s supported state-led industrialization. Reflecting, and leading, the evolution of India's Five Year Plans was the steady increase in emphasis given to poverty reduction directly, through phases such as the focus on rural development and on "basic needs" (ILO 1976). Robert McNamara, then President of the World Bank, gave a

celebrated speech (McNamara, 1973) emphasizing poverty, and the Vice-President for Development Economics and his team published a book (Chenery et al. 1974) entitled *Redistribution with Growth*. The greater focus on poverty seemed to strengthen the case for the role of the state in development strategy.

Alongside India, countries in Africa and Latin America were very much in tune with these global perspectives. In a speech to the United Nations in 1957, Ghanaian President Kwame Nkrumah said that, because institutions in his country were so weak, Ghana had to rely on state-led development. Houphouet Boigny, who would soon be his counterpart in Côte d'Ivoire, disagreed: because institutions in his country were weak, he would rely on market-led development. Despite this "West African Wager," both countries, as well as most of Africa, adopted strategies with a strong role for government. The disappointing performance has been called "Africa's growth tragedy." By the 1980s, Africa's slow growth and high poverty were attributed to excessive and inappropriate government intervention in the economy (World Bank 1982).

Meanwhile, the success of the export-led East Asian "tigers" in delivering historically unprecedented growth together with falling or at least stable inequality, with substantial poverty

reduction as the result, raised major questions on the inward-looking strategy in India and globally. The growth success of China through opening up and liberalization, albeit with rising inequality, also raised questions on the inward looking import substitution strategies favored in the immediate post-war period. It should be noted, however, that the role of the state in the success of East Asia and China has been much debated. Freeing up of some controls has been emphasized by some, but the role of the state in guiding exporting industries through credit and other instruments has been emphasized by others. The lesson from these experiences is not necessarily a light state but a pragmatic, efficient state as the basis for development. Be that as it may, the fall of the Berlin Wall in 1989 seemed to be the final verdict on the type of central planning that went on behind it.

The 1980s thus culminated in a shift away from concern with market failure toward a concern with government failure—the seeming inability of statist strategies to deliver sustained growth and poverty reduction. Williamson (1990) captured this shift in a list of policy positions that, he argued, constituted the Washington Consensus. Some of the points in his list (for example, a more equitable distribution of public expenditure—see Kanbur 2009) may surprise those who are familiar only with summaries of the "consensus." Nevertheless, by and large the consensus does

represent a move toward the market-oriented end of the spectrum of policy stances, and the shift that started in the 1980s continued into the 1990s.

A certain triumphalism accompanied this swing in the pendulum. Fukuyama (1992) spoke of "the end of history," meaning that all previous debates had been settled, and that market economics (and liberal democracy) had won the day. However, as is already clear from India, and would have been clear in light of the long arc of development thinking, such declarations were premature. As Kanbur (2001) noted, "the end of history lasted for such a short time." No sooner had the Washington Consensus been announced, indeed even before it was formulated, than the arguments against it began to coalesce, driven by a number of development outcomes of the market-oriented 1990s and 2000s: (i) the East Asia financial crisis of 1997, driven by liberalization of international capital flows; (ii) the "shock therapy" experience of many Eastern European economies' transition to market in the1990s; (iii) the poor growth performance of Latin America and Africa in the 1980s, even after having adopted the tenets of market liberalization; (iv) the fact that India and China had not, in fact adopted full-throated market liberalization, especially on their international capital accounts, and yet had delivered high growth rates in the 1990s; and (v) the sharp rise in inequality that accompanied several fast-growing countries in the 1990s.

These challenges to the Washington Consensus were in turn absorbed in development thinking to produce a swing back to a better balance between state and market, but without returning all the way to the statist strategies of the immediate post-war phase. The Growth Commission of the mid-2000s, whose members included leading policy-makers from developing countries, captured this emerging consensus well:

> "In recent decades governments were advised to 'stabilize, privatize and liberalize.' There is merit in what lies behind this injunction—governments should not try to do too much, replacing markets or closing the economy off from the rest of the world. But we believe this prescription defines the role of government too narrowly. Just because governments are sometimes clumsy and sometimes errant, does not mean they should be written out of the script. On the contrary, as the economy grows and develops, active, pragmatic governments have crucial roles to play." (Commission on Growth and Development 2008: 4)

> "The Commission strongly believes that growth strategies cannot succeed without a commitment to equality of opportunity, giving everyone a fair chance to enjoy the fruits

> of growth. But equal opportunities are no guarantee of equal outcomes. Indeed, in the early stages of growth, there is a natural tendency for income gaps to widen. Governments should seek to contain this inequality, the Commission believes, at the bottom and top ends of the income spectrum. Otherwise, the economy's progress may be jeopardized by divisive politics, protest, and even violent conflict. Again, if the ethical case does not persuade, the pragmatic one should." (Commission on Growth and Development 2008: 7)

The Growth Commission's report was published before the global financial crisis of 2008. The caution against the simple injunction to "stabilize, privatize, and liberalize" can only be stronger in the second decade of the new millennium.

Beyond state and market

Our account of post-war development thinking and policy has focused, by design, on the debates between market-oriented and state-oriented development strategies. This debate, as we have seen, dates from before the war, is still at the core of the development discourse, and will no doubt continue. However, there is a key element in the debate that was not present in pre-war or

immediate post-war thinking, or indeed for the first three decades after the Second World War. This is the role of civil society.

In Devarajan and Kanbur (2007) we have argued that between market failure and government failure is an area that is the domain of civil society:

> "When markets do not work well, the economic system generates outcomes that are not efficient, nor need they be equitable. . . . If the interventions that are needed in theory can be implemented by a benevolent, informed and competent government, market failure can be easily overcome. Of course in reality, governments are not fully benevolent, informed, or competent. . . . This is government failure. . . . Just because there is some market failure does not mean that all markets fail all the time. Just because there is some government failure does not mean that all government fails all of the time. Moreover, even when markets and government both fail, perhaps especially when they both fail, sometimes civil society organizations step in and provide services and activities that fill the gap. . . . However, the gap is not filled completely, by a considerable margin—otherwise the record on poverty reduction would be stronger and more widespread. This is civil society failure." (pp. 379–80)

Three examples can illustrate what we have in mind (these are discussed in greater detail in Devarajan and Kanbur 2007).

There is clearly market failure in the credit markets for poor people in many developing countries. This failure has been the rationale for government interventions in credit markets. But alongside these government schemes one finds microfinance initiatives led by civil society organizations like Grameen in Bangladesh and SEWA in India. This is partly because the government schemes display key features of government failure—incompetence and corruption. Civil society has stepped in to fill the gap.

As another illustration, self-help groups in Andhra Pradesh, the Rural Support Program in Pakistan, and the National Solidarity Program in Afghanistan are all examples of partnerships between government and civil society to help deliver government programs that attempt to overcome market failures, but to deliver these while minimizing government failures.

A third example is that of Citizen Report Cards in Bangalore, where an NGO, the Public Affairs Centre, collected and collated information about the quality of public services and then

publicized its findings to put pressure on local government to do better. Such a perspective clearly takes us beyond the simple state-versus-market dichotomy that dominated so much of the post-war debate on development. It changes the question to what can improve the functioning of the state even as the state tries to improve the functioning of markets.

Civil society is now a player in the development discourse in two senses. First, its role in directly correcting market failures, and its role in addressing government failures, is the centerpiece of much development thinking. Second, civil society is itself engaging in the development debates, bringing their ground level experience to bear on matters which were previously thought to be the domain of technical analysis. The heated exchanges between Arthur Lewis and Sydney Caine on laissez-faire versus state intervention in development policy were carried out behind closed doors. Today the debate would be between Lewis, Caine, and Ela Bhatt, the founder of the Self Employed Women's Association (SEWA) in India, or Mohammed Yunus, the founder of Grameen Bank in Bangladesh.

The greater involvement of civil society in development debates raises another aspect of the evolution of development thinking on markets and the state. The debates reviewed so far have been somewhat technocratic in nature, concerning a range of policies that would be adopted, and

if adopted then implemented well. But the political process through which the policies were adopted and implemented, whether for good or ill, have not been explored. A greater awareness of the political economy dimension of development policy making is a characteristic of the current phase of development thinking. We turn now to a closer examination of this dimension.

Politics and policy

The previous sections have described a stylized process by which development economics thinking translates into policies that in turn lead to outcomes; and then, in light of these outcomes, the thinking is revised and policies adjusted accordingly. The truth is that all three—thinking, policies, and outcomes—are influenced, if not driven, by underlying political forces and institutional incentives. In this section, we attempt to explain the emergence, persistence, and transitions in development policies, drawing on recent research on politics and institutions in development.

The pre-war colonial era bias toward laissez-faire—against which Arthur Lewis rebelled —could be attributed to what Acemoglu and Robinson (2012) call "extractive institutions." The colonial

powers wanted to extract from the colonies as many resources as possible, as efficiently as possible. Minimizing government intervention, with little regard for equity, would come close to maximizing efficiency.

The heavy government intervention after independence in South Asia and Africa was partly a reaction to the laissez-faire of the colonial era. Now that India was independent, so the argument went, it would develop its own industry, rather than be the supplier of raw materials to British industry. But this does not explain the persistence of the state-led model for so long, especially in the wake of anemic growth and poverty reduction.

The period of statist intervention was sustained, and eventually abandoned, because of politics and institutions. In the case of India and other democracies, although growth was slow, the policies and regulations, including import controls, created huge rents in the domestic economy. These rents were shared between the few industrialists who were fortunate enough to receive import protection (and monopoly power in the domestic economy) and the highly educated civil servants who had discretion in implementing policies, such as issuing import licenses. Inasmuch as these two groups constituted most of the elites of society, they commanded considerable power. Furthermore, in heterogeneous societies like India, with (at least then) a strong caste

system, the prevailing Fabian socialist principle of free, public provision of basic services like health and education did not translate to universal access to these services. Doctors and teachers, who were themselves part of an educated elite, did not want to treat or teach those of a different caste. The result was that health and education levels of the poor remained low, further increasing the premium for the educated elite.

In non-democracies, such as the military dictatorships in Africa in the 1960s, 1970s and 1980s, the state-led model persisted, but for slightly different reasons. To stay in power, military leaders needed to curry favor with those who might overthrow them. This included other military officers (who might launch a coup d'état similar to the one that brought the current dictator into power), as well as the urban elites, who might support such an attempted takeover. One way to keep these groups satisfied was to ensure that food and import prices were low (Bates 2008). Accordingly, these countries maintained overvalued exchange rates and subsidies or controls on food prices. These policies discriminated against producers of food and exports (most of which were in agriculture), which was the majority of poor people in the country. Bates (1981) offers a further explanation for this "urban bias," which rests on the idea that industrial products are more differentiated, so that it is easier for producers of specific manufactured goods to mobilize for protection (and harder for consumers to register the impact of protection on the prices they face),

whereas a more homogeneous commodity like food requires millions of farmers to organize and demand protection.

If this statist model of development was a political equilibrium, how did it change? While individual circumstances differ, a common feature was that almost every country faced an external shock, such as the oil price spikes of the 1970s (or the price collapse of the late 1980s), and the collapse of the Soviet Union in the late 1980s, which made the current policy regime unsustainable. The shocks triggered a balance of payments crisis (which had already been brewing, thanks to the overvalued exchange rates). The knee-jerk response to the shocks—imposing exchange controls, for instance—exacerbated the problem. Moreover, the East Asian countries, which had liberalized their trade regimes earlier, fared better during the shocks (Balassa 1985). Lacking intellectual legitimacy and rents to capture, the elites either lost power (as in Ghana) or had to re-think their development strategy (as in India). Those that had been advocating for more market-oriented policies were now given more credence. And because it was a balance of payments crisis, external organizations, especially the International Monetary Fund (IMF) and World Bank, became important players.

Despite being triggered by a crisis and supported by a volume of academic work, the transition to more market-based policies was by no means smooth. First, because the balance of payments support was being provided by the IMF and World Bank, the accompanying policies or "structural adjustment programs" were seen as externally imposed. Political protests ensued, policy reforms were reversed or not enacted at all, and some countries found themselves in worse circumstances than before the crisis. As Devarajan, Dollar, and Holmgren (2001) show, the problem was not that these were the wrong policies. Rather, it was that they were designed from outside the country (usually in Washington, DC), which made it difficult to build a domestic political consensus around them. Desperate for the money, governments agreed to the "conditions" but did not implement them because the political costs were too high.[1] Countries such as Uganda, Ghana, and Tanzania, where the reform program was designed from within, with widespread consultation in the country, were able to sustain reforms and register strong growth rates.

Secondly, even for reforms designed in the country, there were problems particularly with trade reform. In addition to the usual phenomenon of losers (protected industrialists and government bureaucrats) colluding to resist reforms, there was an issue with exporters—who would normally

benefit from the reform—because of the uncertainty associated with entering new markets (Fernandez and Rodrik 1991).

Uncertainty about whether they would be winners or losers led people to vote against reforms, resulting in a status-quo bias in reform programs. However, when the initial bias was so extreme, as in Ghana with a severely overvalued exchange rate, and there was political competition (also in Ghana since 1992), then there was widespread support for reforms that shifted the terms of trade in favor of agriculture (Block and Bates 2012).

Notwithstanding the difficulties in the transition, most developing countries by the early 2000s had transformed into macroeconomically stable, market-oriented economies. Trade barriers had come down; there were fewer state-owned manufacturing enterprises; and so on. In a sense, these countries had adopted the Washington Consensus, but rather than being imposed from outside, it was increasingly developed from within. Their strategies were expressed in Poverty Reduction Strategy Papers, which were written by the government, based on widespread consultation. The substantial increase in political competition in Africa contributed to the reform momentum (Chauvet and Collier 2009). Furthermore, these countries were experiencing rapid economic growth—five to six percent a year in Africa, eight to nine percent in India.

Nevertheless, this growth was not reducing poverty fast enough. India's rate of poverty decline was the same as before the 1990 reforms; fast-growing Tanzania saw only a slight decline in poverty during the 2000s. One reason was that agricultural productivity growth was still quite limited in Africa and South Asia (where the gains from the green revolution had dissipated). Another was that there was little growth in productive employment. About seventy to eighty percent of the labor force remained engaged in low-productivity informal farms or household enterprises. Finally, human development was lagging: Africa and most of South Asia had stubbornly high child mortality rates; while primary enrolment rates were soaring, learning outcomes were disappointing; and India had about double the child under-nutrition rate of Africa.

These indicators confirmed the worst suspicions of the anti-globalizers. It looked as if market liberalization had led to the rich getting richer and the poor poorer. In India, electoral sentiments appeared to be moving back to the center. An alternative interpretation is that the problems with agriculture, employment, and human development have to do with government failures that were not tackled during the first wave of reforms. For instance, the high level of subsidies to farmers in southern Indian states (estimated at one percent of state GDP) crowd out much-needed public

investment in agriculture, resulting in slow productivity growth. But these subsidies are politically sensitive: any politician who attempts to reduce them is likely to lose the next election. Likewise, formal-sector employment growth is hampered in India by restrictive labor regulations and in Africa by infrastructure constraints. The latter too are the result of policies and regulations that are politically difficult to reform. And the weak human-development indicators have a lot to do with poor service delivery—absentee teachers and doctors, leakage of public funds—that are in turn a reflection of politically powerful teachers' and doctors' unions that remain unaccountable to poor citizens (World Bank 2003).

Given that they represent a new political equilibrium, even in countries with competitive elections, these government failures will be difficult to overcome. Some solutions such as increasing the accountability of service providers by tying their pay to performance, have shown encouraging results (Basinga et al. 2011). But these can only be attempted if they have political support. If the underlying political system is distorted by clientelism, then the only way to get reform may be by informing the public about the costs of these distortions, so they can bring pressure to bear on politicians for reform. Even this approach may not always work (Keefer and Khemani 2012), but there is scope, especially with the widespread use of cell phones in these

countries, so that citizens can be better informed, and in turn inform elected officials about their views.

Looking ahead: markets and state in the global and the local context

Having described and interpreted the evolution of development economics thinking in terms of balancing market and government failure, we now look ahead and ask how this debate will play out in the future. Our view is that the nature of both states and markets—and hence of their failures—will change over time.

The nation state at the confluence of the global and local

The nation state has been at the foundation of development debates. The implicit assumption in much of the development policy discourse, from the Second World War right up to the present, is that the policies being discussed and debated are national policies. Whether with regard to

monetary stability, fiscal balance, trade liberalization, public expenditure, etc., the policies are applied by the national government, taking into account global conditions but without regard to the repercussions on other nations.

There are at least two senses in which the nation state's being the fulcrum of policy is problematic. First, when a nation is large its policies have a direct impact on other countries. Chinese exchange rate policies or reserve accumulation policies of emerging markets are examples. Second, even if each country is small, the collectivity of their actions can impact the group as a whole. An example of this is when each country attempts to grow by exporting the same commodity: the expansion of global supply leads to a fall in the price of the export, hurting all countries together.

More generally, as cross-border trade, investment, and migration have expanded, and as environmental resources come under stress, externalities from one country's actions to another country's well-being have multiplied and intensified. Managing these spillovers requires policies at the level above the nation state, and yet we do not have those structures in place. Rodrik (2007) has gone further and posited a trilemma for the world economy: "I have an 'impossibility theorem' for the global economy. . . . [D]emocracy, national sovereignty and global economic

integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full. . . . Pretending that we can have all three simultaneously leaves us in an unstable no-man's land."

Looking outward globally from the nation state is only one of two perspectives. The other, of looking inwards at the components of the nation state, has been and always will continue to be important. In *The Black Man's Burden: Africa and the Curse of the Nation State*, the historian Basil Davidson assessed the colonial legacy to Africa—a collection of artificial states formed more for the convenience of, and through bargaining among, colonial powers. The Berlin Conference of 1884–85 left a map of Africa whose straight lines reflect the arbitrariness of the nation states at independence. These states had to develop a national identity, adopt mechanisms to give effect to national policies, and manage the politics of these policies. If it took Europe more than a century to solidify the Westphalian state, why would we expect Africa to do it any faster?

Today, the nation state is coming under greater pressure from within, particularly in large nations that have ethnic, religious, historical, geographical, and other cleavages. The formulation and implementation of national level policies must take into account their impact on local

jurisdictions. These twin departures from the conventional focus on the nation state, one toward the global and one toward the local, form the focus of this section of the paper.

International public goods

Let us start with some basic economic theory of public goods. A “pure public good” is defined as one which is “non-rival” and “non-excludable” in consumption. By non-rival is meant that consumption by one does not reduce the amount available for another. By non-excludable is meant that it is in fact not possible to exclude anyone from consuming that good. National defense would be a concrete example of a pure public good: all citizens are equally and simultaneously defended from foreign attack, and no citizen can be excluded from such defense. Exchange rate policy is another example of a national level public good: all citizens are simultaneously affected by it, and no citizen can be excluded from its impact. Somewhat more abstractly, the symbols of “national identity”—the flag, the national anthem—are public goods. In practice many goods are only “impure public goods” since they only partially satisfy the conditions of non-rivalry and non-excludability. But the sharp formulation of a pure public good is analytically useful.

Basic economics teaches us that markets will supply inefficiently low levels of public goods (Cornes and Sandler 1996). This market failure is one of the major arguments for state intervention in a range of activities, including activities to mitigate externalities, spillovers from one individual's actions to another which are not meditated through markets. Such mechanisms to address externalities—for example, a coordination mechanism to manage deforestation—are themselves public goods: the mechanism by definition applies equally to all. It follows that such mechanisms will also be undersupplied by the market, leading to an argument for state intervention.

The basic structure of analysis at the level of the individual can be translated up one level by replacing the community of individuals in a nation state by the community of nations in the world as a whole. What nations do—their national policies—have spillover effects on other countries that are not fully mediated by markets. Refugees, greenhouse gases, deforestation, underground water exploitation, infectious disease immunization, financial regulation, etc., are all cross-national externalities in an integrating world economy. Mechanisms to address these many externalities are public goods. Markets will undersupply these public goods. What is needed, then, is the equivalent of a state at cross-national level to provide the public goods that

are the coordinating mechanisms to manage cross-border externalities. Without them, global development and well-being will be lower than they would be otherwise.

Cross-national coordinating mechanisms will of course mean giving up of some national sovereignty in deciding some national policies, as in Rodrik's trilemma. One solution is to not have as much "hyper-integration" in the world economy, "I am skeptical about the global governance option. . . . There is simply too much diversity in the world for nations to be shoehorned into common rules. . . . The only remaining option sacrifices hyperglobalization." (Rodrik 2011: 203–4)

One can make three observations about the comment above. First, there is still something to be said for at least some cross-national coordination. Second, as Rodrik recognizes, some aspects of globalization may now be beyond us to "walk back," linked as they are to technological and social changes. Third, where walking back is possible, this will itself require international coordination.

There are two further aspects of the public good of international coordination that need to be emphasized. First, some cross-border spillovers are not necessarily to do entirely with global

economic integration. Greenhouse gas emissions or deforestation would be issues even if there were less hyperglobalization. Second, Rodrik's focus seems to be primarily on global spillovers and global public goods. There are often spillovers and externalities between neighboring countries within a region—for example, vector borne diseases in Africa, or countries that share a common water table—that require a more localized but still cross-national coordination.

Viewing the evolution of the development discourse as an ever-shifting balance between state-oriented and market-oriented strategies, as we have done in this paper, comes up against an interesting variation in the case of International Public Goods. Public goods at the national level are of course ones where market failures are inherent, and perhaps where attempts to supply public goods through the state led to government failure. But International Public Goods are also a case where there is clearly market failure, but the experience of international non-market provision is limited, because the experience of international coordination is limited. Perhaps strong instances of international government failure will arise when we try such mechanisms, but we will not know until we try.

Sub-national pockets of poverty

The terrain of development has shifted significantly, especially in the last quarter century. The conventional classification of countries is in terms of their Gross National Income (GNI) per capita using the World Bank's Atlas method. The latest available classification is using data for 2010: (i) Low Income Countries (LICs), less than $1,005; (ii) Lower Middle Income Countries (LMICs), $1,006–$3,975; (iii) Upper Middle Income Countries (UMICs), $3,976–$12,275; and (iv) High Income Countries (HICs), more than $12,276. Strong growth in a number of large developing countries has moved them from LICs to LMICs. Countries that have made this transition include India, Indonesia, Ghana, Zambia, and Philippines. China is now an Upper Middle Income Country, as is Thailand. Brazil, Mexico and other Latin American countries are also UMICs, and South Korea is an HIC. Mexico and South Korea are members of the OECD.

If development were to be defined by increasing per capita national income, the world can point to considerable success in the post-war period. However, there are two features of this global picture that sound notes of caution. First, there is a group of countries stuck in a low income trap for a number of reasons, including conflict and political fragility. Second, even within countries that have exited from the LIC category, significant numbers of people languish in poverty. Using

official definitions, Sumner (2012) establishes the following stunning stylized fact. Twenty years ago, ninety percent of the world's poor lived in LICs. Today, seventy percent of the world's poor live in MICs. In other words, the vast bulk of the world's poor now live in non-poor countries. In nation states that have succeeded according to the conventional definition of development, there are significant pockets of poverty.

These pockets of poverty almost invariably have a geographical nature. Spatial disparities are and always have been a feature of development the world over. These disparities have intensified in the past two decades in almost every developing country (Kanbur and Venables 2005). This divergence of economic performance within nation states can be linked to globalization, which has led to sharper expression of comparative advantage within each nation state. In Mexico, regions furthest away from the U.S. border have lagged behind; in India, states with an educational advantage have raced ahead; in Indonesia, the outer islands have not done as well as the core; in China, coastal provinces have performed more strongly than inland ones.

When the pockets of poverty align with cleavages such as geographical divisions, which are themselves the product of history, the nation state itself may be challenged. The challenges come along a spectrum from political activities by regional parties, through claims for greater regional

autonomy, to outright wars of secession. Even where political dissent cannot be expressed in the open, the ruling elite has to address it one way or another. Examples of such tensions are abundant. In China, the Western provinces have significant Islamic and ethnic minority populations. In India, pressures to split up large states into smaller entities are constant, and have been conceded periodically—for example, the new states of Uttarakhand, Jharkhand, and Chattisgarh, and ongoing agitations for a new state of Telengana. In Ghana, Nigeria, and Côte d'Ivoire, the north-south divide coincides with a religious divide and regional economic balance, and is central to political balance and viability. In large federations such as Brazil, regional disparities are prominent in the political discourse.

We thus come to an issue which is largely missing from the "market versus state" spectrum that has structured so much of the development discourse in the post-war period: whether the state itself can survive as currently structured. The question of "too much state" or "too little state" becomes moot if divisions within the state lead to challenges to the legitimacy of the state. Indeed, if the divisions within the state are intensified with a market-oriented development strategy, then the state which adopted this market-oriented strategy may be called into question. Paradoxically, perhaps, we need the state to maintain regional balance and legitimate the nation state, through which a national policy of market-oriented reforms can in turn be legitimated! This

certainly puts the “market versus state” debate in a new perspective, a perspective that is likely to endure in the coming decades.

Conclusion: Revolutions or evolution in development thinking?

To those engaged in the cut and thrust of development debates, the twists and turns seem large and significant. The turn toward market oriented development strategies in the 1980s appeared to both supporters and opponents as “revolutionary.” For Fukuyama (1992) these shifts were epochal in the right direction. For others the “neo-liberal” or “Washington Consensus” strategies were equally epochal but in the wrong direction. However, viewed in the perspective of the long arc of development thinking, stretching back to the Second World War, the inter-war period, and before, these decadal shifts appear as relatively small adjustments.

In fact, it would be difficult to identify “revolutions” in the progression of development thinking that we have described in this paper. Rather, what we have seen is the pendulum swinging back and forth between two visions of development strategy, where each swing absorbs key features of the challenges to the previous dominant mode of thinking and converts itself into the next consensus waiting to be challenged. New challenges and issues may appear, such as the increasingly important role of civil society, but older issues do not entirely disappear. Mechanisms such as state intervention in agricultural research, discussed by Arthur Lewis in his

challenges to Sydney Caine, which became orthodoxy in the next phase but were then dethroned in the phase thereafter, are once again present as policy possibilities.

Development economics thinking does not seem to have revolutions in the sense of Kuhn's (1962) "scientific revolutions" which sweep all in their path and establish a new discourse and completely new ways of thinking. This is perhaps because, as argued by Bronfenbrenner (1971), the evolution of economic thinking itself cannot be seen in these terms:

> "Ptolemaic astronomy, phlogistonic chemistry, and humoral medicine are examples from natural sciences. . . . But in economics, where are their equivalents? Currently fashionable incomes-policy proposals are based on elements of the medieval *justum pretium*. . . . A French physiocrat or *économiste* of the eighteenth century is brain brother to an American agricultural fundamentalist of the twentieth. The Keynesian and the Hicksian crosses—paradigms in the most literal sense of the term—have supplemented but never displaced the Marshallian cross of supply and demand. The quantity theory of money, once considered moribund, has been resuscitated, after a brief trance, by Professor Milton Friedman and his Chicago colleagues. Economic paradigms, economic

> 'normal science,' both display a certain tenacity Kuhn has not found in the natural sciences across the quadrangle." (Bronfenbrenner 1971: 2)

Bronfenbrenner goes on to characterize the progression of economic thinking as being more dialectical in nature. The thesis of the dominant paradigm is under continuous challenge from a range of antitheses, which are not necessarily in agreement with each other. The synthesis involves the paradigm modifying itself by absorbing some but not all of these challenges, many of which live to fight another day. This synthesis becomes the thesis for the next phase, and new and old challenges act as the antitheses as circumstances change and issues arise. We have certainly seen this in our brief assessment of the post-war development economics discourse. The "market versus state" debate has gone back and forth, ever constant but also ever changing. If there is a synthesis now, it is perhaps one that has learned the lessons of the overzealous embrace of markets at any cost, but one that is not prepared to go back to the simple nostrum that state intervention can solve everything. This synthesis now faces challenges to the notion of the role of the state itself, and so the evolution continues.

[1] A further problem was the behavior of the donors. Knowing that a withdrawal of funds would leave these countries in disastrous shape, the international financial institutions continued to provide assistance. The countries quickly learned this. For example, the World Bank issued three structural adjustment credits to Kenya for the same agricultural price reform (Devarajan, Dollar, and Holmgren 2001).

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