International Encyclopedia of Public Policy

Volume 1—Global Governance and Development

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GPERU, Perth
Australia

2011

[Page Proofs: Monday 4 July 2011, 9.38am]

First published 2011
by GPERU

International Encyclopedia of Public Policy:
Volume 1: Global Governance and Development

GPERU is an imprint of the
Global Political Economy Research Unit

Typeset in Times New Roman, Algerian, Comic Sans MS
by GPERU, Perth, Australia.

British Library Cataloguing in Publication Data
A Catalogue record for this book is available from the British Library

Library of Congress Catologing-in-Publication Data
A Catalogue record for this book is available from the Library of Congress

INT ISBN 0-515-34523-X (set) [Pending]

PBK ISBN 0-515-46411-X (set) [Pending]

HBK ISNB 0-515-78322-X (set) [Pending]

International Encyclopedia of Public Policy

Volume 1: Global Governance and Development

Editorial Team

How to Reference (Example):

John W. Dietrich, "World Government", in P.A. O'Hara (Ed.), ***International Encyclopedia of Public Policy: Volume 1—Global Governance and Development.*** GPERU: Perth, 2011, pp. 571-581. http://pohara.homestead.com/Encyclopedia/Volume-1.pdf

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AIDS and HIV

Phillip Anthony O'Hara

Introduction

The AIDS and HIV so-called epidemic is currently one of the most critical medical, social and governance issues facing the world. An understanding of the topic encompasses such a wide array of disciplinary areas, including biology and chemistry; medicine and health; global poverty and affluence; power and authority; community and social networks; plus lifestyle and drug issues. It is a controversial topic with many unresolved issues, conflicting theories, and vested interests involved. Understanding the issues requires a holistic perspective that scrutinises a wide spectrum of literature.

Issues that would later be seen as involving AIDS were first brought to the attention of doctors in Los Angeles, New York and San Francisco in the late 1970s and early 1980s. The thing that perplexed medics was the existence of a combination of vague and specific diseases that normally were not serious suddenly manifesting in problematic ways. A Los Angeles general practitioner noticed an increase in mononucleosis-type symptoms such as high fever, swollen lymph glands, chronic diarrhoea, thrush and weight loss (opportunistic infections) among his young gay patients that never completely disappeared. Some were hospitalised with respiratory distress. Other LA medics had similarly young gay patients coming down with Pneumocystis carinii pneumonia (PCP) and candidiasis. The five cases of PCP were noted by the US federal government Centre for Disease Control (CDC) and documented in their weekly bulletin.

Other strange and unusually toxic infections were noticed in New York and San Francisco. A normally benign skin and mucosal cancer called Kaposi's sarcoma which tended to inflict the elderly, along with opportunistic infections, began causing serious problems and even death among young gays during 1980 and 1981. Other diseases that appeared were cryptococcal meningitis and serious cases of herpes. Over the next few years hundreds of young gay men came down with a combination of opportunistic infections, severe thrush and/or herpes, pneumonia, Kaposi's sarcoma, cerebral lesions and toxoplasia infection. By late 1981 the CDC reported 108 such patients and within a year half were dead. By April 1982, 248 cases were isolated, apparently at least 40 of them having had homosexual relations with one particular person, Gaetan Dugas, a French-Canadian Air Canada flight attendant. (He was nicknamed "Patient Zero", and died in March 1984.) By the end of 1984, 8000 people had been diagnosed with this syndrome in the US.

Soon it became apparent that the US was not the only nation with this affliction. A few cases were isolated in Europe and Haiti; while equatorial Africa soon became seriously involved. While AIDS patients in the West were predominantly homosexual, in Africa they were almost exclusively heterosexual (especially women). Many of the African cases seemed to have an earlier genesis to the US ones, going back to the mid-1970s, and having links with Europe. The French put forward the "African hypothesis": that the first (European) wave of the syndrome emanated from Africa, followed by a wave from the US. Some evidence then arose alluding to a Congolese patient going back to 1962 (Grmek 1990:30).

The interconnected nature of the afflictions quickly became apparent, and by June of 1982 the CDC had began to call it AIDS, the Acquired Immunodeficiency Syndrome. Various other, equivalent, acronyms were used in non-English speaking nations. Early on AIDS was linked to lifestyle factors, such as drug use, sexual promiscuity and inadequate nutrition. Soon attention began to be focussed on a viral cause, thanks to the combined work of the French Pasteur Institute, the US National Institute of Health, and others. In 1984 it became apparent to many that a certain retrovirus with a propensity to destroy helper lymphocytes was the "ultimate cause" of the syndrome. During 1984-86 the mechanisms and processes of how the human immunodeficiency virus worked were better understood, at least in their basic form. Since then virtually all the attention has been given to how to fight this virus through drugs, vaccines and preventative measures such as condoms, better blood preparations, reducing needle exchanges and moderating promiscuous tendencies. UNAIDS, the World Health Organisation, national centres for AIDS policy, non-government organisations, and a host of community networks have all played their role in AIDS awareness, prevention and control.

Global Distribution of AIDS/HIV

A major problem obtaining consistent statistics on HIV and AIDS are the changes that occurred in definition and testing methods over the decades. Comparable multi-regional cross-section data exist only for recent years. See Table 1, below. Worldwide there were over forty million HIV-positive persons in the world in 2005. Of these, over 60 percent of the cases were in sub-Saharan Africa (SSA), where, on average, 7.2 percent of the whole adult population had antibodies for the virus. Of the 4.9m new cases of HIV in 2005, 65 percent were from SSA. However there is a far greater percent of people dying from AIDS in SSA: of the 3.1m deaths from AIDS worldwide, over three-quarters were from SSA. Projected new adult infections per year in SSA are expected to increase from 2.55m (2005) to 3.75m (2020), while adult AIDS-related deaths rise from 1.9m (2005) to 2.6m (2020). The incidence of HIV and AIDS in Africa thus far outweigh the experience elsewhere on Earth, both in terms of the absolute seriousness of the problem and the proportionate rates of mortality vis-à-vis those living with the virus.

Table 1: Regional HIV & AIDS Incidence 2005

	Living with HIV	New HIV Cases	HIV Adult Rate	AIDS Deaths
Sub-Saharan Africa	25.8m	3.2m	7.2%	2.4m
Caribbean	300,000	30,000	1.6%	24,000
Eastern Europe & Central Asia	1.6m	270,000	0.9%	62,000
South & SE Asia	7.4m	990,000	0.7%	480,000
North America	1.2m	43,000	0.7%	18,000
Oceania	74,000	8,200	0.5%	3,600
Latin America	1.8m	200,000	0.6%	66,000
Western & Central Europe	720,000	22,000	0.3%	12,000
North Africa & Middle East	520,000	67,000	0.2%	58,000
East Asia	870,000	140,000	0.1%	41,000
TOTAL	**40.3m**	**4.9m**	**1.1%**	**3.1m**

Source: Adapted from UNAIDS/WHO (2005:3)

Regional differences in HIV and AIDS in SSA are considerable. For instance, HIV-prevalence among pregnant women attending antenatal clinics in SSA in the mid-2000s was 38 percent in Botswana, 30 percent in South Africa, 22 percent in Zimbabwe, 19 percent in Mozambique, 11 percent in Ethiopia, plus 8, 7 and 3.5 percent, respectively, in Cote d'lvoire, Kenya and Ghana. Major differences also exist within particular nations. For instance, HIV-prevalence in parts of Mozambique varies greatly, from 34 percent in C.S. Ponta-Gea to 26 percent in C.S.E. Mondlane to 10 percent in H.R. Montepuez and C.S. 25 Setembro (2004).

The seriousness of HIV outside SSA varies greatly, from an adult prevalence rate of 1.6% in the Caribbean to 0.9% in Eastern Europe and Central Asia, 0.7% in North

America and South & South East Asia to 0.6% in Latin America, 0.5% in Oceania, to relatively low rates of 0.3% in Western and Central Europe, 0.2% in North Africa and the Middle East and the lowest rate of 0.1% in East Asia. While 58% of adults with HIV are women in SSA, the percent is about equal between men and women in North Africa, the Middle East, the Caribbean and Oceania. Everywhere else in the world—Asia, the Americas, and Europe—HIV is heavily concentrated among men (about 75%) (2005). In regions where female HIV cases predominate, such as SSA, babies and children constitute a relatively large percentage of the infections, being equal to the other high-HIV age category, 25-40 years. (UNAIDS 2005.)

The best time series data are from the US, as shown in Table 2, below.

Table 2: USA: Annual AIDS Cases 1985-2003

	1985	1990	1995	2000	2003
New AIDS cases	12,000	50,000	70,000	42,000	43,000
AIDS Deaths	7,000	33,000	52,000	18,000	18,000
Persons Living with AIDS (%↑)	15,000	85,000 (567%)	218,000 (256%)	340,000 (156%)	410,000 (121%)

Source: Adapted from UNAIDS/WHO (2005:67)

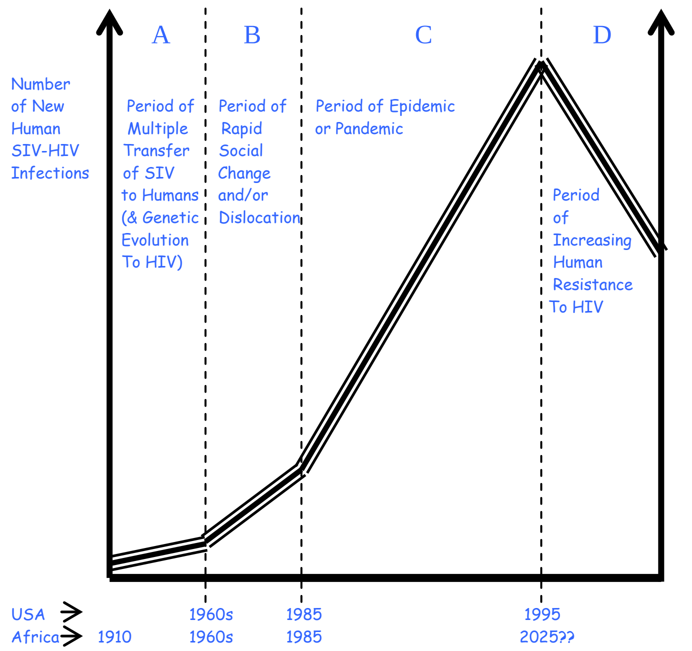
The number of people living with AIDS in the US has been increasing over the past twenty years at a fairly consistent level, while the rate of increase has diminished since the early 1990s. The epidemic of new AIDS cases reached a peak of 80,000 in 1992 and 1993 (not shown), with the peak of 52,000 AIDS deaths per year occurring three years later in 1995. Since then new AIDS cases and AIDS deaths have stabilised at around 42-43,000 and 18,000, respectively, in 2003.

People are living much longer from AIDS diseases in North America, Europe and Oceania, often 15-20 years; while quite a few who are HIV-positive never exhibit any major symptoms of AIDS.

Natural History of HIV

Figure 1 illustrates the natural history of SIV-HIV as it originated in western Africa and spread throughout the world.

Figure 1: Natural History of SIV-HIV among Human Beings



It shows Phase A, the origins, starting around 1910-1920 with the transfer of two types of Simian Immunodeficiency Virus, SIV_{CPZ} (from chimpanzees [troglodytes]) and SIV_{SM} (sooty mangabeys) to humans, in the form of HIV-1 and HIV-2, respectively. Transmission occurred by sharing blood or mucosal tissue through dietetic, sexual and/or domestic relationships with simians. HIV-1 and HIV-2 parasites slowly became part of the pool of micro-organisms infecting human beings, and genetically evolving in the process through various sub-species of viruses. Phase B led to the initial spread of the viruses through the population from very small pockets to the wider society, as a result of rapid social change or dislocation. This includes, for instance, the end of colonial rule and wars of independence in western Africa in the 1950s (vis-à-vis Portugal, France, Belgium); and the sexual and gay liberation movements as well as the explosion of recreational drug use and international travel, in the US (and Europe) in the 1960s and 1970s.

Phase C was the emergence of the virus in the medical and social consciousness as it gradually became a problem of epidemic proportions, at least in certain sub-populations or the population in general. From the 1980s it spread rapidly through homosexual populations in New York, Los Angeles and San Francisco; as well as spreading through the general population in Sub-Saharan Africa; and more latterly in the Caribbean, Eastern Europe and parts of Asia (during the 1990s). Phase D, declining incidence of HIV and reduced deaths from AIDS, both emerged in the mid-1990s in the US. As human beings began to increase their immunity to HIV-AIDS though natural or drug-enhanced measures, the US epidemic subsided, while SSA as a whole is yet to peak, and may not do so for another ten to twenty years.

There are two major strains of HIV, HIV-1 and HIV-2, both of which originated in sub-Saharan Africa. There are three groups of HIV-1, including M (major), O (outlier) and N (neither M nor O). Within the major M group are numerous subtypes A-J, accounting for over 90 percent of all worldwide HIV infection. Group O origins are isolates from west-central Africa (Cameroon, Gabon and Equatorial Guinea), while N, which is rare, emanates from Cameroon. HIV originates from cross-species infections between monkeys and humans, specifically by simian immunodeficiency viruses (SIV) mutating into HIV.

Evidence points to at least three independent introductions of SIV_{cpz} from chimpanzees to humans. Zoonotic transmission of primate lentiviruses to humans is supported by SIV-HIV similarities in viral genome structure, phylogenic relationships, geographical linkages and plausible routes of transmission. The most likely subspecies involved is the common chimp (Pan troglodytes) through $SIV_{cpz(P.t.t.)}$ since they were kept as pets and eaten in west-eastern Africa (Gao et al 1999). SIVs do not cause diseases in monkeys as they have effective immunity to the viruses.

Samples of blood contaminated by HIV-1 have been collected as early as 1959. But the origins of zoonotic transmission are much earlier. Evidence points to a likely mean year of the most common ancestor of the O-subtype HIV virus (which *may* indicate the time of cross-species SIV infection) of around 1920-1930 (with a far lower probability of it occurring as early as 1850 or as late as 1950). It has been estimated that "group 0 infections have doubled approximately every 9 years since 1920" (Lemey et al 2004:1064).

Of the HIV-1 genus M there are 11 subtypes labelled A-K, the first five (A-E) having been studied closely. Korber et al (2000) present evidence that "the last common ancestor of the HIV-1 [M] group point to the first half of the twentieth century", which could indicate the time of cross-species infection by SIV, specifically around 1930 (circa 1908-1950). A-J are found mostly in sub-Saharan Africa; B originated mainly in the US, Europe, and Haiti; a mix of A-C and D-G being common in central and eastern Africa (Uganda, Kenya, Tanzania and the DR Congo); while M subtype E is common in Thailand. Vasan et al (2006) studied the degree of virulence of subtypes A, C and D (plus recombinants of these) in Tanzania, concluding subtype D to be the most deadly, followed by C, then A-C-D recombinants, and the least problematic being A. It is likely that most of the African M-subtypes (A, C, D), plus the Thai subtype E, are more virulent than the B subtype common in the US, Europe and Haiti. Korber argues that the B-subtype which became manifest in the mid-1970s, likely had a pre-epidemic period of evolution of 5-15 years, possibly beginning in 1960 (circa 1939-1972). Despite a large degree of regional specialisation, all the M-subtypes exist globally, likely migrating from sub-Saharan Africa as a result of imperial pursuits, trading and wars of independence.

HIV-1 is significantly more virulent than HIV-2 (Jaffer 2004), while the natural history of HIV-2 is more certain. HIV-2 has seven sub-types, HIV-2(A-G), with only HIV-2(A,B) being epidemic in nature. HIV-2 is restricted mainly to western Africa (especially Guinea-Bissau). It originated from cross-species infection between sooty mangabeys (monkeys) and humans through SIV_{sm} due to dietetic, social and sexual factors. The most recent common ancestors have been estimated at 1940±16 (HIV-2A) and 1945±14 (HIV-2B), which are possible upper limit proxy dates for cross-species transmission of SIV_{sm}, although a broader model gives 1889±33 as a lower limit for cross-species transmission (Lemey 2003).

For group A, after cross-species infection and mutation into HIV-2, there was a period of low endemicity (eg, 1930-1963) in this closely-knit, kinship-based society of Guinea-Bissau. This was followed by a period of exponentially increasing infections (1963-1992) likely initiated by the war of independence from Portugal (1963-1974), when social dislocation and trans-migration were common. The *war hypothesis* is supported by epidemiological evidence of HIV-2 cases among Portuguese veterans who served in the colonial army during the war. The principle source of the exponential growth is said to be the high rate of unsterilised injections.

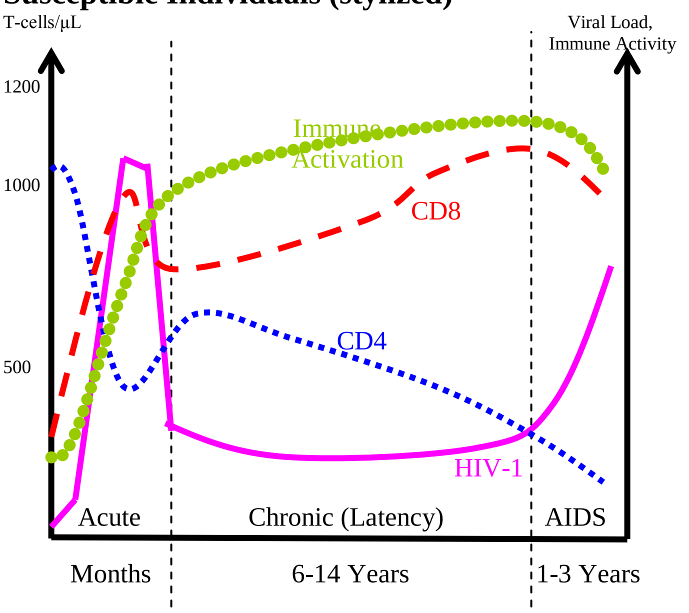
Natural History of HIV-AIDS in Individuals

One problem that has always plagued the HIV theory of AIDS is that it does not directly cause the syndrome. Rather, the usual proximate ailments that are part of the complex are all caused by other micro-organisms. HIV is said to ultimately precipitate these ailments by destroying the helper white blood cells (CD4+ T-cells). When levels of such lymphocytes are at critically low levels—which could take ten years or more—immunodeficiency sets in where any number of AIDS diseases can manifest themselves. The most common ailments being serious cases of skin cancer, tumours, pneumonia, thrush, herpes, and painful feet and legs.

What is called the "natural history" of HIV in the human body includes three main phases (see Figure 2). The first phase is "acute" infection with the virus, whether through sexual contact, dirty needles, and/or blood exchanges. When the virus infects the body, "seroconversion" occurs as the body starts to produce antibodies to the parasite. Some people succeed in stopping the virus at this point, but in others there is a sudden increase in viral load in the cells and a sharp decline in helper T-cells below the normal level of 1000/μL (1000 per micro-litre), especially in the mucus cells and to a lesser extent in the blood. A major immune response occurs as the body produces antibodies to the invading virus. Usually relatively minor symptoms emerge, including swollen lymph glands, fever, diarrhoea, dry cough, numbness of the feet, and other vague symptoms. This phase may last a number of weeks or months, at the end of which the number of helper cells (CD4) stabilises, as does the viral load and the immune response.

The second major phase is then reached in most HIV cases, the "chronic" stage, which lasts on average about ten years, with variations mostly in the order of 3-5 years. Some call this the asymptomatic "latency" period, since the mortality-promoting (late-period) opportunistic diseases ("AIDS") have not yet appeared. In this slow moving phase major symptoms typically do not emerge. A number of patients never go beyond this stage and hence never get the typical AIDS diseases, with or without anti-viral drugs. Yet after a number of years mucosal CD4 helper-cells decline moderately, while CD4 helper-cells in the blood decline slowly but significantly. At the end of this 10 year period CD4 helper T-cells typically decline from their normal level of around 1000/μL to the AIDS-defining level of <200/μL. Immune activation stays at a high level, while viral load increases only slightly.

Figure 2: Typical Natural History of HIV-AIDS in Susceptible Individuals (stylized)



Source: Adapted from Grossman et al (2006:293); Joly (2006:858); Lederberg (2000:90); Feinberg (1996:241,244)

The third phase of the condition then typically begins to manifest as AIDS around the 10 year (6-14 year) period as helper T-cells decline to very low levels (<200/μL) level, viral load begins to escalate, and immune activation declines somewhat. A combination of major diseases, caused by specific organisms, then begin to develop as the body's immune response is slow and ineffective. Some of the typical AIDS-defining diseases include pneumocystitis Pneumonia, Kaposi's sarcoma, AIDS-related lymphoma, peripheral neuropathy, and opportunistic diseases.

It has to be said that HIV and AIDS reveals (or exploits) a *major limit* to the human immune system. This limit occurs in the chronic phase when CD4 T-cells decline while CD8 T-cells increase, in about equal proportions, while total T-cells remain about constant. CD4 and CD8 refer to a heterogeneous group of cell-surface glycoproteins on T-lymphocytes that enhance T-cell response to foreign antigens. In general, though, CD4s are called "helper" T-cells because they assist other white blood cells perform their immune function; while CD8 cells include "killer" T-cells that can destroy infected target cells (Mosier 1997). More specifically, CD4 cells provide helper functions for proper development of T-cell cytotoxicity and also for B-cells to produce immunoglobulin and lymphocyte populations. CD8 cells inhibit the proliferative response of infected cell immunoglobulin creation. CD4 and CD8 cells are more effective when working in tandem and their functions are somewhat interrelated, since killer CD4 cells and helper CD8 cells also exist (Parnes 1997).

It is generally believed that CD4 functions are more critical than those of CD8 cells. But the body's homeopathic system responds only to changes in *total* CD cells. While the critical CD4 cells decline with HIV progress, since they act as cell-surface receptors for HIV, no effective response is made to increase their production because CD8 cells are increasing instead. Hence the major limit of human immunological function that HIV exploits. As a result, when CD4 cells are below 200/μL a combination of the following diseases tend to develop, while death usually follows CD4 levels of below 50/μL, as these diseases become more serious. HIV thus does not directly cause AIDS, but is said to eventually lead to a combination of infections when CD4 levels reach very low levels and the body is apparently unable to develop effective resistance to disease.

Pneumocystis Pneumonia (PCP). PCP is the most common opportunistic HIV-related infection, occurring in up to 85% of AIDS cases. Historically it has been the most important cause of morbidity, associated with the fungus *pneumocystis jiroveci*. It is most common with CD4 cell counts of under 200/μL, and also for those with under 300/μL who have other opportunistic infections. It affects the lungs, typically causing recurring pneumonia, breathing difficulties, fever, dry cough, weight loss, and constitutional weakness. It can be treated now quite effectively with combination antibiotics TMP/SMX, Dapsome, Pentamidine, Atovaquone and antiretroviral therapy (ART).

Kaposi's Sarcoma. This is a common ailment, caused by the human herpesvirus-8 (KSHV), affecting around 20% of AIDS cases. It usually takes the form of various lesions, tumours, and ulcers on the skin and sometimes in lymph nodes, mucosal surfaces, and internal organs (Cornelius et al 2004). It can be localised, indolent, widespread or aggressive. KSHV typically evade recognition by T-cells by using human protein cell molecule xCT to reproduce itself (NIH 2006). Chemotherapy, radiation, retinoic acid, liposomal and anti-cancer drugs have been used against this disease; and increasingly through the effective use of highly active antiretroviral therapy (HAART).

AIDS-Related Lymphoma (ARL). This is the third most common immunodeficiency disease, being the cause of death for 12-16% of HIV patients, and including a heterogeneous group of AIDS-related lymphomas (ARLs) (Silvestris et al 2002). The most common include cancers caused by the Epstein-Barr virus (EBV), HHV-8 and through other, genetic propensities. One interesting variety is PEL, associated with HHV-8 and EBV, manifesting as tumour masses, especially in the gastrointestinal tract. Systemic ARL attacks the immune system, blood stream and organs simultaneously. While chemotherapy, azidothymidine and rituximab have proved toxic in the treatment of ARL, some success was found by minimal chemotherapy followed by HAART (Lim and Levine 2005) for patients with CD4+ cell counts of >100/μL. Prognosis is poor for those with <100/μL.

Opportunistic Infections (OIs). OIs are an array of diseases that in combination can contribute to morbidity in patients with low-CD4 levels. The most important of them, PCP, is important enough to be considered separately (above). The others can under some circumstances be critical, and include thrush (a fungal infection) of the mouth, throat, anus and/or vagina, even in high CD4 ranges; cytomegalovirus (a viral infection) that can cause blindness, especially in <50 CD4 cases; serious cases of herpes simplex (virus) of the mouth or genitals, at any CD4 level; mycobacterium avium complex, which causes recurring fever, digestion anomalies, general sickness, and serious weight loss, especially with CD4 counts of <75/μL; toxoplasmosis, a protozoal affliction of the brain, typically for those of CD4 counts of <100/μL; plus malaria and tuberculosis, which tend to be more severe with AIDS. (NMAETC 2005.)

Peripheral Neuropathy. This is the most common neurological complaint associated with AIDS. It represents a whole series of neurological diseases, more commonly associated with sore feet, weak muscles, numbness and tingling in peripheral nerves, back pain, and bowel and bladder incontinence. It may become systemic to include gastrointestinal weakness, hepatitis, pneumonia, cervicitis and pancreatitis when associated with cytomegalovirus (CMV). A disturbingly high number of cases are precipitated by antiretroviral drugs, especially NRTIs, while the disease itself may predispose individuals to the neurotoxic effects of these medications. However, evidence seems to point to the positive influence of HAART in the prognosis of patients (Ferrari et al 2006).

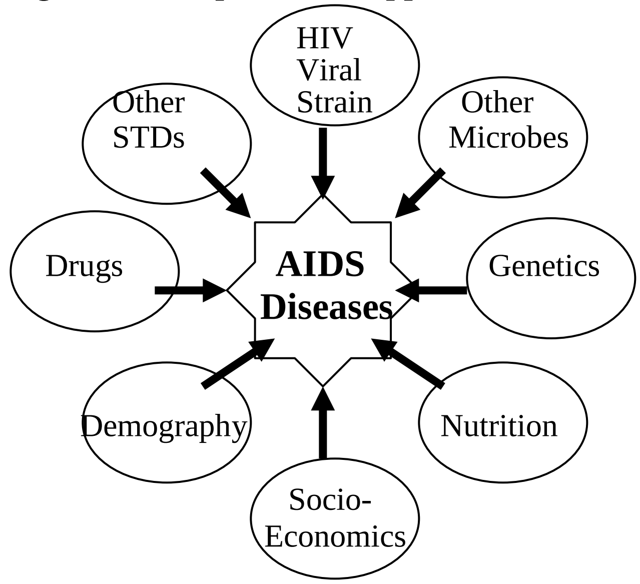
It is worth emphasising that HIV develops into AIDS at different rates in different risk groups. For instance, haemophiliacs, older patients, those in lower socioeconomic groups, and those with synergistic infections and cofactors, develop AIDS much quicker than the average 10 years: 2-3 years is common. Quite a few HIV-positive people do not manifest symptoms or go on to develop AIDS (5%). Some are even repeatedly tested HIV-negative after being found seropositive. This is related to the concept of transient or incomplete infection where sero-reversion (from HIV-positive to negative) occurs in healthy individuals. (Root-Bernstein 1996.)

Cofactors and Causal Controversy

Early in the history of AIDS research lifestyle factors were emphasised, such as sexual preference, sexual activity, drug use, nutrition levels, and so on. With the discovery of the HIV link to declining helper cells the viral factor became predominant. This is still the case today. However, evidence does support a multifactorial approach, and a substantial critique of the viral theory exists among a minority of researchers.

The multifactorial approach looks at the link between a number of critical variables, as, for instance, shown below in Figure 3:

Figure 3. Multiple Factor Approach to AIDS



Research indicates that the degree to which individuals are susceptible to the HIV virus depends upon an array of factors, including genetics, diet, stress, other infections, and the specific strain of HIV in question. Similarly, the speed and magnitude to which initial and later AIDS symptoms and diseases progress depend on this complex pattern of lifestyle, genetics and socioeconomic position. Individuals are more likely to progress to AIDS with HIV-1(D) than HIV-1(A) or (B), and also with HIV-1 than HIV-2.

Individuals are also more likely to come down with AIDS-defining diseases if they have a poor diet, especially if lacking vitamins A, C and E; ingest substantial amyl or butyl nitrate, chemotherapy or toxic anti-retroviral drugs (not HAART); are older; and/or infected by critical microbes causing hepatitis, thrush or herpes. (Strathdee 1996.) Many people are HIV-positive but fail to develop symptoms, others have symptoms but live for decades, while numerous others have AIDS-type diseases but are HIV-negative. Cofactors thus become critical to the mortality and well-being of individuals, acting as risk modifiers that impact on CD4 levels, viral load and disease manifestation.

Some researchers have a particular angle on cofactors, strongly attacking the mainstream emphasis on HIV. They either give priority to cofactors or deny the role of HIV altogether. Peter Duesberg and his associates tackle the HIV theory in the most critical fashion, concluding that recreational and antiretroviral drugs are the major cause of AIDS in the US and Europe, whereas malnutrition is the main culprit in Africa and many other underdeveloped areas. Others may be less extreme, concluding that HIV may be neither necessary nor sufficient (or necessary but not sufficient) for the onset of typical AIDS-defining diseases such as Kaposi's sarcoma, AIDS related lymphoma, opportunistic infections and peripheral neuropathy.

The Duesberg-type arguments against the "HIV-causes-AIDS" hypothesis are complex and multifarious, some technical and others general (Papadopulos-Eleopulos et al 1996). Many of his supporters argue, for instance, that HIV is an opportunistic or synergistic infection—or possibly just a "passenger virus"—that becomes manifest only in people predisposed to or in contact with agents that propel immune deficiency. AIDS is seen as primarily an immunodeficiency (not a viral) disease, where cofactors propel cumulative impairment of the immune system and leads patients to be predisposed to (passenger) HIV. It is seen as a multiple agent-induced series of conditions where cooperative infections create magnified destruction of the effective immune response. For instance, older haemophilia patients typically develop AIDS very rapidly, within 2-3 years, due to frequent use of clotting concentrates, transfusions, steroidal use, viral contamination, opiate drugs and joint injury treatment (Root-Bernstein 1996). Mono-causal models are seen as reductionist and inferior to more holistic models of analysis.

Many critique the assumption of HIV-positive results necessarily linking to AIDS. It is argued that being HIV-positive simply means the body has produced antibodies against HIV in the past; it is not necessarily evidence that HIV is currently active in the system. The best way to prove the presence of a virus is said to be through direct isolation and estimation of infectious particle numbers in immobilized cell culture. A correlation between HIV and AIDS may exist because of a combination of specious factors. These include the negative psychological impact of being found HIV-negative; the negative impact of HIV drugs (including wide-spectrum antibiotics) on the immune system. Many HIV-positive people do not get sick, while others work off the virus.

Many HIV-negative patients have all the typical symptoms of AIDS, including a combination of low CD4-count, opportunistic infections, Kaposi's sarcoma, pneumonia, and so on. Also, there is a paucity of studies investigating patterns and processes involving CD4+ cell levels among HIV-negative people. Could the high level of CD8+ T-cells adequately compensate for the low level of CD4+ T-cells in typically symptom-free HIV cases, since some research has indicated a cross-over of functions between CD4 and CD8 T-cells in some cases?

90 percent of AIDS patients emanate from high risk groups, such as homosexual or bisexual men; injecting drug users; recipients of blood and its components; inhabitants of undeveloped nations; and sexual partners of injecting drug users. These groups have a very high risk of low CD4+ levels, cancers, lymphoma, and opportunistic infections due to a combination of factors, such as being inflicted with other venereal diseases, the known impact of certain drugs on the immune

system, malnutrition, and low socioeconomic position. (Koliadin 1996).

Many argue that the typical time taken from being HIV-positive to full-blown AIDS is excessive. The usual 6-14 years for the onset of typical diseases has been shown to be problematic on mathematical grounds, especially vis-à-vis the usual periodicity of viral toxicity. One such model predicts that the number of T-cells in a HIV+ person should have fallen by 84% in two years. As Mark Craddock (1996: 93) says: "it is very difficult to see why a large number of infected cells actively replicating takes so long to cause a disease. … Such a virus should cause disease quickly or not at all."

A paradox of the HIV-AIDS hypothesis is said to be that a virus that is present in 1 out of 500 susceptible CD4+ T-cells could cause disease. Such a virus should also destroy such T-cells because control of such cells is supposed to promote reproduction of viral load. Viruses are parasites that require a living host and cell to reproduce. CD4+ T-cells must, it is argued, therefore, be killed by other agents, such as recreational drugs, anti-retroviral drugs, chemotherapy, inadequate nutrition, and opportunistic infections. (Duesberg et al 2003: 403).

A strange situation has arisen in the scientific community where the "Duesberg camp", which is globally quite numerous, is often given some limited degree of space for their work, while at the same time being discouraged and excluded (more often) from publication. When government has taken their arguments seriously, such as President Thabo Mbeki in South Africa, they have been denounced by many in the international community, even by those who are not scientists or health professionals (eg, Butler 2005). John Maddox (1995), the editor of *Nature*, states succinctly his understanding of the reason, namely, that if Duesberg and company are correct then most of the rest of the scientific community are wrong.

This conclusion, however, is not quite true, since a multifactor analysis of AIDS comes close to allowing for both major groups being at least partially correct in their analysis. And it is this multifactor approach that this paper utilises as perhaps the best way to comprehend AIDS. With this in mind we turn to the socioeconomic impact and policy-responses of the pandemic.

Socioeconomic and Political Factors

The question now arises as to what are the socioeconomic and political impacts of AIDS and HIV, as well as the governance responses that may reduce the extent of the epidemic. Eurocentric works concentrate on the nature of the problem in the US or Europe. This despite the fact that here AIDS problems are no longer on an escalating scale. The real crisis is in Sub-Saharan Africa, and to a much lesser extent in the Caribbean and parts of south Asia. In SSA as a whole AIDS constitutes a system-problem inhibiting the very function of the social, political and economic institutions. It therefore requires core assistance from the international community. However, it has to be said that AIDS is really an extension of the traditional problems of underdevelopment, poverty and malnutrition. No matter what theory of AIDS one adheres to, the challenge is to propel human development in the region as one critical solution to AIDS.

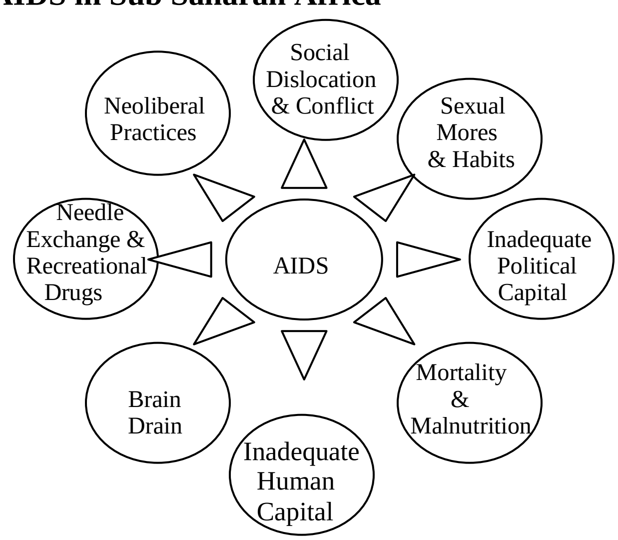
Anomalies of underdevelopment are reinforced by AIDS, although regional differences are important. Real economic growth *per capita* has been less than 1 percent per annum in SSA during the 1990s and 2000s (O'Hara 2006). In one study, the average rate of adult-prevalence of AIDS in SSA is about 8 percent, resulting in a decline in GDP growth of 0.5 per annum, or 27 percent over 20 years, as a result of declining human, physical and social capital. (Freedman et al 2005:671). However, the impact in many nations of SSA are much greater; especially in Botswana, Lesotha, Namibia, and South Africa, where GDP is likely to decline by 50-70 percent over twenty years due to AIDS (Haacker 2004:71).

AIDS causes lower growth due to declining levels of productivity, increased absenteeism, loss of experience and skills, high labour turnover, and greater recruitment and training costs. Declining income reinforces this through deteriorating levels of demand and low multiplier and accelerator effects. AIDS especially impacts on governance as public officials become sick, while education is severely impacted as the student-teacher ratio increases and the stock of knowledge declines or increases at a lower rate. Community trust and interaction diminish as networks are disrupted and bonds of sociality destroyed. Also, government spending is redirected from physical infrastructure, communications and education to the US$4.23 billion spent on HIV-AIDS projects per annum in low-income nations (Haacker 2004:63).

Mortality has been greatly increased in SSA as a result of AIDS. Life expectancy at birth with AIDS is markedly different than without it in many nations. For instance, the average life expectancy for a Botswanan is currently 34 years, and without AIDS it would have 76 years (2004). For South Africa the figures are 67 years without AIDS and 44 years with it; while for Zambia people would have on average expected to live to 56 years, while they actually live on average 39 years. Crafts et al (2004:189) call this situation “catastrophic” and estimate the welfare losses involved. Using a “value of life” model, they estimate the aggregate decline in welfare (based on “discounted life expectancy”) of 93% for Botswana, 77% for South Africa, 75% for Zambia, 44% for Cote d’Lvoire, and 30% for Ethiopia. These welfare losses are far greater than the narrower economic costs.

These large social costs of AIDS are due to magnified results of a multitude of factors, illustrated in Figure 4, below. The inability of certain African nations, in particular, to get beyond the epidemic phase of the disease is linked closely to centre-periphery dynamics. Many SSA nations adopted key planks of the neoliberal policy framework, which contributes to declining emphasis on public capital such as physical infrastructure, education, health, and communications sector development. Partly for this reason, social resources have been severely limited in dealing with the AIDS crisis. In addition, high levels of poverty, malnutrition and death are perfect breeding grounds for immunodeficiency and the spread of HIV. High levels of brain drain sap the energy of especially the business, health, education and governance sectors. Social instability linked to wars of independence, ethnic conflict, changes in sexual mores and habits, plus drought and famine lead the virus to be spread more rapidly through the community. Inadequate political capital delay and diminish the vital responses needed especially in the early-medium stages of the epidemic.

Figure 4. Magnified Impact of Multiple Factors on AIDS in Sub Saharan Africa



More generally, AIDS in SSA takes the form of a crisis in social reproduction (Bujra 2004). The multiple factors associated with AIDS have multiplied the extent of the social dislocation since social support structures have diminished, protective responses to AIDS are insufficient, and community resources exhausted (O'Hara 2007). Development has been inhibited as mortality rates are high, human capital levels in short supply, and networks of relations have been dislocated. Socioeconomic fragmentation is promoting AIDS which further stimulates disarray and dislocation (Freedman et al 2005). AIDS and its cofactors are thus severely inhibiting the achievement of the New Millennium Goals by 2015 of eradicating extreme poverty and hunger, achieving universal primary education, promoting gender equality, reducing child mortality, improving maternal health and ensuring environmental sustainability (Whiteside 2005).

Further Governance Issues and Practices

Five planks of policy are critical for reducing and understanding the incidence of AIDS, especially in Sub-Saharan Africa, but also other continents. The first plank is that a multi-factor approach needs to be utilised. This is one that recognises the importance of cofactors, such as viral load, other microbes, drugs, genetics, socioeconomic status, nutritional and lifestyle factors, culture, prevention, and demography. Policies that incorporate these multiple contributors to the disease are more likely to impact than those that take a more reductionist approach. Being more holistic, the cofactor method seeks to situate individuals within the social and economic context of their predicament. In this sense it takes into account their age, gender, cultural embeddedness, general health, infection status, habits and network relations. Any policy that seeks to promote behavioural change in individuals needs to recognise the multifaceted environment in which they operate.

The second plank follows from the first, namely, that policy-making in an AIDS environment needs to be multi-sectoral, including a high level of political commitment, with extensive community involvement. These seem to be the priority areas of the most successful approaches, for instance those undertaken in Uganda, Senegal, Thailand and Brazil (Moran 2004). Being multi-sectoral involves decision-making across a wide range of actors and participants. The major sectors that need to be included are government, NGOs and civil society.

Governments can help through leadership, providing resources and coordinating communication and interaction. For instance, in Uganda where AIDS prevalence has declined since the early 1990s, President Museveni played a key role in stimulating debate and action among core community groups. Uganda also has a decentralised system of governance where regional and community players have key roles. In most successful AIDS policy environments, the Department of Health is especially important, being at the centre of education and awareness campaigns. An over-centralised approach (such as in South Africa) will likely inhibit success by denying community input and participation (Butler 2005).

Governments need, though, to take into account the cultural beliefs and values within civil society. AIDS policies are unlikely to succeed where the community has not been actively engaged. If state policies go against the dominant values in the community it is unlikely that they will succeed. For instance, a conservative religious community that believes in the values of abstinence and not being open about sex—such as in Botswana—is unlikely to be inspired by a policy advocating the widespread use of condoms and sex education, at least in the short to medium term. (Allen and Heald 2004.) In such a conservative environment, subtle influence on the community is more likely to succeed in the long run.

The third plank of governance needs to recognise the limitations of policy in an environment where human resources are likely to be scarce. In much of Sub-Saharan Africa the number of health workers, teachers and administrators are limited not only by low levels of development but also by AIDS itself. For instance, in Malawi during 1990-2000 the average rate of such human capital attrition has been 2.3% per annum among these core groups, mainly due to death by AIDS. The majority of those who die from AIDS are in their prime sexual, reproductive and productive period of life. This loss of human capital is magnified by brain drain to more developed areas, and severely constrains policy measures to educate and equip societies for reducing AIDS. (Moran 2004.)

A fourth plank of successful policy relates to access to critical knowledge, technology and materials. Technology is a key aspect of any modern policy paradigm. In nations with high rates of AIDS it is difficult to access knowledge, products and processes that may help alleviate the condition. Being able to promote networks of access to products that are subject to patents can help access to antiretroviral treatment, including drugs and potential vaccines. For instance, collaboration with NGOs and local companies enabled many poor countries to locally produce cheap generic AIDS drugs. Linkages to global health and medical research networks may in the future enable (poor) countries to access HIV vaccines (McMichael 2006).

The fifth plank of anti-AIDS policy recognises that, ultimately, individual behaviour modification is the key to success. This involves dissemination of knowledge, modification of habits, and implementation of preventative and prophylactic methods. This variously requires a reduction in the extent of needle sharing, declining sexual promiscuity, improved health, poverty reduction, and declining illiteracy. These measures link to both anti-AIDS measures and broader development goals. Ultimately, especially in developing nations, the fight against AIDS is also a fight against ignorance, poverty and malnutrition.

It is worth noting that the declining incidence curve for diseases will eventually come into play in SSA, as it has in the West. In SSA as a whole, and some other areas, however, it is unlikely to occur for a decade or two. However, it is important not to miscalculate successful policy-making for the declining incidence curve. Declining incidence may occur, for instance, when a less virulent strain of the virus is dominant. Successful policies can also bring on an earlier incidence of the curve.

Conclusion

This article has developed a holistic view of the AIDS and HIV predicament that has befallen humanity. It started by surveying the historical and natural evolution of the condition, including its global geographical incidence and individual patterns. The historical origins of the HIV virus were examined, along with the major AIDS conditions. Special reference was given to a multi-factor approach that is capable of including apparently incompatible scientific perspectives on AIDS. The paper concluded with some policy perspectives and policies for the future.

While AIDS has followed a declining trajectory in the West, it is propelling socioeconomic disarray in Sub-Saharan Africa and potentially many other places. The multi-causal model can also be linked to policy through a multi-sector approach. Such an approach recognises the need to include governments, communities, NGOs and corporations in a strategy of modifying individual behaviour. Central governments can provide leadership, Health Departments coordinate education and intervention, cultural values and habits need to be addressed, and corporations may assist in providing resources and drugs.

AIDS and HIV need also to be situated in a broader context of development. While a naturally declining curve of incidence will eventually prevail, even in the worst affected areas, linking AIDS and development policies are likely to speed up the trajectory. AIDS does not exist in a vacuum but is affected by and in turn impacts negatively on resources, human capital and institutions. Seen as a multi-causal process, both AIDS and underdevelopment can be tackled as a problem of interacting processes.

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Balance of Payments

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Introduction

The Balance of Payments summarizes all the transactions between a country and the rest of the world. The BP is usually divided into two main accounts, namely: the Current Account (CA) and the Capital Account (KA).

The current account includes the exports and imports of goods and services, the former appearing as credit items and the latter as debit components. Exports of commodities give rise to a claim on the rest of the world that foreigners must discharge by making payments to the domestic producers, and *vice versa* in the case of imports of commodities. Exports and imports of services—such as travels, interest and dividends of investments, and unilateral transfers—imply analogous transactions. It is important to note that interest payments on outstanding debt are part of the current account, and in several cases this is the most important component of the balance of payments. The transactions in the CA generate income flows, and the CA is in equilibrium, surplus or deficit, if payments equal, fall behind or exceed receipts, respectively.

The capital account includes foreign direct investment (FDI) and portfolio investments, in which the latter constitute the so-called hot capital flows, that is, the purchase of financial assets rather than equipment, machines or installations. When a domestic firm, or household, purchases foreign assets—e.g. a productive plant, real state, or a financial instrument—an outflow of capital is generated. Capital outflows are accounted as debits, since the domestic buyer has to pay to the foreign seller, in the same way that an importer of goods and services would do. By symmetry capital inflows appear as a credit item. The transactions in the KA generate asset flows, and the KA is in equilibrium, surplus or deficit, if payments equal, fall behind or exceed receipts, respectively.

The overall BP is given by the net result of the CA and KA. So that, if a CA surplus is matched by a deficit in the KA, then the BP is in equilibrium. In a fixed exchange rate system—when the monetary authority stands ready to buy and sell the major currencies on a continuous basis, at specified bid and ask prices—an overall BP surplus or deficit may occur. When there is a balance of payments surplus the official exchange reserve holdings of the central bank will increase, and they will decrease in the case of a BP deficit. In formal terms

$$(1)\quad BP = CA + KA = \Delta R$$

where ΔR stands for the variation in official reserve holdings. For example, if a CA surplus exceeds a KA deficit, there will be an excess demand for the domestic currency. To avoid the appreciation of the domestic currency the central bank will sell domestic currency, and accumulate foreign reserves.

Under a flexible exchange rate regime—in which the exchange rate is free to float without intervention from the central bank—the overall BP must be in equilibrium, since deficits and surpluses will be eliminated by exchange rate changes, rather than changes in reserve holdings. A surplus in the CA implies that the domestic currency will appreciate, leading to a rise in the price of imports and a fall in the price of exports, that will stimulate exports and discourage imports, eliminating the CA surplus.

The remainder of this entry will discuss briefly the main theories, and their limitations, explaining the process of balance o payments adjustment, and the literature on the causes of balance of payments crises. It will also analyse the contention that the balance of payments is the main constraint to economic growth. The last section discusses the policy lessons associated with the recent balance of payments experience.

Balance of Payments Adjustment

The theory of balance of payments adjustment has gone in full circle, from the automatic adjustment views of David Hume's specie-flow mechanism, to the Keynesian interventionism of the neoclassical synthesis, to the revival of hands off views within the intertemporal approach.

David Hume (1752) developed the price-specie-flow mechanism not only as an interpretation of the BP adjustment process, but also as an argument against the mercantilist defence of government intervention. According to the price-specie-flow mechanism the BP is self-adjusting. If a country runs a trade deficit, then there will be an outflow of capital, which will lead to deflation in the deficit country, and to inflation in the surplus country. As a result of the fall of prices in the deficit country, its exports will become more competitive, thus restoring the trade balance equilibrium. In other words, capital (gold) flows eliminate any trade imbalance.

The balance of payments adjustment is a purely monetary phenomenon, and all the adjustment is done by changes in relative prices (one must not that Hume himself admitted short run changes in the level of activity). This was the standard model for balance of payments adjustment by the time of the final collapse of the Gold Standard in the 1930s—and still is in a sense (Eichengreen 1996).

Hume's specie-flow was thought for a world with fixed exchange rates. In the 1930s that assumption became considerably less relevant, and new ideas had to be developed. The elasticities approach was for a while the dominant model, and emphasized the role of substitution effects in bringing the balance of payments to equilibrium.

Most authors at that point remained prisoners of Say's Law, and as a result the level of activity was excluded from any role in adjusting macroeconomic disequilibria. It was only with the formal development of the principle of effective demand by John M. Keynes that the possibility of having the level of income as the adjusting variable entered the scene. As correctly pointed out by Taylor (1990:73), "this [Keynesian] revolution fundamentally attacked Say's Law, and hence the specie flow mechanism."

In Keynes's work the level of income works as the adjusting variable between savings and investment. In an open economy environment the level of income operates as the adjusting variable for a trade deficit (Harrod 1933). That is, if a country runs a persistent trade deficit, and capital inflows are lacking, then a reduction in the level of income would lead to a contraction of imports, and the adjustment of the balance of payments. This came to be known as the absorption approach to the balance of payments. The absorption approach also meant that there was a great degree of elasticity pessimism, that is, the idea that depreciation would have a minor effect in adjusting the balance of payments.

Structuralist authors pointed out later that even exchange rate movements affect the balance of payments not through its impact on price competitiveness, but through its effect on income distribution and the level of activity. Krugman and Taylor (1978), building on the work by Albert Hirschman and Carlos Diaz-Alejandro, show that depreciation leads to a contractionary adjustment if the economy has a trade deficit or if it redistributes income to higher income groups. In the first case, if the volume of imports is high and the value increases after devaluation, contraction of output may be the only way to reduce the trade deficit. In the second case, if the redistributive effect of depreciation increases the income to low spending groups (higher income groups), then a contraction of output also follows.

The Mundell-Fleming model—a great synthesis of the absorption, elasticities and monetary approaches to the balance of payments developed during the 1950s and 1960s that started with James Meade's (1952) classic *The Balance of Payments*—remained for a long while the dominant view on balance of payment adjustment. In this view, then the adjustment is partially done by changes in the relative prices and partially done by variations in the level of activity. However, to the extent that economists relied more on the concept of a natural rate of unemployment—associated to some optimal level of output—it became evident that in the long run, variations in the level of output cannot be central for balance of payments adjustment.

More importantly, in monetarist criticism of Keynesian models of balance of payments adjustment noted that the latter analysis did not take into consideration the accumulation of stocks. In other words, Keynesians analyzed the flows of goods, services and capital, but not the accumulated stocks of debt in the form of assets that resulted from balance of payments disequilibria. The monetary approach to the balance of payments and the intertemporal approach that finally came to dominate were designed to solve that problem. In both cases, a central part of the analysis consists on the fact that a country's ability to spend more than it earns is limited by a budget constraint. In the monetary approach the emphasis is on the control of the domestic money supply stock, while the intertemporal approach emphasizes the possibility to smooth out spending patterns over long periods of time. The main conclusion from the intertemporal approach to the balance of payments is that if a country runs a current account deficit in the early periods—for example because it has fiscal deficit and the output level is above the natural level—then it must run a surplus in the future in order to pay the debt that is accumulated in the initial periods (Sachs 1981; Obstfeld and Rogoff 1995). In fact, the intertemporal approach brought about an analogy between the budget constraint and the external constraint that was only implicit in previous conventional analysis (Currie 1976).

Hence, in a world with developed financial markets a country may choose to smooth out spending patterns and delay the adjustment of the balance of payments for several periods. The conventional wisdom is that economies tend to be at the output level that corresponds to the natural rate of unemployment in the long run, and as a result in the long run the adjustment is done by variations of relative prices, either a deflation or a deprecation of the currency. In both cases, monetary policy is seen as the main instrument to achieve the balance of payments equilibrium.

There are several limitations to this analysis. A crucial problem is the idea of a natural level of unemployment, which subtracts any relevance to changes in the level of activity in the balance of payments adjustment process. The natural rate of unemployment corresponds to the full employment level. It is worth noticing, however, that the natural rate has been conspicuous for its absence in the 1990s.

In the early 1990s in the US most macroeconomist agreed that the natural rate was around 6 per cent. If unemployment fell below that rate, then the economy would overheat and inflation would follow. Yet, by the mid-1990s unemployment had fallen to around 4 per cent and inflation was nowhere to be seen. The Federal Reserve Board was praised by the market for not hiking interest rates when unemployment rates started falling. Some economists argued then that the natural rate had fallen to around 4 per cent.

In fact, to understand the importance of adjustments in the level of activity one does not need to make a big effort. All balance of payments crises (e.g. the Latin American debt crisis of 1982, the Asian Crisis of 1997, etc.) were followed by severe contractions of the level of activity and increasing levels of unemployment. Further, as the contraction helps to reduce trade imbalances by reducing the level of imports, patterns of trade are also affected. Usually countries cut the imports of superfluous goods, and maintain imports of intermediary goods essential for production. These changes are seldom—if ever—determined by changes in relative prices.

In sum, a crucial element in the conventional view about balance of payments adjustment depends on a proposition that is—to say the least—difficult to defend in theory, and that has scant evidence in its support. Full employment or tendencies towards it are not a common feature of modern economies. So one could ask what would be the consequences of abandoning that assumption, and assuming a more pragmatic macroeconomic theory for the theory of balance of payments adjustment.

A second and interrelated critique of the dominant approach is the notion that the balance of payments is self-adjusting, and that led to themselves markets would adjust towards equilibrium. Intervention on the balance of payments is, however, pervasive, since markets have indeed a tendency to lead to balance of payments crises. Calvo and Reinhart (2000) have noted that even countries that claim to pursue flexible exchange rate policies tend to intervene in foreign exchange markets, showing signs of what they refer to as fear floating. The reason behind fear floating is the perception that the balance of payments will not adjust by itself.

The recent experience with balance of payments liberalization is a good illustration of this point. Some of the problems of the dominant view become clearer in light of a discussion of the causes of balance of payments crises.

Balance of Payments Crises

The canonical model of balance of payments crises was developed by Krugman (1979), based on the work of Girton and Henderson (1976). According to this view the main cause of a balance of payments crisis is overspending. Governments tend to run fiscal deficits, which in turn are financed by money emission, leading through the simple Quantity Theory of Money to inflationary pressures. The inflationary pressures imply that domestic goods become more expensive, leading to current account deficits (twin deficits) and, hence, to pressures for depreciation. Depreciation and the substitution effects that it provokes adjust the balance of payments, but a new crisis can only be avoided by fiscal adjustment.

Several authors extended the conventional story. In particular, it was noted that governments not only had to be fiscally responsible, but they had to be perceived to be fiscally responsible. In other words, credibility is the key to avoid balance of payments crisis, so creating a reputation for fiscal responsibility should be the main task of financial ministers around the world. In that case, it is not impossible to imagine a situation where a country suffers a balance of payments crisis even though it pursues market-friendly policies. Obstfeld (1986) shows, using a model that is in essence the same as the one developed by Krugman, that countries with pegged exchange rates are particularly vulnerable even if they pursue responsible fiscal and monetary policies.

To illustrate alternative views on balance of payments crises, one could concentrate on some specific episodes, and adequacy of the conventional approach. The German balance of payments crisis of the early 1920s, the collapse of Bretton Woods, the Latin American Debt Crisis of the 1980s, and the more recent Asian Crisis provide rich periods for analysis.

The conventional view that the balance of payments crisis was caused by fiscal irresponsibility was for example the interpretation of the balance of payments crisis and the hyperinflation in Germany during the 1920s put forward by most economists (Bresciani-Turroni 1931). The German officials that had to deal with the day-to-day problems of running an economy under hyperinflationary conditions saw the problem, not surprisingly, from a different perspective. The most notorious defender of the so-called balance of payments theory was Karl Helfferich (Câmara & Vernengo 2001).

For Helfferich the main cause of hyperinflation was to be found in the reparations of the Versailles Treaty. Helfferich argued that the permanent unfavourable trade balance, caused by the war and the impositions of Versailles, led to depreciation. This was the root of German problems. This idea that at the root of the balance of payments crisis is a terms of trade problem, or some other real cause that reduces the ability of the country to enter international markets in a competitive position would be taken again by Latin American structuralists (Prebisch 1959).

In this view, then, the conventional story is put upside down. A term of trade shock—or a reparations problem as in the case of Germany—imposes a financial burden on the balance of payments that cannot be paid out of the current account surpluses (when they exist). Hence, the country is forced to depreciate to generate the current account surpluses, leading to higher prices of imported goods and to inflation. Further, contraction of the domestic output level is also needed to cut imports to the minimum. Depreciation, one should add, in typical structuralist fashion, works by redistributing income to exporters—usually capitalists with higher propensities to save—and reinforcing the contractionary effects. Hence, the balance of payments is adjusted by output contraction, and the income effects rather then the substitution effects are the one that count, as in the Keynesian interpretation of balance of payments adjustment.

The Latin American Debt crisis—that followed the Mexican default of August 1982—was also seen by conventional authors as the result of government overspending. Latin American neo-structuralists, on the other hand, saw it as the result of a combined terms of trade cum interest rate shock that made the foreign debt unserviceable, leading to depreciation and contraction (a lost decade was the nickname for the 1980s), as the only way to adjust the balance of payments. The similarity with the German balance of payments crisis of the 1920s, which also was associated to hyperinflation, was well noted by several Latin American authors (Câmara & Vernengo 2001).

The alternative view then would emphasize the role of terms of trade shock—prices of commodities, including oil fell considerably in the 1980s—and the interest rate shock caused by the hike of American rates by Paul Volcker, the then chairman of the Federal Reserve Board, as the two main causes for the debt crises. Faced with an increasing debt servicing bill and with reduced resources, Latin American countries were forced to contract the level of activity to reduce imports, and devalue their currencies—with both contractionary and inflationary effects—to adjust the balance of payments.

The collapse of the Bretton Woods system also provides an interesting contrast between the conventional and alternative interpretations of balance of payments crises. For the conventional neoclassical analysis the main cause of the demise of Bretton Woods is associated to the inflationary pressures brought about by the expansionary fiscal policies in the U.S., and the propagation of these inflationary pressures through the international system. The increasingly expansionary fiscal policies of the 1960s—resulting both from the Vietnam War and the Great Society experiment of the Kennedy-Johnson administrations—led to growing balance of payments deficits. The U.S. deficits were initially considered instrumental for the working of the international monetary system that was desperately in need of dollars to obtain the essential imports of capital goods needed for reconstruction. However, by the late 1960s the accumulation of idle dollar balances started to put pressure on the money supply of the rest of world, leading to inflation. That is, according to the neoclassical logic, inflation was caused by the U.S. fiscal and monetary policies, and transmitted to the world as a result of the system of fixed parities.

The collapse of Bretton Woods is then related to the unwillingness of foreign countries to import U.S. inflation. That eventually broke the credibility of the fixed exchange rate commitments, and the willingness of the several central banks to cooperate in order to maintain the fixed parities. In other words, the Bretton Woods system failed because the fixed parity commitment was not credible in the face of accelerating inflation.

An alternative explanation for the inflationary pressures of the 1960s is possible though. This alternative explanation would minimize the effects of the U.S. expansionary fiscal policy in the demise of Bretton Woods. The Golden Age regime implied a commitment to full employment and the creation of a safety net for unemployed workers. Additionally, the imposition of capital controls and the cheap money policies—which led to low real rates of interest—implied a favourable environment for workers. Parties with strong ties with the labour movement were in power in several Western countries, and this was tolerated, to a great extent, since it was considered a form of reducing the dangers of the Soviet menace. Further, full employment tends to increase the bargaining power of the working class.

In this environment, workers pressures for higher nominal wages would be usually accommodated. For a given real rate of interest, and a fixed nominal exchange rate, the only effect of rising wages would be higher prices. In sum, inflation was the result of wage pressures (cost-push) rather than the expansionary fiscal and monetary policies (demand-pull). In that sense, the abandonment of the fixed parities is not connected to the loss of credibility in the face of higher inflation, since the causes of inflation lay somewhere else (Vernengo 2004).

The alternative view emphasizes the role of financial liberalization in the collapse of the Bretton Woods regime. Davidson (1982) argues that the U.S. dollar represents the asset of ultimate redemption, and hence is used as the measure of international liquidity. As a result the U.S. benefits from a more liberal financial system, since the centrality of U.S. financial market allows it to attract funds to finance persistent current account deficits. For that reason, beginning in the 1960s the U.S. adopted a more self-centred financial policy, promoting financial openness in order to be able to face the growing current account deficits. It is the increasing financial openness of the 1960s, built into the American support for the Euromarket that ultimately made the Bretton Woods system untenable.

Similar debates regarding causes of the Asian Crisis in 1997 resurfaced. The conventional view could not blame excessive fiscal spending as the main cause of the crises, since it was clear that most Asian countries had kept their budgets in surplus, as noted by Stiglitz (2002). On the other hand, the heavily interventionist policies that led to the so-called Asian Miracle—that is, the exceptional rates of growth of South East Asian economies—were to blame. The Asian values that have been considered essential for development were now seen as signs of crony capitalism. McKinnon and Pill (1998) for example argued that overregulation led to perverse incentives, and misallocation of resources. Hence, the process of development was illusory and financial markets would have to discount the actual costs of the oversized governments. In fact, Krugman (1994) in a widely acclaimed paper compared the Asian Tigers to the Soviet Union, and forecasted their collapse.

Several critiques of the conventional interpretation were raised, in which the role of financial liberalization and the lack of proper regulation on capital flows is seen as the main culprit for the balance of payments crisis. Chang (1998) argues that corruption and mismanagement only increased after the crisis leading to more lax regulation in the case of South Korea. The liberalization of the capital account of the balance of payments required for entry into the OECD group, and in general promoted by the IMF, is seen as the main cause for the balance of payments crisis.

Taylor (1998) provides a general overview of the effects of capital account liberalization around the developing world during the 1990s, one in which the Keynesian view that international financial markets may very well be unstable and prone to crises is at the centre of stage. For example, a country may receive inflows of capital as a result of the increasing confidence of international financial markets on its ability to grow—say for example, that the main reason is a recent history of fast growth. The inflows of capital lead to an increase of imports, and also to an appreciation of the domestic currency. Both effects tend to lead to a worsening of the trade account. The trade deficit is not necessarily bad. If these inflows were used to buy machines and equipment and lead to higher investment, and higher productivity, one would expect that exports in the future would more than compensate the initial deficits. In this case, the inflows would be sustainable and there is nothing to worry about.

On the other hand, if the inflows are used for consumption, and there are no prospects of higher exports, then one might be in trouble. Also, the appreciation of the currency, caused by the capital inflows, may force competitive firms out of business. This has hardly anything to do with lack of comparative advantage, since the only reason for failure is an appreciated exchange rate. Often countries in this situation would hike interest rates to attract capital flows and allow the trade deficits to continue for a while. This only makes things worse, since continuous inflows keep the exchange rate appreciated, and the high interest rates compress domestic investment. A trap of low growth and an unsustainable balance of payments are the results. The final crisis is usually triggered by some outside event that leads to capital flight and depreciation of the domestic currency.

Depreciation, however, is also contractionary, as we already saw. The depreciation means that those with debts in foreign currency (and usually revenues in domestic currency) have a prospect of a higher debt-servicing burden. Also, it is not uncommon to encounter that international debts were contracted short, while revenues are long. Hence, the currency and term mismatches mean that debtors are bankrupted, leading to lower levels of activity, lower growth and higher unemployment. It is the contraction of output, and the consequent fall in imports that helps adjust the balance of payments. Debt restructuring, unemployment and lower rates of growth for long periods tend to follow.

In other words, international financial markets can make the balance of payments adjustment process quite painful. That was the reason why Keynes advocated capital controls during the Bretton Woods conference. It is also behind the argument put forward by Stiglitz (2002) that the two countries that escaped the Asian Financial Crisis were China and India, the two countries with more comprehensive foreign exchange controls. Or more dramatically, this is also the reason why The Economist—a bastion for defenders of free trade in goods, services and capital flows for decades—has finally admitted that regarding liberalization of capital flows "the anti-globalists are on to something," and that in this light "for some countries, imposing certain kinds of control on capital will be wiser than making no preparations at all," (Crook 2003). Even Krugman (1998) has advocated capital controls in the face of severe balance of payments crises.

The International Monetary Fund (IMF)—which was originally devised to support countries with balance of payments problems—has also admitted recently that the experience with balance of payments liberalization has been less forthcoming than expected (Prasad et al 2003).

The recent negative perception regarding financial liberalization and the renewed defence of capital controls—as for example the discussion of Tobin taxes—is directly related to a resurgence of exchange-rate pessimism (Lane 2001; Obstfeld 2002; Obstfeld and Rogoff 1995). In recent years, many countries have suffered severe financial crises, producing a staggering toll on their economies, particularly in emerging markets. In Latin America there was a second Mexican crisis in December 1994, the so-called Tequila Crisis, the Brazilian crisis of January 1999 and the Argentinean meltdown of December 2001. Also, East Asia that survived the 1980s unscathed by financial crises and growing at miracle rates was hit by a crisis which spread from Thailand to other countries in the region during the second half of 1997, with contagion effects in Latin America as well as in Russia.

As noted by Pieper and Taylor (1998) the revival of the liberal creed has made balance of payments adjustment more painful for developing countries. The severity and frequency of the crises brought again the preoccupation with the negative effects of balance of payments disequilibria to long run growth to the centre of the debates.

Balance of Payments Constrained Growth

The idea that the balance of payments constitutes a constraint to economic development can be traced back to Raúl Prebisch and other Latin American authors of the United Nations Economic Commission for Latin America (ECLAC). Kaldor (1970) articulated a simple demand driven model of accumulation in which the balance of payments—foreign demand—had a crucial role. The development of his ideas dates back to the introduction of his technical progress function at the end of the fifties, and his interpretation of the slow rate of growth of Great Britain in the mid sixties, in which he developed the so-called Kaldor-Verdoorn Law, which states that productivity growth depends on demand stimulus.

Dixon and Thirlwall (1975:203) have correctly emphasized, "the main thrust of

Kaldor's argument is Hicks's view that it is the growth of autonomous demand which governs the long run rate of growth of output." In particular, the long run rate of growth is assumed to depend fundamentally on the growth of demand for exports. The growth of exports leads to higher rates of growth, which in turn force the system to generate innovations to keep pace with demand growth. The Kaldor-Verdoorn Law implies higher productivity and higher levels of income per capita, which generate a renewed increase in demand. Hence, a cumulative process of growth is put into motion.

Thirlwall (1979) showed that if a country is forced to keep its balance of payments in equilibrium, then the Kaldorian model implies that rates of growth should be proportional to the ratio of export growth to the income-elasticity of demand—also know as Thirlwall's Law. In other words, if export growth is the main cause of GDP growth, and GDP growth leads to increasing imports, exports have to grow in tandem with imports to keep the balance of payments adjusted. McCombie and Thirlwall (1994) show that Thirlwall's Law fits the data for most countries relatively well.

Dooley *et al.* (2003) also argue that export-led growth has been a staple source of growth in the periphery of the capitalist system. For them, the economic emergence of a fixed exchange rate periphery in Asia has re-established the United States as the centre country in a revived Bretton Woods international monetary system. They argue that the normal evolution of the international monetary system involves the emergence of a periphery for which the development strategy is export-led growth supported by undervalued exchange rates, capital controls and official capital outflows in the form of accumulation of reserve asset claims on the centre country. The success of this strategy in fostering economic growth allows some countries in the periphery to graduate to the centre.

If periods in which export-led growth are feasible in the periphery show that the balance of payments is central for development, its also true that periods of financial liberalization show that the balance of payments is the main constraint.

Lessons and Policy Alternatives

One important lesson from the last wave of balance of payments crises is that fundamentals do not seem to be the unique or even the main cause of them. Most countries in East Asia, for example, had fiscal surpluses, high private saving rates, and low inflation; and in most cases their exchange rates did not seem out of line. It should be then painfully obvious that the traditional measures recommended by the IMF—contraction and depreciation—will not solve the current set of problems (Stiglitz 2002).

It is not clear what will emerge from the general sense of inadequacy regarding the international financial architecture, but it is clear that it will change. The Meltzer Report in the US wants to reduce the role of the IMF in the process of balance of payments adjustment to reduce the problems of moral hazard. That is, it is expected that free markets will impose discipline on economic agents. The crowds of people protesting against globalization in the World Bank-IMF annual meetings also want to eliminate the IMF, or at least their policies. Stanley Fisher, the ex-deputy director at the IMF recognized that the IMF would have to step in more frequently as a lender of last resort in order to make the balance of payments adjustment smoother. The world economy seems to be at a decisive juncture.

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Brain Drain

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Introduction

The concept of "brain drain" is generally defined in terms of the mobility of a particular country's highly skilled workers. Within a particular country, this mobility can involve certain industries drawing the most talented individuals from other industries (for example, an increase in high-paying computer jobs creating a shortage of computer science teachers). The global version of brain drain (the focus of this discussion) is generally defined as a migration of talented and competent workers who leave their home country to live and work abroad. The most common view of this migration is that a relatively small number of countries benefit from the increasing participation of talented foreign workers in the labor market, while many other countries are adversely impacted by a continual loss of talent.

The primary pattern of global brain drain migration involves movement from developing countries (particularly in Africa, Asia and Latin America) to industrially developed countries (primarily Australia, Western Europe and the United States). This movement is sometimes temporary—for example, a doctor from a developing country may travel abroad to acquire first-hand knowledge of medical practices in industrialized countries, with the intention of returning and working to improve practices in his home country. However, if this doctor decides to stay in the developed country—perhaps to enjoy higher wages, more personal freedoms, or an overall higher standard of living—then one can describe this as an example of the global brain drain phenomenon. Clearly, the migration patterns which frame this discussion have important global public policy implications, especially for the developing countries that continually lose the best and brightest members of their labor pool.

Global Patterns

The United Nations Development Program (UNDP) estimates that around 750,000 highly trained professionals from developing countries live and work in industrially developed countries each year. Two recent reports by the United Nations Educational, Scientific, and Cultural Organization (UNESCO) indicate that Africa has lost nearly a third of its skilled professionals over the last decade. Their research suggests that each year about 20,000 professionals leave Africa, emmigrating to the developed countries of Western Europe and North America. This pattern is similar in the developing countries of Latin America, Asia and Eastern Europe. (UNESCO 2003). For example, recent studies have shown that migration to the U.S. has taken a large share of the most educated proportion of the workforce from El Salvador, Guatemala, Jamaica, and Mexico (Adams 2003).

Because global migration is expensive, the well-educated and well-off in these countries are more likely to afford it than the poor. For example, about 30% of all highly educated Ghanians and Sierra Leonians live abroad (UNESCO 2003). The costs of the brain drain to countries like these can be enormous. An abundance of research on human capital theory indicates that higher education levels contribute to greater workforce productivity. Indeed, human capital is an essential ingredient for any country's economic growth in science, technology and knowledge-industries. Thus, the loss of the most highly educated members of a country's workforce can severely handicap their ability to develop a robust, mature industrial economy.

In addition to the loss of productive potential, the brain drain involves a country's most important taxpayers. For example, a recent Harvard University study indicates that the one million Indian citizens who live in the U.S. earn the equivalent of 10% of India's national income.

While developing countries lose their best and brightest, the developed countries benefit considerably from the global brain drain phenomenon. For example, according to the Organization of Economic Cooperation and Development (OECD), 25% of all highly skilled workers in Australia are foreign-born. Similar figures are seen in Canada (close to 20%) and the United States (nearly 10%) among those employed in highly skilled jobs (OECD 2003). According to the 2002 U.S. Census, 28% of the foreign born population age 25 years or older (over 4.2 million persons) had attained at least a bachelor's degree; of these, nearly 50% were from Asia, 22% from Latin America, and 20% from Europe. According to the Pew Hispanic Center, the U.S. is home to nearly 75% of Jamaica's population with higher education and 30% of all Mexicans with Ph.Ds. Turning again to the connection made by human capital theorists between higher education levels and greater workforce productivity, it seems clear that the overall impact of these trends is considerably beneficial for the industrially-developed countries. While exact figures are difficult to calculate, it can be estimated that the educated, foreign-born population in the U.S. contributes tens of billions annually to the nation's GNP.

In addition to work-related migration, higher education plays an important role in the global brain drain phenomenon. According to UNESCO, nearly 1.5 million academic professionals annually study or teach in countries other than their own. Like work-related migration, the primary trend involves individuals moving from less-developed countries to those with highly developed education systems. The U.S. and Western Europe host the majority of foreign academic researchers. According to the Institute for International Education (IIE), over 84,000 international scholars lived and worked in the United States during the 2002-2003 academic year, and nearly 18% of them were from China (IIE 2003).

Even larger numbers are seen among international student migration patterns. A relatively small handful of countries (including the U.S., Canada, Australia and the United Kingdom) play host to almost the entire population of students abroad. The primary source of these international students include many countries in Asia, Africa and Latin America. Students with considerable promise in developing countries are recruited by colleges and universities in the developed countries, and after graduation these highly skilled individuals often have little difficulty finding employment and other reasons that far outweigh the attraction of returning to their impoverished country of origin. It is also common for wealthy elites in developing countries to send their children to school abroad, given widespread dissatisfaction with the educational systems and opportunities available at home.

Many observers view study abroad as a student's first step toward resettling abroad permanently. Each year about a third of them come to one country—the United States. On average, over a half-million foreign students annually spend 3-5 years in the U.S. in undergraduate and graduate degree programs, and estimates indicate that about one-third of them do not return to their home countries (World Bank 2002). Over half of the international students in the U.S. study are enrolled in business and management, engineering, mathematics, and computer science programs (IIE 2003)—programs which are widely considered to provide the necessary credentials for highly-skilled professions. And according to data collected by the National Science Foundation (NSF), at the turn of the century over 26% of all science and engineering doctoral degrees in the U.S. were held by foreigners, and over half of all doctoral degrees awarded to foreign-born students were in civil engineering (NSF 2000).

While the migration of academic and professional talent is often described as a pattern of movement from the developing world to the developed, there are other important patterns of brain drain migration to consider. For example, Southeast Asian countries with ambitious industrialization programs—like Singapore, Malaysia, and Thailand—are increasingly seeking to attract students and professionals from Vietnam, Cambodia, and other countries where the obsolete and backward education systems, lack of social and economic advancement, and other conditions are encouraging the best and brightest to go abroad (Altbach 2003). Scientists and professors from India and Pakistan are drawn to universities in the Arabian Gulf as well as to Southeast Asia, attracted by higher salaries and better working conditions than are available at home. Even European countries are grappling with various forms of brain drain. For example, according to a 2003 study published by the European Commission, 73 percent of Europeans who receive Ph.D.'s in the United States decide to stay there, up from 49 percent in 1990 (IPTS 2003). After the collapse of the Soviet Union, Western Europe and the United States saw a rapid increase in the number of highly-skilled Russians, Ukranians, and Eastern Europeans seeking work visas in order to emigrate to the West.

In sum, the primary (but not exclusive) migration patterns which frame the global brain drain phenomenon involve the movement of highly talented workers, academics and students from developing countries to industrially developed countries. The reasons for this migration include a variety of motivators (generally, the search for a better life) and facilitators (like globalization, transportation, and the liberalization of immigration policies in developing countries).

Motivators

Generally speaking, there are two kinds of forces behind global workforce migration—the "push" dimension (reasons for which someone would want to leave their home country) and the "pull" dimension (reasons why an individual would be attracted towards living and working in a particular country other than their own). As there are many types of professionals within the highly skilled category of migrants, the push and pull factors for their migration are various (Mahroum 1999). Discussions of brain drain often account for such factors as governmental policies, economic and social environment, scientific infrastructure, academic freedom, and the climate for entrepreneurship—factors that are seen as contributing to the migratory motivations of highly skilled individuals.

Push factors may include war, political or religious oppression, famine, disease, climate, inadequate scientific infrastructure, economic collapse, ethnic persecution, and poverty. Educational opportunities to attend a college or university in a developing country are clearly limited, compared to those in developed countries. According to figures provided by the World Bank, higher education enrollment in developed countries is roughly five to six times that of developing countries. Less than half of the countries on the African continent have literacy rates above 50%, and most are well under 80%. At the turn of the century, only a third of African children of appropriate age were enrolled in secondary school (World Bank 2002). Not only do brain drain participants consider their own future when considering leaving their home country; many have families, and want the best for their children. The education and health systems of many developing countries are abysmal compared to those elsewhere, and bright, talented individuals are the most likely members of a country's population to recognize this.

Pull factors include a variety of economic, social and educational opportunities available outside one's home country. For example, industrially developed countries offer a variety of political and social freedoms, greater earnings potential, and intellectual opportunities virtually unseen in developing countries. As a general dissatisfaction with local conditions in their home countries sharpens people's desire for something better, the global spread of access to information has allowed them to see more clearly the alternatives to what their home countries have to offer. In essence, pull factors can cover a wide spectrum of tangible and intangible perceived benefits that one can derive from relocating to another country.

A discussion of motivators for academic-related patterns of global migration often incorporates a view of the world in terms of centers and peripheries. In this view, a select few countries are seen as centers of commerce and global knowledge networks (including advanced scientific research), while all other countries are seen as relatively peripheral. The U.S. and Western Europe are considered by many to be at the center of the international academic system, with most other countries relegated to the periphery. An overwhelming majority of publishers are found in these countries, as are most agencies and foundations which support academic research. The quality and availability of Internet connections in the West is far greater than in any other region of the world, where a majority of websites and other electronic resources are hosted. And most all substantive information resources in scientific and academic disciplines are published in English or another language of Western Europe (Altbach 1987, 2003).

Scientists, faculty and students in the developing world are clearly disadvantaged by this centralization of the world's knowledge resources. It is often difficult for non-Western scholars to get published in the major international journals because they use different research paradigms, have less access to libraries and the most up-to-date laboratories and are sometimes at a disadvantage in terms of expression in English (Altbach 1992; 2003). Overall, this view suggests that scientific researchers and academics at the center dominate the global knowledge networks and have greatest access to them, while many others around the globe tend to be excluded. Thus, for the best and brightest of the developing world to make the most use of their talents, they often find it necessary to leave their (peripheral) home country and move to a more industrially-developed (central) one.

Facilitators

Beyond an individual's motivations for seeking better fortunes abroad, a variety of facilitators (particularly in the realms of transportation and immigration policy) have contributed to the global brain drain phenomenon. For example, the evolution of air transportation has had an increasingly important enabling effect on global migration patterns. Several decades ago, purchasing an airline ticket from Nigeria or Malaysia to the United States or Europe was prohibitively expensive except for the very well off. Today, many families of even the lower middle classes are able to take advantage of modern means of global transportation. Unfortunately, observers have noticed a consistent pattern in many countries, wherein those families who have achieved a significant modicum of socio-economic success are also those who can best afford to send their children abroad (and to pay for a university education in the United States or Western Europe), and are more likely to do so rather than encourage their children to remain at home and contribute to the development of their country. Thus, a common observation is that more often than not, the brain drain phenomenon involves a drain on the developing country's elite.

Another important facilitator for the global brain drain can be seen in the immigration policies of several industrially developed countries, which are in many cases designed to encourage talented personnel to migrate and establish residency. As described earlier, research clearly shows that industrialized countries have much to gain from the immigration of academically talented individuals, which helps explain their active promotion of these migration patterns. For example, during the mid-1990s, the United States increased the 65,000 annual quota for the H-1b visa program through which individuals can get a visa to work in an occupation requiring at least a bachelor's degree for up to six years. Subsequently, 48% of all H-1b certifications issued have been for computer-related or electrical engineering positions (NSF 2002). Overall, there is considerable evidence that U.S. immigration policies, and the influx of highly-skilled foreign workers resulting from these policies, have indirectly contributed to this country's central role in the information technology revolution of the last two decades.

These and other facilitating dimensions of the global brain drain have helped the industrialized countries maintain their already overwhelming advantage in the scientific and scholarly knowledge networks of the world. The renewal of links between academics who migrate and their countries of origin may mitigate this situation somewhat, but the fact remains that developing countries find themselves at a disadvantage in the global academic labor market (Altbach 2003). Clearly, then, the results of these migration patterns—and the motivators and facilitators which contribute to them—have important implications for public policymakers worldwide.

Implications for Public Policy

If the brain drain phenomenon is viewed as a zero sum game, there are clearly winners and losers. The developed countries—the winners—gain a great deal from the recruitment and retention of highly skilled and talented workers from the developing nations. Their contributions to economic development and scientific advancement—particularly in the Silicon Valley of the United States during the 1980s and 1990s—has been widely documented (cf. ITAA 1997). According to research conducted by OECD, the data suggest that a quarter of Silicon Valley firms in 1998 were headed by immigrants from China and India, collectively generating almost USD 17 billion in sales and 52,300 jobs. Other research by OECD estimates that foreign temporary workers account for one-sixth of the total US information technology workforce. In general, research shows that there are several net positive effects for the host countries of highly skilled foreign workers, notably the stimulation of innovation capacity, an increase in the stock of available human capital and the international dissemination of knowledge (OECD 2002)

Another indicator of how developing countries benefit disproportionately from the global brain drain can be seen in the number of Nobel prizes awarded to US-based researchers of European or Asian origin. For example, 32% of U.S. Nobel-prize winners in Chemistry between 1985 and 1999 were foreign-born. In considering these and other indicators, some policymakers in the industrially-developed countries propose that it is a vital necessity to encourage and welcome the inbound migration of other countries' most talented and promising youth, noting that this will ensure the relative economic superiority of the "centers" over the "peripheries." On the other hand, some policymakers (including those at UNESCO) argue that the constant "international welfare" drain on the developed world's resources, in the form of economic and humanitarian assistance to the developing world, can only be stemmed if we send them back where they came from, and force them to contribute to the development of their home countries.

The latter view is more likely to be shared by the policymakers of developing countries, who are typically seen as the losers in this zero-sum game view. The impact of the brain drain in developing countries (which have so few scientists to begin with) can be devastating. For example, more Ethiopian holders of doctoral degrees work outside of Ethiopia than at home, and 30 percent of all highly educated Ghanaians and Sierra Leoneans live and work abroad (The Economist 2002). For developing countries, then, the most significant challenge involves retaining their pool of highly-skilled workers, talented students, well-educated scientists and academic professionals. But how to convince these highly-intelligent individuals—educated by their developing country—not to take their talents and skills to the highest global bidder?

In order to reduce brain drain in Africa, a number of international organizations (including the International Organization for Migration, the UNDP, and UNESCO) have proposed a variety of different strategies. Some approaches have used various incentives to encourage African nationals abroad to return to their home countries, but these have seen limited success over the past two decades. However, some localized initiatives—such as the Transfer of Knowledge Through Expatriate Nationals (TOKTEN) project implemented at the University of Mali by the UNDP and UNESCO—have achieved better results. Other approaches have suggested that legal restrictions should be placed on an individual's ability to emigrate, while still others have suggested that a "departure tax" should be paid by receiving countries to a worker's country of origin.

On a national level, many observers point to India as a country that has had some success in reducing brain drain. The near-universal emigration of their computer science graduates in the 1990s had declined to 70 percent by 2002 (World Bank 2002). This has largely been due to the growing number of highly paid jobs with national and multinational corporations that were established following market liberalization. Growing demand for skilled graduates in fields such as software engineering, financial services, and telecommunications has also provided some impetus for improved training in these fields throughout India (Altbach 2003).

As developing countries industrialize and invest in their infrastructure, the attraction of returning home for some becomes more salient. However, without complementary changes in the political and social dimensions of these countries, many of these individuals—who very often come to enjoy a great many freedoms of a liberal democracy that are not available in their countries of origin—will be reluctant to return home. These individuals often leave the developing world in search of better political or social or economic conditions, and the government leaders of these countries—a number of them autocratic, corrupt, or inept—bear some direct blame for this loss to their country's economic potential. From Saudi Arabia to Uganda to Vietnam, too little has been done in many parts of the world to provide ample reasons for the best and brightest to stay home (or return home) and contribute to the development of their country.

As a developing country continues to lose its most talented workers and students—as well as the children of its elite families—who opt for a better education and quality of life overseas, the competence of their home country's political leaders can (and should) be called into question. In Saudi Arabia, for example, citizens are increasingly asking why (rather than lining the pockets of the Saud family regime) the country's vast oil wealth has not enabled the development of an economic and educational infrastructure comparable to those of developed countries. In some cases, the leaders of developing countries have tried to stem the loss of their best and brightest by clamping down on those seeking to go outside the country for employment or education. As one might expect, this approach produces a significantly negative effect, simply increasing the attractiveness of the alternative to a seemingly oppressive and inept regime. In such countries, the development of public policies are in the exclusive domain of those responsible for the brain drain affecting their country, offering little hope that real change is foreseeable.

Despite these challenges, however, there is some good news on the horizon. For example, the number of skilled professionals from the industrially developed world working in developing countries—as experts employed either by international organizations or by multinational companies—is on the rise (UNESCO 2003). The training and employment of local experts, both by multinational companies and by international organizations, is rapidly becoming an accepted norm of all development aid projects. And distance education programs (Internet-based and otherwise) and branch campuses run by colleges and universities in Australia, the United States, and Western Europe are playing an increasingly important role in breaking down the conceptual central-peripheral hegemony in the global knowledge networks.

It is currently too early to assess the effectiveness of these and other burgeoning initiatives. Their success will depend largely on the fiscal and political competence, goodwill and perseverance of all parties involved. But at the very least they are widely heralded as a step in an important direction. Clearly, a critical mass of local expertise is a necessary condition for developing countries to reduce their dependence on foreign aid and to reach self sustainability. And in turn, achieving these objectives will provide the best opportunity for slowing—or perhaps even reversing—the global migration flow of their most talented citizens.

Conclusion

The purpose of this discussion has been to provide a broad overview of the global brain drain and its public policy implications. There is a wealth of literature available to those wishing to explore any of the various dimensions of the issues described here, including the economic, political and social ramifications for both developed and developing countries. Clearly, all three dimensions are interconnected at the public policy level for all countries.

Government leaders in the developing world must adopt new policies in order to stem the brain drain. Political freedoms, rule of law, economic infrastructure, health and education policies—these are just a few of the dimensions that must be addressed in order to convince the best and brightest to stay home and contribute to the development of their countries. While improving governance and resolving conflict is perhaps the most basic necessity for developing countries to stem the adverse effects of the brain drain, clearly these countries will not be able to accomplish their development agendas without investing in their people.

Persuading would-be leaders to stay, or at least return, may be a developing country's only hope for getting out of their economic, social and political quagmire. The retention of academic professionals in developing countries requires improved governance in higher education institutions, greater intellectual opportunities, higher professional salaries, and better working conditions. Countries must also provide incentives such as academic freedom, support for international collaboration, and enhanced job security, in order to lure back and retain their most talented scientists and engineers (Altbach 2003). Clearly, the brain drain is an important phenomenon which requires further study at the local and national level. The problems are deep and complex, with great importance for public policy. How policymakers around the world manage the brain drain phenomenon will undoubtedly frame patterns of knowledge and wealth distribution for the foreseeable future.

Internet Sites

Africa Policy Information Center www.africapolicy.org

Department of State: Bureau of African Affairs. www.state.gov/www/regions/africa

Institute of International Education. www.iie.org

Organization for Economic Development and Cooperation. www.oecd.org

Transfer of Knowledge Through Expatriate Nationals (TOKTEN) Website: www.tokten-vn.org.vn

United States Agency for International Development. www.info.usaid.gov

UN Economic Commission for Africa. www.un.org/Depts/eca

United Nations Development Project: Sustainable Human Development. www.undp.org/indexalt.html

United National Educational, Scientific and Cultural Organization (UNESCO). www.unesco.org

World Bank. www.worldbank.org

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Capability Approach to Development Policy

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Introduction

The capability approach is a general normative framework for the evaluation of individual well-being and social arrangements, and the design of policies and social improvements. The capability approach is not only used in development thinking, but also in other fields including welfare economics, social policy and political philosophy. It can be used to evaluate a wide variety of aspects of people's well-being, such as individual well-being, inequality and poverty. It can also serve as an alternative to social cost-benefit analysis and design and evaluate policies, ranging from welfare state design in affluent societies, to development policies by governments and non-government organizations (NGOs) in developing countries. In academia, it is being discussed in quite abstract and philosophical terms, but also used for applied and empirical studies. In development policy circles, it has provided the foundations of the human development paradigm.

The core characteristic of the capability approach is its focus on what people are effectively able to do and to be, that is, on their capabilities. This contrasts with philosophical approaches that concentrate on people's happiness or desire-fulfillment, or on theoretical and practical approaches that concentrate on income, expenditures, consumption or basic needs fulfillment. A focus on people's capabilities in the choice of development policies makes a profound philosophical difference, and leads to quite different policies compared to neoliberalism and utilitarian policy philosophy.

Philosophical Foundations

Some aspects of the capability approach can be traced back to Aristotle, Adam Smith, and Karl Marx, but the approach in its present form has been pioneered by the economist and philosopher Amartya Sen (1980, 1983, 1989, 1999). Sen argued that in social evaluations and policy design, the focus should be on what people are able to do and be, on the quality of their life, and on removing obstacles in their lives so that they have more freedom to live the kind of life which, upon reflection, they find valuable.

The capability approach clearly distinguishes between the means and the ends of well-being and development. Only the ends have intrinsic importance, whereas means are only instrumental to reach the goal of increased well-being and development. What are then, according to the capability approach, the ends of well-being and development? Well-being and development should be discussed in terms of people's capabilities to function, that is, on their effective opportunities to undertake the actions and activities that they want to engage in, and be whom they want to be. These beings and doings, which Sen calls achieved functionings, together constitute what makes a life valuable. Functionings include working, resting, being literate, being healthy, being part of a community, being respected, and so forth. The distinction between achieved functionings and capabilities is between the realized and the effectively possible, in other words, between achievements and freedoms. What is ultimately important is that people have the freedoms (capabilities) to lead the kind of lives they want to lead, to do what they want to do and be the person they want to be. Once they effectively have these freedoms, they can choose to act on those freedoms in line with their own ideas of what kind of life they want to live. For example, every person should have the opportunity to be part of a community and to practice a religion, but if someone prefers to be a hermit or an atheist, they should also have this option. Thus, the capability approach is clearly a liberal theory, albeit of a critical strand within philosophical liberalism.

The capability approach to development policies thus focuses on people's capabilities. It asks whether people are healthy, and whether the resources necessary for this capability, such as clean water, doctors, protection from infections and diseases, and basic knowledge on health issues, are present. It asks whether people are well-nourished, whether the conditions for this capability, such as sufficient food supplies and food entitlements, are met. It asks whether people have access to education, to political participation, to community activities, to religion. For some of these capabilities, the main input will be financial resources and economic production, but for others it can also be political practices, such as the effective guaranteeing and protection of freedom of thought, religion or political participation, or social structures, social institutions, public goods, social norms, traditions and habits. The capability approach thus covers the full terrain of human well-being. Development is regarded in a comprehensive and integrated manner, and much attention is paid to the links between material, mental, spiritual and social well-being, or to the economic, social, political and cultural dimensions of society.

Basic Needs and Human Development

In development studies, the capability approach could build on the basic needs approach. The prevalent view is that the basic needs approach has now been incorporated into the capability approach (Alkire 2002:167). The basic needs approach shares with the capability approach its direct focus on people. However, the capability approach differs in two important aspects from the basic needs approach. Firstly, the capability approach is wider, as it does not focus exclusively on minimum levels of decent living. Secondly, the capability approach has a rigorous philosophical foundation which is absent in the basic needs approach. Nevertheless, when applied to poverty reduction policies, or when applied to development policies in very poor countries, both approaches will often recommend similar policies (Alkire 2002).

In policy circles, the capability approach is probably best known because it provided the theoretical foundations of the human development paradigm, which was originally launched by the United Nations Development Program, UNDP (Fukuda-Parr 2003; Fukuda-Parr and Shiva Kumar 2003; UNDP 1990-2004). In fact, a number of heterodox approaches to development, including the basic needs approach, have been used to develop the human development paradigm. However, "it was Sen's work on capabilities and functionings that provided the strong conceptual foundation for the [human development] paradigm" (Fukuda-Parr 2003:302-303). Nevertheless, the human development paradigm should not be equated with the capability approach to development. The human development paradigm is probably best seen as one particular way to use the open and flexible framework offered by the capability approach.

Theoretical Problems

It is widely accepted in the theoretical literature on the capability approach that it is a flexible open framework which can be used in different ways to analyse diverse aspects of well-being, inequality and poverty, and which opens up several ways to formulate social policies and development policies, instead of imposing a rigid approach on how to do research and design policies. Many scholars working on capabilities regard this as a strength of the paradigm, as the flexible nature of the approach makes it useful for applications in both post-industrial and developing countries, and allows to make it sensitive to the context and local characteristics and concerns. However, in theoretical terms the flexibility and openness of the capability approach creates two challenges. The first is that Sen has always refused to specify a well-defined list of valuable capabilities, hence how do we know which capabilities are valuable? The second challenge is to decide how to trade-off different capabilities against each other when policy decisions have to be made.

The question on how to select the relevant capabilities has been addressed in quite different ways. Martha Nussbaum (2000 2003) has used the capability approach to propose a list of universal capabilities that can provide the foundations for a just constitution. Her list of capabilities cannot be negotiated, that is, from a moral point of view every government should guarantee this list to its citizens. Each country can then translate these general capabilities into more specific capabilities, depending on the local context. Nussbaum has been criticized for the overtly normative nature of her list, which leaves little room for public discussion and participation (Alkire 2002), which can reduce its political legitimacy (Robeyns 2003). In addition, her approach takes for granted that governments will have to guarantee those capabilities, which is based on an idealised notion of the government, which stands far from the reality in many countries (Menon 2002). Other authors have searched for more participatory and procedural ways to decide which capabilities should be selected. Sabina Alkire (2002) has argued that the relevant capabilities can be found by means of practical reasoning, that is, by iteratively asking what the most basic reasons for acting are. Such a process would guarantee that the affected people are included in the process of determining which capabilities are relevant given the context in which it is applied. Ingrid Robeyns (2003) has developed another procedural approach to selecting the capabilities by proposing and defending a number of principles that should be respected during this process, and which should guarantee that the procedure of selecting the capabilities would be democratic, legitimate and just. Given that the literature on the capability approach is developing extremely rapidly at present, it is expected that other methods to decide on the relevant capabilities will be developed in the years to come.

The second theoretical problem inherent in the flexible open character of the capability approach is the question how to decide which capabilities to prioritize, or how to decide on trade-offs between capabilities. Obviously, policy makers and societal agents always try to search for ways in which no such trade-offs are necessary. For example, if primary education is available to all children, then an effective prohibition of child labor might increase those children’s capability to education, but it could simultaneously worsen their capabilities for being well-sheltered, well-fed and decently clothed, if their family depends on their income from labor. Unfortunately, in the capability approach little work has been done to address such problems at a theoretical level. Amartya sen (2000) has explicitly stated that the weights attached to aggregate capabilities into one index of well-being or development, and the trade-offs between these capabilities, is a matter of social choice, and cannot be taken over by a simple technical solution. In other words, Sen stresses that people have to evaluate explicitly and critically what they want, and what kind of trade-offs they want to make. Nussbaum (2000) argues, at the level of moral philosophy, that trade-offs between the valuable capabilities should never be tolerated, and that any such trade-off is a tragedy. While this can be true as a moral judgment, it doesn't provide much help for governments, NGOs and other agents who are trying to improve the quality of life of poor people. In the messy business of "development practice", the capability approach would have to join forces here with on-going discussions of pros and cons of different possible trade-offs in specific situations. When the capability approach is used at a higher level, for example to decide on how to allocate the national budget, then it would stress the importance of open democratic public debate and deliberation on the prioritization and trade-offs between capabilities. As such, the capability approach is not neutral between dictatorial and democratic governments, and Sen has provided several arguments on both the intrinsic and instrumental importance of democracy for a people-centered development (Sen 1999).

Other Development Paradigms and Policies

The capability approach entails a strong critique of two other visions of well-being and development. These are utilitarian approaches, and those that focus primarily on economic production and growth, such as neoliberalism.

Utilitarian philosophy judges social evaluations based on individual utilities, which are either defined as satisfaction or desire fulfillment, or as happiness. These feelings are certainly not unimportant. If the same level of socioeconomic development can be reach while people are happy, then this surely is to be preferred over a situation with the same socioeconomic development but with unhappy people. Thus, the capability approach does not claim that utility is unimportant. However, the approach does warn against taking people's subjective assessments of their own situation as an indicator of their well-being for the purpose of interpersonal comparisons or for policy design. There is empirical evidence that social notions of class, caste and gender hierarchies lead to the paradoxical observation that people from higher classes or casts complain more about aspects of their quality of life than the poor, and the same holds for men versus women. Moreover, people in affluent societies do not seem to be happier in proportion to their material affluence in comparison to people in developing countries. These are some of the reasons why the capability approach rejects an evaluation of a person's or societal well-being on reported notions of happiness or desire fulfillment only.

The capability approach also rejects the idea that development can be equated to Gross National Product (GNP), and that economic growth can be measured as the increase in GNP. This position is dominant in neoliberalism, which has its theoretical foundations in mainstream (or neoclassical) economics. In a paper comparing the human development paradigm with the neoliberal paradigm, Richard Jolly (2003) draws out a number of differences. The human development paradigm focuses on people and the expansions of their capabilities, uses equity as its guiding principle, emphasises ends instead of means, focuses on poverty reduction, defines poverty in terms of multidimensional deprivation and uses as its key indicators the human development index and other indicators measuring approximations of capabilities. The neoliberal paradigm, in contrast, focuses on the maximization of economic welfare and the working of markets, uses economic efficiency as its guiding principle, emphasizes the means but does not discuss the ends of development, focuses on economic growth, defines poverty as the population below the minimum income line, and relies on key indicators such as GNP, GNP growth and the percentage of the population below the poverty line.

There is empirical evidence to support the capability approach's view that development should not be equated with the increase in GNP, and that a focus on income alone can be misleading. Some countries, such as some oil states in the Middle East, have high GNP per capita levels, but have much lower average life expectancy, or school enrolment rates, than a country with a much lower GNP per capita, such as Costa Rica or Sri Lanka (UNDP 2001). GNP per capita does not tell us anything about how this income is distributed, and more importantly, it does not tell us much about people's quality of life in terms of health, education, employment, political empowerment, religious freedom, and so forth.

As a logical consequence, the capability approach criticizes the idea that development policies should strive to increase economic growth for its own sake (Alkire 2002; Fukuda-Parr 2003; Sen 1999). Economic growth can be crucially important, if it is people-centered in the sense that it creates possibilities for individual people, for example, through the creation of decent employment. But the importance of economic growth should always be judged by asking how it affects people's capabilities. The vision that development policies should focus on increasing economic growth could be justified by the assumptions that economic growth eventually will lead to income improvements for everyone, and that there is a high positive correlation between personal income and people's achieved functionings and capabilities. The latter has been tested empirically in several ways, and has been questioned frequently. For example, Ruggeri Laderchi (1997) tested on 1992 Chilean data to what extent an income indicator can capture some of the most essential functionings (education, health and child nutrition). She concluded that the income variable appears an insignificant determinant for shortfall in the three selected functionings. Klasen (2000) and Qizilbash (2002) found for South Africa that not all people who are deprived in terms of achieved functionings are also deprived in terms of income or expenditure, and the other way round. Household or aggregate average income are thus far from perfectly correlated with people's capabilities and achieved functionings.

Measurement Issues

As the capability approach aspires to provide a framework for the evaluation of individual well-being and social arrangements, we want to know how capabilities, or at least the achieved functionings, can be measured. The measurement of functionings can be seen as a special case of the measurement of multi-dimensional well-being, and this type of analysis poses challenging statistical and econometrical problems.

The first measurement problem concerns the availability of data. At the micro-data level, household surveys are useful existing data-sources for the measurement of functioningslevels. Qizilbash (2002) used the 1996 South African Census, while Ruggeri Laderchi (1997) analyzed the 1992 Encuesta CASEN, a bi-annually collected Chilean household survey. Many of the household surveys in post-industrial countries have also been analyzed from a capability perspective. However, an obvious limitation is that many developing countries do not have household surveys with a similar richness of information.

Aggregated data used by the UNDP are also known for not always being very reliable. The *Human Development Index* only requires information on school enrolment rates, incomes, and life expectancy at birth. But even this information is not available for all countries, or is unreliable, and consequently in the earliest *Human Development Reports* the UNDP had to rely on a significant number of estimates. However, the political importance and global popularity of these reports has been an incentive for governments to provide better data more recently. Both for micro- and for macro-data, it is to be expected that over time better data will become available. Indeed, around 2002, several research institutes were initiating projects to collect data on capabilities well-being, instead of having to rely on data that are not collected with the capability approach in mind as the underlying theoretical structure.

The second measurement problem is the measurement of functioning levels based on single indicators. For example, the functioning of being well-sheltered could be derived from the level of humidity in the dwelling, the ability to keep the house at a good temperature, the number of household members per room, and the safety against burglary. In the technical literature, there are two main techniques being used to undertake this data reduction: factor analysis and fuzzy sets theory. Unfortunately, neither of these methods is without shortcomings (Kuklys and Robeyns 2003). Factor analysis is a statistical technique which simultaneously reduces the number of functionings (e.g. from 50 variables to 7 functionings) and assigns numbers to the achieved level of each functioning. To avoid double-counting, all applications published so far have used orthogonal factor analysis, but this implies that the functionings are taken to be uncorrelated, which is a questionable assumption. In addition, the aggregation of variables into functionings is done based on the statistical weights generated by the factor analysis, but it is equally defendable that we should use the researchers' or politicians' values, or the subjective preferences of the individuals. Fuzzy set theory, which is an extension of scaling technique, avoids both problems, as the researcher keeps full control over the selection of indicators and their respective weights. But this is precisely what some economists don't like, as it grants a lot of explicit discretionary power to the researchers. It is questionable, however, whether there is any way to measure individual well-being or the wealth of a nation without making implicit or explicit value judgments; even the currently dominant concepts of GNP and economic growth after all rely on a selection of production which is deemed valuable, and some which is not (e.g. all the unpaid work of the care economy).

Note that the empirical studies of the capability approach to development need not be confined to large-scale measurement only. Indeed, one of the most interesting empirical assessments of the capability approach to development was undertaken by Sabine Alkire in a study of three small-scale development projects in Pakistan. The three projects that were studied were goat rearing, female literacy classes, and rose garland production. Alkire does not *measure* the changes in the functioning levels of the participants in those projects, as she shows that only ordinal and incomplete assessments can be made—and no cardinal assessments, which are necessary for proper measurement. She shows how a standard social cost-benefit analysis, which would translate all changes in monetary terms partly based on estimated 'shadow prices' (that is, hypothetical prices), can only give us a partial view on the impact of these three development projects. If this information is supplemented with a qualitative ranking of the impact of the projects, a different evaluation emerged. For example, the female literacy project is negatively evaluated by the standard cost-benefit analysis, as there are no employment opportunities for the women who took part. But it had a fundamental transformative effect on these women, which cannot be quantified and finds no place in cost-benefit analysis. These intangible effects include that they learn that they are equal to men, that they do not have to suffer abuse, that literate women can solve their own problems, that they learn how to read, and that being educated generated a subjective experience of great satisfaction. Similarly, the rose cultivation project revealed a contrast between the negative internal rate of return of the project, and a number of non-economic intangible effects. The bottom line, which very much gets to the heart of the difference between the capability approach and other approaches to development, is that the choice for a certain development policy or project "cannot be made on technical grounds but rather is a morally significant choice" (Alkire 2002:286).

Conclusion

The actual theoretical and empirical work on the capability approach to development policies make clear that this is a paradigm in the making, where several foundational problems remain to be addressed. Nevertheless, the growing global resistance against the alternatives, such as neoliberalism and the Washington consensus, also show that the capability approach speaks to many people's hearts and minds. The next few decades should show whether the capability approach remains primarily a philosophical framework, or whether it will grow into a rich paradigm for development, well-being and social policy.

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Child Labour

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Introduction

Child labour is a social problem that, despite a broadly accepted understanding that it has to be eradicated, lingers on in many parts of the world. The late 1990s saw a series of initiatives by the major international organisations and the inclusion of universal primary education leading to the elimination of child labour as one of the millennium development goals. Since moreover it is usually accepted, also by governments and civil society organizations in developing countries, that children should not be exploited as labourers, it should be rather easy to tackle the problem. But apparently it is not. There are various reasons as to why it continues to be such a tenuous social problem. There is disagreement on the causes of child labour and thus also disagreement on the solutions. There actually is also disagreement on the application of one universal standard of childhood and on the extent of the problem of child labour.

Childhood

Child labour has existed throughout the history of humanity. In ancient societies, the difference in the daily occupations between adults and children was gradual: children were being socialized by learning the skills, customs and tricks, so that by the time they reached adulthood, they had become fully accomplished and skilled males and females. Work was part of education and actually was the only form of education.

Urbanisation and industrialisation brought about a rupture in this traditional form of childhood. Child labour in the late medieval period and in the early stages of industrialisation was still socially accepted. It was indeed considered socially benign if mill-owners and craftsman employed young children. The conditions in which children were forced to work were often akin to slavery but getting them to work and off the streets was preferred to idleness and vagrancy. Many of the children, moreover, had been sent to the workplace by parishes and local poor committees because it would teach them necessary skills for later and because it would lessen the financial burden of caring for them. The English Poor Law of 1601, for example, explicitly authorized the work placement of children as a necessity for their upkeep. Cunningham (2001:19) concluded sarcastically: ‘The demand for child labour created by the mechanisation of textile spinning in the late eighteenth and early nineteenth century came as a godsend to Poor Law authorities in England desperate to find suitable employment to children in their care’. This was common practice elsewhere in Europe and North America as well (Cunningham 1991; Cunningham & Viazzo 1996; Caty 2002).

In the 19th century, the perception of childhood started to change. The industrial revolution, which initially made the child labour problem much worse than it had ever been, also became the cause of its eradication. Industrialization, in the words of Hindman (2002:13), transformed child labour from what in pre-industrial society was generally considered as a normal aspect of a child’s growing up into not merely a social and economic problem but a moral evil. That transformation into a novel type of childhood, in the developed nations was basically over by the early twentieth century. A child henceforth was supposed to be free from labour obligations and was to be educated and disciplined in school.

The then colonial countries were still kept at a stage where education was not considered necessary, neither for economic development nor for nation building, and children by and large continued to gradually develop into adults through work and socialisation. Child labour was prolific deep into the 20th century. It was part and parcel of childhood for the simple reason that, except for the top layer of society, no alternative existed. This state of affairs started changing after independence when the national governments embarked on a process of modernisation, which included universal education and the (gradual) elimination of child labour.

In that process, child labour emerged as a problem, but it was not until recently that it started evoking international attention. The international concern was reflected in the adoption in 1989 by the United Nations of the Convention on the Rights of the Child (CRC). The CRC sets an international standard for looking at child labour. It stipulates that children should be protected from economic exploitation and from performing any work that is likely to be hazardous or to interfere with the child's education, or to be harmful to the physical, mental, moral or social development. All governments in the world, except for the USA, have ratified the CRC and it thus provides a broad framework for judging child labour.

The CRC, however, has not gone uncontested. Especially in Western academic circles, the similarity of childhood in the developing countries and the developed countries has been questioned. Many authors have argued that the introduction of one concept of childhood, akin to the ideal type of the child in developed nations, borders on the imposition of western ideas on indigenous cultures. They argue that children in other parts of the world should not be measured with the same yardstick and that decent forms of work should be accepted as features of non-Western childhoods (Boyden, Ling and Myers 1995, James, Jenks and Prout 1998, Feeny and Boyden 2004). The opposition to the idea of a universal type of childhood has even led a number of authors (e.g. Swift 1999, Liebel 2004) to take the extreme position that labour actually should be treated as a right of childhood. This discordant view on childhood has led some of the big child-centred development aid organisations, particularly Save the Children, to give somewhat more preponderance to participation and organisation by working children than to an uncompromising struggle against child labour as such.

Magnitude

The magnitude of child labour has always been a matter of debate. The debate existed in England in the nineteenth century, when the first public outcry against child labour led to official investigations (Nardinelli 1990; Lavalette 1999). It still exists today (Lieten 2001, 2005). The figures that are presently provided by the International Labour Organisation and the World Bank are contestable for the same reasons as in the nineteenth century.

One problem relates to the invisibility of many of the child labour activities, particularly when legislation exists which bans such labour. It is difficult to access the places of work and survey instruments often falter because the information is collected by proxy and by field staff who are not properly trained. Children often do not have identity cards and the determination of their actual age is fraught with difficulties.

A second problem relates to the usage of data as advocacy statistics (Anker 2000). During the early phase of industrialization in the now developed countries, concerned citizens and politicians wanted to drive home how serious the problem was and in order to do so they focused on the most wretched forms and suggested that such abject forms of exploitation were common for the entire industrial production. A similar tendency to overstate nowadays is still common practice with a variety of institutions that prefer inflated figures for political or funding reasons. Western governments tend to use such exaggerated figures in order to buttress their argument for the inclusion of child labour as a social clause in the World Trade Agreements. To the NGO's as well as to international child-centred organizations, the inflated figures are helpful for generating public awareness and for increasing the financial support for their interventions.

A third problem with the collection of reliable information is even more serious. It relates to the very definition of what child labour is. Whereas child labour is a concept that actually covers a miscellaneous category of children, any overall number would suggest a homogeneous category of working children. There is therefore sufficient reason to be weary of having a precise number. Putting down one figure for the complex category of child labour means putting apples, pears and oranges in one basket: children who are deprived of education and who occasionally may be engaged in some type of work in and around the household, children who on a regular basis are doing some work for cash or on the family farm and children who are at work most of the day and most of the year and who are impaired in their normal development as a child. The three broad categories have a different rationale, a different impact and different solutions.

In the 1980s, the ILO estimated that there were 50 million child labourers, but it rightly cautioned that statistics that try to capture in one number the manifold dimensions of a complex phenomenon as child labour can be treacherous. Global figures were not considered to be very meaningful since they do not tell anything about the nature of the work children are doing or the circumstances and conditions under which it is being done.

Yet, the apparent need for a concrete figure imposed itself. At the start of the 1990s, the estimates were 80 million working children up to 14 years, but this number was adjusted because a much higher percentage didn't go to school and it was assumed that there were many working children amongst this group. In 1995, when the ILO could make use of specific empirical data on 25 countries, most of it from World Bank surveys, the number was fixed at 250 million children between 5 and 14 years of age. In 2000, SIMPOC (Statistical Information and Monitoring Programme on Child Labour) of the International Program on the Elimination of Child Labour (IPEC) of the ILO used other sources and methods of research to arrive at yet a new figure: 211 million at the beginning of the millennium, of which only 2 million children were in developed countries. The overall figure implies that 1 in 9 children in the world, according to the official statistics, is a child labourer (ILO 2002; UNICEF 2005).

Child labour, in the assessment of the ILO, can be divided into three categories: all economically active children in the age group 5-11, all economically active children excluding those in light work in the 12-14 age category and all children in the 15-17 age group involved in hazardous work. Of all child labour in the world, 60% is stated to occur in Asia, 23% in Sub-Sahara Africa, 8% in Middle and Latin America and 6% in North Africa. In Sub-Sahara Africa, 29% of children are reported to be active as child labourers; the participation rate is 19% in Asia, 16% in Latin America, 15% in North Africa and only 2% in developed countries. Various case studies give a good illustration of the variations across countries and across sectors (Boyden & Myers 1995; Green 1998; Schlemmer 2000; Seabrook 2001; Lieten at al. 2004).

Causes

In the search for causal explanations, two debates are going on. While many consider poverty as the major cause, others regard cultural backwardness and the lack of political commitment to intervene effectively as the major reason. While some look almost exclusively at the attitude of the parents who are thought to make a rational choice for sending their child to the labour market, others consider the unregulated labour markets, particularly the unscrupulous entrepreneur, as the major cause. This is a crucial distinction to be made, namely the distinction between supply and demand factors.

It is generally accepted that poverty is the major determinant of child labour on the supply side: child labour is more prevalent in poor countries, within countries in the poorer regions and within those regions among the poorer households. This does not necessarily mean, however, that economic poverty cause children to work. The relationship may be of a different order. Children may be working because of the generally low levels of modernisation and of child-centred infrastructural facilities. Conditions in many of the remote agrarian districts in Sub-Saharan Africa and South Asia are such that schools are scarce, too expensive and malfunctioning. As a consequence, a majority of the children may not be attending school and by default may be working. In these cases, the provision of good educational facilities may go a long way in doing away with the excessively high numbers of child labour in those areas.

In all areas, however, despite the best possible institutional facilities, there will remain a sizeable number of destitute families. They have such low levels of income that the extra income which children can provide is necessary for the bare survival. Such families are often characterised by specific variables. Landless and illiterate parents with many children and with a low bargaining power in the labour market usually have a higher tendency to send their children out to work.

A closer look at these families suggests that in many cases the structure and composition of the household is decisive. Many child labourers belong to incomplete or dysfunctional families. The death of one of the parents, structural illnesses and a divorce or alcoholism are factors that are common to many of the most gruesome cases of child labour. Young children are then made to carry the responsibility as income earners. A family breakdown can be associated with specific factors such as natural disasters, the migration to cities, the aids epidemic or civil wars. Some sources suggest for example that 13 million children around the world below the age of fifteen have lost either one or both of the parents to AIDS. Such disasters leave the households short of income and short of adults to do the household chores and the farm work. At the most severe levels of deprivation, below the minimum thresholds of nutrition, sanitation, health and shelter, there is not much of an option between work and non-work. Children living under such conditions, especially when a shock event has torn normal family life apart, will work in order to survive. By working, they find an individual answer to calamities for which society does not take responsibility.

Most of the child labourers in Africa and Asia reside in the countryside and assist the parents on the family farm or in the traditional craft. Parents may see such work as a form of apprenticeship, preparing them, better than any formal or informal school system could, for the income generating profession in adulthood. Children are expected to contribute to the income and acquire moral and ethical attitudes and work habits at an early age. The alleged attitudes of parents as the mechanism behind child labour are captured with the culture of poverty analysis as well. Poor households are considered to have a separate system of norms and values and either cannot appreciate the value of education or make wrong decisions in favour of added income in the short-run to the detriment of human capital formation, which would help the child later as an adult to more job opportunities and higher earnings.

This is also the assumption behind much of the analyses by World Bank economists who have done numerous studies based on the luxury hypothesis which had been developed by Basu and Van (1998). The luxury axiom states that parents send their children to work only if the household falls below a poverty line threshold. When the household earnings increase, parents tend to forego the extra income provided by the children. The econometric tests, in this approach, indicate the degree of parental altruism: if less poverty does not lead to a reduction in child labour, then it is clearly a case of parents who opt for extra income in the short run rather than for a more rational choice of investing in the child's education (Bhalotra & Tzannatos 2003).

Most of the research on the cause of child labour, particularly by neo-classical economists, has gone into the push factor. Individual parents and children are assumed to take these decisions on the basis of 'a rational choice'. The onus for child labour in this frame of mind rests with the family, not with the employers. Parents, as optimising, rational-choice decision makers, in the neo-classical model, are seen to opt for 'quantity' rather than 'quality'.

Both the poverty and culture of poverty argument have in common the focus on the supply factors. Mere survival sometimes makes it necessary for parents to send their children to work. That is the push factor within from the poverty-stricken families. For poverty to lead to child labour, there, however, should be a pull factor as well. More often indeed, there indeed is an external force, which pulls children towards the furnaces and the looms, towards the kilns, the quarries and the brothels. One causal factor on the pull side is the profit motive. The 'nimble finger' factor argument has been used to contend that employers in certain industries prefer the child labour hands as being more dexterous and more productive. Studies conducted by the ILO, however, have argued that the prevalence of specific skills or specific dexterity does not cut much ice. In the industries where the argument is being used, for example in carpet weaving, diamond polishing and sport goods stitching, adults and children work side by side. When some of the tasks are performed exclusively by children, the skills required are so minimal that child labour is clearly replaceable by (male or female) adult labour (Anker et al 1998). One reason for employing children apparently is their docility, but it has also been considered useful to look at the segmentation of the labour market. The labour market in developing countries is often characterised by segmentation in a set of submarkets with different employment conditions and different labour profiles. The segmentation of the job market, as the evidence shows, usually occurs in an environment in which there is a reasonably high demand for labour and a low degree of labour empowerment (Rodgers & Standing 1981).

Policy options

Since the causes are the subject of an intense debate, solutions also are contested. The history of the developed countries, where child labour by and large has been discontinued as a social problem, does not provide much clarity. Legislation may have played a role in bringing child labour to an end as a social problem, but historians tend to focus more on other aspects such as the introduction of compulsory education, the growing organizational strength of the workers' movement that led to higher wages, the long-term increase in welfare, the technological developments whereby tasks typically carried out by children were henceforth carried out by adults and the general process of civilization in the sense of the development of democratic societies in which impoverishment, lawlessness and lack of safety hampered the better off and the national integrity in general.

Basically three strategies dominate the contemporary policy debates on child labour: a complete ban, an immediate elimination of the worst forms of child labour and reforms in working conditions so that children can work without being exploited. These three strategies are related to the different ways of looking at the effect which it has on the child: harmful, harmful unless properly regulated, or even beneficial.

The latter strategy of allowing children to work is based on the stand that childhood in developing countries has always been associated with work and that the working children themselves not only need to work for their mere survival but also should have the right to decide what is good for them. In a number of countries, notably in Peru, Senegal and India, child labour unions have been formed in order to defend the labour rights and improve the working conditions. In practice, they are rather support structures for self-employed adolescents than unions of working children. They have established an international network, supported by Save the Children Sweden. At the second meeting of the World Movement of Working Children and Adolescent in Berlin in May 2004—the first one was in Kundapur (India) in 1996—the adolescents present called for the right to dignified work and denounced the policies of the ILO for such policies, the declaration stated, are jeopardizing the right to work. For this reason, they also denounced the organisers of the *Global March Against Child Labour,* a movement that in 1998 and later launched a massive worldwide campaign in which numerous NGOs and trade unions participated. Most organisations that are active on the child labour front would support the overall thrust of the global march. They include the ILO, UNICEF, the World Bank, governments and a conglomeration of international NGOs such as Plan International, Oxfam, Terre des Hommes and World Vision.

The corporate sector also has become reasonably active. The concept of Corporate Social Responsibility has been used by internationally operating companies to indicate that they themselves are implementing a pro-active policy. Some of the bigger companies have started to address child labour in their supply chains or have participated in developing certificates for child labour free products. Such activities have come in the wake of exposures, which have had a detrimental affect on the trade volume and the public image of companies. Particularly affected were the companies operating in the upper-market segments of wearing apparel, sports goods, toys, carpets and furniture. The Corporate Social Responsibility image, supported by a label, has reduced the risk of customer outrage about the use of child labour in consumer products on the western markets (UNICEF 2005). Reducing the involvement of child labour in export products from developing countries has been a main concern of the US government and its substantial funding of eradication programmes since the early 1990s has concentrated on this sector (USDOL 1994, 2002). Cleaning this sector from child labour reduces the unfair competition in the world market but leaves the involvement of children in production for the local market unaffected.

It is generally accepted as a policy that children should be in school and should not be working and that actually the achievement of universal education would go a long way in also solving the child labour problem. Such a policy would make economic sense in the long run, but will swallow money in the short run. The ILO has calculated that a massive financial injection is needed into the expansion of school facilities and the upgrading of school quality and into some income transfer to defray the cost to households of transferring children from work to school. The massive financial outlay would bring about the eradication of child labour and the program would start generating net economic profit after 10 years; after 10 more years the benefits would exceed costs by a ratio of 7 to 1 (ILO 2004a). Unfortunately, political realism puts a shadow on the implementation of the program: the total annual cost would amount to an annual outlay that would be as big as the total development aid.

The lack of wherewithal pre-empts a frontal attack in many of the most child-prone regions of the world. But there is another problem that makes eradication of child labour problematic. There always is a grey area between permissible activities and activities that are intolerable. In this connection, a basic distinction is being made between child labour and child work. The distinction indicates a conceptual difference between a mental or physical activity that is part of the daily chores in the life of people and that are undertaken as part of the normal process of socialization. Jobs in the household, on the farm, in the family business and other such tasks after school and even small and regulated jobs to earn some extra pocket money need not be harmful. They actually are a necessary part of the child's upbringing. Child labour, on the other hand, relates to work done by children under the age of 18 that is harmful to the child's health or its physical, mental, social or intellectual development. Such a formulation was adopted in the CRC (article 32) of 1989 and since then has been a guiding principle, also for the International Labour Organisation.

Legislation and International Conventions

Legislation on child labour has gone through two periods. The first period covered most of the nineteenth and early twentieth century. The second period relates to the global efforts to reduce child labour in the developing countries. This second period was given impetus in 1973 by the adoption of Convention 138 by the ILO but came into fruition in the 1990s.

In the first period, the period of the industrial revolution, the governments in Europe and North America introduced a series of legislation which gradually increased the age at which children were allowed to be employed. The first such legislation was introduced in England in 1833. That legislation prohibited the employment of child labour under nine years of age in the textile factories and limited the working hours of children age nine to twelve to nine hours per day. Many more rounds of modifying the legislation was needed before the age limit for children to be employment was generally put at fifteen, which also became the minimum age of compulsory schooling (Nardinelli 1990; Heywood 1988; Cunningham & Viazzo 1996).

The eradication of child labour in the Western World was a long haul which ended with the adoption in 1941, after a long legal battle, of the Fair Labor Standards Act in the USA. In a perceptive study, Hindman (2002, p. 85) has concluded that the US federal act was anticlimactic since by the time it was passed, child labour had already been effectively abolished, but also that 'numerous exemptions and exceptions enabled child labour to continue to flourish in many of the street trades and permitted child labor to creep back into the sweating sectors of the economy.'

That actually is a conclusion which applies to the developed countries generally. But in developed countries, unlike in many developing countries, the institutions of the state generally see to it that children attend school as well and that, when working during out-of-school times, strict labour regulations are adhered to. Child labour in Europe is actually fairly widespread (Fyfe 1989; Hobbs & McKechnie 1997; UNICEF UK 2005). Usually, a blind eye is turned to child labour, as long as children do not get injured physically and do not seem to be exploited excessively. Lavalette (1999, p. 138) has convincingly argued that children have not stopped working, but that the regulations have 'deproblematized' their labour activities. 'Out of school' work increasingly has become viewed as a healthy pastime and an embodiment of the work ethic.

After the various waves of decolonization, the various governments in developing countries were confronted with numerous problems of poverty and social injustice. Child labour was one such issue. Usually legislation against child labour has been on the statute books but because of poverty, poor educational infrastructure and a weak government machinery to enforce implementation, laws frequently have been disregarded and traditional practices have continued. The governments generally took the position that universal education was a basic tenet of policy but that, in view of the low levels of development and financial constraints, compulsory education had to be put on the backburner.

National policies, however, are increasingly being shaped and monitored by international agencies. International (child) labour standards are elaborated in the annual Conference of the International Labour Organisation where governments, organizations of employers and labour unions representatives agree on universal labour standards. The ILO Conventions thus are tripartite agreements and carry great weight. They provide benchmarks for formulating national legislation and individual countries, after rectifying them, are expected to conform to them in their legislation and in action.

The Minimum Age Convention No 138 of 1973 is the main international framework for action against child labour. The Convention establishes that the minimum age for admission to employment should not be less than 15 years of age, with an exception of 14 years for developing countries, which may be considered to have a lower age as compulsory schooling. The ILO Convention, in addition, allows for light work to be performed by children from, respectively, 13 years and 12 years onwards. The exact meaning of light work has not been spelled out, but it is generally accepted that 2 hours a day under safe and harmless conditions would be an acceptable norm.

Much of the work that is being done by children, both in developing countries and in developed countries, may fall under this light work category. A strict application of this concept of light work is difficult, and aberrations may always be around the corner. In developing countries, the problem is more complex. On a daily basis they need not necessarily work harder and longer children in developed nations. One problem, however, is that, even if they have accomplished the primary school stage, they usually, unlike their working counterparts in the developing nations, will have left school by the age of 12. This big category of working children includes children looking after farm animals or participating in crop cutting, children collecting fodder, children attending to the shop of their parents and children working on the traditional family craft for a couple of hours a day. It would also include children who assist in household chores, such as water collection, cleaning and cooking and looking after siblings. Often this work engages the work only for a couple of hours a day and may be considered permissible childhood activities, even under the ILO regulations. Since these children, however, are not attending school, it is tempting to classify them as child labourers.

In order to evade such ambiguities and to focus on the hard core child labour problem, the ILO towards the end of the millennium agreed on a new Convention on the Worst Forms of Child Labour (ILO 1998). This Convention No 182 of 1999, unlike Convention 138, could immediately count on wide support and in a short period of time a big majority of countries had ratified. These worst forms are activities that are hazardous to the development of the child.

The Convention distinguishes two types of worst forms. The first type can be classified as worst forms by definition or as non-negotiable worst forms. They include activities that are often illegal and also unacceptable for adults and that by definition cannot have the working conditions improved so as to make them acceptable. It is a limited list. It includes all forms of slavery or practices similar to slavery such as trafficking, debt bondage and forced labour and the involvement of children in armed conflict. In the second place it refers to prostitution and pornography and in the third place different forms of explicitly illicit activities such as the production and trafficking of drugs.

The second type of worst forms relates to the activities that are hazardous by condition and that in each country shall have to be identified. Such lists could include a ban on an entire sector (e.g. mining, deep sea diving, work in chemical plants, the transport sector) or could specify under which conditions a child is allowed to work in a specific sector. Work in agriculture, for example, by and large would not be considered as hazardous. Most of that work is done on the basis of a joint labour effort within the household. However, when that labour involves excessive hours, working with dangerous machinery and equipment, the handling of heavy loads, and the exposure to hazardous substances, like pesticides, the type of work shall be considered as hazardous.

Further Developments

Child labour during the 1990s has become an issue of policy concern. Much of this concern was related to the protection of Western markets from unfair competition. That concern may not last long since child labour involvement in export products appears to have declined perceptibly. A further reduction of child labour in developing countries is very much associated with reduction in poverty and welfare measure to support the most deprived families, with the availability and accessibility of education and with properly functioning state systems so that transgressions can be dealt with.

The long and chequered history of the struggle against child labour in the developed countries serves as a warning that there is not one single solution. What seems to be happening in international policy approaches is a targeted effort to do away with certain manifest forms of child labour, for example child labour in export industries, in the sex industries and in mining, and that a comprehensive approach directed at all child labour is missing.

In September 2000, the heads of state set themselves eight goals for ending global poverty, the so-called Millennium Development Goals. Universal completion of primary education should be reached by 2015. Indications are that the poorest countries, where child labour is widespread, are not going to achieve the goals. Not simply enough money is being provided by national governments and by the international aid system to build the schools and get the children into the schools. Since abject poverty also remains widespread, the phenomenon of child labour, despite the sensibilisation, the international conventions and the national legal systems, is expected to continue.

Internet Sites

Child Labour. www.childlabour.net

Child Trafficking. www.childtrafficking.org

End Child Prostitution, Portnography and Trafficking (ECPAT). www.ecpat.net

European Federation for Street Children. www.efsc-eu.org/index.php

International Program on the Elimination of Child Labour. www.ilo.org/public/english/standards/ipec

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Debt Crises and Development

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Introduction

International credit and debit relations are exceptionally important in explaining the patterns of growth in developing countries. International financial markets may be a very important instrument in promoting development. However, if international financial markets are unstable and developing countries are recurrently forced into default, the effects on development might be detrimental. In short, while debt might be instrumental in promoting modernization, recurrent debt crises have severe negative effects on development.

It is worthwhile to have a broad picture of the size and the composition of the debt problem in the developing world before we discuss the relation between debt crises and development. The total debt of all developing countries in 2001 was US $2.4 trillions up from US $73 billions in 1970 (Global Development Finance). The debt to exports ratio—which measures the ability to repay—corresponds to 112.2 percent. Total debt service (i.e. interest plus principal) in 2001 correspond to 17.6 percent of developing countries exports. The numbers for severely indebted middle income countries (Argentina, Brazil, Ecuador, Gabon, Guyana, Jordan, Peru and Syria) are more dramatic. Total debt in 1999 was US $535 billions, which corresponded to a debt to export ratio of 423 percent, and a debt service to export ratio of 80.7 percent.

A note of caution on the definition of debt crises is essential at this point. Some authors use the term debt crises in an almost indistinguishable way from balance of payments crises (e.g. Dymski 2003). In that case, for example, the Asian crisis would be also seen as a debt crisis. It is true that a debt crisis more often than not implies inability to pay foreign obligations and results in a balance of payments crisis with runs on the domestic currency.

However, debt crises are also characterized by severe debt overhang problems and the need for debt restructuring. In that case, the Asian crisis is not comparable to the Latin American debt crisis of the 1980s. Also, the African continent has been plagued by debt overhang problems, and with economic stagnation for decades, while balance of payments crises have only been sporadic. Thus, the term debt crisis will be reserved for crises in which debt accumulation and debt overhang are central.

It is also important to note that debt crises are not recent phenomena. Sovereign lending goes as far back as the Italian City States. The default of Edward III in the 1340s and the subsequent bankruptcy of the Florentine banking houses of Bardi and Peruzzi show that sovereign lending was always a risky affair (Cipolla 1982; Kindleberger 1996). The long history of sovereign lending led some authors to argue that long term debt cycles are directly connected to the cyclical instability of creditor countries (Marichal 1989). Others have argued that long term debt cycles are directly connected to the technological transformation of the central countries, in particular the so-called Kondratieff long waves (Suter 1989, 1992).

This entry will discuss briefly the notion of long term debt cycles, and analyze in more detail the last wave of debt crises. It will emphasize the interaction of the 1980s debt crisis and the change in the strategy of development pursued by most developing countries namely Import Substitution Industrialization (ISI). It will discuss whether the conventional wisdom according to which ISI strategies can actually be blamed for the debt crisis is accurate. An alternative view that emphasis financial fragility and more liberal international financial markets is also analyzed.

The problem of debt-overhang and procedures devised to solve it will be also considered. The final section pulls together the arguments to evaluate possible lessons and alternatives; in particular, the possibility of debt cancellation for highly indebted poor countries is examined and the idea of bankruptcy protection for indebted countries.

Long Term Debt Cycles

Marichal (1989) argues that debt crises in peripheral countries are usually associated to financial cycles in central countries. Cycles of growth and expansion of international trade lead to surges in lending to developing countries, as the funds in central countries grow faster than their needs, leading to a frenzy of speculation. Ultimately investors became overextended and retrenchment occurs leading to a reversal of capital flows and eventually to default.

Cipolla (1982) describes the bankruptcy of the Bardi and Peruzzi banking houses as the first international debt crisis. According to Cipolla (1982:7-8):

"The large companies of the dominant economy (Florence), which operate in the underdeveloped country (England), have a vital interest in securing the local raw material (wool) for the home market. By logic of events they are led to grant increasingly larger credits to the local rulers, on whose benevolence the licenses for the export of raw material ultimately depend. The rulers of the underdeveloped country, however, instead of using the credit to finance productive investment, squander the funds in war expense and are soon forced to declare bankruptcy."

Sovereign borrowers were caught up in a vicious circle, where high risk led to high interest rates, which, in turn, made debt unsustainable in the long run, and to recurrent bankruptcy. The house of Medici was also brought down by sovereign debt defaults. The logic of Cipolla's first debt crisis fits very well the subsequent debt cycles.

Defaults are not always the result of spend thrifty Princes with no control over their purse. Sovereign defaults were associated to the increasing fiscal necessities of the State. Schumpeter (1918) argues that the rise of the Tax State is essentially associated to the development of modern capitalist societies. Hence, the increasing spending necessities of the State, and its inability to raise taxes in accordance, led to overborrowing and to bankruptcy.

Sovereign default threatened the banking sector of the developed nations when international markets relied on bank lending. The development of bond markets changed the situation. In the 19th century bond finance dominated international financial markets. In this case, the lender negotiated the bond agreement, advanced the funds to the borrower, and sold the bond to the general public. Hence, the risk was carried by the bond holders rather than the banking sector. Bond holders could complain but there was little else they could do. The so-called Palmerston Doctrine—named after British Prime Minister Lord Palmerston—introduced the notion that the British government would not intercede in favor of bond holders when foreign nations defaulted on their obligations.

It is important to note, however, that despite the risk of default, more often than not, bond holders benefited from higher interest payments from developing countries. Lindert (1989) and Lindert and Morton (1989) show that investors in Latin American government bonds in the period from 1850 to 1914 received more than a third than holders of British consols in spite of defaults.

Since the advent of the Industrial Revolution in England in the late 18th century five debt cycles can be observed.

Credit boomed in the 1820s, 1860s, 1920s 1970s and 1990s. All the periods were followed by crises and defaults. Suter (1989 1992) suggests that debt cycles are directly correlated with Kondratieff's long waves. In other words, technological innovation and growth in the center are directly correlated to growing indebtedness in the periphery.

To be more precise, expansion of periphery indebtedness coincides with the peak of a global growth cycle. The growth cycle in the center begins with a major innovation or a cluster of innovations, as in Schumpeter (1911), leading to higher profitability. In general, in this phase the center-periphery financial relations are interrupted, since debts from the previous cycle have not been rescheduled. Following the life-cycle of the product (Vernon 1966), technology diffuses, production becomes standardized and profits tend to fall in the central countries, as markets become saturated. In the diffusion phase financial relations with the periphery are reestablished old debts are rescheduled and indebtedness increases.

Suter (1992) finds evidence of decreasing profitability in the center and higher indebtedness in the periphery. This view of long term debt underplays the role of domestic investment policies and public finance in the peripheral countries. Marichal (1989) also emphasis the cyclical instability in central countries in his explanation of long term debt cycles in Latin America.

The Latin American debt, in fact, is as old as the independent countries themselves. In the 1820s most Latin American countries obtained credits in the London City to finance the war efforts (Dawson 1990). By the late 1820s almost all had defaulted. International flows of capital to Latin America were relatively reduced for the next thirty years.

The new wave of international lending that started in the 1860s ended up once again in default. A new short lived boom and bust cycle led to defaults in the 1890s, in which the all powerful Barings Brothers, overexposed to Argentinean bonds almost went under (Fishlow 1988). The cycle was renovated in the 1920s with a new default in the 1930s. The following cycle started in the 1970s with the recycling of the petrodollars and ended in the 1982 debt crisis. The crisis was still unresolved when a severe recession in the developed world led to a reversal of capital flows in the 1990s (Calvo et al 1993). The crises that followed can be seen as the unfolding of a story that began in August 1982 with the Mexican default. In that respect, then, the debt crisis of the 1980s was the last of a series, and was part of a long-standing pattern of cyclical lending flows to developing countries. Table 1 shows the evolution of debt indicators for all developing countries during the last debt cycle.

Table 1, Developing Nations: Debt, (US $ Billion)

	1970	1980	1990	2000
Total Debt (TD)	--	568.7	1,459.9	2,527.5
TD/GNP	9.8	18.2	30.9	37.4
TD/Exports	--	84.4	160.7	114.3
Debt Service/TD	--	12.8	18.1	17
Short Term/TD	12.9	23.7	16.8	15.9

Source: Adapted from World Bank, Global Development Finance

The table shows that the total debt to Gross National Product ratio increased from less than 10 percent to almost 38 percent. In terms of the amount of foreign resources that developing countries are able to rise through exports the burden of debt peaked in 1990s at 160 percent, and in 2000 was around 114 percent. Debt service consumed in 2000 17 percent of exports up from 12 percent in 1980. The share of short term debt was in

2000 close to 16 percent of total debt. We concentrate now on the causes of this last debt cycle and its consequences on development strategies, in particular the Latin American experience, since it is the region mostly associated with debt payment problems.

Import Substitution and Debt Crisis

Crises are usually catalysts for change, and debt crises are no different. The wide spread debt crisis in what used to be called the Third World—in particular in Latin America—in the 1980s corresponds to a period of transition in the cycles of State intervention. In Latin America the reinvigorated role of the State after the depression of the 1930s took the form of an Import Substitution development strategy. The Latin American debt crisis is the landmark that divides the Import Substitution Industrialization (ISI) strategy, devised under the intellectual guidance of the Economic Commission for Latin America and the Caribbean (ECLAC), and the market friendly approach, institutionalized by the International Monetary Fund (IMF) and the World Bank (BIRD).

Initially several commentators presumed that the effects of the debt crisis would be temporary, and growth would resume since the traditional solutions, adjustment and finance, would be effective in surmounting what was seen as a short-lived balance of payments crisis. There is a fundamental difference between crises where a country's underlying debt position is sustainable over the long run and those where debt restructuring is unavoidable. Many thought that the crisis unleashed by the Mexican default of August 1982 was of the former type.

The crisis, however, was more lasting and acute than expected, and, in fact, the 1980s became known in Latin America as the lost decade. By the mid-1980s most analysts were certain that the crisis was going to be long lived (Diaz-Alejandro 1985) and some argued that a radical change in the development strategy was necessary. The policies that were suggested—and then imposed in the context of international agreements—and that eventually became known as the Washington Consensus (Williamson 1990), are, therefore, the result of need for a new development strategy.

In many respects, the crisis of the developmental State, and the Debt Crisis represent for Latin America what the so-called fiscal crisis of the State does for the developed world. In that respect, the market friendly approach to development is the other face of the conservative revolution of Reagan and Thatcher in the developed world.

Capital flows to the developing world in the last financing cycle, in particular to Latin America, started before the 1970s. Foreign Direct Investment (FDI) flows in the 1950s, official aid flows in the 1960s—linked to the Alliance for Progress—preceded the private capital flows of the 1970s that took the form of bank loans. Conventional wisdom presupposes that from World War II to the debt crisis—during the ISI period—economic policies were focused on domestic markets, and an anti-export bias was developed (Edwards 1995). The ISI strategy was characterized by high levels of import tariffs and a relatively high dispersion of the tariff structure protecting domestic production, an overvalued exchange rate discriminating against the exports of primary goods and favoring the imports of intermediate and capital goods. The rate of growth was as a result highly dependent on the expansion of domestic demand. Conventional wisdom presumes that government spending crowded-out private investment, and that protectionism meant that inefficiencies abounded.

In this view, the results were the accumulation of trade and fiscal deficits, and the pilling up of debt. In addition, the investment effort was beyond the fiscal capacity of the State. Foreign savings provided the necessary finance for the development strategy, but when the unsustainability became clear then capital flows dried up and the debt crisis ensued. In addition, the response to the oil shock is seen as an important cause of the debt crisis.

For most non-oil exporter countries in the Third World the oil shocks meant increasing trade deficits. There are basically two solutions for the problem. If the deficits are deemed temporary one may finance the short lived balance of payments disequilibria. On the other hand, if deficits are seen as long-lived, then adjustment—depreciation and lower rates of growth—is needed to contain the deficit from ballooning.

The other consequence of the oil shocks of the 1970s was the creation of large trade surpluses for the OPEC countries. These dollar surpluses were deposited in the Euro-dollar market, providing a huge amount of liquidity into a deregulated market. Interest rates became negative, and, as a result, the finance option became far more attractive than the adjustment one for developing countries. Further, international financial markets forcefully tried to push loans to developing countries (Darity and Horn 1988). In this view then countries continued to pursue ISI development strategies, and were able to do it because of favorable conditions in international financial markets. However, negative terms of trade shock and an additional interest rate shock made the strategy unsustainable. The Mexican default of August 12 1982 was, then, the result of a misguided development strategy, and the ultimate solution depended on adopting a new one.

The problem with the conventional wisdom is that the ISI period corresponds to a high growth phase for most developing countries, one in which they catch up with the developed world despite the fast growth in the latter. In fact, Dani Rodrik (1999:71) argues that "contrary to received wisdom, ISI-driven growth did not produce tremendous inefficiencies on an economywide scale. In fact, the productivity performance of many Latin American and Middle Eastern countries was, in comparative perspective, exemplary." Furthermore, several countries had already abandoned ISI policies in the 1970s. The Southern Cone countries had moved into neo-liberal policies by the mid-1970s, Brazil and many South East Asian countries were experimenting, with varying degrees of success, with export oriented strategies.

The ISI period, which basically corresponds to the 50s and 60s, led to only moderate accumulation of foreign debt, and in many cases to falling debt to GDP or debt to exports ratios, which denotes sustainable debt dynamics. Hence, ISI policies, and the fiscal consequences of those policies seem to be of secondary importance in explaining the debt crisis. The following section explores an alternative explanation.

Financial Fragility and Development

The collapse of Bretton Woods in the early 1970s foreshadowed an era of more open and deregulated international financial markets. In fact, the pursuit of such open financial markets by American authorities is one of the reasons for the collapse of Bretton Woods (Vernengo 2004). The oil shocks and the cost pressures that followed implied that initially real interest rates would be negative. However, that was but a short-term accident.

By the late 1970s Paul Volcker, the then chairman of the Federal Reserve Board, hiked interest rates. Real interest rate became strongly positive, and would remain so for a long period. Smithin (1996) refers to the interest rate shock as the revenge of the rentier. That is, the rentier class that was under attack during the Bretton Woods period—which ultimately had imposed Keynes' euthanasia of the rentier—was able to impose higher rates of remuneration at the expense of the rest of society. Interest rates increased in the rest of the world, in tandem with the American rates.

Higher interest rates were the inevitable outcome of the collapse of Bretton Woods and the more open international financial system that followed. The elimination of capital controls in several developed and developing markets meant that central banks around the world could compete for speculative capital flows. Also, more volatile exchange rates meant that international speculators would pursue arbitrage possibilities from perceived or real exchange rate misalignments.

The period of relatively low rates of interests and the recycling of the petrodollars had negative impact in the developing countries decisions to manage the balance of payments effects of the oil shocks, as we already discussed. Darity and Horn (1988) stress that unregulated commercial banks overlend to borrowers in developing regions. Developing countries that were locked out of international credit markets in normal times suddenly have access to credit in the midst of a situation of excess liquidity. In this context the interest rate shock had terrible consequences for the developing world.

Theoretical reasons for the limited access to international financial markets are sometimes explained in terms of asymmetrical information. Asymmetric information models of the credit market assert that borrowers may have informational advantages of two kinds over lenders: information concerning their capability to repay and information regarding their willingness to repaying the loans they receive. Lenders optimal response is to ration credit and/or to use signaling mechanisms to screen borrowers (Miller & Zhang 2000; Ghoul & Miller 2003).

Several countries entered into Ponzi schemes—in the Minskyan sense of being unable to pay the principal and interest on debt. At the time they contracted the debt it did not seem that was the case. Interest rates were low, and the oil shocks with the higher imports appeared to be temporary. However, debt was contracted at fluctuating interest rates. The typical Latin American debt was syndicated with American Banks and tied to the London Inter-Bank Offer Rate (LIBOR). Hence, the interest rate shock changed the whole scenario.

To make matters worse the hike in interest rates was associated with negative terms of trade shock that sapped the export revenues of developing countries. As a result debt-servicing requirements went up at the very moment that revenues dwindled. Debt to export and debt to GDP ratios went up, making financial markets less willing to foot up the bill. The Mexican default then hit adversely most developing countries, and contagion meant that finance dried up for the developing world in general—East Asia being a partial exception.

At the early stages of the debt crisis the key players—developing nations, international banks, and multilateral institutions—suggested no integrated solution, in part because the crisis was seen as one of liquidity rather than solvency. In fact, muddling through was the normal approach (Cardoso & Dornbusch 1988). Countries contracted the level of activity to reduce the need for imports, they depreciated the currency with the same purpose—depreciation had also contractionary effects—and to increase exports. A side effect was that depreciation and increased prices of imported goods fuelled inflationary forces. Inflationary shocks, together with wage indexation, in turn, led to inertial inflation and in some extreme cases to hyperinflation (Bresser Pereira & Nakano 1987; Câmara & Vernengo 2004).

Hence, repayment of loans at market conditions, for those countries that could afford it, led to stagnation and high inflation. Darity and Pastor (1990) argue that it also led to worsening income distribution and to heightened class warfare. It was clear, then, by the mid-1980s that muddling through was not enough, and that the crisis was more profound that anticipated.

Solutions prescribed would depend on the diagnosis. The conventional wisdom would imply that a new development strategy, one that favored market reforms were needed (Williamson 1990). The explanation advanced in this session implies that the problem lies with a system of international finance that provides liquidity to cash starved developing countries in intermittent cycles, and that capital flows vanish exactly when they are needed. More stable flows of capital and heavier regulation of their uses are, then, the prescribed solution. It should not be a surprise that international banks, and multilateral institutions held the upper hand, and Structural Adjustment Programs (SAPs) were provided for those countries that promoted the market friendly reforms.

SAPs implied laundry list of reforms that indebted countries must pursue to obtain funds from the IMF and the World Bank. The list included the liberalization of trade (i.e. elimination of quotas and reduction of tariffs), and capital (i.e. removing restrictions to foreign capital flows) accounts of the balance of payments, the deregulation of financial markets, the privatization of publicly owned enterprises, and the maintenance of responsible macroeconomic policies (i.e. fiscal and monetary policies should aim exclusively at price stability). These policies would reorient the developing economies to export promotion, and would reduce the risks of international lending to those countries. The following section examines the actual course of events and the main consequences of the Washington Consensus with respect to debt and development.

Debt Overhang and Debt Relief

Initially few governments felt eager to receive SAPs. However, muddling through had reached its limits, since US private banks made IMF and World Bank consent a prerequisite for debt rescheduling. Hence, SAPs became the IMF-World Bank seal of approval for international banks. Effectively this forced most developing countries into accepting the terms of SAPs.

By the late 1980s, most debtors designated by the then secretary of the Treasury, James Baker, as top-priority debtors—including Argentina, Brazil, Mexico, the big three Latin Americans had agreed to SAPs. From 3 percent of total World Bank lending in 1981, structural adjustment credits rose to 19 percent in 1986. Five years later, the figure was 25 percent. By the end of 1992, about 267 SAPs had been approved. However, the voluntary nature of the so-called Baker plan, and the lack of enforcement of debt restructuring agreements made international banks weary of the scheme. From 1985 to 1988—the period of the Baker Plan—public sector lending to debtor countries amounted to US $15.7 billion, while private bank lending was limited to US $12.8, slightly more than have that was expected (Cline 1995).

Several authors argued that market solutions for dealing with the debt overhang were needed. Krugman (1989) argued that debt overhang acts as a tax on developing countries. High levels of debt, and reduced access to credit, limit the ability of developing countries to grow. Lower growth, on the other hand, reduces the ability to repay the initial debt. As a result, reduced debts would, in fact, boost repayments, and should be favored by the international private banks. In other words, a Laffer curve for international debt exists, and developing countries may be on the 'wrong' side of the curve, so that debt pardoning leads to higher debt servicing collection for banks.

Pardoning part of the debt would then help solve the debt overhang problem. Also, given that big chunks of debt were negotiated below par in international markets, it was suggested that debtor nations could buy back the debt in secondary markets. If the discount was big enough the amounts of debt reduction could be substantial. Debt buybacks did represent a fair amount of debt reduction as a matter or fact. Debt-equity swaps, in which debt holders exchange debt for equities in the debtor nation, represents the other source of market solution for the debt overhang problem.

However, market solutions for debt overhang are plagued by the free rider problem. In other words, although private creditors do benefit from debt reducing schemes, they have no incentive in promoting them unilaterally. Any given creditor would benefit if all the others pardoned parts of the debt, while keeping its share intact.

The Brady Plan was devised to solve the problems of the Baker Plan, and the market solutions. The Brady Plan was developed under the guidance of US Treasury Secretary Nicholas Brady in 1989. A similar proposal had been suggested by Luiz Carlos Bresser Pereira, the Brazilian Finance Minister, but was dismissed by American authorities. The Brady Plan replaced the region's commercial bank debt with tradable securities, and reopened the international capital markets to Latin America—although the American recession and lower interest rates in the US also did play a role (Calvo et al 1993) —setting the scene for the capital account liberalization of the 1990s. The typical Brady plan would reduce debt by 30 to 35 percent (Cline 1995). Debt reduction typically took the form of swapping existing short-term debts for longer maturity bonds. Although officially voluntary, international private banks were pressured by the US Treasury into accepting the Brady deals. This was not a completely unheard of practice, since the Treasury had in the past 'praised' for recycling the petrodollars in the 1970s.

It was widely accepted that growth resumption implied solving the debt overhang problem. A mix of market friendly reforms and debt restructuring would achieve the objective of lower debt and higher growth. Capital flows to the developing world did resume in the 1990s, and many saw this as a confirmation of the success of the Brady Plan (Cohen 1991). Also, most developing countries were able to stabilize their economies, as the developed countries did. However, growth resumption proved far more elusive.

In many countries growth resumed only to collapse after the series of international financial crises of the 1990s. In some cases growth was export-led, but even in the majority of those cases import growth swamped the effects of exports. In several cases exports did not grow, and domestic demand was the main force behind grow resumption. All in all market friendly strategies produced relatively poor results (Taylor 2000). The failure of export orientation in Latin American, Middle Eastern and African countries implies that debt problems lie ahead. The Argentinean default of December 2001, in particular, shows the weakness of the SAPs and the persistence of debt overhang problems. The last sections analyses some of the alternative solutions that have been put forward since the Brady Plan.

Lessons and Policy Alternatives

Debt management is essential for successful developing strategies. Debt crisis lead to stagnation, and increase the gap between developed and developing nations. In that respect, solving the current problems of debt overhang that strangulate growth in several poor countries should be high on the developing agenda.

It should be noted that contrary to conventional wisdom defaults not always condemn debtors to a position of international pariahs. Eichengreen (1991) argues that countries that countries that serviced their debts in the 1930s did not have a privileged access to international capital markets in the next debt cycle. In fact, both defaulters and non-defaulters suffered alike when capital markets shut down, and benefited in the same scale when they reopened.

Arguably default might affect the credit terms rather then the volume of credit. In that case defaulters would face a higher rate of interest than non-defaulters. Lindert (1989) shows that there is no impact of default on defaulter's interest. Fishlow (1989) argues that credible regime changes may explain why defaulters are able to recover international credibility.

Analyzing the 1931-33 and 1978-85 periods Suter (1992) concludes that default can be avoided by higher rates of output and export growth, by holding higher levels of foreign reserves. Also higher rates of interest are associated to higher probability of default or debt rescheduling processes. Contrary to the findings of Eichengreen and Portes (1985), and using a longer periods, Suter (1992) finds that there is no reliable connection between sound fiscal policy and absence of defaults.

These results imply that, when everything else fails, default might be a good alternative for developing countries. It is clear, however, that to the extent that default can be avoided without disrupting the functioning of the economy, it would be the best alternative. Orderly defaults that protect creditors without causing harm to debtors are the rational solution for debt crises. It is generally acknowledged by domestic legislation that an orderly process of bankruptcy should protect debtors at the same time that it gives guarantees to the creditors. An equivalent framework for sovereign debtors does not exist.

Proposals for sovereign debt restructuring are more complex when debt takes the form of bonds rather than bank lending, since the number of creditors that need to agree becomes impractical for effective negotiation. The emergence of the so-called Vulture Hedge Funds—funds that buy distressed sovereign bonds in the secondary market in order to sue for full payment—makes debt restructuring more difficult. Eichengreen (2002) suggests that collective action clauses in debt contracts should be included to allow the majority of creditors to negotiate the terms of restructuring. Several proposals are being discussed to allow for orderly sovereign debt restructuring.

The IMF, the World Bank and the Paris Club of government creditors in 1996 set out an initiative for Highly Indebted Poor Countries (HIPC), which involves cancellation of excessive debt. The idea is to leave poor countries with debt repayments that are considered sustainable and that do not restrict their ability to grow. The main criterion for debt sustainability is export to GDP ratios. If a country has too much of its exports committed to debt servicing, it will have to forgo essential imports (e.g. capital goods) and its rate of accumulation will slow down as a result.

For this reason the HIPC initiative uses the debt service to export ratio as a criteria for debt reduction. The HIPC presumes that a 20 to 25 percent ratio is sustainable. These levels seem to be on the high side, given historical precedents, and suggest that as currently proposed the HIPC initiative will be not enough and too late. However, the fact that the multilateral institutions accept the idea of debt pardoning—one should note that debt pardoning does have precedents, for example, the German inter-war debt was pardoned.

However, even if the problems of debt overhang are resolved, and stable flows of capital for developing countries were to become standard features of the international financial system—a highly optimistic scenario, one might add—still we would have to face eventual debt crises. For this reason rules for dealing with sovereign bankruptcy should be created.

In most countries bankrupted firms and individuals are protected from rapacious creditors, and are allowed to pay without falling into abject misery. Similar civilized rules for countries do not exist, although they have been discussed by developing countries in the past. Raffer (1990) argues that an equivalent to the US legislation for municipal debt restructuring—known as chapter 9—should be adopted for international sovereign defaults. Arguable the balance of opinion is shifting toward an international legal framework for cash-strapped countries to seek payment standstills, but a definite solution for debt problems is not at hand.

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Development Governance

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Introduction

The debate on the appropriate policy package for governance in developing countries has been more intense and varied than the debate on economic policies to be followed in the developed world. Policy approaches have differed in the first place, because development itself is a contested and changing concept. Generally, it has meant that underdeveloped countries are expected to gradually overcome low equilibrium pattern variables such as illiteracy, low levels of industrialisation, massive poverty and low productivity in order to come closer to the social, economic and political patterns as they exist in the developed countries. Development then actually implies that national or international organisations, with the authority to do so, have the blueprints and the financial and technological wherewithal to bring about such a closing of the gap.

In more analytical terms, development also means that all territories in the world are progressively being included in the market economy and that older regimes of self-sufficiency and reciprocity are replaced by commoditised production systems. Many political movements and governments in developing countries have not always accepted such a replication of the Western economic system as the only option of development and have introduced various other solutions such as socialism, community development, self-reliance, Islamic socialism and eco-development. Each vision of development requires appropriate instruments of governance and different priorities.

Development governance is a diverse concept for another important reason. All developing countries have their own specificities. The differences in all possible pattern variables can be enormous between, for example, countries in Latin America and in Sub-Sahara Africa. One blueprint, which would apply to all developing countries and all sectors, was therefore generally not accepted policy. In the past it was, however, also commonly accepted that developing countries were different from the developed countries and needed dissimilar governance. They were also referred to as underdeveloped countries, for good reason. In a classic article, entitled 'The Limitations of a Special Case', Dudley Seers (1963) raised the argument that existing economic theories were valid only for Western industrial capitalism. The debate on specific development governance was the terrain of development economics, non-western sociology and social geography and was thus clearly based on different assumptions and parameters. The exception was during the 1980s and 1990s, when the IMF decreed one governance regime for all countries; a governance that was based on the simple prescription of limiting the role of governments to providing the appropriate environment for a free market as the autonomous driving force of a world-wide development.

Governance is basically the choice of instruments and institutions for the management of a country's economic, social and natural resources for development. The policies with which the development process is to be stimulated have basically gone through three phases: the colonial phase with an emphasis on exploitation for the sake of the coloniser; the post-colonial phase with an emphasis on state intervention; and the globalisation phase with an emphasis on civil society and the free market (Kitching 1982; Hettne 1990; Cowen & Shenton 1996; Preston 1996; Rist 1997).

A Chequered History

The origins, however faint, of development governance can be located in the colonial period. For a very long time, the colonial administration had two major functions. It put a basic infrastructure of roads, railways and harbours in place, essentially to move raw materials to Europe and to import industrial products for the local market, and it supervised the process, if necessary by violent means, of revenue collection. The idea of a deliberate effort by the institutions of government aimed at the overall development of society was not yet entertained. The theories of the classical economists in the 18th and 19th century gave legitimacy to the policy of limited governance. Progress in the end would be the natural outcome of unfettered freedom of trade. In the meantime it was not considered good policy to do away with the dual economy in the sense that the overseas territories were not yet imbued with Western rationality and commercial acumen and could not possibly be integrated.

The perceptible destruction wrought by the process of colonial trade and exploitation, with incredible human suffering, led to political turmoil and the emergence and expansion of nationalist movements. It also led to a perception in Western countries that the developed world had a responsibility in assisting the 'backward' countries along the road to civilisation and modernisation and development. Colonisation was increasingly defended in the name of trusteeship and development. The League of Nations, established with the peace agreements at the end of the First World War, specifically referred to the international task of the development of all people in the world 'as a sacred trust of civilization'. During the decades that followed, until the turmoil after the Second World War, however, colonial policies did not contribute much to bringing about the human and economic development of the colonized countries. The colonial administration, in addition to erecting the infrastructure for foreign trade and for revenue collection, created the rudiment of an educational and health structure, but these generally were accessible only to the indigenous elite. Colonial governance had little positive impact on levels of development or the administrative infrastructure of colonized countries.

After 1945, the near complacency of Western governments suddenly ended. Communist victories and left-leaning independence movements strained the colonial dominance and governance by compulsion was put on a new footing. President Truman then, in Point Four of his Presidential address in January 1949, launched the beginning of a new development era; an era which was to last until the end of the Cold War in the late 1980s. He said that the West possessed all the knowledge and skills (although not the resources) to relieve the suffering of people in the so-called underdeveloped areas: "Our main aim should be to help the free peoples of the world, through their own efforts, to produce more food, more clothing, more material for housing, and more mechanical power to lighten their burdens. … We should foster capital investment in areas needing development. … Democracy alone can supply the vitalizing force to stir the peoples of the world into triumphant action."

Development aid, as it was implemented during the next few decades, had three features that Truman alluded to. First, it was related to GNP (and did not mention human capital development); second, it centred on capital flows; and third, it was restricted to countries which embarked on capitalism.

Transition Policies

A major problem that development planners encountered was the dualistic nature of underdeveloped economies, namely the coexistence of a small modern sector with a backward or traditional sector and the assumed traditional, non-economic ways of thinking which were said to hamper the process of modernisation. Most countries that were struggling free from colonialism lacked an industrial and administrative infrastructure and had neither the financial capital nor the technology to set out on the path of development. The pioneers of development economics therefore formulated policies, which took these different structural bottlenecks into account and prescribed ways of overcoming the constraints by specific governance applicable to underdevelopment. Lewis (1955), Gerschenkron (1962) and Hirschman (1985) were some of the influential authors who analysed the entire set of forward and backward linkages and proposed an active government regime that would divert resources from the traditional sector to rapid industrialisation in the modern sector and would thereby bring about the structural transformation of the economy and of society.

Development governance in the 1950s and 1960s was thus based on fairly simplistic assumptions. The task was to externally induce dynamic elements so that the economy could develop from a low-level equilibrium into a dynamic growth cycle. The state, according to the Lewis model, had the responsibility of transferring the labour surplus from the subsistence sector to the capitalist sector. With the influx of capital and technology, societies would replicate the transition process for which the Western countries stood as examples and that was summarized in the sequence provided by Walter Rostow in his 'The Stages of Growth. A Non-Communist Manifesto' (1960). The scheme was fairly simple: after preconditions for take-off had been created in traditional societies, take-off would follow and the drive to maturity would start.

The development governance leading up to the take-off stage was based on the idea of diffusion of Western values such as universalism, achievement orientation, rationality, entrepreneurial spirit and functional specificity. The modernisation school, which was deriving theoretical support from leading American sociologists such as Hoselitz (1960) and Eisenstadt (1970), focussed its governance prescriptions on the replacement of traditional pattern variables by modern ones. A modernizing bureaucracy, working on the diffusion of modern values, would have to instigate a process of modernization as the basic requirement for economic development. Development governance in the 1950s and 1960s thus very much depended on Western values and resources. The dominant role of the state was not under contention. On the contrary, the Keynesian interventionist line of thinking was dominant and by-and-large remained unquestioned.

A Radical Turn

By the late 1960s, development governance went into an even more radical period. In most countries hardly any broad-based development had taken place; poverty and polarisation had sharpened and as a consequence political turmoil erupted in many countries across the globe. If development had taken place, for example a spurt in agrarian production as a consequence of the Green Revolution, it had done so in pockets of the economy, leaving the rest of the agrarian hinterland unaffected. Polarization had been further accentuated and the backward looking elite, the bearers of tradition and feudalism, had been strengthened.

Some influential publications around that time reflected a new way of thinking.

Development with equity, with the focus on agriculture and protection of the infant indigenous industry became important aspects of governance. Gunnar Myrdal (1968), for instance, published the 3 volume *Asian Drama*, where the lack of development was associated with a soft state and with insufficient attention to human development investment in education and public health. The link between development and a strong state was seen in terms of the government machinery imposing social discipline and breaking with the traditional culture of patronage and parochialism.

Political economists on the left, who were influential during the period, argued that governments in most developing countries were reasonably strong, in the sense that they had well-organised repressive institutions of the state. The weakness in terms of the development agenda, they argued, was a direct consequence of the class nature of the state bureaucracy and dependency on the world market. Celso Furtado (1964), André Gunder Frank (1970), Paul Baran (1973) and other neo-Marxists brought out a series of books on unequal world power structures and the need for more autonomy and structural reforms. They also argued that development governance had to be separated from the dominance of the Western world, which was portrayed as the continuing cause of underdevelopment.

Theresa Hayter (1971) and Susan George (1976) were very influential with their arguments that even foreign aid was only adding to imperialist subjugation and further impoverishment. Around the same time, Michael Lipton (1977) wrote his influential book on *Why Poor People Stay Poor*, arguing that the urban bureaucracy had prioritized urban development and that the scales should be turned around. Chenery (Chenery et al. 1974), in a World Bank sponsored study *Redistribution with Growth*, argued that unequal access to resources, particularly of land assets, was one of the basic obstacles to development. The consensus was that trickle-down through the market had not worked and that direct support had to be given by the state to the poor and the powerless.

In the early 1970s, governance above all was considered as an instrument of prioritising development sectors and of strengthening the many, including women, against the few so that development could turn into a wide social movement. Some of this thinking entered official policies and many experiments were entertained in organising village communities and target groups, sometimes taking the Chinese example of communes and peasant power as a reference of how governance should be turned upside down (Kitching 1982, Hettne 1990).

A fundamental modification in development governance thus took place. It was accepted that developing countries had specific social and economic structures and that a smooth transition as had earlier been understood with the take-off metaphor was not possible. The goals were redefined as growth with equity. The ILO and UNICEF proposed that economic growth should be directed at providing basic needs for the poor and that the state should use public spending to correct the failures of the market. The new development governance consisted of five elements:

A new international economic order in which the power of multinational corporations would be restrained and in which trade preferences and financial transfers would help developing countries build a self-sufficient economy based on import substitution rather than on export-led growth.

Land reforms that would do away with feudal obstructions to agrarian production and which would lead to higher levels of productivity and to broad-based rural purchasing power.

Rather than putting a one-sided emphasis on industrialisation, the new approach stressed the importance of developing agriculture and the gradual expansion of small-scale industries within a protected environment as a means of solving mass unemployment and poverty.

An increasing role for the state in fulfilling basic human needs, which implied that welfare policies were needed in order to protect the poor from further immiseration.

A relocation of investments to education and health, which were then considered not only as basic human needs but also as sound economic investment.

The development process needed more state intervention. Governance was the introduction of an entire package of complementary and supportive policies for which the state had to prepare plans. State planning was considered necessary to redirect the scarce financial resources into areas that were of crucial importance for long-term economic objectives (e.g. steel plants, chemical industry, irrigation systems as well as the energy and transport infrastructure), and to increase revenue, so as to rapidly expand the health and education infrastructure. The case for resource mobilisation and allocation was strengthened by the market failure argument. Commodity markets and finance markets in most developing countries were permeated by imperfections and rigidities and were not conducive to efficient production and distribution (Drèze & Sen 1989; Wade 1990).

Neoliberal Turnaround

It had generally been accepted, from the second half of the 1960s onwards that the market had failed to bring about growth and development. At the same time, however, state planning, with the exception of the socialist countries, never gained control of the economy. It was an active policy instrument in the sense that it attempted to push the economy in a desired direction, but it did so by providing favourable conditions for the market to operate. The policy instruments were primarily concerned with the fields of monetary, fiscal and foreign trade relations. This policy was abandoned before long as around 1980 neoliberal policies gradually started dominating the debate.

The new theoretical trend was termed the counterrevolution in development governance (Toye 1987). The anti-Keynesian wave restored an orthodox belief in the market mechanism and free trade policy. It also rolled back involvement of the state in economic development. Such a new governance regime derived its arguments from the many failures of the previous policy paradigm. The failures were real and were ascribed to the intrinsic character of state bureaucracies and state regulations. Since allegedly over-extended governments had by and large been unresponsive to the needs of poor people and had wasted resources and energy in a top-down approach, with undemocratic and corrupt bureaucracies throttling the economy, states had to be cut to size and markets should come in to allow the entrepreneurial dynamism to blossom and to do so through a rational allocation of economic resources.

Up to the mid-1980s, many development economists and governments in developing countries continued to believe that a developmentally active state was essential for balanced development. The new approach was basically driven by the USA and the IMF/World Bank institutions and has commonly been referred to as the Washington Consensus. The crunch came with the onset of the debt crisis, starting with Mexico in 1982. Heavily-indebted government after government had to turn to the IMF in order to reschedule debts and acquire finances to underwrite the functioning of the administration. The negotiations led to a Structural Adjustment Policy which was meant to stimulate a free market without factor distortions through subsidies and tariffs and which usually included a set of measures commonly applied to all developing countries, irrespective of differences in economic development and factor endowments. The basket of measures included:

Devaluation of the local currency in order to gain a competitive edge in the world market, jointly with domestic financial market liberalisation;

Foreign trade liberalisation, which basically meant the slashing of import duties;

Tax reductions and the scrapping of subsidies on both agrarian inputs and products of mass consumption such as food and transport;

Deregulation and privatisation, which led to a massive withdrawal of the state from involvement in economic activities and also a greater role for private organisations in what hitherto were considered as public utilities, such as education, health, water and electricity supply and public transport

Changes in national legislation so that labour could be made more flexible.

The 1980s was basically a transition decade in which the new market-based governance had not yet become dominant and in which ways were sought to replace the existing development paradigm so that a market-driven development could be put in motion. Development governance remained contested and there were so many different paradigms that vied for dominance that the entire development discourse became a hybrid. Since the free market regime only became dominant in the 1990s, the 1980s are now referred to accordingly as the lost decade.

By 1990, most governments in the developing countries had adopted the Washington consensus and the public interest view of the state had effectively been undermined. Unlike in the previous decade, when governance was a contested terrain, the new governance approach was inflexible and orthodox. Development was considered to be the consequence of the successful participation in the world economy. Practically all governments accepted this policy advice as internal and external liberalisation were rapidly implemented. The slashing of financial and trade restrictions helped as an instrument of promoting international trade. Since import barriers were lowered, international trade was boosted. The increasing importation of Western products and limited access to Western markets, however, led to an increasing gap between imports and exports in the developing countries. The recourse to foreign loans to finance the trade deficit led to a further worsening of the debt crisis and a lowering of growth rates. As more and more developing countries got into the debt trap, more and more emphasis came to be placed on structural adjustment, less and less on human needs.

Most states in the developing world already had a low share in the national economy, compared with developed nations. Structural adjustment led to greater polarisation as one section of the population could avail of the new opportunities while the poorer section was increasingly excluded. The vulnerability of the poor in a number of countries grew dramatically.

In order to alleviate social problems, governance after the mid-1980s emphasized structural adjustment with a human face. The World Bank, realizing the negative impact on the poor of financial volatility, the economic crisis and polarization of incomes, re-invented some of the policy approaches of the

1970s. States were called upon to provide a social safety net. The measures of structural development with a human face, however, in view of the reducing government finances, often amounted to a further reduction in public services. Subsidies and services were to be narrowly targeted on the poorest families, especially women, but this selectivity and conditionality suffered from the same governance weakness as in previous decades, namely the indifference of many governments to the plight of its poor people (Cornia et al 1987).

Civil Society

The government's function henceforth was to provide a framework in which private entrepreneurs and traders could operate and in which the voluntary sector, often referred to as civil society, could enter and provide education and health services as well as charities. The enormous expansion of the non-governmental organisations (NGOs) filled the gap left by the withdrawal of government.

The rolling back of the state demands a more active involvement of civil society in the development process, filling gaps in human needs that are not adequately covered by the market or state. The locally organised voluntary agencies are understood to be flexible and concerned organisations which, in contrast to the allegedly callous and predatory bureaucracy, can deliver the goods more efficiently and more appropriately, without leakages to the non-poor and the non-deserving poor. The reliance on civil society involves notions such as participation, ownership, decentralisation and grassroots development. These concepts have added to the attractiveness of the new model. The writings of Robert Chambers (1983, 1997) on *Putting the Last First* have given the theoretical and empirical underpinning to the idea that development should be a process from the bottom up rather than a top-down approach. A participatory civil society, together with a dynamic and free market, became the two pillars in development governance, with the state bureaucracy functioning only as the provider of an enabling environment.

The bottom-up approach fitted the strategy of rolling back the state. Citizens, whether they were peasants, traders or entrepreneurs, should be given more opportunities to follow their drive and insights and develop initiatives which possibly would require the state to provide the enabling environment but not its restraints and regulations. The idea of social capital, re-introduced by Robert Putnam (1993), towards the end of the millennium spread like wildfire in development theories. It was presented as the missing link in development. Social capital is the elaborate structure of social relationships in which people participate and which provide them the resources to develop political and economic activities. Economic development thus essentially depends on the extent of social capital and the mobilisation of such resources. Government policies henceforth would have to be directed at encouraging local self-help (Dasgupta & Serageldin 2000). The focus of development and poverty alleviation was henceforth on micro-credit programs and the active involvement of citizens around NGOs as the advocates of a people's based-development. The protective role of the state had allegedly failed and was substituted by a movement of active citizens leading to empowerment and development rather then to tutelage and stagnation.

Since the mid-1980s, the NGOs have become officially recognized partners in the international development aid program. Generally, NGOs have gradually taken on the role of complementing the state, and even in replacing the state, providing services that the state had abandoned. NGOs in fact have become tied to mainstream international development aid industry and have become extension structures supported by international funding agencies, national governments and the commercial sector. Various acronyms, such as BINGO (Big NGO), CONGO (Commercial NGO) and MANGO (Maffia NGO), indicate that the character of the non-governmental aid organisations is so varied that the original idea of grassroots organisations is applicable to only a few of them. Some of their methods and approaches, such as the micro-credit program and the gender sensitive approach, have been widely advertised and copied with various modifications. At the same time, they have reinforced the idea of active and harmonious communities and that in these communities, people autonomously could thrive and move forward on the basis of social capital. Theoretical work on power differentials, unequal access to resources and social exclusion (e.g. by Bourdieu 1993; Harriss 2001) continued to be influential in academic circles but its actual impact on development governance was dreadfully low.

A Return to Government

By the turn of the millennium, it became obvious that structural adjustment policies had failed as an instrument of development governance. In quite a number of countries across the developing world, growth declined, local industries had withered, polarization had worsened and the vulnerability of poor people had increased. It again has become the mainstream understanding that because of market failure in these segments, public spending is necessary (Stiglitz 2002; Held & Koenig-Archibugi 2003; Chang 2003).

The UNDP in its *Human Development Report* of 1999 stated unequivocally that the new opportunities for development very much depend on stronger governance. The challenge, it was increasingly argued around the turn of the millennium, was to find rules and institutions for stronger local, national and global governance so that the advantages of global markets would combine with equity, inclusion and sustainability.

Many of the changes introduced during the 1990s (privatization, decentralization, contracting out, provision through NGOs, empowerment and participatory development) failed to meet the many challenges. It has been realized that market-based economic development will not lead to the eradication of poverty—the number of poor in 2000 was higher than in 1990—and will not lead to a substantial improvement in human development indicators. Public services may have become more dysfunctional and have not reached the poor people, while a differentiation in policies across the globe is now considered necessary (Hyden et al 2004; Sinclair 2004).

The functioning of markets, nation building, social cohesion and social justice, are normative justifications for more government responsibilities, as even the World Bank admits in a departure from earlier policies. The national peculiarities have made the World Bank (2004:46,54) realize that none of the new solutions, which had recently been introduced, are a panacea, and that ‘One size does not fit all’. On the contrary, these innovations ‘pale before the twin ideas of nation state and public sector bureaucracy’. Development governance thus needs to be based ‘on the most powerful innovation of the previous century, namely the responsibility of the government rather than the market for the welfare of its citizens’. In the 2000s it is again considered that the functioning of the public sector with its civil service employees is the most effective way of producing the public goods. In the chain of service delivery, the four main actors (government as policy makers, government departments, implementing agencies and citizens as clients) have to work out an effective structure of efficiency, enforceability and accountability.

Human Development Governance

For ages, development governance was approached vis-à-vis economic parameters and success was measured in terms of growth of GDP. Around 1990, the UNDP started developing a Human Development Index. The HDI includes three variables: education, health and national income. The index was developed for two reasons.

Firstly, it is associated with the notion of basic human rights. The well-being of citizens does not only depend on access to material goods but also on entitlements to education and good health. Some countries with a low economic base, such as Sri Lanka, Cuba and Zimbabwe, have a high achievement in literacy, child mortality rates, longevity and gender equality. Others with a high GDP, such as Kuwait and Saudi Arabia, have a rather dismal performance in terms of education, child mortality and gender equality. Since poverty was increasingly seen as a multifaceted phenomenon, policies had to be geared to increasing the access of poor people and poor children to better health services and education.

Secondly, the index was introduced because improving levels of education and health have a direct bearing on economic growth. They require massive public funding before economic development can take place; but finances for universally accessible public goods, such as education, health, water and electricity, are seen as investments rather than as consumption.

An important departure in the new policy approach, with far-reaching implications for governance priorities, was the adoption in 2000 at the UN of the eight Millennium Development Goals (MDG). Each goal is to be reached by 2015: halving the number of people living in poverty, achieving universal primary education and gender equity, two-third reduction of child mortality and maternal mortality ratio, reversing the spread of HIV and halving the number of people without access to potable water.

The MDG framework intends to build on mutual responsibilities between poor and rich nations. Poor countries must improve governance in order to mobilize and manage resources more effectively and equitably. Rich countries must increase aid, debt relief, market access and technology transfer. These commitments were made in the last of the eight development goals, namely the goal of developing a global partnership for development. Goal Number 8 specifically commits countries to developing an open trading and financial system, to introduce measures to make debt sustainable by cancelling official bilateral debt and offering debt relief for heavily indebted countries, and, in cooperation with the private sector, making available the benefits of new technologies.

The policy for this partnership was formulated in the Monterrey (Mexico) Consensus of 2002. Development aid should play an important role. The Monterrey Consensus recognized the need for a substantial increase in foreign aid, urging donor countries to increase their aid efforts in order to reach the target of 0.7 % of gross national income which was agreed upon already in 1970. Achievement has generally not exceeded 0.4 % of GNP and since 1990, with the demise of the Soviet Union, development aid has slipped to around 0.25 of donor countries' gross national product. Declining aid has hit hardest the regions and countries in greatest need. It is agreed that under the umbrella of the Fast Track Initiative various measures are necessary, such as a steep increase in aid and a 20% aid budget allocation to education. Stepped-up external support is important since the countries that face deep-seated structural problems are also the countries that have a severe trade deficit and high debt levels (UNDP 2005).

Good Governance

In the framework of support agreed on by the OECD countries, conditions have been attached to aid. It has been stipulated that rich countries should base their support for poor countries more on performance than continue seeing it as a freely available entitlement. Development Aid selectivity, linking aid and debt relief to a sound economic policy, has been advanced with the argument that overseas aid has often been wasted and led to more corruption and disruption rather than to development, except for countries with a commitment to sound economic policies (Fowler 2000; Chakravarti 2005). It is now generally accepted that aid as such does not bring about development. A massive injection of resources by governments, international organisations and NGOs has created distortions and led to aid dependency without reducing poverty or stimulating the economy.

External support for such important policy clusters as investment in basic education and health, basic infrastructure, industrial development and sustainable agrarian production thus requires consensus on what has been termed good governance. The concept of good governance, however, is open to interpretation. Commonly it is being suggested that good governance and development are coterminous with freedom and democracy (Sen 2000; UNDP 2002). The historical record, however, is a mixed bag of democracies that have failed and authoritarian regimes that have succeeded. The World Bank defines good governance as synonymous with sound development management. Four important areas of sound development management are an efficient public sector management through appropriate budgeting and sound economic policies, an independent judicial system, decentralization towards lower administrative units and civil society organisations, public accountability and transparency. European countries put somewhat more emphasis on participatory political processes and respect for human rights. The underlying assumption that runs through the concept of good governance is that sound and efficient development management requires a free market economy and a liberal political regime. The concept of good governance in its implications is synonymous to the policy regime of the Washington consensus.

Further Developments

In the 1990s, there was a clear TINA (There Is No Alternative) feeling. Since then the dogmatic orientation on the market and retreat of government from the economy and from the social service sector has increasingly been modified. Declining growth rates, the rapidly increasing gap between rich and poor countries, the absolute increase in the number of people below the poverty line and the exclusion of many countries from economic development has led to some reconsideration of the unrestricted world market as the panacea for development.

Doubts have arisen about governance based on the Washington consensus and about the spread of economic benefits in the wake of globalization. Governance at the IMF is dominated by the richest countries, particularly by the USA, and a fundamental reorientation in policies is not likely to emerge. Governance at the World Trade Organisation, which is crucially important for the regulation of international trade, however, is largely by consensus. The imposition of policies by the United States, Japan and Europe, which was the case in the 1990s, appears to have come to a close. The emergence of left-leaning regimes in the Third World, particularly Brazil, Venezuela, South Africa and India, have brought back some of the countervailing power which developing countries had in the 1970s and which at that time led to a governance shift in the direction of more state intervention and protective policies. International and national governance accordingly may shed some of the orthodox neo-liberal features such as the imposition of free trade, the rolling back of the state and the reliance on civil society, and may return to a post-Washington consensus with some of the governance features which characterised the developmental and pro-active state up to the late 1970s.

Given the unprecedented changes in communication, transportation and computer technology, globalisation cannot be reversed. Globally mobile banks and multinational corporations have swept away legislative obstructions and undermined national policies in developing countries. In the next wave of globalisation, governance as a deliberate choice by governments between modes of intervention may reassert itself. The contest will be between the unrestricted access by international finance capital and business firms to markets in developing countries without contributing to nation building, development or equity, and a global movement for social justice and sustainable development.

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European Union Macroeconomic Policies

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Introduction

Macroeconomic policy is the policy influencing systemic variables of the economy (GDP, total demand, money supply) in order to stabilise the economy and to achieve the objectives of full employment, sustained and balanced growth, low inflation and balanced external trade. Macroeconomic policy usually refers to fiscal and monetary policies.

The subject is dealt in the following way: first I recall the key concepts that are required to understand the policies; then I review the competing theories in order to show what inspired the choices made by the European institutions. The description of the policies and the aspects of governance are completed with a critical assessment.

A. Fiscal Policy

Fiscal policy refers to government spending and taxation in order to achieve the above objectives, as well as other ethical and political goals like social justice and cohesion. To understand European policy, three notions are recalled here: (i) primary balance and total budget deficit, (ii) automatic stabilizers and (iii) cyclical versus structural deficits

Definitions

Primary Balance and Total Deficit

The *primary balance* is the difference between total receipts (direct and indirect taxation) and total expenditure (public consumption and investment, social transfers, subsidies to enterprises), whereby expenditure excludes interest payments on government debt. *Total deficit* (or surplus) is obtained when expenditure includes interest payments. Total deficit is the variable targeted by European fiscal rules.

The normal way to finance total deficit is by issuing government bonds and then selling them on the market (the *primary* market). In the secondary market these bonds are subsequently traded. European Union rules forbid financing deficits by means of printing money (monetary financing).

Automatic (or built-in) *stabilisers* refer to the smoothing effect on the business cycle resulting from some categories of public expenditure, such as unemployment benefits, welfare programmes as well as progressive income taxation. During recessions, the first two kinds of expenditure grow because unemployment and poverty increase; this supports effective demand and attenuates the severity of recession. During expansion, the opposite occurs.

Progressive taxation leads to the same smoothing effect since the percentage rate of taxation increases proportionally more than income.

Cyclical versus *Structural Deficits*

The public deficit exhibits cyclical movement: it increases during recessions and diminishes (or even becomes surplus) during expansions. Structural deficits, i.e. deficits greater than those due to recession, can be justified for coping with high unemployment.

Theories

Two competing theories are involved: the Keynesian theory, on the one hand, and the neoclassical theory and its developments (Monetarist and New classical economics), on the other.

The Keynesian theory starts from the fundamental results of the *General Theory* (Keynes 1936) showing, first, that total demand and expectations play a dominant role in determining the level of activity and, secondly, that the market does not guarantee sufficient total demand by itself, which means that full employment is not guaranteed. It is precisely this absence of an automatic tendency towards full employment that requires public intervention. One of the pillars of such action is fiscal policy. In addition, the Keynesian theory is characterised by a concern for a fairer distribution of income and wealth, which in turn requires public action.

Public spending influences total demand through the multiplier effect: a one-euro increase in deficit spending leads to an increase in demand of more than one euro. Keynesaian Policies can require structural deficits but, obviously, this does not imply irresponsible policies, with no limits on deficit. We have two Keynesian "golden rules" in fact: the first is that the balanced budget need not be obtained on an annual basis but over an entire business cycle. The second is that while public consumption must be entirely financed by taxes (as it otherwise produces crowding out of private consumption and investment), public investment can be financed by debt without introducing an unbalancing element into the system. The reason is that public investment is productive, and consequently it provides the resources for repayment of debts.

The Neoclassical theory starts from the opposite view: perfect wage and price flexibility and free competition produce the best outcomes for individuals and for society at large. In particular, the unbridled play of the market ensures full employment. Within this context there is only a minimal role for the State ("the government that governs least, governs best", is the neoclassical motto). The government must operate limited spending and limited taxation while keeping a constantly balanced budget. Otherwise we face inflation and crowding out of private investment and consumer spending.

The monetarist theory fully subscribes to this analysis, emphasising that State intervention is either negative—as it distorts the optimal market outcomes—or, at best, is ineffective. This is referred to as the "Ricardian equivalence", stating that there is no expansionary effect of public deficit financed by debt (Barro 1974). The reason why a deficit-financed increase in government spending will not lead to an increase in aggregate demand is that "rational" consumers will save more now to compensate for the higher taxes they expect to face in the future, as the government has to pay back its debts. The increased government spending is exactly offset by decreased consumption on the part of the public.

The New Classical Economics—a development of monetarist theory that flourished in the US during 1975-85—supports the above neoclassical and monetarist positions by emphasising that public intervention, which is discretionary, increases uncertainty without necessarily being effective. It follows that we must lay down stable rules for public finance in order to facilitate agents' expectations. This is the rationale for the European rules which we will now turn to.

European Policies

The pillar underlying the European Union fiscal policy is the Maastricht Treaty (1992), whose targets were considerably strengthened by the Stability and Growth Pact (1997).

The Maastricht Treaty—Basic Principles

The Maastricht Treaty formalises the member States' decision to deepen the existing monetary agreements by opting for a common currency (the euro, which replaced the majority of national currencies in 2002). For this purpose, the Treaty established two broad requirements: (*a*) the discipline of public finances, (*b*) convergence criteria targets for price stability, interest rates and exchange rates during the transitional period ending with the introduction of the euro.

On public finances, the Treaty established two numerical targets applicable to each Member State. They concern, firstly, the total deficit, that must not exceed 3% of GDP in any year, and secondly. the stock of public debt, which should gradually reach the maximum level of 60% of GDP. The intention here was that these targets should guarantee *sustainable public finance*. In 2005 only five countries of the euro area fulfilled this debt requirement (Spain, Ireland, Luxembourg, the Nederlands and Finland). Four others remained slightly above the 60% threshold (Germany, France, Austria and Portugal), while the remaining 3 were far above, i.e. 93.2% for Belgium, 107.5% for Greece and 106.6% for Italy.

Two other general principles inspired the Maastricht Treaty. The first one, referred to above, prohibits financing public deficits by creating money (no monetary financing). The second is the "no bail-out principle", stating that the Community or a Member State "shall not be liable for or assume the commitments of ... governments... of any Member State" (Art. 103 of the EU Treaty).

Within these limits, national fiscal policies remain autonomous. This is justified by the fact that national authorities can react more effectively to individual exogenous shocks, that they have a better knowledge as to which public goods to produce and, also, by the fact that Community policies should be inspired by the subsidiarity principle. This principle states that the Union undertakes or regulates only what cannot be done more efficiently at national or regional level.

The main theoretical source of inspiration underlying the Maastricht principles and criteria is the New Classical Economics, whose aim is to limit discretionary policies by imposing a deficit ceiling and prescribing a balanced budget in the medium term.

Stability and Growth Pact

At Germany's request, the European Council adopted more compulsory rules for fiscal stability in 1997 by defining new objectives for public finances and more precise rules for the surveillance and coordination of national policies.

(1) The quantitative target for public finances was tightened by establishing that the medium-term budgetary objective should be "close to balance or in surplus". The 3% ceiling remains an absolute limit although commitments are stronger, as the new objective aims to have zero deficits over the business cycle. Thus, possible deficits during recessionary periods must be compensated for by corresponding surpluses during expansions.

(2) On surveillance and coordination policies, the Pact was implemented by two Regulations (Regulations 1466/97 and 1467/97, published in the *Official Journal of the European Union*, L 209, 2 August 1997).

The first Regulation establishes that each year Member State submits a Stability programme to the European authorities listing the budgetary measures in order to reach the medium-term objective of zero deficits. These programmes should show the trajectory for attaining such an objective, providing details on the underlying hypotheses (growth, taxation, etc.), a description of the measures to be taken to reach the objective as well as the budgetary repercussion of any change in the main hypotheses. Member States not belonging to the euro area are submitted to a similar obligation, as they must submit a convergence programme.

The second Regulation speeds up and clarifies the excessive deficit procedure.

♦ As a preliminary step, when a Member State exhibits a divergence between planned and actual deficit, the European Commission issues an early warning to the State in question, asking it to take measures to avoid reaching the 3% limit;

♦ When the total deficit exceeds the 3% threshold, the excessive deficit procedure is set in motion. It covers the following stages:

(a) The Commission submits a report to the Council, taking into account all relevant factors on the country's economic situation and the medium-term perspectives

(b) If the Council decides that an excessive deficit exists, it makes a recommendation to the Member State with a view to bringing the situation to an end within a given period

(c) If, after ten months, the deficit still exceeds 3%, the Council can adopt a sanction, involving a non-interest bearing deposit ranging between 0.2% and 0.5% of GDP

(d) If, within two years, the deficit still remains above the threshold, such a deposit becomes "in principle" a fine.

There are two exceptions to this stringent procedure. The first applies automatically when the Member State experiences a slowdown resulting in a minimum 2% annual decrease in its GDP, or when there are exceptional events not caused by the State's behaviour (e.g. natural disasters). The second exception applies when the severity of recession is less pronounced, i.e. when the GDP in real terms decreases by 0.75% at least in one given year. In this case, suspension of the excessive deficit procedure depends on the Council's political assessment of the situation and on the prospects for the State in question.

The beginning of the years 2000s was characterised by budgetary problems in the major euro-area countries, with Germany, France and Italy exceeding the 3% deficit threshold. This triggered off lively discussions on reforming the Stability and Growth Pact. The institutional debate was settled by the European Council in March 2005, which allowed for greater flexibility on two points (Council of the EU 2005). First, medium-term budgetary objectives are now differentiated depending on the country concerned in order to take into account country-specific circumstances and reforms. Secondly, "exceptional events" enabling circumvention of the excessive deficit procedure have become less restrictive: instead of a 2% decrease in GDP, it is considered as "exceptional event" a "negative growth rate" or an "accumulated loss of output during a protracted period of very low growth relative to potential growth".

Aspects of Governance

Institutions

The main institutional bodies responsible for the definition and coordination of fiscal policy are the European Commission and the Council. "Council" refers to the European Council, composed of the Heads of State or of Government, as well as to the Council of Ministers acting on specialised areas (economic and financial affairs, in our case). The Commission has the right of initiative while the Council takes the political decisions. For this purpose, the Commission initiates procedures (e.g. early warning), submits proposals, reports, opinions and recommendations to allow the Council to decide.

Broad Economic Policy Guidelines

Since 1993 economic policy coordination in the EU has been driven by the Broad Economic Policy Guidelines—a programme-related document adopted by the Council, acting on a Commission proposal. These lay down the common objectives in terms of inflation, public finance, exchange rate stability and employment. The Council, on the basis of reports submitted by the Commission, monitors economic developments in each Member State and in the Community and assesses the consistency of economic policies with the guidelines. Then it issues recommendations to policy makers. The guidelines result in a political commitment involving no sanctions.

Discussion

A discussion of European fiscal policy should initially focus on its theoretical basis. A comparison should accordingly be made between the New Classical Economics that fundamentally inspires European policies and its theoretical rival—the Keynesian political economy—to establish which is better suited to tackle current problems facing society (unemployment, income distribution, sustainable growth, stability, etc.). However, such a general discussion is beyond the limits of this entry; only sustainable public finance will be addressed here.

The Notion of Sustainable Public Finance

Domar's (1944) seminal article provides the starting point. The essential thrust of his argument is that public finance is sustainable when government is able to successfully face its debt obligations. This occurs when the Debt/GDP ratio in nominal terms is stable or declining over time. In fact, we shall see below that the stability (or decline) of such a ratio implies that nominal GDP growth provides the resources to pay interests.

Economic theory gives us only this guidance, with no indication as to the optimal level of debt, that is taken exogenously. The Maastricht criteria fill this alleged gap of the theory by the arbitrary fixing of the above quantitative targets. Let us now proceed towards a more careful assessment of these prescriptions (See Pasinetti 1997, 1998).

Let us write the definition of total deficit (*DF*) and primary surplus (or deficit), *SP*. For the sake of convenience, *DF*—a negative magnitude—is initially taken as an absolute value.

In a static situation (GDP does not grow) we have:

$$(1) \qquad DF = \left| R—G—i\,D \right| = \Delta D$$

where: R is total revenue; G is public expenses; i is nominal interest rate; D is the stock of debt and ΔD is its (absolute) increase.

Formula (1) shows that the increase of the stock of debt equals the amount of total deficit. From the same formula we can also see that the level of debt remains constant ($\Delta D=0$) when the primary surplus covers interest payments

$$(2) \qquad R - G = i\,D = SP$$

Obviously, to satisfy formula (2) (a constant level of debt), the primary surplus must be higher than in the case of formula (1).

Consider now a dynamic situation (GDP growing). The *sustainability condition* is verified when the total deficit/GDP ratio in nominal terms is constant (or declining), i.e. D/Y *is* constant when DF/Y is constant. Y refers to GDP

This condition is fulfilled when the percentage rate of GDP growth (g) is equal to the debt growth rate (d)

$$(3) \qquad d = g$$

In analytical terms, the (total) deficit /GDP ratio should read:

$$\frac{DF}{Y} = \frac{\Delta D}{Y} = \frac{\Delta D}{D}\frac{D}{Y} = d\frac{D}{Y}$$

Taking into account condition (3), we have

$$(4) \qquad \frac{DF}{Y} = g\frac{D}{Y}$$

More generally (i.e. considering also the case of a declining share of deficit), public finance is sustainable when GDP growth rate exceeds the debt growth rate ($g > d$) , i.e.

$$(5) \qquad \frac{DF}{Y} \leq g\frac{D}{Y}$$

On incorporating the Maastricht parameters in formula (5), we see that a 60% debt share combined with a 3% deficit is possible if GDP nominal growth is 5%.

This result of formula (5) calls for two comments:

(i) Stability is determined by two factors: the Debt/GDP ratio, and the rate of growth of *nominal* GDP. This last element is crucial: given the *D/Y* ratio, to obtain sustainable finance the nominal GDP should increase sufficiently to keep *DF/Y* at a stable level. In turn, GDP nominal growth is determined by two elements: growth in output volume, and price increases. Obviously, inflation is a destabilising factor of the economy and should be kept under control. However, *moderate* inflation can act as a stimulus of economic activity and help relieve the debt burden.

(ii) The stability condition (5) applies to *any level* of Deficit/GDP ratio, not only for a particular specific ratio as is prescribed under the Maastricht criteria. In fact, the theory did not quantify sustainability for the very simple reason that, for such a purpose, *we do not need quantitative targets* to be uniformly applied to member States. The stability or decline of the Debt/GDP ratio in nominal terms is quite sufficient. Thus, instead of these arbitrary Maastricht figures, European member States could declare the level of Debt/GDP ratio in respect of which they enter into an (absolutely) binding commitment not to be exceeded. Obviously, this commitment implies strict fiscal discipline, albeit with the double advantage of taking into account each country's historical path and, above all, it obviates imposing the unnecessary burden to refund the debt in order to reach the mythic value of 60% of GDP.

Sustainability and Primary Surplus

The relation between total deficit and primary surplus (or deficit) is important to show, among other things, the role of the interest rate in contributing towards the overall sustainability of public finance.

Let us start with the definition of primary surplus with respect to total deficit (formula 1 above), in which *DF* is not taken any more as an absolute value but with its negative sign:

$$SP = R - G = -DF + iD$$

Then proceed as before:

$$\frac{SP}{Y} = -\frac{DF}{Y} + i\frac{D}{Y}$$

Substitute the stability condition (4) for *DF/Y*

$$\frac{SP}{Y} = -g\frac{D}{Y} + i\frac{D}{Y} = (i-g)\frac{D}{Y}$$

The sustainability condition for the primary surplus is:

$$(6) \qquad \frac{SP}{Y} \geq (i-g)\frac{D}{Y}$$

We see that the *primary* surplus that satisfies the stability condition depends on three external magnitudes: (i) the debt/GDP ratio; (ii) the nominal interest rate *i*, and (iii) the growth rate of nominal GDP (*g*). As in the previous case, this last element is crucial. In fact, if nominal GDP growth is large enough, the sustainable level of primary surplus is correspondingly reduced, the surplus being equal to *(i—g)D*. Such a surplus requires a tax rate (*t*, as a percentage of GDP) expressed as follows (Pasinetti 1997:164):

$$(7) \qquad t = (i - g)\, D/Y$$

In the most favourable case, when the rate of GDP growth is larger than the interest rate ($g > i$), we could even have a primary *deficit* instead of a primary surplus. Debt does not entail any burden on the taxpayer, as the resources made available by growth cover it.

Thus the primary surplus is a measure of the debt's social burden, a burden that can be reduced in two ways: by acting on the level of nominal interest rate and by promoting growth. This requires an internationally defined and coordinated strategy for growth leading to two obvious results: unemployment will fall and there will be fewer financial pressures on the general public because the debt servicing will not require additional taxation.

The following general conclusions emerge. Firstly, the Maastricht criteria are just one possible target for sustainable public finance. These kind of rigid—and arbitrary—criteria are a direct consequence of the theoretical inspiration of present European policies (New Classical Economics). However, it is important to stress that it is far from proven that such a theoretical approach is better than its rival (the Keynesian theory).

Secondly, the best way to keep public finance under control is to promote a growth policy at the international level and to keep interest rates low. The rigid application of the Maastricht targets—combined with an excessive concern to combat inflation—have produced the opposite effect: public and private demand were severely constrained and, by the same token, stifled the economy (Lombard 2000).

And thirdly, interest payments are indeed the only true constraint, as there is no compelling reason to have a declining stock of debt (reaching zero level in the worst scenario)—debt coming to maturity being replaced by new debts. Obviously, this does not justify irresponsible public finance policies leading to an explosive debt growth. The reason for this are twofold: first, the Keynesian golden rule referred to above states that *only* public *investment*, being productive, could be safely financed by debt. Secondly, as already noted, keeping the Debt/GDP ratio absolutely constant requires strong fiscal discipline.

B: Monetary Policy

Monetary policy is the Central Bank's management of monetary aggregates with a view to achieving a number of macroeconomic objectives, such as low inflation, growth and control of exchange rates. Monetary policy can take very different forms and can involve the use of different instruments, as content and objectives are strongly determined by the theoretical approach guiding general macroeconomic policy. In the European Union monetary policy is the sole responsibility of the European Central Bank.

I begin by recalling some technical notions and definitions that underlay the current policy.

Key Concepts and Definitions

Quantity Theory of Money

This explains inflation as a purely monetary phenomenon. The theory starts from the macroeconomic identity:

$$(8) \qquad M\,V \equiv P\,Y$$

where M is the stock of money, V the velocity of circulation, P the price level and Y is GDP.

If one adopts the behavioural assumptions that the equlibrium velocity of circulation (V) is constant over time, and the full-employment level of output (Y) is constant in the short run, one concludes that the price level depends on the stock of money:

$$(9) \qquad M = k\,P$$

where k = V/Y , supposedly fairly constant over time

Credit Multiplier

This describes the mechanism of money creation by commercial banks. For any given amount of deposits banks can grant credits for a multiple of such an amount, credit expansion being constrained by the level of reserves banks must keep for prudential reasons

Monetary Aggregates (ECB 2004:114).

The means of payment can be defined in several ways depending to their degree of liquidity. By decreasing order of liquidity we have: *M1*: currency in circulation plus overnight deposits; *M2*: M1 plus deposits with an agreed maturity of up to two years and deposits redeemable upon notice up to three months; *M3*: M2 plus debt securities with maturity up to two years, money market fund shares and other relatively liquid assets (e.g. repurchase agreements).

Functions of Central Banks.
Central Banks usually have six roles, i.e. issuing banknotes; conduct of monetary policy through interest-rate fixing and the control of the system's liquid assets; lender of last resort facilities; exchange rate monitoring; Treasury banking; and monitoring of the banking system, by fixing the amount of compulsory reserves and the prudential control of bank solvency

Optimal Currency Area
It is the optimal geographical domain of a single currency (or several currencies). In the optimal currency area exchange rates are irrevocably fixed and can fluctuate only in unison with the rest of the world. An optimal currency area is based on a large number of theoretical requirements, particularly on common monetary and fiscal policies. The Euro zone can be considered an optimal currency area, as it satisfies the main theoretical conditions.

Theories

As in the case of fiscal policy, the two rival theories already quoted give contrasting analyses and policy prescriptions.

Three main points characterise the *Keynesian monetary theory*. The first is that inflation is a phenomenon which originates in the real economy, not a purely monetary result. The second is that total money supply is endogenous. And the third is that monetary policy affects both output and prices.

As regards the first point, the Keynesian theory points out that inflation is generated by three causes related to the real economy: (*a*) cost-push, e.g. price increases for some basic materials that cannot be offset by increases in productivity; (b) conflicts over income distribution: if wage claims undermine the level of profits and capitalists are unwilling to accept such a situation, they transfer the additional wage cost on prices; and (c) insufficient productive capacity with respect to the level of effective demand.

Endogenous money supply refers to money creation by commercial banks, and to the Central Bank's corresponding inability to control the quantity of money circulating within the system. Indeed, the role of the central bank consists in making available the reserves required by the banking system by fixing interest rate, i.e. the price at which it satisfies the liquidity needs of commercial banks. This official interest rate is the basic reference for the market rate of interest charged by commercial banks.

Money is created because firms, on the basis of their production plans, ask for loans at the market rate of interest; while commercial banks meet all credit demand by worthy firms, thereby increasing the total quantity of money. Central banks thus cannot determine money supply: once it has fixed the rate of interest, the money supply function is horizontal for that level of the interest rate.

With regard to monetary policy, Keynesians maintain that interest rate policy influences prices through output. The main transmission mechanism is the relation between interest rates and investment: an increase in the interest rate entails a decline in the demand for investment, as some projects are postponed because it is more expensive to finance them. This reduces total demand. This effect could possibly be reinforced by consumers' decision to save more, as saving is more beneficial. The increase in the interest rate has also an indirect effect on investment because of its negative influence on expectations. In fact, when the central bank raises the interest rate, it sends out a message that it fears inflation and wants to slow down the economy.

The result of this process is: a decline in total demand, a corresponding contraction of total output and a downward movement of the price level (lack of effective demand). As a consequence of a reduction in the price level, the stock of money has shrunk, but—and this is the crucial point—the smaller quantity of money is not the cause but rather the effect of the reduction in the price level.

The roots of the monetary analysis of the *New Classical Economics* is the monetarist theory. The starting-point is the quantity theory of money, which forms the basis for the theoretical treatment of inflation as a monetary phenomenon (ECB 2004:42). Here, rational agent's behaviour depends on real variables, meaning that changes in the price level do not modify such behaviour (no money illusion). Monetarists further maintain that the stock of money is an exogenous element of the system (it is determined by the central bank), and that the role of monetary policy is to control money supply. This is possible for two reasons. First, the central bank has direct control over the quantity of money it creates. Secondly, the central bank has indirect control over credit money because it is aware of the credit multiplier.

The New Classical approach fully endorsed the monetary view of inflation and argued in favour of the long-run neutrality of money (ECB 2004:115). However, it abandoned the idea of having full control of the money stock. The principle of money neutrality is derived from the quantity theory: "a change in quantity of money in the economy ... will be reflected in a change in the general level of prices and will not induce permanent changes in real variables such as real output or unemployment" (ECB 2004:41). Thus, "in the long run, the central bank cannot influence economic growth by changing the money supply" (ECB 2004:42). It follows that the sole purpose of monetary policy is to control inflation.

Monetary policy must be credible. Thus it should not be operated by politicians, who are subject to pressures from private interests and electoral concerns, but by experts in the form of an "independent" Central Bank that is above day-to-day politics.

To conclude this review of alternative theoretical approaches, we can state that both Keynesian and neoclassical theories (with their different variants) consider interest-rate fixing by the Central Bank the main instrument for pursuing monetary policy. However, this agreement is very limited in scope, as Keynesians and Neoclassicals deeply differ on the goals to be achieved and on the relevance of other instruments for macroeconomic stabilisation. In fact, under the neoclassical theory, inflationary control must be the sole concern for monetary policy, while the Keynesian theory's essential concern with regard economic policy (including monetary component) is the attainment of full employment. For this purpose a low interest rate is helpful as this can stimulate investment, although it is not enough as fiscal policy is more effective in sustaining total demand. Hence the need for a "policy mix" that combines the two.

As we shall see now, the Keynesian approach is not taken into consideration by the European rules which, on the contrary, fully endorse the New Classical Economics principles governing the objectives of monetary policy and the nature and role of the institutions.

European Central Bank (*ECB*) and the European System of Central Banks (*ESCB*)

Objectives

The Treaty establishing the European Community states, in article 105, that the "*primary objective*" of monetary policy is "to maintain price stability". It adds that, as a secondary objective, subordinated to the first one, is "to support the general economic policies in the Community". As laid down in article 2 of the Treaty, the policies of the Union aim at attaining a wide set of economic and social objectives such as, e.g., a "sustainable development ... a high level of employment and of social protection".

The ECB has quantified price stability in terms of an increase below or near to 2% per annum of the consumer price index for the euro area. This target is to be maintained in the medium term (ECB 2004:50-51)

Institutions

Monetary policy in the European Union is carried out by the European System of Central Banks, an institutional framework that establishes an organic link between the European Central Bank, and the Central Banks of the 27 Member States, i.e. the 13 Member States the Euro zone and the Central Banks of the States that have not yet adopted the European common currency.

Basic tasks of the ESCB are to:

- Define and implement the monetary policy of the Euro zone (the "Eurosystem");
- Conduct foreign exchange operations;
- Hold and manage the official foreign reserves of the Member States;
- Promote the smooth operation of payment systems;
- Contribute to the smooth conduct of policies pursued by the competent authorities, relating to the prudential supervision of credit institutions and the stability of the financial system. (Article 3 of the Statute of the ESCB; see ECB 2004:181ff.)

Three decision-making bodies of ECB govern the ESCB: the Governing Council, the Executive Board and the General Council.

The *Governing Council* is the supreme decision-making body. It comprises members of the executive board of the ECB and the governors of the national Central Banks of the countries that have adopted the euro. It defines the monetary policy for the euro zone: it sets the ECB interest rate, it regulates the money supply and gives guidelines to the national Central Banks of the Euro zone for the execution of their monetary policy operations.

Decisions are taken by a simple majority, each member of the Council having one vote. The proceedings of the meetings are confidential. However, the ECB can inform the public of any relevant aspects of the Council's deliberations.

The *Executive Board* is the operational body, responsible for day-to-day decisions and for the ECB's current business. Its main responsibility is implementing monetary policy in line with guidelines and decisions laid down by the Governing Council. In so doing, it gives instructions to the national Central Banks of the Euro area. The Board is composed of six members (the President, the Vice-President and four other persons) appointed by the governments of the Euro area. Decisions are taken by a simple majority vote of members, who bear collective responsibility.

The *General Council* ensures an institutional link between the Eurosystem and the national Central Banks of the non-euro area Member States. It is primarily responsible for giving advice on preparations for joining the Euro-system. It is a temporary body that will be dissolved when all Member States have adopted the Euro currency. It is composed of the President and Vice-President of the ECB and governors of all EU national Central Banks.

Rules of Governance

Three basic principles seek to facilitate the primary task of assuring price stability. The first is the total independence of the ECB, in

order to protect it from political pressure. As already stated, this also contributes towards the institution's credibility and policies.
The two other principles have already been mentioned in chapter A above, and relate to:

- A ban on monetary financing of national government deficits. Thus, ECB cannot buy government securities on the primary market;
- No responsibility for national government debt (the "no bail-out principle": the Union will not repay national public debts).

The ECB's independence should be supplemented with some forms of democratic control, affecting the institution's *accountability* and the *transparency* of its decisions.

As regards the first point, a recent ECB publication explained that "the ECB is accountable first and foremost to citizens of the European Union ... and—more formally —to the European Parliament" (ECB 2004:66). This essentially means that the ECB submits an annual report on its activity to the Parliament, the EU Council and the Commission. The Parliament adopts a resolution assessing the ECB's policy and conduct. However, no sanctions can be envisaged and, in any case, Parliament is not allowed to modify the statutes of the ECB and ESCB.

Transparency is of paramount importance, because the effectiveness of a policy heavily depends on the expectations of private agents who, in order to integrate monetary policy directives into their behaviour, must know the objectives as well as the logical background to any decisions. As regards the objectives, transparency is complete as the ECB clearly states the numerical target for inflation (less or near 2%). As regards decisions, however, transparency is poor, as we have seen above that the ECB does not publish Governing Council's minutes. The Executive Board's presidency obviously explains the conclusions of all Council meetings at a press conference and makes an analysis of the economic situation on which decisions were taken. However, his comments exclusively cover the decisions without disclosing any details as to the manner in which they were taken.

Monetary Policy Instruments
The ESCB and the ECB implement their policy using four instruments (ECB 2004: 71-90): key interest rate, open market operations, standing facilities, and minimum reserve requirements, discussed below.

Key Interest Rate
The official interest rate set by the ECB concerns its own operations, i.e. what it charges banks when they ask for money to meet the public demand for currency. The Central Bank exerts a dominant influence on money market interest rates because commercial banks, when lending money to their customers, need to pass on the cost of their borrowing to the Central Bank. As noted above, the interest rate level influences agents' expectations, their investment decisions, total demand and, at the end of a complex chain, the price level.

Open Market Operations.
They consist in buying or selling securities by the ESCB in order to regulate the liquidity of the system and to stabilise short-term interest rates. The ESCB does not operate directly on the markets but intervenes through the national Central Banks (ECB 2004:73-76). The mechanism is as follows: to provide liquidity to the system, the Central Bank buys securities from commercial banks or directly on the market, and vice versa when it wants to reduce liquidity.

Eurosystem operations are divided into four categories. The first is the main refinancing operations, whereby the Central

Bank buys or sells assets on the basis of a repurchase agreement at a specified price on a predetermined date, or conducts credit operations against financial assets pledged as guarantee for the repayment of loans (reverse transactions). The maturity of these operations is one week. The second is longer-term refinancing operations, with a three-month maturity. They take the form of reverse transactions. The third is fine-tuning operations, to deal with unexpected fluctuations in market interest rates. Buying or selling securities influences their price, with a corresponding inverse effect of their effective yield. And the fourth is structural operations, with the aim of adjusting the Eurosystem's global liquidity position vis-à-vis the banking sector by creating or reducing liquidity over the long term. These operations can be conducted using reverse transactions, buying or selling directly on the market ("outright operations") or issuing ECB debt certificates.

Standing Facilities

These are short-term operations to provide or absorb liquidities of commercial banks on a day-to-day basis. They consist in overnight deposits or withdrawals (lending facility) on an account commercial banks have with a National Central Bank of the Eurosystem at the official interest rate.

Reserve Requirements

In order to control commercial banks credit expansion, the ECB requires credit institutions to hold compulsory deposits on accounts held with National Central Banks

Analytical Framework of the ECB's Strategy

ECB bases its strategy for controlling inflation on an analytical framework covering two types of indicators, the so-called "monetary" and "economic" analyses.

The "monetary analysis" is taken from the New Classical Economics: considering that inflation is regarded as a monetary phenomenon, it is important to monitor the evolution of money supply. To illustrate this, let us rewrite the formula of the quantity theory of money (formula 8) in terms of (instantaneous) percentage rates of change (in small letters):

$$(10) \qquad m + v \equiv p + y$$

Supposing that, for a given year, GDP grows by 2% and that the velocity of circulation decreases by 0.5%, formula (10) shows that, in order to achieve the target for a 2% rate of inflation, the stock of money should grow by 4.5% at most.

This numerical example was chosen on purpose because it reflects the results of some medium-term forecasts for the European economy carried out in the late 1990s. Relying on these forecasts, in December 1998 the ECB's Governing Council choose as reference the broadest aggregate M3, setting at 4.5% per annum the medium-term growth rate for M3 that is consistent with price stability (ECB 2004:64-65). M3 was taken because it consists of activities that can easily be substituted for one another and because it is more stable than M1 or M2. It is, therefore, the most appropriate leading indicator for future price developments. This reference value for annual M3 growth is still in force in 2007 (ECB 2007:Annex:XV).

The "economic analysis" focuses on economic and financial developments in order to evaluate the short to medium-term risks for price stability. Two broad sets of indicators are considered, relating to both demand and supply. The demand-related indicators cover, for instance, the development of wages and salaries and that of private wealth. On the supply side, one can note: the unemployment rate, the degree of capacity utilisation, the wage costs as well as the dynamics of raw material prices and of financial activities. Their analysis aims at identifying the nature of shocks hitting the economy, their effects on cost and pricing behaviour and the prospects for their propagation within the economy.

C: Assessment

An assessment of the ECB's policy essentially depends on the validity of its theoretical basis, i.e. the New Classical Economics. The above survey of theories provides an idea on the deep divide between alternative schools of thought. My comments will be limited to the inflation target and democratic implications of ECB action.

The Overwhelming Concern for Inflation

Inflation control as the sole concern for monetary policy is subject to strong criticism because it ignores the fact that economic performance is not an end in itself but that it should be a mean to achieve society's general objectives of full employment, welfare, social justice, environment protection, etc.. The above-mentioned survey of existing theories shows that it is far from proven that the overwhelming concern for inflation can really contribute towards achieving those general objectives. For instance, mainstream theory indicates that (at least in the short run) there is a trade-off between unemployment and inflation (the NAIRU—non-accelerating inflation rate of unemployment). Faced with a choice, the monetarist scholar will opt for the second aspect of this dilemma, believing that, in the long run, low inflation will necessarily lead to more growth and employment—a view that is fully shared by the ECB. On the other side, post-Keynesians would argue that this has more to do with doctrine than empirical evidence.

In the light of this debate, the provisions of the Union Treaty (art. 105) are very disappointing, as the objective of building an economy for its citizens has been relegated to second position.

At this juncture, a comparison with the Central Bank of the United States (the FED) is instructive, as it is officially stated that the FED's present mission consists in "conducting the nation's monetary policy .... in pursuit of maximum employment, stable prices, and moderate long-term interest rates" (FRS 2006). Thus, the first objective of monetary policy is employment; then, and only then, follows price stability

Democratic Insufficiency

What is said above on governance shows how huge is the democratic gap surrounding the ECB. Accountability is the most striking aspect.

The sentence drawn from an official ECB publication—according to which "the ECB is accountable first and foremost to citizens of the European Union"—is amazing, to say the least. In reality, European citizens have no power to check ECB policy, and in practice this is also true of their representatives in the European Parliament, as parliamentary control is a mere formality.

In this case too, any comparison with the FED shows up a negative result for the EU as, in the USA, the FED is truly accountable to Congress. It must report annually on its activities to the Speaker of the House of Representatives and twice annually on its monetary policy plans to Congress's banking committee. Contrary to what happens in the case of the European Parliament, the Congress exerts true power over the FED: among other things, it can amend the Federal Reserve Act that defines the Central Bank's mandate and can also veto the appointment of a member to FED's Board of Governors.

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Foreign Aid

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Introduction

Foreign aid (also known as development aid, official development assistance, development cooperation, or development partnership) is the transfer of resources from donor countries to recipient countries, that are intended to serve first and foremost the recipients' interests, but which may also be used to pursue other objectives. Aid can take several forms, including grants (for which no payment is required), concessional loans (which, by definition, must include a grant element), or gifts in kind. It may be given for a number of reasons, including humanitarian objectives (for example, to deal with an emergency arising from a natural disaster), promotion of economic development and welfare in recipient countries, or political and commercial reasons.

Aid may be bilateral, that is, given by a single country to another country, or multilateral, which is given by an international organization to a recipient country. Since multilateral aid is the result of the coordinated efforts of several states, it reflects commitment to assistance as a shared international responsibility. The bulk of global aid is provided by the Organization for Economic Cooperation and Development (OECD) countries in the form of bilateral aid, and by the international organizations that are supported by them (such as the United Nations Development Program, the World Bank, and the Regional Development Banks) in the form of multilateral aid. As well as being publicly funded, aid is also supplied by non-government organizations (NGOs) which comprise certain endowed foundations, religious bodies, private and volunteer aid organizations, and emergency relief agencies.

The literature on aid makes a distinction between tied and untied aid. Tying of aid signifies that the recipient country is in some way restricted in the expenditure of the financial resources it receives. For instance, the recipient may be required to use the aid to purchase specific commodities produced in the donor country. By contrast, untied aid specifies no restriction or formal obligation on the part of the recipient. Obviously, multilateral aid and untied bilateral aid are more valuable to a recipient since the recipient is free to obtain the imports financed by aid from the cheapest source.

There is much debate about the proper definition of foreign aid. For example, while export credits and tied aid achieve similar objectives, the former are often excluded from the aid concept; or, while preferential tariff treatments given to developing countries are sometimes more effective than many transactions listed as aid, they are not classified as aid.

Marshall Plan Led the Way

The origins of aid can be traced to the immediate post-World War II period that saw the creation of the United Nations (UN) and the nascent independence movement among former colonies of several countries. The Marshall Plan, under which the US helped to rebuild a battered Europe, funneled $13.3 billion ($96.9 billion in 2003 dollars) of assistance to this region over four years. The plan was propelled by the Harrod-Domar view of economic growth, which centered upon the role of investment in promoting economic expansion. The success of the plan prompted the US, along with the UK and France (and later other Western European countries), to provide aid to other nations, especially to many of the former European colonies who had gained independence.

Given their ideological differences, from the beginning both the US and the Soviet

Union began offering their own tailored programs of economic assistance. This is especially evident in US President Truman's foreign aid doctrine, specifically the Mutual Security Act of 1951, which made clear that aid could only be given if it "strengthened the security of the US."

Industrialized countries now coordinate their aid programs through the Development Assistance Committee (DAC) of the OECD whose efforts and policies are summarized in its Annual Report under the title *Development Cooperation*. (See the annual NGO publication *The Reality of Aid* for a critical assessment of the DAC Report.) DAC countries together are the most significant providers of aid in the world. Principal donors outside DAC have been the Organization of the Petroleum Exporting Countries, whose rise and decline as a donor is well documented, and the former Soviet Union which has been transformed from a significant monolithic donor to a number of fragile fragmented states, many now seeking assistance themselves.

Over the six-decade history of aid, there has been much discussion on its usefulness. Supporters of aid have emphasized aid's beneficial effects not only for the recipient, but also for the donor through the increased income of the recipient. A recent demonstration of the persuasive force of their argument is the channeling of a significant portion of European Community (EC) aid to Central and Eastern Europe and the New Independent States of the former Soviet Union. Donors are said to benefit by enabling these countries to become their future trading partners. At the same time, a number of critics on the extreme right maintain that aid does more harm than good—arguing that aid is often disbursed to governments that maintain policy environments inimical to economic growth, or that aid, at best, makes recipient governments less accountable to their taxpayers and, at worst, does little more than support corrupt governments. An equally cynical view on the far left is that aid is merely an instrument of exploitation used by donors for their own selfish advantages. Finally, since global poverty remains pervasive after so many billions of dollars of aid, the issue of the effectiveness of aid has received much attention in recent years (see later discussion).

Aid Disbursement and Political Economy of Aid

Over the period 1990-2003 (see OCED Online Data), the percentage of Gross National Product (GNP) given as aid by DAC countries fell from 0.33% to 0.25%. According to preliminary data, in 2003 total DAC aid stood at $68.5 billion. It is clear that aid, on average, is well below the long-standing UN target of 0.7% of the GNP, as recommended by the Pearson Commission in 1969 and adopted by the UN in 1970. Historically, only Scandinavian countries and the Netherlands have consistently met this target, although donor countries are committed to raise aid's share of their GNP by 2015. The decline in aid in recent years is often attributed to aid fatigue by donors—brought about by fiscal constraints at home, growing skepticism about the effectiveness of aid, corruption in some recipient countries, and by a sense that the aid process has created dependency in some countries, thereby reducing these countries' incentives to solve their own problems.

Although a reasonable assumption, it would be incorrect to think that the allocation of aid is determined by the relative needs of the recipients. From 1990 through to 1999 international aid to Eastern Europe and the former Soviet Union totaled $44 billion, equivalent to only about half the Marshall aid, and spread over a much larger population. From a different perspective, on a per capita basis in 2000, poorer European countries received nearly eight times as much aid as countries in Asia. In the same year, Jordan and Israel each received well over a hundred times more per capita aid than India and almost sixty times more compared with Iran, while Nicaragua received nearly thirty times more aid per capita than that procured by Cuba. Although most of the world's poorest people live in South Asia and sub-Saharan Africa, only 42% of world aid went to these regions in 2000. Least developed countries (LLDCs) have borne a disproportionate share of the decline in aid. Over the past two decades aid per capita to these countries has fallen more steeply than aid to other recipients.

Evidently, the pattern of allocation of foreign aid is dictated as much by political and strategic considerations as by the economic needs of the recipients. McGillivray (1989) studies the extent to which donors base their aid allocations on the relative needs of the recipient countries. His performance measure is an index based on the income per capita of a recipient country. The closer a donor's aid reflects the income per capita of a recipient, the greater the donor's performance and the higher its ranking. McGillivray's ranking places Scandinavian countries and Belgium at the top and the US at the bottom for the quality of aid. A more recent study by McGillivray et al (2002) compares the donor performance of four donors—US, Japan, UK, and France—by comparing actual allocations with the optimal allocations by each donor. The study finds that, by this measure, France has the best performance and the US the worst. Yet another study (Alesina and Dollar 2000) highlights the distortions in the aid policies of the "big three" donors in recent decades: the US disburses roughly one-third of its aid to Egypt and Israel; France rewards its former colonies; and Japan discriminates in favor of countries that vote in tandem with it at the UN. Therefore, at least up to the new millenium, the big donors did not appear to be primarily concerned with poverty, democracy, sound policy, and good government in recipient countries. Some steps toward a change have occurred in recent years (see later).

A related strand of the aid literature examines population and middle-income biases in the disbursement of aid by individual countries or groups of donors such as the EC (see, for example, Isenman 1976, Arvin et al 2001, Neumayer 2003a). The empirical studies find a marked tendency for smaller (less populous) countries to receive more aid per capita than larger countries. A number of explanations are advanced in order to explain this bias, including international governance by donor nations: Because even a small country can affect a donor through its voting pattern in the UN, a donor may spread its aid to many nations in the hope of spreading its influence. In other words, the cost, in terms of aid, of exerting political leverage over countries with smaller populations is less than the cost associated with exerting such leverage over more populous countries. Analogously, some empirical studies find existence of a middle-income bias. This is the tendency of per capita aid to increase with the per capita income of a recipient, and to decline after high per capita income levels are reached. A number of arguments have been put forth to explain this pattern of aid disbursement. It has been suggested that higher income recipient countries are perhaps more important to donors in terms of political, economic, and security interests than poorer nations. In addition, donor criteria for aid allocation may bias which countries receive aid. For example, rewarding good economic performance and governance with further infusions of aid is likely to favor higher-income countries whose more competent bureaucracies are not only more likely to apply for aid programs, but then subsequently administer the aid receipts more effectively. At very high levels of per capita income, however, a developing country's need is not as great, explaining why aid to these countries may be low compared to that received by their middle-income counterparts.

In the same vein, a number of studies suggest that the colonial past is a major determinant of foreign aid. For example, Alesina and Dollar (2000) find that doubling the length of time as a former colony of France would yield a country a 151% increase in aid, *ceteris paribus*. Other studies find that British and Canadian aid discriminates in favor of the Commonwealth countries, while EC multilateral aid favors the African, Caribbean, and Pacific nations covered by the Lomé Convention (Arvin et al 2001). Some studies even suggest that donors' aid has religious undertones. For instance, Neumayer (2003b) presents evidence that Arab aid favors Arab, Islamic, and sub-Saharan nations as well as countries that do not maintain diplomatic relations with Israel. Yet another form of aid bias appears to be geographic. For example, recent empirical evidence (Arvin et al 2002a) suggests that Italy discriminates in favor of countries that are geographically close to it. Obversely, three UN agencies provide more aid to countries that are geographically more distant from the centers of the Western world (see Neumayer 2003a).

To sum up, the past failure of aid has not been attributed simply to poor allocation by donors. Critics have placed the blame equally on recipient governments, citing aid dependence, corruption, aid fungibility (redirecting of assistance received for other, perhaps less useful, purposes), weak governance, or poor economic policies as culprits for aid's failure.

Given the controversy surrounding availability of limited funds and aid effectiveness, some authors suggest an alternative to the status quo. For example, Van der Hoeven (2001) advocates a global redistributive system, financed through global taxation, using international taxes on items such as internet use, air transportation, and capital movements to bring assistance to needy countries.

Tying of Aid

A recent debate in the aid literature is the controversy surrounding tied aid. It has been argued that donor countries should untie their aid in order to give the recipient countries a wider choice of options. Some commentators argue that untying would damage the political support for aid. Jepma (1994) refutes this idea in an empirical study. Jepma (1991) estimates that the direct cost of tied aid is between 15 and 30 percent. This means that developing countries pay on average 15-30 percent more for goods and services procured under tied aid requirements than they would if they could buy from other suppliers. For their part, developing countries have long argued that aid tying not only limits choice, but also undermines aid effectiveness because aid is aimed at supporting commercial interests rather than focusing on poverty reduction and sustainable development. In a way, willingness to untie aid is often seen as a measure of donor countries' commitment to aid effectiveness and responsible global governance.

In 1998, DAC members agreed to work toward a recommendation to untie bilateral aid to the LLDCs. OECD ministers and G-7 leaders endorsed this initiative and an agreement was reached in April 2001 to untie such aid to LLDCs except for food aid and its transport. The European Commission went further and in a new Communication *Enhancing the Effectiveness of Aid*, adopted by the Commission in November 2002, suggests untying all Community-managed aid to developing countries.

Effectiveness of Aid

The studies on aid effectiveness consist of two types: Studies at the micro level look at the microeconomic effects of aid and mainly consist of project analyses of economic assistance. These studies generally conclude that aid is quite effective. For instance, Cassen (1994) finds that projects produce satisfactory results in a very large proportion of cases. Studies at the macro level deal with the effects of aid on macro variables such as investment, savings, and the growth rate of the economy. White (1998) provides a useful survey of these studies, which do not concur (especially at a theoretical level) on whether the impact is generally positive or negative. The weight of the empirical evidence, however, suggests that aid does not have a positive effect on most macro variables. Mosley (1987) calls the difference in results between the micro and macro studies the micro-macro paradox.

Although numerous macro studies assessing the effectiveness of aid were published over the years, the *WORLD BANK* research report (1998) *Assessing Aid, What Works, What Doesn't and Why* provoked particular interest. A key finding of this report was that aid is only really effective in promoting economic growth when recipient countries have good government policies. The report also found that the pattern of actual aid allocations was highly inefficient in that it was targeted at countries with poorly managed economies. The report made two fundamental contributions: It was one of the first studies to acknowledge that aid effectiveness might depend on the specific circumstances in recipient countries. Furthermore, it offered policy makers in the West a clear set of policy prescriptions on how to disburse their diminishing aid dollars more effectively. Some of the other findings of this report will be discussed in a later section.

Relationship Between Aid and Growth

There has been much theoretical debate, especially since the 1960s, about whether aid has a positive impact on the economic growth of the developing countries. Most earlier empirical studies are inconclusive. Mosley (1980) discusses some econometric flaws in these studies. More recent studies include Mosley (1997), who demonstrates that the net impact of aid is neutral overall, positive in most Asian countries, and negative in most African nations. This is consistent with Easterly (2003) who maintains that since developing countries include a variety of institutions, cultures and histories, no generalizations ought to be made about the impact of aid on economic growth. In contrast, Hansen and Tarp (2000) find that aid impacts growth, as long as the aid to gross domestic product ratio is not excessively high. According to two recent studies (Lensink and White 2001 and Collier and Dollar 2002), above a certain level, aid has a pernicious impact on the growth rate of a recipient country. The two studies, however, find different critical levels. Guillaumont and Chauvet (2001) believe that the effectiveness of aid depends much more upon external factors (e.g., export instability and terms-of-trade fluctuations) and climatic factors (e.g., droughts, flood, and earthquakes) than on the economic environment. Specifically, they argue that aid is more effective in raising a recipient country's income when external and climatic factors are worse.

The implicit message in much of this literature is that, fundamentally, growth is what matters. However, growth does not always bring about poverty reduction. Equally important are education, health, the environment, and other factors affecting the quality of life that may be improved with infusions of aid.

Importance of Good Governance

In 1989 the World Bank first urged the importance of "good governance" (transparency, accountability, and predictability) in developing countries for aid effectiveness. Even though the Bank did not mention the need for democratic reforms, other aid donors like the US, the UK and France, began to support such changes. The emphasis on good governance and political reform culminated in the publication of three major World Bank reports (1998, 2002a 2002b) which summarize the findings of the Bank's research program on aid effectiveness. These reports emphasize that, in order for aid to be effective, the institutional and policy environments in recipient countries must be right. Several other policy conclusions emerge from the reports, including the following. First, aid ought to be allocated not just on the basis of poverty, but also on good economic management. In a sense, the reports suggest that traditional conditionality should be abandoned since many countries have been unable or unwilling to fulfill the conditions imposed on them despite becoming eligible to receive aid (see also Killick 1998). The reports advocate instead that, when giving aid, donors apply selectivity—which means imposing specific requirements on countries on their current and past practice *before* deciding eligibility. When applied, these requirements translate to recipient countries having good economic policies and sound institutional environments. Second, the failure of past aid programs can often be attributed to donors favoring their former colonies or political allies in spite of the recipient's poor record of economic management. Third, aid can be a "midwife" to support effective public institutions and good governance by helping with experimentation and implementation of new ideas to improve public service delivery. Further empirical research by World Bank economists (Collier & Dollar 2001) confirms that aid enhances the growth effect of policy and good policy increases the growth effect of aid.

The views expressed in the reports have shaped opinion and influenced practice in the donor community. However, the underlying analysis and policy implications of the reports have not gone unchallenged (see Hermes Lensink 2001, Beynon 2002). Doornbos (2001) explores the notion of "good governance" advocated in the reports. He points out that perceptions of good governance differ across cultures. In particular, a recipient's view of good governance does not necessarily accord with a donor's notion. He suggests that donors should provide more flexibility for recipients by asking them to set up programs demonstrating how they will arrive at achieving good governance (however defined), then evaluating these and providing aid upon acceptance.

A UN conference in Monterrey, Mexico in March 2002 put in place a framework under which developing countries' commitments to good governance and their respect for human rights would be matched by donor commitments toward policy coherence and support for good performers. Major commitments to increase foreign aid were also made by the US, the European Union, and Canada.

Aid, Democracy, and Corruption

Recent emphasis by major donors to promote democracy in developing countries is a strategy to help establish good governance. But does aid improve the quality of democracy in the recipient countries? Only a decade after aid came into existence as an instrument of development, prominent economists such as Friedman argued that aid, through strengthening and supporting the government sector vis-à-vis the private sector, can be harmful to democracy since bigger governments may have a deleterious impact on democratic rights such as freedom of speech, freedom of the press, freedom to run for office and vote, and enterprise development. According to these economists, civil liberties and democracy are less likely to flourish when the public sector organizes most of the economic activity.

On the other hand, some economists have argued that aid can contribute toward democratization in a number of ways. First, aid has the potential to improve the education level of the citizens of poorer countries through improving access to schooling for children, increasing the literacy rate, and ameliorating the educational attainment of parents, especially mothers. Since a number of empirical studies on the determinants of democracy find that education plays a significant role, aid can promote democracy through raising the education level in the Third World. Second, if aid increases income per capita in less developed countries, then democracy may be positively affected because higher income countries have been linked empirically to democracy. Third, when appropriately targeted at promoting civil society organizations such as a free press and supporting fair elections, aid can be conducive to democratization. Last, aid can support democracy through the promotion of legislative and judicial checks on governance in general and executive power in particular.

Two empirical studies that examine the impact of aid on democratization using a large sample of recipient countries over a long span of time (Knack 2000; Arvin *et al* 2002b) provide comparable results. Using several alternative democracy indices and measures of aid intensity over the 1975-96 period, Knack finds no evidence that aid promotes democracy. Using causality tests, Arvin *et al*. find that there is no causal relationship between democracy and aid for the majority of countries in their 1975-98 study. Put differently, over this period donors do not appear to take democracy into account when allocating aid. Even more startling is the finding that more US foreign aid goes to more countries that are corrupt (Alesina & Weder 2002).

Assessment of Aid

Being tied with geo-politics, trade, and a host of other factors, foreign aid cannot be regarded as purely gift giving. The past few years have witnessed much change in donors' attitudes towards aid, development, and governance. Increasing fiscal constraints in many donor countries and incessant poverty in many parts of the world have led donors to emphasize the need for the accountability of their aid dollars. The new aid paradigm appears to involve rewarding states with good governance and proven records of responsible economic management—rather than disbursing aid largely on the basis of political and strategic considerations. While, otherwise valid, a problem with this approach is that when a country with bad government is penalized, those who would suffer are its impoverished citizens, already hurting from poor governance in many ways.

In order to address the problem of aid dependence, major donors like the World Bank have recently devised poverty-reduction strategy plans in explicit cooperation with developing countries. The approach follows evidence that programs are more likely to succeed when they are not merely imposed by aid-givers, and when they have the support at the local level and are "owned" by those implementing them. At the same time, donors worldwide are paying more attention to issues like institutional strengthening and capacity development in developing countries than ever before.

Despite all the recent innovations in enhancing the disbursement and effectiveness of aid, development assistance still faces a daunting challenge in meeting the Millennium Development Goals—a series of eight specific objectives to eradicate extreme poverty—set out in the Millenium Declaration signed by 189 countries in September 2000. The UN's 2003 *Human Development Report* already warns that the commitments made by wealthy nations to meet these goals, including cutting worldwide poverty by half by 2015, are not being met.

A fundamental problem in meeting development targets in many parts of the world, especially Africa, appears to be the lack of coordination among donor agencies. The uncoordinated operation of a large number of donor agencies in a single country (on average 40-50 in Africa) cannot be regarded as efficient, nor can it be expected to produce significant positive results. The difficulties donors may encounter in coordinating their actions effectively, particularly to mitigate duplication and free riding, is an area for future research. As a next step, one could possibly turn to the wealth of literature in the areas of game theory and public finance.

On the positive side, richer nations are beginning to realize that global cooperation is key to effective global governance. In a step towards this, a meeting of global leaders in Rome in February 2003 attempted to streamline policies and procedures that guide aid delivery worldwide. It is evident that further cooperation by developed nations is necessary. Part of this necessitates the operation of a strong and relevant UN—which has always meant to be a key piece of machinery in global matters—and further development of effective local government institutions in aid-receiving countries.

In sum, good governance is necessary not just for aid recipients, but for aid givers too. Good governance has to balance the national interests of individual donor countries with the global or planetary interests. After all, individual countries acting at the national level cannot realistically handle global development challenges like international debt arrears, spread of infectious diseases, deforestation, climate change, illegal drugs, and refugee problems. In other words, solving these problems requires multilateral action. In that sense, coordination of both bilateral and multilateral aid efforts of donor countries along with increased accountability and renewed partnership with developing countries is necessary for effective global governance. In the final analysis, development progress is a shared obligation which relies on good global governance to deliver global public goods, reduce global public bads, as well as fundamentally help alleviate poverty and suffering around the globe.

Internet sites

Europe Aid. www.europa.eu.int/comm/europeaid

OECD. www.oecd.org/dac

Reality of Aid. www.devinit.org/realityofaid

United Nations Ddvelopment Program. www.undp.org

US Aid. www.usaid.gov

World Bank. www.worldbank.org

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Foreign Direct Investment

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Introduction

The topic of foreign direct investment (FDI) has been thoroughly researched by academics and organizations alike. The literature originally sought to understand how organizations in developed countries made investment decisions in other developed markets. Gradually, however, as these opportunities dried up, the literature focus shifted towards opportunities provided in developing markets (e.g., South America, South-East Asia, Central and East Europe) as more and more companies seek greater returns on their investments due to expanded growth potential in these markets.

The commonly accepted goal of a multinational enterprise (MNE) or a multinational corporation (MNC) or a transnational corporation (TNC) is to maximise shareholder's wealth. Thus, firms enact strategies in order to improve cash flow and enhance shareholder's wealth. The company has a target which is an increased market share and, therefore, it proceeds to various local or foreign investments: (a) if the foreign market "offers" better opportunities (market size, liberalised economy, market prospects, etc.), (b) if the home market (local market, company's market of origin) is over saturated, or (c) due to globalisation and competition pressures, in order to increase its sales and profits. Thus, the company and its management must decide when and which market(s) to enter and which entry modes to implement. All the possible obstacles that the enterprise will face in the foreign market must be considered and the various incentives offered by the host country (recipient country) must also be taken into account.The choice of a market entry strategy is a crucial part of international business strategy. Companies employ special modes to cope with international markets that differ in the control that the entrant attains over the local operations and the resources that are required for the entry. Firms entering a foreign market can choose among an array of possible organizational modes. Foreign involvement looks at different lucrative ways of expanding operations, or capital generating activities in a foreign country.

There are five general ways of getting involved in the economic activities of a foreign country, aas shown in Figure 1. The first one is trading, either importing from or exporting to (direct or indirect) a foreign country. Another two ways are foreign *direct* investment (FDI) and *indirect* (portfolio) investments. Portfolio investment is the mere transfer of money capital that allows the investor to participate in the earnings of a company. Direct investment is differentiated due to the intent of the investor. In portfolio investment the goal is more short-term focused, keeping in mind the quick increase in the money capital of the investor with no intention of interfering with ownership rights, management and voting equity. In direct investment, the primary goal is the beneficial influence (enlargement of market share, elimination of competition, strategic alliance, etc.) of the investment to the investor-company, which should eventually lead to increased profits. Another difference between the two is the percentage of the financial capital involvement. What is considered FDI is different throughout the world due to different regulations concerning the percentage of ownership in the operations in question. However, there is a commonly accepted definition of FDI as shown below.

The fourth way of foreign involvement is employed by MNEs when they perceive a strong need to complement and reinforce their knowledge through collaboration with other MNEs in order to cope with pressures of intense global competition and increasingly complex and rapid technological development. Collaboration

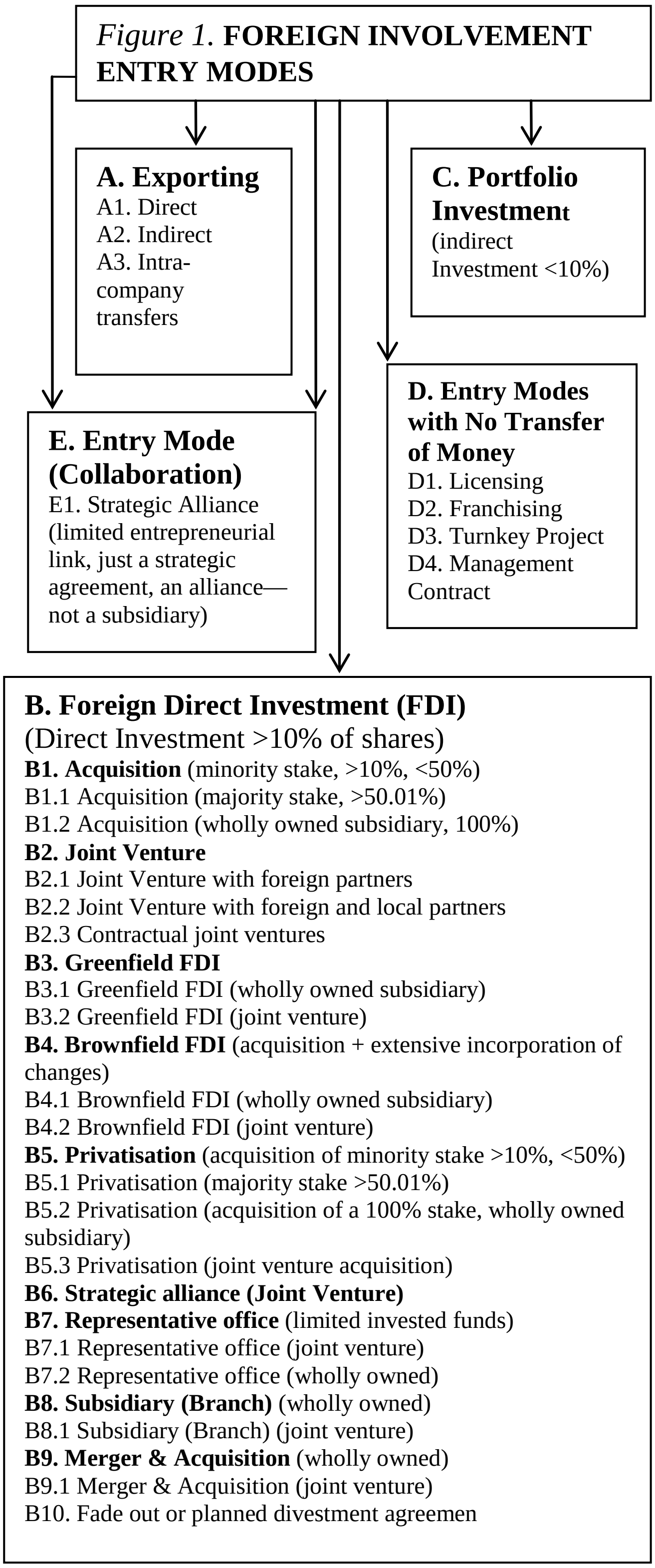

Figure 1. **FOREIGN INVOLVEMENT ENTRY MODES**

can be achieved through participation in a strategic alliance. An alliance is a weaker form of contractual agreement or even minority shareholding between two parent companies: it usually falls short of the formation of a separate subsidiary.

The fifth way of foreign involvement concerns agreements that do not involve money transfers on the part of the foreign partner. Instead, the foreign partner contributes its knowledge and experience around the investment project in return for a reward, either financial or other (strategic). Such involvements include: Licensing agreements, Franchising, Management contracts and Turnkey projects. In the latter, the foreign company starts the facilities from scratch in the host country, and the company operates for a short period of time after which it hands over the operation to the local company. A management contract may follow if it is considered necessary. It involves transfer of know-how, training the local workers and the managerial staff of the local company (Buckley & Casson 1985).

The world is becoming less domestic oriented since companies look to increase profits by growing beyond their own borders. However, empirically they do this mainly through exports and/or FDI (Rugman 2003).

Thus, the choice of appropriate entry mode is a key strategic decision for international business. A Greenfield investment gives the investor the opportunity to create an entirely new organisation specified to its own requirements. However, this is a gradual entry mode. On the other hand, an acquisition facilitates a quick entry, but the acquired company may require restructuring. Sometimes this restructuring is so extensive notable in emerging markets, that the new operation resembles a Greenfield investment. This investment can be called a Brownfield investment since it is a hybrid entry mode (Meyer 2001:575).

Defining Foreign Direct Investment

According to the Balance of Payment manual (IMF 1993), "Direct investment is a category of international investment made by a resident entity in one economy [home country] (direct investor) with the objective of establishing a lasting interest in an enterprise resident in an economy [host country] other than that of the investor (direct investment enterprise). "Lasting interest" implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated".

The IMF's definition emphasizes "a lasting interest", "a significant degree of influence" of the investor over the company outside the home country (Brewer 1994:117). "FDI is defined as investment in equity to influence management operations in the partner company" (Meyer 1998:125]. "There are many different operational definitions of FDI, but all aim to encompass the desire of a home country firm to obtain and manage an asset in a host country" (Barrell et al. 1997:64). "A Foreign Direct Investment is the amount invested by residents of a country in a foreign enterprise over which they have effective control" (Ragazzi 1973:471). Some definitions use "lasting interest" and "significant amount of influence" to define FDI. This is more accurate in explaining the current status of several FDIs, but still it is vague since it does not specify the target of the "influence". "Influence management operations" is even more accurate, but again not enough. In fact, in order to clarify this issue, one must first specify the amount of control the investing company needs over the company that receives the investment. This differs according to what the investing company expects from the investment.

Through the years, many theorists studied the concept of investing abroad, and foreign direct investment in particular. What FDI is cannot be defined in a four-line definition, since it involves much more than a simple money transaction which aims at profit. The complications begin with the very first step economists might take—measuring and comparing FDI flows among several countries. This is because each country may have different standards for a foreign investment to be considered direct. The IMF/OECD (1999) has recommended that the minimum equity stake for an investment to qualify as direct should be 10%. The international manuals recommend this 10 per cent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise) establishes a direct investment relationship—the so-called "10% rule". The differences, though, among countries are distinct. For example in the USA, Canada and Australia the minimum is 10%, in France and Germany 20%, and in the New Zealand 25%.

Another difficulty is to specify the components included in FDI measurement. The following components should be used in FDI when reporting to the IMF:

- Equity Capital: the value of the initial investment.
- Reinvested earnings: all earnings of the affiliate company that are reinvested on the initial investment.
- Other capital: the transfer pricing between the mother company and the affiliate (short and long-term capital).

A problem arises because many countries tend not to record at least one if not two of those components. Brewer (1994) argued that "The reinvested earnings component of FDI is particularly problematic. It is the most difficult component to measure because the data are not collected from foreign exchange records, but are based on surveys of the firm" (p.117). Consequently, this component is left out in many national FDI records.

Major Developers of FDI Theory

The expansion of a company's operations across the same value chain of production in the same or in a differentiated sector is referred to as horizontal integration. It is a strategy used by a company that seeks to sell a "similar" product in various markets (local or foreign) by creating subsidiary companies. The purpose of horizontal integration is mainly to expand the company's market share, eliminate competition, or if applied to a different sector, to employ the company's expertise in the specific level of production (raw materials supply, production, distribution channels, etc.) in order to exploit an opportunity.

Vertical integration is the acquisition of control of various stages in the passage of a product, from raw materials through to production and then retail sale. Vertically integrated companies share a common owner and produce different but integrated products or services. For example, a producer of a certain product expands in retail (forward vertical integration) or a car producer, expands in a production of its inputs (e.g. tyres) (backward vertical integration). At the end, balanced vertical integration occurs when a company decides to produce, supply itself with inputs, and distribute its products. All the above can be done either within a country or internationally. As in the case of horizontal expansion, the company will search for the most cost effective site that simultaneously fulfils the quality requirements. The new location may offer easier access to production factors, such as physical resources or skilled labour, if the integration is backward or limited competition suitable for a new company in relation to both backward and forward integration.

FDI Theories: Market Imperfections

Through his early analysis, Coase (1937), was the first to recognize that the market is imperfect although he did not put it in exactly these words. Coase (1937; 1960) showed that traditional basic microeconomic theory was incomplete because it only included production and transport costs, whereas it neglected the costs of entering into and executing contracts and managing organizations. He mentioned the marketing costs such as the price mechanism costs (information, knowledge, searching or uncertainty costs), the costs of negotiating, or costs of contracting, the bargaining, decision, policing, or enforcement costs, and the costs of organising, which since then become known as transaction costs. Today, transaction cost economics is used to explain among others vertical integration, outsourcing, corporate governance, etc. Coase's theory discusses the cost of market transactions and how the internal organization of a firm may help to avoid them. The minimization of these costs is an incentive for the firm to try an approach of vertical integration, so as to control the intermediate products. Vertical integration is efficient only if the costs mentioned above are very high, or if there is no market for the intermediate product that the firm needs for the final product.

Coase (1960) also argued that the power of analysis may be enhanced if it is carried out in terms of rights to use goods and factors of production instead of the goods and factors themselves. These rights can be called property rights in economic analysis. Coase concluded that there are transaction costs for preparing, entering into and monitoring the execution of all kinds of contracts, as well as costs for implementing allocative measures within firms in a corresponding way. A large amount of legislation would serve no material purpose if these transaction costs are zero. Coase concluded that transaction costs are never zero, which indeed explains the institutional structure of the economy, including variations in contract forms and many kinds of legislation. In cases where transaction costs absolutely prevent a contract, there is a tendency for other institutional arrangements to arise, e.g. a firm or an amended legislation.

Hymer's work (1960; 1968; 1970) is best known for its application of an industrial organizational approach to the theory of foreign production. In order for a firm to undertake an FDI project it relies on certain advantages, which may be called monopolistic, exclusive, or ownership advantages, such as monopoly control of raw materials, financial or marketing advantages, managerial and research skills, etc. He argued that FDI involvement was merely a geographic expansion that exploited the power coming from the use of the above advantages, and pointed out that the MNE is a creature of market imperfections. He overemphasized the market power advantages of a MNE and mentioned as well that a MNE transferred its assets abroad in order to minimize risks and to achieve monopolistic power.

Hymer (1960) distinguishes between FDI and portfolio investment in terms of the presence of control in the former case, and its absence in the latter. Hymer showed that FDI can not be explained by the interest differential theory (as portfolio investment) since if FDI is motivated by higher interest rates abroad the practice of borrowing substantially abroad seems inconsistent. Hymer also explicitly distinguishes between different foreign entry modes such as joint ventures, licensing, tacit collusion, and FDI. He also concluded that if markets were perfect and if a firm could buy everything at a fixed price determined by competition, then the incentive for direct investment would be very weak. Finally, he thought (as Coase) that market imperfections can also be exploited through vertical integration (Hymer 1968).

Williamson (1973, 1992) suggested that there are reasons of market failure that favor the internalization of a firm's operations in the place of market operation. It can be argued that these are also reasons for FDI. He created a framework that leads to the advantages of the hierarchical organization instead of markets, and mentioned the contractual costs, which may be considered as transaction costs. These are: information costs (the cost of informing traders), bargaining costs (the costs of reducing—bargaining) and enforcement (the costs of enforcing the terms of trade) costs. He added that transaction costs would be zero if humans were honest and possessed unbounded intelligence. Thus, Williamson' types of limitations exists in reality as transaction costs. All individuals are unable to absorb all available information in order to facilitate the decision-making. Thus, there is a cost in the acquisition and absorption of information. According to Williamson, the above factors are the reasons why a company may internalize through vertical integration which may happen through FDI.

FDI and Strategic Bahaviour

Aharoni (1966) initiated the behavioural explanation of FDI, especially the initial decision of where to locate FDI. He mentioned the reasons of why FDI is more complex and risky from investing in a home country. Among others he also paid attention to the lack of knowledge concerning the host country, and its political, business, and financial risk. The behavioural approach has been extended and improved by internalisation theory which explains not only the initial FDI decision, but also the reinvestment decisions.

Kogut, B (1985) also treats FDI as a sequential process that leads to the creation of MNEs. The learning and experience of managing diversified activities in different locations and the spreading of environmental risk gives the company a significant edge when competing in either local or international markets.

On the other hand, the Capital Arbitrage Theory assumes that there is a moving of equity capital from countries where returns are low to countries where they are higher, so that profit is generated from the difference (arbitrage) among returns. Aliber, R. (1970) went on to update this theory and mentioned that there are substantial differences among countries in nominal and real interest rates. Because nominal interest rate differentials are poor forecasts of future changes in exchange rates, a wedge is introduced between returns on similar securities denominated in different currencies. In essence, Aliber treats exchange rates as an incentive for MNEs if favorable and as a barrier if unfavorable in regard to the MNE's home and host country.

Graham, E. (1978) hypothesized that an MNE which found its home territory invaded by a foreign MNE would retaliate by penetrating the invader's home turf. A firm may even predict the invasion by a significant competitor and take the first step itself.

Knickerbocker (1973) argues that in oligopolistic industries which are characterized by high seller concentration, one reason for FDI is the tendency of firms to "match their rivals move to move". The firm that takes the first step in a new market exploiting any business opportunity draws the attention of similar firms that can exploit the same opportunities (first mover, be the leader, follow the leader, prevent the leader).

Finally, Kindleberger (1966) argued that a significant part of the decision to undertake FDI is based on the advantage of knowledge and high economies of scale that enable the MNE to operate the subsidiary more efficiently and with less cost that any local firm. Before undertaking FDI, a company analyzes all the alternatives (exports, licensing, FDI) and decides on the optimal solution.

FDI and Internalisation

John Dunning (1973, 1981a, 1981b, 1988, 1993, 1995, 1996; Dunning & Narula 2000) was the first to provide a comprehensive analysis based on ownership, location, and the advantages of internalization (OLI). Dunning's Eclectic Theory provides some answers to the geographic distribution of FDI by analyzing location factors. His taxonomy of location factors emphasizes possession of raw materials, labor costs, government incentives, and servicing of local markets. According to Dunning, the level of FDI of a firm is governed by three sets of factors—namely ownership (firm-specific) advantages (O), location (country-specific) advantages (L) and internalisation advantages (I). The advantages discussed are different in separate countries, industries, and firms and in different time periods. The optimal use of these advantages may lead a firm to FDI.

Rugman (1980; 1982) has developed a general theory that studies the FDI activities of the MNEs regarding the concept of internalization as the link between the various theories explaining the motives for FDI. Based on the market imperfections theory and several early theories about internalization, Rugman incorporated many of those FDI theories in one general theory of internalization. The first step towards accepting the absence of free trade was to realize the imperfections in all markets (goods and factor markets, capital markets, etc.), which made arm's length transactions a utopia. Some market imperfections are the various trade barriers, the asymmetry of information and technology, the transactions costs (real and nominal), and other factors that emerge in the market by the fact that trade activities do not only aim at smooth and efficient trade but also at making profits for governments, firms and individuals. These market imperfections suggest that there is not really free trade. Instead, the transactions are affected by external factors as well as the maximum benefit of the parties involved. What Rugman and previous writers suggest is that companies turn to internalization in order to bypass these imperfections by developing an internal market and thus achieve maximum efficiency and profits in their operations. When internalization is conducted outside national borders, then an MNE is created. According to Rugman, if the world were characterized by a model of free trade, there would be no need for the MNE.

Finally, Buckley and Casson (1976, 1981, 1985, 1991) have discussed the process of internalization as a response to market imperfections. The two theorists added several variables to the internalization theory such as the management decision making, the cultural influence in management decisions, innovation, entrepreneurship, and arbitrage.

FDI and Trade Theory

One of the most discussed trade theories is the Factor Endowment Theory of Heckscher and Ohlin (H/O Theory or model). The theory states that a country will produce and export products that depend mostly on the production factors (particularly capital and labor) that are relatively abundant in the country and will import products that depend mostly on production factors that are relatively scarce in the country. The H/O Theory assumes that the production factors are completely mobile domestically and capital and labor factors are completely immobile internationally. Moreover, H/O assumes that production functions are the same and technology freely and instantly available in all countries. Although the H/O theory is not absolute, it reflects the locational specific advantages of a country that an MNE takes into consideration before directly investing there.

David Ricardo created a model in which trade was based on comparative advantages such as international differences in labor productivity. These differences resulted from differences in production functions and the use of technology. Differences in productivity functions are exogenously or derived from differences in national characteristics such as climate and the quality of natural resources. It can be said that these differences can also be called country–specific advantages. This model also assumes complete international immobility of factors of production. The model considers technological differences which result in productivity differences. Neither the H/O nor the Ricardian models can explain FDI. However, extensions of these models such as the H/O extension model (neo-factor trade theories) which introduces additional factors such as human capital and natural resources and the Ricardian extension model (neo-technology theories) which introduces economies of scale, product differentiation, etc. can both be used as a basis for a significant number of FDI theories. It can be said that there is a link between trade and FDI using the Ricardian model if we expand it with factor endowments mobility and keep in mind the international differences in technology and production functions as a firm–specific advantage and country-specific advantage.

Vernon (1966; 1979) was the first to focus on the so-called country-specific/ locational advantages. Given that there is cross-national trade and all natural and human resources are immobile, Vernon has pointed out that trade also depends upon the technological capability of firms to upgrade these inputs and/or to create—innovate new ones. The ability to renew ones’ resources may be considered as an ownership/competitive advantage. At first, the firm is willing to export its products to foreign markets with similar demand patterns and supply capabilities. When the product matures and the demand becomes more price elastic, the attraction of establishing foreign direct investment activities in a foreign location increases. The final decision of choosing the host country depends on various factors such as the conditions in the host country. The distance between home and host country is also an important factor as the MNE may intent to make the products manufactured in the host country available for re-exportation to the home country.

FDI and New Trade Theory

Governments are the main source of impediments to the free flow of products between nations. Barriers of trade are much more complicated than mere tariffs (quotas, government restrictions, etc.). By placing tariffs on imported goods, governments can increase the cost of exporting, as an entry mode, relative to other entry modes such as FDI and licensing. Similarly, by limiting imports through the imposition of quotas, governments increase the attractiveness of FDI and other forms of foreign involvement. For example, the wave of FDI by Japanese automobile companies in the USA during the 1980s was partially driven by protectionist threats and quotas imposed by the US government on the importation of Japanese cars.

Krugman (1983, 1991) suggests that firms of certain industries tend to concentrate in regions that already have a high sectoral activity. In his opinion, this happens for sector-specific rather than location-specific reasons. When many firms of the same sector are concentrated in the same location, this in turn concentrates skilled labor, technology and suppliers in one area. Therefore the location attracts other firms, given that they can overcome the transportation cost and trade barriers of exports. The firm may establish a subsidiary in a certain location in order to be close to the technological information flow, supporting at the same time the production stage that is not complicated by exploiting location specific advantages (like cheap unskilled labor) in another location. A typical example of agglomeration is the Silicon Valley in the USA, which is the center of R&D activity concerning computers.

Helpman (1984) in his conclusions mentioned that cross-country penetration of multinational corporations is a result of impediments to trade (such as transport costs or tariffs). This theory explains the simultaneous existence of intersectoral trade, intra-industry trade, and intra-firm trade.

Empirical Evidence

Empirical studies regarding the determination of FDI motives have shown that the majority of foreign investors have undertaken such projects to service domestic demand in the host country, particularly to overcome natural or policy-induced barriers to trade. Most investors further emphasize that their focus is to invest in countries with large markets and promising growth prospects. At the same time, investors with efficiency-seeking investments prefer low labour force costs, while those engaged in extractive activity note that foreign investments will be driven largely by the availability of natural resources. However, investors engaged in efficiency-seeking activities, cite the significance of the availability of skilled labour and wage-adjusted labour productivity.

Generally, investors prefer sound macroeconomic fundamentals (stable exchange rate, low inflation, and sustained growth), the availability of infrastructure, a stable and favourable tax regime and stable institutional and regulatory factors and policies, considering at the same time the importance of free trade agreements and regional trade integration schemes. Most investors discuss the importance and availability of infrastructure (electricity, water, transportation links, and telecommunication), rather than their costs in influencing FDI location decisions.

One of the most vital factors a company considers before undertaking FDI is to minimize the investment risk. When a country has an unstable legal system (i.e., regulations change often), lacks appropriate laws, and insufficiently enforces the existing ones, then the investment risk increases. From the economic point of view, if the exchange rate is volatile and the country suffers macroeconomic instability (inflation), and from the political point of view, if the country suffers from political instability or social instability (e.g., high labour unrest and strikes), the risk of investing in this country is also enhanced. Especially in transition economies when the transition process is delayed due to unclear property rights, delay in restitution problems, slow progress in privatisation, in the banking reform, and in liberalization, the existence of the mafia, nomenclatura, corruption, briberies, bureaucracy, etc., then the economic and political instability are heightened, and the risk again increases. Moreover, a significant number of investors observe that the recent financial crises of the 1990s have highlighted the underlying risks of investing in emerging and transition markets and make it necessary to pay greater attention to issues relating to political and macroeconomic stability, the legal framework, corruption and bureaucracy.

Based on Dunning (1988) and Bitzenis (2003), from the theoretical point view, we can outline the motives for FDI according to their *content*. Content is determined mainly through nine such factors:

The first is market seekers per se (size of the market of the host country, prospects of the host country for market growth, the host country is a new market for the MNE to expand its operations)

The second is market seekers *from a strategic point of view* (e.g. meeting the local needs and tastes of the host market, there is a lack of local competition in a host country, there is a local (host) unsatisfied demand for products, a MNE acquires the assets of a local company in a host country (through a joint venture or a M&A, etc.). A MNE may decide to substitute prior trade relationships with a country by undertaking local production in order to avoid trade barriers. Lastly, if a company finds it profitable to expand, either vertically or horizontally, it may look for opportunities abroad, and thereby expand through FDI)

The third is factor seekers (availability of natural resources, exploiting managerial, organizational, marketing and entrepreneurial advantages existing in the host country, access to high technology, low cost of acquiring and using raw materials and human resources in the host country)

The fourth is efficiency seekers (economies of scale, economies of scope, diversify the risk)

The firth is locational seekers (climate and infrastructure in the host country, geographical proximity, cultural closeness and cultural distance between home and host country)

The sixth is exploiting ownership advantages (strong brand name, product innovation, know-how, marketing expertise, existing business links, multinationality)

The seventh is seeking financial aspects (tax relief or other financial incentives)

The eighth is political factors (existence of ethnic minorities, special government treatment for a company due to a specific 'nationality' of the foreign firm, discrimination of specific companies coming from a specific country)

And the ninth includes other factors (overcoming imperfections). In general, motives may be derived from the solutions in order to overcome market imperfections. Thus, there might be other solutions for the same imperfections that may produce many other motives (an MNE may avoid searching, and negotiating costs of acquiring raw materials from other companies, by moving to its vertical integration). However, we can argue that a lot of examples of FDI could fit into more than one of the above categories.

As shown by Bitzenis (2006c), the motives of FDI can be categorized according to their source of creation into the following groups:

1) Incentives offered, directly or indirectly, by the host government (e.g. financial incentive, tax relief, political and macroeconomic stability, stable legal framework, transparency, and liberalisation)

2) Motives "derived" from the host market or the host country (e.g. climate, market size, lack of local competition, and unsatisfied local demand)

3) Motives which can only be connected with the multinational, its origin country,

and the host country (e.g. geographical proximity, cultural closeness, historical links) (Bitzenis 2004c)

4) Internal motives owned and provided by the MNEs (strong brand name, experience, know-how and expertise)

5) Motives which have been created from an external event (from outside the host country), or from the global market pressures or even yet are derived from exogenous reasons outside the host market (war, globalisation pressures, home country is too saturated, collapse of the communist regime, and transition).

Furthermore, as outlined by Bitzenis (2006c 2004c 2006a), the obstacles and constraints of FDI can be categorized according to their source into the following groups:

- Country, geographical and location constraints (geographical distance from the West, lack of raw materials/natural resources, high crime rate (also high economic crime rate), social instability, lack of security, absence of tourist opportunities (absence of sea, mountains, landscapes, mild climate), etc.)
- Business environmental (market) constraints (bureaucracy, corruption, briberies, lack of entrepreneurship, lack of managerial skills, lack of skilled labour force, high competition, problems in co-operation with local citizens (problematic joint ventures), social instability (strikes), technological backwardness, low labor productivity, etc.)
- Legal constraints (unstable legal framework, constant changes of laws, lack of laws, uncertain or imprecise property rights, lack of enforcement of the laws, discrimination in the enforcement of the laws, etc.)
- Taxation constraints (high taxation, high VAT, constraints regarding the repatriation of profits, etc.)
- Political/government constraints (political and government instability, high government intervention, blockage of fund transfers, takeovers, slow pace / progress in the transition process, government inability and government unwillingness for successful reforms, etc.)
- Macroeconomic constraints (exchange rate volatility, high inflation, low per capita income, etc.)
- Infrastructure constraints (technological backwardness, lack of infrastructure (telecommunications, roads, networks, internet), lack of financial intermediaries, etc.)
- Cultural constraints (unawareness of business mentality of local people, cultural consideration constraints, citizens are sceptic of foreign investors, privatisation and consumption, and are unwilling to buy foreign products, etc.)
- Religion constraints (Indian people do not consume beef (cows are considered to be *holly* animals), Muslims do not eat pork, Muslims do not ask for loans (because of interest rates))(Bitzenis and Nito (2005))
- Environmental constraints (environmental constraints can be legal constraints that determine specific functions of production (e.g. health and safety,— product safety laws)); social constraints that determine the tastes and buying patterns of consumers (e.g. healthy foods); ecological constraints that determine the necessary conditions of avoiding aspects of pollution
- External constraints (war, domino effect of an economic crisis, etc.)
- Others (lack of future prospects for market/economic growth, disintegrated economy, lack of participation in regional initiatives, in international organisations and Unions (such as IMF, OECD, NATO, EU, EMU), lack of favourable bilateral treaties, lack of financial incentives, etc.)

Behind the overall conclusion that several factors are important (or unimportant) as motives or barriers, some researchers (Bitzenis 2006d, Iammarino et al 2000) claim the existence of other factors that could also play a decisive role in perceiving motives and obstacles of FDI from a company's point of view. These include:

- The country of origin of investors together with the size of the investing company and the size of the country of origin along with the expectation of the company regarding the market share that it will obtain
- The sector (industry) of the investing company
- The strategic plans of the investing company (which market to serve, etc.).

Impact of FDI

According to the general FDI theory and empirical evidence, there are four groups of areas in a host country that possibly will be affected (positively or negatively, directly or indirectly): 1) Resource transfer effects, 2) Employment effects, 3) Economic growth, and 4) Balance of payments (BOP) effects. Specific areas of possible impact of FDI can be found in a country's macroeconomic indicators, living standards, poverty level, competition, enterprise development, environment, national sovereignty and autonomy, productivity, and quality of products and services offered.

The effects of FDI may be seen either in the short-run or in the long-run. Some effects of FDI can also be found in the home country and in the MNE itself (e.g. BOP of the home country suffers from the initial capital outflow—cultural issues and the importance of positive or negative financial indicators of the host country can affect the MNE and its profitability).

MNEs play the main role in developing countries, by applying and transferring new technology. The technology transfer may lead to an increase in the efficiency of the local firms (efficiency spillover). The technology transfer may also occur through the employee and management training, which familiarizes the people with unknown technologies and upgrades their skills which in turn might be transferred to the rest of the industry. The entrance of MNEs may trigger the development of related industries that recognize the opportunity to provide necessary services or inputs for the MNE at a profit. The services sector in particular, gains a lot by the presence of MNEs since their operations necessitate the existence of banks, insurance companies, financial consultants or financial intermediaries, thus providing incentives for those industries to seek improvement and development. It should be noted that the effects of FDI are stronger in a small market of a developing country rather than in an already big market of a developed country.

The employment effects may be positive and negative. Although MNEs may provide the country with new job positions (especially in the case of Green-field FDI), they may have a negative effect on the employment rate when they tend either to invest in capital-intensive production or to participate successfully in a privatization program where the MNE will proceed to the restructuring procedure under which the MNE may decrease the employment positions in order to increase its efficiency. The effect on the employment rate, though, may be positive if the MNE aims to exploit the low labor cost in the host country and thus creates a labour-intensive industry (e.g. textiles companies). FDI may also increase the total real wages of the labor force, especially in transition or developing or less-developing countries. However, we can argue that the entrance of large and financial strong MNEs in a host country will create problems for the local companies due to increased competition. Consequently, some of them may close down (negative employment effect). Furthermore, an indirect positive employment effect occurs when the establishment of MNEs in a specific industry creates a favourable environment for related industries to appear and operate.

FDI has an effect on the gross domestic product (GDP) of a country since the production sites increase or, if we consider the acquisition of existing companies, the productivity rate may increase. The 'competitive pressure', meaning the increase in the industry's level of concentration (larger number of firms) provides harder competition, commonly accepted as a motivation for higher efficiency. Local firms are pressured by foreign competition to seek more efficient methods in their operations. FDI may bring about changes in "supporting industries" as well. Thus, it is expected that lower prices for the products will be created due to increased competition, although sometimes the opposite appears. The demands of an MNE, in terms of quality of goods and services from local producers, may influence them to pursue better operations, such as time of delivery, stock control, supply networks, etc. The host country gains by the creation of 'external economies'. However, there is, on the other hand, increased competition (Blomström et al 1994). Furthermore, negative effects appear when the MNEs acquire greater economic power, when we have a creation of private monopolies in the host country, when the MNEs threaten the national sovereignty of the host country, and when there is a loss of economic independence of the host government because of the increased power of MNEs. The highly developed and sophisticated MNE may result in the elimination of local firms that are small and weak, if they fail to keep up with the MNE. The local government may block FDI through buyouts in order to encourage 'green-field' investments that encourage competition rather than acquire local firms that eliminate competition for the MNE. Lastly, FDI and the participation of MNEs in a host country may increase the consumer choice, the quality and variety of products, modernize the infrastructure, increase the wages, the production, the GDP, the GDP per capita and thus the living standards.

FDI provides significant financial assistance and the money capital inflows can be utilized in covering the balance of payment deficit or the interest payments on international debt. Although foreign companies tend to export rather than only to serve the local market, empirical evidence demonstrates that they also tend to import much of their inputs and that, on the average, has a negative effect on the trade balance. The effect on the trade balance though, may be positive (current account) if FDI is a trade substitute (an MNE stops exports to the host country and moves to FDI), or aims at establishing an export base (the MNE starts exports to the home country or to any third country). However, the initial capital inflow of the FDI has a one-time positive effect on the BOP of a host country, although the outflow of MNE's earnings (repatriation of profits) to the parent company or to any other MNE's foreign subsidiary has a negative effect on BOP.

FDI Global Trends

FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration, a goal increasingly recognized as one of the key aims of any development strategy and an increased growth rate. It can be argued that there was a continuous increase of worldwide FDI flows up to 2000 and then a significant decrease afterwards. Global flows of foreign direct investment (FDI) fell sharply in 2001 and 2002 (it was the largest decline in the last three decades), following the historical boom during 1999-2000 in which period FDI flows in the world exceeded yearly 1 trillion of US$ (WIR 2003).

The dramatic increase in FDI over the last decade was based on many factors. These include globalisation and economic integration, technological improvements in communications, information processing and transportation, new corporate organizational structures and restructuring processes, the changing framework of international competition, and finally the deregulation of key sectors such as telecommunications which led to the liberalization of capital flows among countries. Moreover, the increase in FDI flows was largely related to the sharp increase in investments in the high-tech and telecommunication sectors in the advanced economies and in the increased M&As cross-border transactions. Lastly, developing and transition countries were increasingly liberalizing their regimes and abolishing their barriers and obstacles in order to receive decisive inward foreign direct investment flows. Thus, an increase of FDI flows is also due to the abolition of monopolies, the elimination of tariffs and quotas and to the increased free trade transactions as a complement to the FDI flows (Bitzenis 2005b).

On the other hand, major factors are responsible for the dramatic decrease in FDI flows after the year 2000. First is the slowdown in the world economy which has reduced world demand and accelerated the global restructuring process of major MNEs in sectors characterized by excess capacity. Especially in 2001 and afterwards, the decline had resulted from the terrorist event of 11 September 2001 in New York City. The decline in 2001 which was mainly concentrated in developed countries was also a result of a decisive drop in cross-border mergers and acquisitions (M&As). The economic recession especially in the USA and the EU (15) has intensified competitive pressures (globalization and competition pressures), and thus forced companies to search for cheaper locations (this is a reason for the stable FDI flows to the CEE region). Furthermore, the issue of lower demand (the economic recession resulted to lower GDP per capita) can be offset by lower prices and lower production cost which may increase the demand. This trend may result in increased FDI flows in activities that benefit from relocation to low-wage economies (e.g. increases of Japanese FDI outflows in China and EU outflows in the CEE region). In general, there has been a redistribution of FDI towards developing countries where growth has reportedly been higher than in developed countries. The rise in developing countries' shares may also reflect the further liberalization of their FDI regimes and the openness of their borders, which was reinforced by the growth in the number of bilateral investment promotion and protection treaties.

However, on account of a strong increase in FDI flows to developing countries 2004 saw a slight rebound in global FDI after three years of declining flows. At $648 billion, world FDI inflows were 2% higher in 2004 than in 2003. Many factors help to explain why the growth of FDI was particularly pronounced in developing countries in 2004. Intense competitive pressures in many industries are leading firms to explore new ways of improving their competitiveness. Some of these ways are by expanding operations in the fast-growing markets of emerging economies to boost sales, and by rationalizing production activities with a view to reap economies of scale and to lower production costs (WIR 2005).

To conclude and with the help of global statistical data regarding FDI, we can argue that FDI flows are not the same or proportionally the same in all countries all over the world in all the different time periods. In each country business environment, there are different FDI motives and barriers that are all submitted to considerable changes through time. Thus, the MNEs choose the country that maximizes the possibility of success for their investment plan (Bitzenis 2004b). Moreover, only a limited number of countries became net providers (outflows overcome inflows) of direct investments to the rest of the world. For example, the UK

(400 billion US$) ranks first, followed by Japan (270 billion US$), France (250 billion US$) and the USA (120 billion US$). In terms of net inflows, when FDI inflows overcome outflows, China has the largest net inflows (475 billion US$), followed by Brazil (180 billion US$), Mexico (140 billion US$) and Ireland (120 billion US$). Among the top 20 countries with the largest net inflows, 5 were economies in the Asian region, namely, China, Malaysia, Singapore, Thailand and Indonesia.

However, one must consider that the market conditions are always changing and the changing character of the boundaries and the globalization theory will definitely create new challenges and opportunities for a company to seek value-adding activities internationally in ways different from the ones studied up to now. As the authors of the FDI theories concluded on reasons on why a company may undertake FDI by examining certain subjects (countries, motives, barriers) in certain time periods, we could argue that no theory can be general and applicable for one country, for any time period to any foreign company. Since every country offers different motives and incentives for investment and has different obstacles that are all submitted to considerable changes through time, the MNEs choose the country that maximizes the possibility of success for their investment plan. Even when two countries hold the same properties, an MNE bases its investment decision on evaluation of all factors in relation with the corporate priorities and needs. The choice requires examination on the part of the country and the MNE (or the industry), and the choice must always be in relation with the time period.

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Free Trade Area of the Americas

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Introduction

In 1994, the leaders of the thirty-four democracies of the Western Hemisphere agreed to develop a Free Trade Area of the Americas (FTAA) by a target date of 2005. The goal was to create the largest free trade area in the world, with a combined annual gross domestic product of over $13 trillion and a population of over 800 million. The FTTA also was intended to establish closer political and economic links across the region, and to reinforce economic policies of free market capitalism. The negotiations soon ran into difficulties. Vast differences in size, stage of economic development, and interests of the countries involved complicated talks. The process was further challenged by financial crises affecting several Latin American countries and by U.S. domestic politics.

In 2001, a draft treaty was released; however, much of the treaty language remained in brackets signifying the need for further negotiations. As the negotiations continued, the FTTA faced increased criticism from those who worried about its economic impacts on particular countries or particular economic sectors, its social implications for workers and the environment, and its implications for the ability of sovereign states to choose their economic policies and priorities. Certain key countries, particularly the United States and Brazil, also held different perspectives on a number of issues. With progress stalled, the countries agreed in November 2003 to pursue a more limited agreement that would allow each country to decide which commitments it would make. Few subsequent negotiations were held, and the 2005 target date passed with no agreement. Notably, the negotiations had proven to be much slower and less U.S.-dominated than many observers had expected in 1994.

Origins of the FTAA

The idea of economic integration in the Americas dates back at least to Simon Bolivar in the 1820s (Moss 2001). In the 20th century, the idea periodically resurfaced in U.S. policy initiatives, such as Kennedy's Alliance for Progress, and in discussions at the Organization of American States (OAS), but no real progress was made to implement the proposals. Beginning in the 1980s, a series of changes at the international, state, and regional level reinvigorated talk of integration (Wrobel 1998).

The end of the Cold War shifted global attention from confrontation and security interests toward cooperation and economic development. Additionally, reforms in Eastern Europe and Russia helped trigger increased acceptance of democracy and free market capitalism throughout the world. In the mid-1980s, Chile and Mexico introduced new economic policies based on removing trade barriers, encouraging foreign investment, privatizing state-owned industries, and reducing government spending. Encouraged by the United States, the International Monetary Fund (IMF) and others, countries across Latin America soon adopted similar market-oriented reforms, which came to be known as the Washington Consensus. The spreading reforms coupled with lessons learned from the success of the European Union (EU) led to new economic agreements. Canada, the United States and Mexico created the North America Free Trade Agreement (NAFTA). Argentina and Brazil led efforts to create a Common Market of the South (Mercosur). Ties among countries in the Andean region and in the Caribbean were strengthened. These new agreements also showed a decision to move forward on trade liberalization through regional agreements in response to slow progress in global talks (Bulmer-Thomas and Page 1999).

In 1990, George Bush announced the Enterprise for the Americas Initiative (EAI), which included new proposals on investment and debt relief, and the goal of creating a hemispheric free trade agreement (Morici 1996). Because Latin American trade was not Bush's highest policy priority, attention soon narrowed to negotiating NAFTA. After NAFTA was approved in 1993, the Clinton administration invited all freely elected heads of state, intentionally excluding Cuba's Fidel Castro, to a Summit of the Americas the following year. The summit's original agenda included a variety of regional issues, but it became heavily focused on trade issues. At the December 1994 summit in Miami, the countries agreed to a Plan of Action that established a timetable for trade ministers' meetings to launch the negotiations of the FTAA, which was to be completed by 2005.

Some observers have portrayed the FTAA as a largely U.S.-driven initiative. They suggest that the United States has long been interested in the subordination of Latin America, in order to get access to cheap labor, resources, and market domination. They portray the FTAA as a way to consolidate an "informal empire" and reinforce adoption of neo-liberal economic policies that favor the United States (Petras 2002:16; Brunelle 2004). The FTAA has also been depicted as a U.S. effort to reverse "global hegemonic decline," by giving the United States new economic resources and a means to deny other global powers, such as the EU, access to the Latin American market (Payne 1996:104). Others, though, have suggested that the FTAA to a large degree was promoted by Latin American countries, which saw it as a way to gain access to the rich U.S. market and a reward for adopting free market policies. These observers suggest that U.S. officials in fact were surprised by enthusiastic responses to broad U.S. speeches on hemispheric trade. Additionally, they feel that it was Latin American countries that pushed trade higher on the Summit of the Americas' agenda, and it was Latin American interest in the project that kept the process moving for several years despite the Clinton administration's focus on other priorities (Fauriol & Weintraub 2001; Phillips 2003; Prevost & Weber 2003).

Early Challenges

The FTAA was a particularly challenging multilateral trade negotiation because of the economic diversity of the countries. In the hemisphere, the United States stood as a giant. Roughly 80 percent of the entire hemisphere's production came from the United States. U.S. production was over 200 times that of the total produced by the 15 countries of the Caribbean, and roughly 20 times that of Brazil, Latin America's largest economy after Mexico. NAFTA partners Canada and Mexico were the next highest producers, followed by Brazil, then a large drop in totals down to Argentina. The United States and its NAFTA partners similarly dominated trade figures, although Brazil and a few others had recently increased their exports to Europe and Asia.

The disparity in economic figures stemmed from not only differences in size, but also differences in economic development. The United States, Canada and, to a lesser extent, Mexico and Brazil were diversified, industrial, and high technology economies. Some other countries had become exporters of manufacturing based on existing trade preferences and cheap labor, but had few indigenous corporations. Others remained exporters of primary products. Many in the Caribbean were heavily depended on tourism for growth. These differences led to variability in countries' goals at the start of FTAA negotiations. Some looked to expand existing business laws and lower barriers to trade in services and technology, while others were more interested in obtaining access to the U.S. market while not losing too much government tariff revenue.

Events soon highlighted the gulf in economic power and goals. First, the Mexican government's decision in

December 1994 to devalue the peso triggered capital flight from Mexico and other emerging markets, highlighting the continued volatility of these economies. Subsequent American stabilization loans to Mexico then reinforced the difference in international power between the countries. Second, NAFTA went fully into effect. Optimists predicted that it would stimulate growth; pessimists countered that it would lead to significant job losses and environmental damage. Notably, both sides declared the results verified their claims. Overall, the NAFTA debate led many political, business, and labor leaders away from unquestioning support of free trade (Weintraub 1997). Finally, President Bill Clinton repeatedly failed to win fast track trade negotiating authority from Congress. Consequently, many Latin American leaders questioned the overall U.S. commitment to trade and the merits of spending years negotiating a FTAA that risked being rejected or modified by a protectionist U.S. Congress.

The Negotiation Process

Following the plan of action agreed to in Miami, the trade ministers' first meeting was held in Denver during June 1995. The ministers agreed to set up seven working groups to research and discuss key issues; in March 1996, the ministers established four more working groups. In March 1998, the ministers agreed to the Declaration of San Jose, which outlined the future negotiation process. Future ministerial meetings were planned, but a Trade Negotiations Committee (TNC) at the vice-ministerial level would lead negotiations between meetings. The chairmanship and vice-chairmanship of the TNC would rotate, but during the final phase of the planned negotiations Brazil and the United States would be joint chairs. Negotiating groups, largely mirroring the earlier working groups, were established to discuss market access, investment, services, government procurement, dispute settlement, agriculture, intellectual property rights, subsidies, antidumping and countervailing duties, and competition policy (Moss 2001; Duquette & Rondeau 2004).

At San Jose, the ministers also agreed that the negotiation's end product should be a "single undertaking" rather than a series of incremental agreements. This requirement allowed for more flexibility to negotiate trade-offs across several issues. For example, the United States might make a concession on agricultural imports in response to a Brazilian adjustment on the very different issue of intellectual property rights. Originally, many U.S. officials and others expected the FTAA would be established by the gradual addition of countries to NAFTA. Brazil and others objected to the leverage this formula would give the United States, so the ministers agreed to establish a new treaty. They also agreed that countries could negotiate as members of sub-regional trade blocs. This concession was particularly important to Brazil, which hoped to build the importance of Mercosur even as the FTAA went forward, and to use the bloc to help offset U.S. dominance.

At the Denver ministerial meetings in 1995, private sector representatives began holding meetings paralleling the government meetings. The American Business Forum meetings helped establish ties between corporate leaders throughout the region, and gave them input into the negotiations. The original Miami declaration said that the FTAA process should be open to civil society participation and concerns, but many labor, environmental, and other groups felt that they in fact were being excluded. At San Jose, a Committee of Government Representatives on Civil Society was established, but many groups suggested that the committee was little more than a "mailbox" soliciting input, but giving no firm promise of response (Anderson 2003:49). Concurrent with the second

Summit of the Americas held in Santiago, Chile in 1998, civil society groups organized the First Peoples Summit to discuss shared concerns and to try to counterbalance the American Business Forum's influence.

The nine negotiating groups made enough progress by the 1999 meeting in Toronto to enable the ministers to call for preparation of a draft treaty by 2001. The Toronto meeting was also important because the countries agreed to implement eighteen business facilitation measures, the first tangible outputs of the negotiations. The draft treaty was ready in time for the Third Summit of the Americas held at Quebec City in April 2001. In an effort to combat the prevailing impression that the negotiations were a secretive, elite-dominated process, the draft treaty was publicly released. The 434-page document included over 7,000 bracketed portions indicating areas where wording still needed to be resolved. Therefore, some hailed the progress toward a treaty, but others cautioned that most of the real work remained. At Quebec City, the leaders formally stipulated that the Summit of the Americas process was open only to democratic countries, but whether a "democracy clause" would be included in the FTAA remained uncertain.

Optimism about the FTAA's future rose when George W. Bush made it a policy priority. During his campaign for president and first months in office, he spoke of establishing a new relationship with Latin America and of the need for presidential Trade Promotion Authority (TPA), the renamed fast-track authority, to further U.S. interests. In August 2002, Bush was granted TPA, but in order to achieve a one-vote victory in the House of Representatives, he had to promise lawmakers future special protection on textiles, oranges, and a number of other products. In 2002, Bush also signed a farm bill that included over $100 million in new subsidies for U.S. farmers to help them dominate export markets. The United States thus was taking steps both forward and backward on contentious trade issues while refocusing its policy priorities on the war on terrorism.

The Case for the FTAA

Supporters of the FTAA raise many of the economic arguments suggested in general discussions of free trade and regional integration, but also suggest that it would have important political impacts at the state and regional levels (Marshall 1998; Schott 2001; Salazar-Xirinachs 2001). They feel that trade increases markets, leading to larger sales and cheaper production costs because of economies of scale. Trade also spurs competition, which promotes innovation and low cost products for consumers. Integration would also increase foreign investment and technology transfer when multinational companies established factories in areas with cheap labor. Additionally, standardizing laws in areas such as market access and foreign investment would lessen risk and promote long-term commitments to developing economies. Collectively, these benefits, along with wise domestic policy choices, would help bring macroeconomic stability and lower inflation to a region previously plagued by market collapses and hyperinflation. Strong proponents of free trade conclude its economic benefits also will alleviate poverty and allow progress on other issues such as environmental sustainability.

Projecting exact economic outcomes under the FTAA was difficult because there was no precedent for such a large and diverse association. Most countries would see gains in one area offset by losses in another. Therefore, trade officials often cited broad statistics to show that in recent years countries implementing free market reforms had outperformed others. Using econometric models, Monteagudo and Watanuki (2002) predicted a net 0.55 percent increase in hemispheric real GDP per annum. Other economists, using various models, suggested that there would be a "substantial" increase in overall trade, an 11 percent gain in agricultural exports, and a near-100 percent surge in foreign direct investment in Latin America per annum (Estevadeordal et al 2004). The models, though, often were dependent on assumptions such as implementation of an instantaneous liberalization with no excluded products.

Supporters also feel that the FTAA would reinforce Latin American trends toward economic and political reform. The FTAA would force countries to institutionalize many of the market reforms begun in the late-1980s and push them to reform further. Crucially, the expected economic benefits of the FTAA could reward countries for their actions and help convince wavering countries to continue on the path of reform. Many of the Washington Consensus reforms had lost support with key Latin American constituencies, who felt that the reforms were only rewarding a handful of domestic and international elite. This economic disenchantment also was leading to decreased popular commitment to the democratic political systems that had been introduced along with the economic reforms in many Latin American countries.

Finally, supporters argued that the FTAA could further develop regional cooperation. This cooperation might allow regional infrastructure projects to more efficiently use energy resources or develop transportation capabilities. Integration would also encourage countries to come to the assistance of their neighbors in times of economic or other distress. Economic cooperation could lead to cooperation on other regional issues such as immigration, drug trafficking, education, security concerns, and the environment. Few expected that the Americas would ever reach the integration of the EU with its common currency and growing political infrastructure, but there was hope that regional dialogue on key issues could be institutionalized.

Opposition to the FTAA

Opposition to the FTAA initially came from those concerned about the possible impacts of the specific treaty; however, after the invigoration of antiglobalization protests beginning at the 1999 WTO meeting in Seattle, opposition to the FTAA additionally became part of a broader social movement (Dawkins and Moncada 2004; Smith 2004). Specific worries over the economic impacts of free trade varied greatly by country and also by industry, depending on levels of economic development and competitiveness. Many Latin Americans feared that their markets would be flooded with cheap U.S. industrial, service, and high technology goods, driving local businesses into bankruptcy. Most Latin American countries maintained higher average tariffs than the United States, so the U.S. market would not open substantially, but opportunities in Latin American would increase. Critics also cited Mexico's post-NAFTA experience of trying to compete with subsidized U.S. corn exports selling at less than the normal cost of production. In more economically developed countries like the United States and Canada, fears of import competition centered on textiles, specific agricultural products, and assembled goods that could be produced with cheap labor (Arnold et al 2003). Others feared that U.S. companies would move production facilities abroad in search of cheap labor and weaker regulations. Governments of smaller, poorer economies noted that they would be disproportionately hurt by the loss of tariff revenue and might have to cut back government services. Overall, the critics suggested that the macroeconomic gains would not meet optimists' projections and would fall primarily to the richer countries or richer elite within countries, thereby worsening income inequality. They noted that, when the EU expanded to include poorer countries, billions of dollars in development grants had been funneled into those countries, but the FTAA included no such provision (Anderson 2003). In fact, many were hostile to the idea of increased foreign aid.

FTAA opponents also argued that the plan, and the pro-market polices it would reinforce would harm the region's workers, environment, indigenous cultures, and overall social stability. Bankruptcy of local industry or farms would force workers to accept jobs with lower wages and fewer protections of rights. These trends might be exacerbated by countries competing to attract multinationals' factories by lowering wages, opposing unionization, lessening safety inspections and so on, in what trade opponents frequently refer to as "the race to the bottom." Environmental damage might increase as industrialization spread and natural resources were further exploited. With competition increased, companies would be looking for ways to increase cheap production, rather than ways to guarantee sustainable development. Economic expansion and increased trade also threatened the preservation of the rights and traditions of indigenous peoples. Overall, opponents suggested many in the region would be faced with decreased quality of life, sparse government services, and weakened traditional supports.

Underlying many opponents' worries is sharp distrust of all large corporations. Trade opponents frequently argue that strong corporations and international economic institutions impact not only individuals, but also sovereign states by dictating policy reforms necessary to attract future economic rewards (Gill 1995; Brunelle 2004). They argued that the FTAA, specifically, would hurt governments by promoting the privatization of government services such as healthcare, education, water and electricity. Further, some charged that expanding NAFTA's chapter 11 provisions on international investment would sharply challenge sovereignty. NAFTA requires government compensation for "expropriation," but the term is defined expansively to include regulations that lower the profits of international investors (Altieri 2003). Therefore, companies can sue foreign governments that impose environmental or other public interest regulations that lower profits. Chapter 11 also limits capital controls that some governments implement to limit quick withdrawals of capital and currency speculation. Surrendering control of government services, regulatory control, and financial policies leaves governments with few tools to implement their distinct national priorities.

The United States and the FTAA

The FTAA could not move forward without support from the United States and some recognition of its distinct interests. Most observers argued that the United States stood to gain relatively little economically from the FTAA (Gordon 2001). As negotiations moved forward during 1995-2003, annual U.S. exports to the hemisphere, excluding exports to its NAFTA partners, averaged $56 billion, comprising only 8.1 percent of all U.S. exports. These observers further suggested that U.S. exports were unlikely to surge after the FTAA since average Latin American incomes would increase slowly. Additionally, U.S. export gains were expected to be at least partially offset by increased imports and the movement of U.S. companies seeking cheap labor supplies. The net effect risked being a worsened trade balance and loss of U.S. jobs.

Supporters of the FTAA conceded that it alone would not create a boom in U.S. business, but suggested that an agreement would bring positive results. During the 1990s, Latin American economies had grown, seeing an over 11 percent increase in imports (Schott 2001). Additionally, the U.S. share of imports in key economies such as Brazil and Argentina remained comparatively low, so there was hope that the FTAA might stimulate exports to these regional leaders. Importantly, more than 85 percent of U.S. sales to Latin America were manufactured goods, including those from high wage sectors such as electrical equipment, pharmaceuticals, and chemicals. Global trade agreements had reduced many barriers, but they remained highest in areas such as services, technology, foreign investment, and government procurement where U.S. businesses were highly competitive. Thus, an FTAA that went further than global agreements in these areas would be beneficial. Finally, although imports might cost some Americans their jobs, they could also lead to lower prices for U.S. manufacturers and consumers.

Observers on both sides, though, agreed that the United States stood to gain more politically than economically from the FTAA. If the FTAA helped lock in economic and political reforms in Latin America, U.S. long-term interests in regional stability would be met. If it promoted regional cooperation on non-economic issues, it might aid progress on long-standing U.S. concerns such as drug production and illegal immigration. There also was a chance that agreements reached in FTAA negotiations, which the United States hoped to dominate, would lead to a "spiral of precedents" that would set a new baseline for subsequent global trade negotiations in which U.S. influence normally was balanced by other major powers (VanGrasstek 1998). The FTAA could also help the United States meet rising economic challenges from other regions by giving preferential access to U.S. businesses and, likely, by decreasing the chance that Mercosur or others would move forward on a proposed free trade area with the EU. President Bush openly suggested at Quebec in 2001 that "freer trade would better enable the Western Hemisphere to compete against Asia and Europe" (Carranza 2004:324)

Throughout the negotiations, U.S. officials were interested in reaping the FTAA's political and economic benefits, but at a minimal cost. They hoped to gain concessions in areas such as investment and services, but opposed changes in certain controversial U.S. policies, such as anti-dumping laws, protection of particular goods, and agricultural subsidies, which the United States suggested would only be reduced as part of global negotiations. They knew the FTAA might help the United States, but was not essential, so they could maintain firm positions.

Brazil and the FTAA

During the FTAA negotiations, Brazil sought to protect its economic and political interests, but also to expand its role as a leader of Latin America (Barbosa 2001). With Latin America's largest economy and its leadership in Mercosur, Brazil had become the region's economic leader. It also was a global trader with roughly equal amounts of exports going to North America, Europe, and Asia. These facts meant that certain sectors in Brazil stood to gain under the FTAA from exports to the United States; however, many Brazilians placed more emphasis on developing ties within Latin America and felt they could survive without increased access to the U.S. market.

Although Brazil has developed its manufacturing, technology, and service sectors to be a regional leader, U.S. companies still have advantages in these areas because of greater technology, greater access to cheap capital, and established reputations. Some Brazilians therefore feared that the FTAA would lead to a flood of U.S. goods that would come to dominate both the Brazilian and Latin American markets causing bankruptcies in Brazil and a setback in development efforts. At first glance, many observers assumed that these national losses would be partially offset by gains in Brazilian exports to the United States. In areas such as shoes, orange juice, and other agricultural products, Brazil had the comparative advantage. The difficulty was that many of these key Brazilian sectors were the ones most likely to face continued barriers, since the United States opposed changes in certain protective tariffs and agricultural subsidies. Brazilian calculations in 2000 were that their top 15 exports to the United States faced average tariff and other barriers of 45.6 percent (Barbosa 2000).

Brazil's political goals also would be deeply affected by the FTAA. Many Brazilians saw the country as a natural regional hegemon. Mercosur had helped it economically, but also allowed Brazil to take a leadership role in the region. Brazil hoped to increase its influence in areas such as Colombia's drug problems, Argentina's economic difficulties, and Cuba's continued tension with other states. Brazil also hoped to assert itself as a major player globally, with influence in line with its population and GDP size. For example, Brazilians spoke of possibly gaining a permanent seat on the UN Security Council. Brazil, therefore, was wary of any proposal that might slow Mercosur's growth, increase the U.S. role in regional affairs, increase Brazil's dependence on the U.S. economy, or appear to put Brazil in the role of junior partner (Hakim 2004).

Within Brazil, the FTAA was supported by agribusiness groups and textile manufacturers who hoped to increase exports, telecommunications and banking firms who sought foreign investment, and government economic agencies, but many others opposed it. In 2001, Brazilian President Henrique Cardoso stated that the FTAA would be "irrelevant, or worse undesirable" if it did not address Brazil's concerns over U.S. barriers (Carranza 2004:322). While running for president, Brazil's leader Luis da Silva went further, calling the FTAA "a policy of annexation of Latin America by the United States" (Altieri 2003:872). In an unofficial 2002 referendum organized by labor, church and political leaders, over 90 percent of those voting opposed the FTAA. Other polls and government statements indicated that much of Brazil's business elite considered further development of Mercosur to be a higher priority than the FTAA (van Rompay 2004).

Final Negotiations

Disagreements between the United States and Brazil made progress in negotiations difficult. The two countries differed on what issues should be included in the FTAA negotiations, let alone how they should be resolved. Other countries also pursued specific goals depending on their particular economic and political interests. Furthermore, the talks were complicated by changes in a number of regional and global factors.

In the late-1990s and early-2000s, the United States and many Latin American countries saw economic slowdowns. These downturns made it harder for free trade advocates to argue that expansion into these markets would bring significant gains. The downturns also made groups even more worried about further job losses that might accompany expanded imports. Additionally, the downturns further eroded public support in many Latin American countries for both free market economic reforms and the governments that had implemented them. In several countries, elections brought more populist leaders to power who sought to lessen or reverse reforms. The situation was exacerbated when Brazil and then Argentina suffered more significant economic setbacks. In the Argentine crisis, the Bush administration chose to let others take the lead in responding, reinforcing a leading regional role for Brazil.

The economic slowdowns and other factors also contributed to an overall different environment for trade negotiations than in 1994. The rise of China and further development of the EU shifted much business attention away from Latin American markets. Also, disputes between developing and developed countries led to a collapse of global trade negotiations at Cancun in 2003. These disputes carried over into FTAA negotiations, in part because the United States and Brazil both suggested that difficult regional issues needed to be resolved through global talks, but progress in those talks appeared unlikely.

The terrorist attacks of September 11 2001 also changed the negotiations. At first, some observers suggested that the attacks might aid the FTAA process by helping President Bush rally the country around his foreign policy ideas (Altieri 2003). In time, though, the war on terrorism shifted U.S. attention away from Latin America, since it was not home to either important bases of terrorist operations, or countries that could contribute significant military and financial assistance to U.S. efforts. Within U.S.-Latin American relations, focus shifted away from broad cooperation to areas of security risk, such as Colombia (Castañeda 2003). Early on, most Latin American countries supported U.S. antiterrorism efforts, although some were wary of an activist United States. Disputes were much sharper, however, over U.S. policy in Iraq. Several key states openly questioned U.S. actions. Even Mexico refused to support some proposed U.N. Security Council resolutions authorizing war.

Finally, the FTAA enjoyed support from some industries, but did not become a central focus of business lobbying efforts (Wise 2003). In contrast, it faced widespread criticism from social movements. By the time of planning for a key ministerial meeting in Miami in November 2003, a good amount of the discussion focused on how to control significant crowds of protestors and how to placate important labor and environmental groups that were rallying public opinion against any further trade pacts.

The 2003 Miami meeting was seen as crucial if negotiators hoped to meet the 2005 target for implementation. In the months before the meeting, the deputy ministers of the countries met as scheduled in Port-of-Spain and then representatives of key states held a “mini-ministerial” in Washington to negotiate terms of declarations planned for Miami. In these fall meetings, Brazil and its Mercosur neighbors proposed lowering the aims of the FTAA negotiations to concentrate on trade in goods rather than a comprehensive deal on services, investment rules and other contentious issues. At first, the United States expressed continued support for a broad NAFTA-like agreement, but it still did not want to negotiate on issues such as farm subsidies. U.S. and Brazilian officials crafted a declaration in November that “recognize[d] that countries may assume different levels of commitments” on different issues. The declaration also stated that there should be “an appropriate balance of rights and obligations where countries reap the benefits of their respective commitments,” but did not lay out specific punishments for countries choosing to opt out of obligations (Bluestine 2003). The agreement was dubbed “FTAA-Lite” by critics and received a cool reception from Canada, Chile, and others who still favored a comprehensive agreement. Many countries, though, accepted that progress of any kind was better than a full breakdown of talks. Ultimately, all the ministers approved a declaration supporting further negotiations under the new understanding. Business leaders expressed frustration at the step away from a full deal, while social groups celebrated the slowing of negotiations.

In 2004, few further negotiations were held because the countries disagreed about what issues should be part of the scaled-down FTAA. Progress was also slow because the countries’ ability to opt out of obligations made it difficult to match concessions in one area with those in another. The 2005 target date came and went with no agreement.

The decade-long progress shows that future trade agreements are contingent on world and regional circumstances, will not be dominated by the United States and other great powers as much as in the past, and must overcome significant disparities among countries' economies and national interests.

Conclusion

The FTAA's provisions would have had an important impact on governance at the state and regional levels. Those who argued that shaping economic and social regulations by treaty terms and possible arbitration would have been a setback to democracy and sovereignty were pleased by the FTAA's demise. This group also noted the power of grassroots opposition from numerous civil groups. Others who felt that the FTAA would help lock in economic and political reforms were naturally less pleased.

Both sides recognized that trade policies are still significantly shaped by domestic pressures. An internationalist business and political consensus that free trade is an important core goal no longer exists. Few businesses rally to the prospect of potential gains from further opening of markets. In contrast, narrower interests that would be hurt by trade agreements, and those concerned with labor, environmental and social issues have emerged as consistently active voices in opposition to further trade pacts.

Internet Sites

Business views on FTAA. www.counciloftheamericas.org/coa/advocacy/ftaa.html

Official website of the FTAA www.ftaa-alca.org/

Social group opposition to FTAA. www.globalexchange.org/campaigns/ftaa

U.S. Commerce Department information. www.mac.doc.gov/ftaa2005/

U.S. government articles on FTAA. usinfo.state.gov/journals/ites/1002/ijee/ijee1002.pdf

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Free Trade and Protection

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Introduction

Arguments between supporters of free trade and advocates of protectionism have raged for years (Irwin 1996). Proponents of both points of view have found statistics, models, theories, anecdotes, and analytic studies that support their side of the debate or undercut their opponents' views. Like most long-standing controversies of some significance in the social sciences, there is really no single and definitive answer that holds for all cases in all time periods. In the last half century, however, supporters of free trade—or at least freer trade—have gained the upper hand in the ongoing debate, and the flows of goods, and increasingly services and capital, have faced diminished barriers.

Historical Framework

Under the leadership of Great Britain free trade ideas were ascendant for much of the nineteenth century. The expansion of unconditional most-favored-nation treatment (any tariff reductions granted to one state automatically were extended to all other most favored trading partners) among the European countries progressively opened up the international trading system. By the end of the nineteenth century, however, there was a movement away from freer trade as Great Britain faced new industrial competitors, including both Germany and the United States. These challengers had their own reasons for favoring policies incorporating protection rather than supporting the free trade regime that have been established under British leadership (Krasner 1976). The tendencies to move toward greater protection were present at the beginning of the twentieth century in the years before World War I. The outbreak of the war, of course, contributed to major reductions in trade.

After World War I, many countries, including almost all the European nations, were faced with a variety of political and economic problems. Needless to say, national leaders gave recovery in their own countries priority over potential problems in the international economy, and countries used protectionist policies in efforts to help rebuild with minimal concerns elsewhere. The most dramatic example was the disappearance of the economic unity of large portions of the Danube Basin that has existed under the Austro-Hungarian Empire. The new countries of central and eastern Europe and the countries that survived the war but had significantly different boundaries adopted protectionist policies to favor domestic economic sectors as they sought both to create viable national economies to strengthen their independence. The economic requirements of German reparations and repayments of Allied war debts (principally to the United States) led countries to seek to expand their exports while limiting imports so as to accumulate the necessary currency reserves. A somewhat fragile structure of economic interconnections dependent upon German productivity and the American willingness to extend loans to finance debt repayments came into being. When the Great Depression struck, German productivity declined and the United States retreated into economic (and political) isolation, and the fragile financial and trade structure collapsed.

Elsewhere, the crisis led to increases in economic nationalism as countries more and more attempted to gain economically at the expense of their neighbors. Economic nationalism reinforced political nationalism. The major nations also sought to become as self-sufficient as possible in certain strategic goods and to have assured access to raw materials and food supplies. Germany even before the advent of Hitler and the Nazis worked to strengthen economic ties with central and southeastern Europe in order to avoid the dependence on overseas suppliers that was such a liability in World War I. This tendency towards greater self-sufficiency increased when the Nazis came into power (Hirschman 1969).

Many observers and analysts of these events felt that the economic nationalism and protectionism had been important in contributing to the events that led to the breakdown of the international economic system between the wars. Further, they have seen this breakdown as one of the important causes of World War II. While it is also possible to suggest that the economic tensions between countries were a direct consequence of increasing levels of international political hostility, the perception that economic nationalism had made a good situation bad or a bad situation worse was a spur to efforts to promote free trade after the conflict.

The efforts to create the International Trade Organization—which ultimately failed—the resulting reliance on the General Agreement on Trade and Tariffs (GATT), and eventually the successful creation of the World Trade Organization (WTO) were all intended to open up the economic system and to remove barriers. The accepted view was that freer trade would improve opportunities for economic prosperity and bring about a reduced danger of war in an era of greater economic interdependence. It is of more than symbolic importance that the Soviet Union and its allies sought to create self-contained economic units after the war and distanced themselves from the global and capitalist economic system of the West since incorporation into such a system might have limited the political and diplomatic options open to these countries. Even in this era with the increasing support for free trade, however, there remained proponents of protection in western countries as well.

Arguments for Free (or Freer) Trade

One major potential political advantage for free trade has just been noted. There is the suggestion that freer trade and greater economic interdependence will help to limit the chances of major war breaking out (Gartzke *et al* 2001). Greater trade among countries can promote peace because the increased linkages among countries will create domestic constituencies in the various nations that favor peace over war. Local investors, businesses and consumers who benefit from trade will be much less likely to support conflicts and more willing to pressure governments to find peaceful solutions to problems (Gerace 2004:3). Conflict may also prove to be less likely since countries will now lack the necessary self-sufficiency and access to the materials that would be essential for successfully conducting hostilities.

The economic advantages of free trade are usually considered to be pretty straightforward. With free trade every country is able to use comparative advantage to produce most efficiently the goods that it can specialize in relative to the other countries in the world. Relative factor endowments of capital, labor, land, a skilled and educated workforce, and geographic location will help to determine where the comparative advantage for a country lies. The end result from this specialization and comparative advantage is greater global efficiency and increases in the overall level of productivity (Alcala & Ciccone 2004). These increases in turn will result in higher standards of living since all countries benefit from the trading relationship to gain goods more cheaply than if they tried to produce them by themselves. It might be possible to exclude countries from the benefits that occur with the freer trade, but then some of the countries would have no incentive to employ free trade. As a consequence, it becomes important for other countries in the system to share the benefits in order to increase their gains. The economic market place in conjunction with comparative advantage will help to determine the trade patterns that are present. Transport costs for bulky goods may mean that regional comparative advantages can also be present, complementing those at the international level. Since free trade leads to greater global efficiency, the proponents of free trade also consider it to be a good choice as an economic development policy for countries in the developing world.

It is often pointed out that the Asian newly industrializing countries (NICs) of Singapore, Hong Kong, Taiwan, and South Korea grew more rapidly with trade oriented economic policies while the Latin American countries of Mexico, Argentina, and Brazil fell behind their Asian counterparts when they relied on protectionist policies in an effort to create a national industrial base. The comparison can be a compelling one since at one point the Latin American states were wealthier than the Asian ones, a situation that has now been reversed. The more advanced Latin American economies fell below those of the Asian countries. Hong Kong as crown colony was one of the most economically open systems in the world in the 1970s 1980s, and 1990s, and one of the fastest growing. Of course, since its reincorporation into China, Hong Kong's economic policies reflect the more interventionist policies of China itself.

Arguments for Protectionist Policies

Free trade is basically one position, while protectionism incorporates many exceptions to the idea of free trade with the associated justifications; consequently, there are many more arguments used by proponents of protection and many more positions. Early mercantilists and current neo-mercantilist thinkers view the world in relative terms. In a competitive world a policy that helps your country but helps potential enemies or competitors even more becomes a bad policy. On the other hand, if free trade benefits your country, especially relative to competing nations, then support for free trade is eminently justified. In fact, support for free trade has been considered a special kind of strategic trade policy (Cowling and Sugden 1998). Thus, in the early 19th century when Great Britain was the preeminent industrial country in the world, free trade provided major advantages for Britain. Both ideological free traders and some mercantilists could agree on the value of liberalizing trade under these conditions. Similar arguments in favor of freer trade were prevalent in the United States after World War II when the country was especially well placed to benefit from a more liberal trading system. American business saw the period as an excellent opportunity to penetrate the markets of the colonial possessions of the European states, increasing sales, foreign investment, and access to raw materials.

Of course, countries not so well placed to take advantage of the benefits of free trade (which could be most of them in many time periods) might be at least selectively inclined to use protectionist policies to serve the national interest. For example, many would argue that it is essential to maintain (protect) some economic sectors in the interest of national defense (Gerace 2004:90). It would hardly be prudent if all the spare parts for important military equipment were produced abroad, especially in a competing state. In the western countries the exclusion of the Soviet Union and its allies from some of the benefits of free trade was considered a very wise policy by some, even if it had economic costs for the West.

The idea that greater economic interdependence that comes with free trade leads to a greater likelihood of peace can be challenged. With greater contact the scope for disagreements may increase. Countries that do not trade with each other may have little to argue about, at least in the economic realm. When countries are involved in important trading relationships, however, disputes can become serious. Disagreements between the United States and Europe over economic issues have led to relatively mild forms of economic warfare, but the disputes have threatened to expand on a number of occasions, and they have in the past. For example, the trade links between Japan and the United States in 1940 proved to be counterproductive for the maintenance of peace. The trade sanctions that were eventually imposed by the United States in its political disputes with Japan were effective enough to imperil the Japanese economy. The Japanese leaders saw only two choices available to their country—they could either capitulate to American demands or to go to war to seize the resources that they needed. Of course, the government in power chose the second option. Clearly in this case the presence of important trade ties did not prevent the outbreak of war. The absence of such ties might not have prevented war, but their presence surely did not forestall it.

Those who argue for protection rely on a variety of economic arguments in addition to national security concerns. They suggest that free trade may not be a mechanism for growth and that free trade may keep some countries in inferior economic positions. O'Rourke (2000) found evidence that between 1875 and 1914 it was the countries with the higher tariffs that experienced the greatest growth, not the ones that were most open. The results of analyses that measure trade openness and growth have been mixed, and it has not always been clear that free trade has provided the expected advantages (Lutz 2001). Openness, in fact, may only work as a growth strategy when international and domestic circumstances are favorable (Sen 1997). The Asian NICs were able to grow using export-oriented policies when world economic conditions were supportive. Even though the Latin American countries may have been unwise to pursue other policies in the 1970s and 1980s (a position many would debate), the success of the Asian countries has not been one that all countries have been able to replicate in later years. The Asian NICs also gained from openness elsewhere in the international economic system, particularly in the industrialized countries; they were not completely open themselves, and they used protection selectively in their rise to economic prominence.

In other cases, freer trade might be disadvantageous. Free trade can lead to de-industrialization. Baumgartner and Burns (1975) suggested that the exchange of British textiles for Portuguese wine, a classic case used to illustrate comparative advantage, also points to the dangers that can come with trade. While Britain was a more efficient producer of textiles and Portugal a more efficient (and better) producer of wines, one result of the trade between the two countries was the demise of the textile industry in Portugal. Portugal was deprived of a manufacturing sector that could have served as the base for further and more extensive industrialization. The knowledge gained by workers and managers from one industry can be transferred to other areas of the economy providing an important spur to growth and development (Dasgupta and Stiglitz 1988). Portugal lost this potential advantage, and the country even suffered long-term negative disadvantages from the decline of its textile sector, even if there were short-term gains from trade. In a more modern setting de-industrialization in the pursuit of comparative advantage may mean the loss of skilled labor jobs and important production processes to other countries. Labor unions in the industrialized countries have been especially concerned about such job losses to countries that have lower wage scales (a comparative advantage). Arguments about de-industrialization are actually quite difficult to evaluate in many cases since the effects of comparative advantages are sensitive to productivity levels and other factors as well as wages.

Other economic arguments have been put forward to justify protectionist policies. Some are based on what are considered to be special exceptions. One of the oldest is the infant industry argument that included among its proponents Alexander Hamilton when he was the first Secretary of the Treasury in the United States. The idea underlying the infant industry case is that new domestic industries cannot possibly compete with established foreign firms, not even in their home market; thus, a period of protection is necessary to permit these firms to have an advantage in the domestic market if they are to become truly competitive. This protection can create a new industrial base or prevent national de-industrialization. Portuguese textile manufacturers might have survived to maturity had they not been thrown to the British wolves, according to this view. The United States created its first industries behind protective tariff barriers (with the protection supplemented by the judicious pirating of key technology with little regard to intellectual property rights). Industrialization in the German Empire occurred behind the tariff walls created by Bismarck. At the other end of the industrial life cycle from infant industries are cases of very mature industries that are in decline. It is suggested that these industries need protection so that their demise can be controlled and so that the displacement of workers and resources is more gradual. In yet other circumstances industries may face surges in import competition from new foreign producers—perhaps even from former infant industries that had received protection from their governments and have matured. Protection becomes necessary in the short term so that these industries can adjust to the new competition—by applying new technology, shifting away from the production of non-competitive goods and moving to more specialized production, or by undertaking other adaptations that will improve their level of competitiveness. Government subsidies to threatened firms as a form of disguised protection can also provide an effective mechanism for improving the competitive position of domestic producers.

It should be noted that protection justified for infant industries, mature industries, or industries facing a sudden surge of imports is designed to be temporary. Infant industries mature, declining industries disappear, and the threatened industries adapt. In point of fact, however, protected industries often develop a political power base. Investors or owners, management, workers, suppliers, and local communities where factories are located have every incentive to maintain protection if such is essential for the survival of a company or a plant, and the resulting political pressure will often prevail in governmental circles (Kurer 1996). Office-holders running for re-election need support from voters, while even leaders in most non-democratic systems must take public sentiment into account and may seek to avoid the negative consequences that could come with factory closings or loss of support among members of the business elite who are adversely affected by the withdrawal of protection.

Fair Trade

There is another group of rationales for protection. Many of these arguments assume or point out that the assumptions under which free trade is presumed to provide for global efficiency are not met. The presence of monopolies or duopolies rather than a multitude of small firms, undervalued or overvalued currencies, the lack of information or the presence of uncertainty, and the actions of other states that interfere with the free flow of goods are among the factors that undercut the proposition that free trade will be mutually beneficial. Supporters of these views argue for fair trade since free trade is an ideal that is seldom met in the real world. While unilateral free trade may still provide an excess of benefits over costs in some cases, in other cases states may gain advantages by not practicing free trade. One issue falling under the rubric of fair trade involves the effects of state trading companies These companies were often able to enter the international market as consolidated buyers and sellers for everyone in their country, and they frequently had the resources of their national government behind them, effectively increasing their market influence. Such companies were most prevalent when the former Soviet Union and its allies were centrally planned economies, but they are still important for China and some other countries today. Other countries use marketing boards, especially with agricultural goods, in an effort to influence prices offered in international trade. Other countries may use such state agencies to control or limit the amount of imports.

In some circumstances, countries feel justified in using countervailing duties (contingent protection) to offset foreign export subsidies, dumping, or predatory pricing that is designed to drive competitors out of business. To accept such practices without some sort of action often appears foolish, and the contingent protection can be justified in support of fair trade. Of course, there is always a danger that such countervailing duties that are designed to remove any advantages gained by interference in trade may be used to provide protection for domestic industries that are threatened by imports that are competitive without any government assistance. The likelihood of these practices becoming *de facto* protection has probably increased as the WTO has been successful in reducing other barriers to imports (Feaver & Wilson 2004: 229) In addition to this contingent protection (which may become more permanent and less contingent), in the real world some countries practice protection in other forms; consequently, it becomes essential for the remaining countries to respond to protect their own national interests—such as maintaining an industrial base. This protection can also provide countries with competitive advantages that will require some kind of response from countries adversely affected.

There is no doubt that countries continue to attempt to gain greater advantages at the expense of others than they would gain through free trade. There appears to be an infinite variety in the types of non-tariff barriers that can be used to limit imports. While some of these grey area measures have been eliminated by the new rules of the WTO, others still remain available for use as noted. Interestingly enough, while many countries may use a variety of measures in an attempt to protect domestic economic sectors from imports, some of them are much more adept at manipulating and using these barriers. The United States, on the other hand, has a reputation for being inept when trying to limit imports, unlike its major competitors (Bosworth & Lawrence 1989; Lutz 2001:436). What is less clear is the extent to which US political leaders and the general public have been aware of the relative ineffectiveness of these barriers.

Another issue related to the fair trade arguments is the idea that countries might be able to create comparative advantages for themselves (Gilpin 1988:163; Gray 1998:341). Infant industry protection is actually designed to create such advantages, but presumably where the advantages would otherwise exist. The United States was quite successful in the nineteenth century in doing so, as was Japan after World War II. Policies that help to shift trade patterns might also be effective in this regard. The formation of customs unions and free trade areas not only lead to trade creation among the members but have trade diverting effects as well at the expense of countries outside the trade areas and could lead to comparative advantages that might not otherwise exist. Similarly, scale economies can be efficient even when the norms of comparative advantage are violated, and prior protectionist policies that permitted a firm or a sector to develop the advantages that come with size could help to create such new situations (Baumol & Gomory 1996; Brander 1987).

In addition, brand name preferences, however they have been established—by protection or other means—can provide reputational comparative advantage that can be insulated from the effects of factor endowments (Chisik 2002). If comparative advantage can be created, it becomes possible for supporters of protection to argue that unthinking adherence to free trade ideas and comparative advantage, therefore, may not be a neutral proposition for all countries. Further, current interventions in the trading system to redress the previous effects of earlier protection may be necessary (Brander 1987). Of course, it is virtually impossible to measure the effects of previous protection to know how comparative advantage was modified or to know how much "correction" and of what kind to apply, and whether or not the new corrections are improving the situation or actually introducing greater distortions (McKay & Milner 1997).

There is one additional point that is important for the arguments surrounding the idea of fair trade versus the efficiency of free trade. The factor endowments approach that should specify where comparative advantages would be among nations cannot take into account the fact that a large volume of international trade flows outside the channels specified by trade theory (Gray 1998; Ruigrok 1991). Intra-company trade responds to additional influences than other trade, and intra-industry specialization has meant that capital rich countries export to each other, contrary to many of the expectations of factor endowments (Schott 2004). The presence of customs unions and free trade areas also creates different kinds of trade patterns as noted above. The existence of preferential trade areas in the past, in fact, may be one of the earlier trade practices that help to modify comparative advantage. It quickly became easier, for example, to identify the short list of countries that the European Communities/European Union did not have preferential trade agreements with as opposed to those countries that it did (Pomfret 1988:4-5). The fact that much trade may be less amenable to "true" comparative advantage, of course, reinforces the fears of those who argue for the necessity of fair trade.

Political Realities

Economists have decried the interference of politicians in economic affairs for decades. Even those economists who feel that interventions are justified may have doubts about the ability of politicians to make the right decisions about protection and fair trade. It is thought that governments are prone to make poor policy choices because of domestic political pressures (Caves 1987). There are, in fact, political issues involved in any consideration of the decisions involved in trade policy, and these political considerations may have few or marginal links to the economic rationales put forward to justify trade policy. National security issues and continued protection for infant industries, mature industries, and industries facing import surges have already been mentioned. Economic gains can be subordinate to other priorities as well. The United States acquiesced when West European countries limited imports after World War II, notwithstanding a general commitment to free trade by the United States. A strong, rebuilt Europe was a critical part of US defense policy vis-à-vis the Soviet Union, and the security interests were more important than total adherence to free trade ideas. Bismarck opted for protection in 1870 when Germany was united.

The "Marriage of Iron and Rye" was a collection of tariffs that gave benefits to the agricultural producers of Prussia and the industrializing regions of the new country and provided them with a reason to support the state. Forging national unity had a much higher priority for Bismarck than the overall economic efficiency of the tariff structure. Politicians may also be much more concerned about the jobs that are saved just before an election than the jobs that may be created three years in the future. Of course, the politicians often take a short-term view because the voters hold the same temporal view. The electoral cycle in democracies often accentuates the short-term perspective in policy making.

Conclusions

Ultimately, it is not possible to argue that free trade always is a better policy than protection. Economists disagree among themselves about the choice of free trade and its advantages. Politicians respond to different priorities, including the desires of the voters who put them into office (and who stand ready to put their competitors into office). Governments and leaders may also have other, non-economic priorities that are higher at times than the economic ones, and needless to say it is impossible to argue that economic priorities take precedence over political ones (or vice versa). Political realities will force the hands of leaders who may undertake actions that have high economic costs. In addition, governments have to deal with many policies and issues that are not primarily economic or which are not economic at all. As a consequence, policies are made on non-economic grounds at least some of the time.

Ultimately, as much as we might like to have an answer for the continuing debate over free trade and protection that serves for all occasions, no such answer exists. Most supporters of free trade or freer trade, as noted above, accept the need for some exceptions to the general principles. The greatest supporters of national interest and mercantilism will support free trade when there are clear absolute and relative advantages for the country and if actual or presumed rivals benefit less. It is somewhat easier to phrase the question as a debate between one side that favors freer trade most of the time and the side that favors an increase in protectionism. At the current time, economists have sided most frequently with the freer trade side of the debate, and politicians have often been persuaded to take the same view because of the economic benefits that accrue to their countries; hence, the progress towards freer trade under GATT and the creation of the WTO. As a consequence, the possibility of the collapse of the economic system due to trade wars and economic nationalism as occurred prior to World War II does not look like a major threat in the immediate future, but then totally free trade is also a rather utopian vision.

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Free Trade and Protection: Comparative

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Introduction

It is well known that reaching a consensus among economists on any topic is difficult. Among the few topics in economics on which pretty much every economist will take the same stand is the argument for free trade. Put in its simplest form, free trade allows trade to take place based on each country's comparative advantage benefiting every nation—rich and poor—because it will allow for more efficient use of resources via specialization. Nonetheless, empirically we see a wide variety of protectionist policies in use. Why do we actually see protectionist policies being implemented despite the arguments by economists that free trade is the best practice for all practical purposes? Some of the general arguments calling for trade protection can be summarized as the infant-industry argument, the labor argument, the national security argument, and the retaliation argument. One of the most widely used form of trade barriers are tariffs. Besides tariffs, we observe barriers in the form of quotas, export subsidies, government procurement policies, health and safety standards, and failure to protect intellectual property rights. Over the last 50 years we have observed a large increase in the volume of trade, relative to the growth of overall GDP, indicating an overall reduction in protection practices. One of the developments that contributed to the wider practice of free trade has been the establishment of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). Trade has also been enhanced by many regional trade agreements that have taken place.

In the rest of this article we will first discuss the benefits of free trade, and the different arguments for trade protection in a little more detail. Then we will turn to a detailed discussion of the different practices of trade protection and the institutional developments that have reduced these practices. After discussing gains from trade, we will conclude with some lessons for the future.

The Benefits of Free Trade

As was stated in the introductory paragraph, most economists believe that free trade will benefit every nation. The most widely recognized benefits of free trade are the gains in terms of higher national welfare due to trade based on comparative advantage. However, there are many additional benefits of free trade, including increased economies of scale. Protected markets result in larger number of firms internationally, which prevents the gains from larger scale production. Another argument for free trade is that free trade will encourage entrepreneurs to seek new and different ways to increase exports. Managed and protected trade, where the goods to be exported and imported are government-determined, on the other hand, will result in less innovation and learning taking place.

There are also political arguments for free trade. While most economists argue for free trade in practice, free trade is a first-best policy only for a small country that has no control over its terms of trade. For a large country, a suitably chosen tariff *cum* quota can always increase welfare relative to free trade. This is the optimal tariff argument. Even though the demonstration of the optimality of free trade can only be made in a very restricted, special case model, most economists favor free trade on political grounds. The reason is that what proves to be beneficial in theory may not prove to be the case in practice because trade policies are influenced by interest group politics. It is probable that the protection policy adopted by a government agency will become a redistribution practice for some interest groups.

Two major theories of trade patterns predict the distribution of the gains from trade among groups within society. First, the Stolper-Samuelson Theorem, when combined with Heckscher-Ohlin trade theory, predicts that opening to freer international trade will benefit the owners of a country's relatively abundant factor(s) and actually harm the owners of the relatively scarce factor(s). For example, if we think of the United States as being abundant in college educated (highly skilled) labor relative to its trading partners, especially developing countries, then increased openness should increase the wages paid to college educated workers and lower the wages of non-college educated workers. Thus, the model predicts the common result in the U.S. that unions—as representatives of non-college educated workers—generally oppose free trade agreements, especially with developing countries.

The other model that makes a similar, but distinct prediction is the specific factors model. This model assumes that factors differ in their mobilities between various industries. For example, bank capital may be able to move from sector to sector with great ease while arable land tied to agricultural production. The model predicts that opening to increased trade will harm the owners of factors specific to import industries. Thus, the model correctly predicts that protection of agricultural interests in developed countries will be a high priority since groups with highly concentrated interests tend to form more effective lobbies.

A closely related benefit of free trade is connected with rent-seeking behavior. In making resource allocation decisions firms make a determination on spending for rent seeking (e.g. lobby efforts) relative to investments meant to increase productivity. This decision is determined by the rate of return to investment in rent seeking relative to other investments. A government that commits itself to free trade eliminates the incentive to spend on rent seeking. Free trade thus focuses investment spending by firms on profitability based on efficient production rather than rent seeking.

Moreover, although protecting the domestic industry may prove to be the best strategy in theory, *assuming* other countries' actions do not change, in real life this may not be so simple. If a country chooses to raise tariffs for whatever reason, this may easily be followed by a retaliation, leading to a tariff war, and reducing the welfare of all involved countries.

Besides the danger of retaliation another factor, which is specifically important for developing countries is corruption. The negative impact of government and business rent-seeking activity on growth and the level of income per person is enormous. Transparency International (2002) publishes an annual index of corruption for over 100 countries. This index alone explains a large percentage of the variation in income per person across the world. Richer countries are generally less corrupt that poorer ones. Open trading arrangements tend to diminish the levels of corruption in business and government transactions due to increased competition and improved transparency. Thus, the growth effects of trade are felt directly as discussed above and indirectly through its effect on corruption.

Based on the arguments for free trade outlined above, one can summarize that most economic theory concludes that deviating from free trade is costly; that there are some benefits besides higher national welfare which add to the benefits of free trade and which are difficult to measure; and that although sometimes protection may be the best practice in theory, the actual practice will most probably result in more harm than good.

Arguments for Trade Protection

So, if free trade is the best in practice, and deviating from free trade is so costly, why do we see the different trade protection practices? Is it possible that there are some valid arguments for protection? We will follow Husted and Melvin (2004) in grouping the arguments for protection under two headings: valid and non-valid. However, before moving on to these, it should be stated that the basic reason for the government to pursue any protectionist policy is demands from its citizens, whether as individuals or organized groups. Demand for protection will of course come from the group that will benefit from it. And it should also be noted that there will always be winners and losers from protection. Generally, economic theory suggests that the losses will be smaller than the gains. One reason for governments pursuing policies that lower overall welfare is that these policies benefit more organized and powerful lobbies. Thus, they are used as a tool for getting re-elected.

There are several popular arguments for protection that most economists consider invalid, such as patriotism, employment (increasing the aggregate employment rate by causing a shift in demand from imported goods to domestically produced goods), the fallacy of composition (the argument that if protection is good for one industry, then it must be good for all industries), fair play for domestic industry (protection against the unfair competition of foreign countries), and preservation of the home market.

Arguments that are generally accepted as valid are government revenue, income redistribution (from one sector of society to another), national defense, infant industry protection (protecting a newly established industry from foreign competition until it becomes competitive), domestic distortions (use trade protection policy to ensure that another policy reaches its goal), protecting the environment, and the terms-of-trade argument discussed above.

Although some of the arguments for trade protection are characterized as 'valid', this does not necessarily imply that protection policies should be used. As was briefly discussed above, there is a difference between the best practice in theory and the best practice given political realities. Although it is possible that a protection policy such as a tariff may increase the welfare of the country imposing the tariff, it will only be at the expense of a lower welfare for another country. And because benefits will be less than costs associated with protection, overall welfare for the world will decrease in the sense that additional distortions to the system are created resulting in net deadweight losses. Moreover, with any type of protection, there is the danger of retaliation, which will end up lowering the welfare of all involved countries.

Trade Protection: Policies and Practices

Now we turn to the discussion of the different types of trade protection policies, also called commercial policies. As mentioned above, one of the most widely used trade protection policies is the tariff. *A tariff* is a tax imposed on imports, and as such it increases the price of imports, protecting domestic production. Tariffs will generate losses because they protect the inefficient domestic firms, and prevent domestic customers from being able to buy the cheaper foreign products. In practice, there are three different types of tariffs: *ad valorem* tariffs, specific tariffs, and compound tariffs. An *ad valorem* tariff is a tax in terms of a percentage of the selling price of the product. A specific tariff is levied as a fixed amount of money for each unit of a good imported. Lastly, a compound tariff is a composition of an *ad valorem* and a specific tariff.

The average tariff for a specific country is calculated in two ways: an unweighted-average tariff rate is simply the average of all tariffs imposed on different products, and a weighted-average tariff rate is calculated by weighting each product according to its importance in the total amount of imports.

Tariffs are imposed on final as well as intermediate goods. Therefore, the actual level of protection on any product depends on both the tariff rate and the tariffs imposed on any inputs that are used to produce it. Thus, it is important to look at the effective rate of protection, which takes both into account. In practice, it is not uncommon to see negative effective protection rates, which will be the case if the tariff on the final product is lower than the tariff on the intermediate products used in its production. In this case it is still cheaper to import the final product instead of producing it domestically. If, on the other hand, the tariff on the final product is higher than the tariff imposed on intermediate goods used in its production, the effective rate of protection will be higher than the nominal rate. In this case it is cheaper to produce the product domestically. The effective rate of protection tends to be positive for agricultural and manufactured products, and negative for primary products and services (Södersten & Reed 1994).

The worst effects of tariffs can be felt when a tariff imposed by one country leads to a tariff war: a general imposition of tariffs throughout the world leading to a reduction in world trade. The latest great tariff war was provoked by the Smoot-Hawley Tariff bill, which was enacted by the United States in 1930 with the purpose of stimulating the US production and reducing unemployment. Following this bill, average tariff levels of the U.S. increased to 60 percent. Retaliations followed almost immediately, and by 1933 world trade decreased to almost one-third of its level in 1929.

Other methods of trade protection similar to tariffs, but related to exports are *export taxes and export subsidies*. An export tax is a tax imposed on goods produced domestically for sale abroad. An export subsidy is a negative export tax, where the government pays domestic firms to sell their products abroad. Export subsidies are believed to result in “unfair trade” practices, and as such are widely opposed. Export subsidies are implemented in many different ways, like tax rebates, government funding for research and development, coverage of losses, direct grants and subsidized loans, etc. Export subsidies have been used by developing countries as a part of their export-led growth strategy, and are also part of Europe’s Common Agricultural Policy. One way to cope with export subsidies is to impose a tariff on the subsidized product to offset the subsidy and increase its price. Such tariffs are known as countervailing duties.

An import quota is a government imposed quantity limitation on imports. The effects of quotas are very similar to the effects of tariffs with the main difference being that the government revenue collected with tariffs is in this case distributed to license owners. The revenue from the sale of these licenses may accrue to government if the licenses are auctioned off. Quota licenses give the right to the owner to import into the country a specific amount of the product for a specific period of time. An interesting question with quotas is then the decision of how to allocate licenses. Because quotas are viewed as being more restrictive that tariffs, and in fact they are illegal under the General Agreement on Tariffs and Trade (GATT) rules, their use has been replaced by tariffs or tariff rate quotas (TRQs). TRQs allow for a certain amount of a product to be imported with no tariff, and apply higher tariff rates to any amount exceeding the quota. Tariffs and quotas (mainly tariffs) have been used by developing countries as a part of their import-substitution policy towards growth and development.

There are many other types of non-tariff barriers. *Government procurement* policies are in force when the government is constrained to buy its goods and services from domestic producers. This practice has been used in the U.S., Britain, and Japan as well as many other countries. Similarly, *domestic content* provisions stipulate that a given percentage of the value added for a product has to come from domestic suppliers, or has to be produced by domestic labor. As part of the Uruguay Round agreement in 1994, the WTO Agreement on Government Procurement was signed by Canada, 25 European Community States, Hong Kong China, Iceland, Israel, Japan, Korea, Liechtenstein, Netherlands with respect to Aruba, Norway, Singapore, Switzerland, and the United States. This plurilateral agreement rests on non-discrimination on the basis of most-favoured-nation and national treatment, and it explicitly prohibits the use of domestic content clauses.

Imposing *health and safety standards* is another way of limiting trade. In this case, a particular government may regard certain products as hazardous to the health and safety of its citizens. The latest major dispute on this issue has been the limitation of genetically modified and growth hormone used in U.S. products from the EU markets. Although the imposition of health and safety standards by governments is completely legitimate, it also gives an incentive to local producers to lobby for trade protection. At the same time, the current World Trade Organization (WTO) regulations on health and safety shift risks onto consumers by stating that potentially dangerous products can be banned only after conclusive scientific evidence.

Failure to protect intellectual property rights is yet another trade-limiting policy. Patents, copyrights and trademarks give the inventors the exclusive rights over a product over certain period of time, and as such they encourage the invention of new products. Different countries have different levels of protection for intellectual property. This can have important effects on international trade. More specifically, a failure to protect intellectual property rights can result in great losses to exporting firms by limiting potential exports due to generic production or piracy practices. Economic policy in this area is often a delicate balancing act that needs to take into account both the rights of producers to maintain control over the use, sale and distribution of their products and the need for these products to be sold at prices that the poor can hope to afford. An example of the development of coherent policy in this area is offered by the agreement recently brokered by the WTO between drug companies and developing countries over the issue of the generic sale of HIV/AIDS drugs. The agreement allows the sale of generics in developing countries while ensuring adequate safeguards against resale of these drugs in developed countries. While this agreement represents an attempt at enhancing drug access in less developed and developing countries, the issue is far from being resolved.

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) is used to define international application of intellectual property rights. The pharmaceutical industry is the most controversial application of TRIPs, because TRIPs are viewed as limiting poor’s access to medicine. At the request of the African Group, consisting of 41 countries, and supported by many other developing countries, the issue of intellectual property rights and access to medical drugs was discussed at the Doha Round in November 2001. Agreement was reached that “the TRIPs Agreement did not and should not prevent Members from taking measures to protect public health”. However, although the TRIPs treaty contains provisions allowing for the possibility of overriding patents to protect public health through compulsory licensing and parallel imports, the Doha Round could not resolve the issue of compulsory licensing for countries having insufficient or no capacity to produce their own medicine. This issue combined with the debate on the disease coverage of these provisions raises questions on the full legal enforcement of these provisions.

Another issue related to TRIPs is the so-called bio-piracy. Bio-piracy is the use of wild plants and indigenous knowledge by international companies to develop and produce various drugs without sharing profits with countries from which these were taken. Absence of laws regulating access to these resources results in many court cases by developing countries over patents on their indigenous plants and knowledge.

The failure to address the problems related to medicine access and the complaint by developing countries that their intellectual property is being stolen led to the breakdown of the meetings in Cancun in December 2002.

The non-tariff barriers discussed above are a few examples of the different types of protection used in the past and/or in use today. Laird and Yeats (1990) provide a glossary with more details on many different non-trade barriers that were not discussed here.

Besides economic rationales for imposing limits on trade, political factors play a major role. The use of trade limitations (especially tariffs, quotas, embargoes, which are complete bans on trade in specific goods) as a way of punishment for non-compliance with some agreements or pre-established rules has been a widely used practice in recent years.

Considering the costs related to trade protection and the loss of welfare, there are different agreements that are aimed at reducing trade barriers of any kind, and these will be discussed next.

Institutions Promoting Trade

On the bilateral basis, a country may grant to another country a most favored nation (MFN) status, which means that this country agrees not to charge tariffs to the other country that are higher than the tariffs it charges to any other country. On the multilateral basis, the generalized system of preferences (GSP) is a system in which developed countries impose lower tariff rates on some products imported from some developing countries. The GSP has been an achievement of the United Nations Conference on Trade and Development (UNCTAD). The first country to establish a GSP was the U.S.A.; some others include Canada, the EU and Japan. The aim is to increase the living standards in developing countries as well as to increase the demand for products exported by the industrialized countries.

Besides GSPs, regional trade agreements (RTAs) play an important role in removing or at least reducing trade barriers among the member countries. Such regional arrangements, generally involving neighboring countries, are called preferential (or discriminatory) trade arrangements. Preferential trade arrangements can be grouped into free-trade areas, and customs unions. In a free trade area agreement member countries remove barriers among themselves, however they keep the existing individual barriers against non-member countries. In a customs union, on the other hand, member countries remove barriers among themselves, and they impose common barriers against non-member countries. Many countries today are members of one or more preferential trade arrangement. By the end of 2005, the total number of RTAs in force is expected to approach 300.

The largest customs union existing today is the European Union, founded in 1957 originally among six countries: Belgium, France, Italy, Luxemburg, Netherlands and West Germany. Today the EU has grown to include 25 countries in total. Other examples of customs unions are the Economic and Customs Union of Central Africa (UDEAC), the Economic Community of West African States (ECOWAS), the Economic Community of Central African States (CEEAC), and the Arab Maghreb Union (AMU) in Africa; and the Central American

Common Market (CACM), the Andean Pact and the Southern Cone Common Market (MERCOSUR) in Latin America. Examples of free trade agreements are the Association of Southeast Asian Nations (ASEAN), and the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERT) in Asia; the European Free Trade Association (EFTA), and the Central European Free Trade Agreement (CEFTA) in Europe; and the North American Free Trade Agreement (NAFTA) in North America.

In Africa, the UDEAC was established in 1964 and includes six countries as members (Cameron, Central African Republic, Chad, Congo, Equatorial Guinea and Gabon). A common tariff to non-member countries was imposed in 1990 by four member countries (Cameroon, Congo, Central African Republic and Gabon). The ECOWAS was founded in 1975, includes fifteen countries (Benin, Burkina Faso, Cape Verde (joined in 1977), Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Leone, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra and Togo) and has economic and political union among its goals, both yet to be achieved. The CEEAC was founded in 1981 and it allows free movement of labor and capital within the ten member countries, which are Angola, Burundi, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Rwanda, and Sao Tome and Principe. The AMU was established in 1989 and it also allows free movement of labor and capital within the five member countries (Algeria, Libya, Mauritania, Morocco and Tunisia).

In Latin America, the CACM was established in 1960, collapsed in 1969 because of the war between two of its members (Honduras and El Salvador), and was reactivated in 1993 with Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama as members. The Andean Pact is a continuation of an earlier pact among its members, Bolivia, Colombia, Ecuador and Venezuela, which was reestablished in 1994. The MERCOSUR was launched in 1991 among four countries, Argentina, Brazil, Paraguay and Uruguay, and in 1995 a common non-member tariff was imposed.

In Asia, the ASEAN was founded in 1967 with six members (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) the reduction of trade barriers among which has been a slow and lengthy process because of the on-product-basis negotiations. The ANZCERT was established in 1983 between Australia and New Zealand and it covers goods and services.

In Europe, the EFTA was formed in 1960, and currently includes four countries (Iceland, Liechtenstein, Norway and Switzerland). Three of the members, Iceland, Liechtenstein and Norway, are also part of the European Economic Area (EEA) agreement, which is a free trade agreement between EFTA and EU countries. The EEA includes not only free trade in goods and most services, but also a single labor market. The EFTA countries have also signed free trade agreements with twelve other countries (Bulgaria, the Czech Republic, Estonia, Hungary, Israel, Latvia, Lithuania, Poland, Romania, Slovenia, the Slovak Republic and Turkey). The CEFTA was established in 1993, and currently has seven members: Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

The NAFTA was established in 1994 among Canada, Mexico and the U.S. Tariff reductions were to be completed gradually. Most manufacturing products were to be completed by 2004, and agricultural products are due for completion by 2008.

Since the end of World War II, the volume of international trade has increased rapidly, as trade barriers have decreased significantly. Part of the reduction of trade barriers was the success of the different bilateral, multilateral and regional arrangements discussed above. Another factor that has contributed to these developments in trade has been the establishment of the WTO, which is discussed next.

The World Trade Organization (WTO) is located in Geneva, Switzerland, and it was established in 1995. The WTO was created by the Uruguay Round negotiations in 1986-1994, and it is at the same time a successor to the General Agreement on Tariffs and Trade (GATT). The WTO is an international institution whose main goal is promoting free trade. The WTO acts as an intermediary between member countries, facilitating their agreements, and resolving their disputes. As of April 2004, the WTO has 147 member countries, which in total account for more than 97 percent of world trade. Most WTO members are developing or least-developed countries (LDCs). The WTO is the only global organization that deals with the rules of trade between countries. The main functions of the WTO can be summarized as administering WTO trade agreements, creating a forum for trade negotiations, handling trade disputes, monitoring national trade policies, providing technical assistance and training for developing countries, and cooperating with other international organizations. The functions of the WTO help in the creation of a strong trading system. WTO negotiations have contributed to tariff-free trade in goods, financial services, telecommunications and information technology products.

All WTO agreements contain special provisions for LDCs, which include longer time periods to implement agreements, measures to increase their trading opportunities, handle disagreements and implement technical standards. However, developing countries have difficulty using these special provisions. At the Doha Round developing countries were promised that implementation issues regarding special and differential treatment will be tackled in the future. Since Doha, however, no concrete commitments have been made by any developed country Member, leaving many of the provisions in the 'best endeavour' category, or to be solved in the future.

As was mentioned above, the WTO was created by the Uruguay Round. The main objectives of the Uruguay Round were to continue the negotiations on the reduction of non-tariff barriers, to enlarge the scope of negotiations to include trade in services, and to deal with restrictions in agricultural products. The most difficult objective to achieve has been the reduction in trade protection of agricultural products, because most countries use some type of protection for the domestic agricultural sector.

The outcomes of the Uruguay Round were several. First, as can be seen from Table 1, tariff rates were reduced by 34 percent on average, and by 39 percent by developed countries. By 2005, the average tariff rates on industrial products will reach 4%. Moreover, tariffs on products such as pharmaceuticals, construction and agricultural equipment, furniture, paper, and scientific instruments were reduced to zero by developed countries.

Table 1: Average Tariffs on Industrial Products

Area	**Trade-weighted tariff averages (%)**		
	Pre UR	**Post UR**	**Reduction**
Imports by all countries from:			
World	9.9	6.5	34
North America	8.9	5.5	38
Latin America	9.1	6.1	33
Western Europe	9.8	6.1	38
Central/East Europe	7.7	5.7	26
Africa	3.9	2.7	31
Asia	11.4	7.8	32
Imports by developed countries from:			
World	6.2	3.7	40
North America	5.1	2.8	45
Latin America	4.9	3.3	33
Western Europe	6.4	3.5	45
Central/East Europe	4.0	2.4	40
Africa	2.7	2.0	26
Asia	7.7	4.9	36
Imports by developing countries from:			
World	20.5	14.4	30
North America	23.2	15.7	32
Latin America	27.6	18.5	33
Western Europe	25.8	18.3	29
Central/East Europe	18.4	15.1	18
Africa	12.3	8.0	35
Asia	17.8	12.7	29

Source: Adapted from World Trade Organization Legal Texts, "The Uruguay Round", http://www.wto.org

Second, a decision was made that over a six-year period agricultural subsidies are to be reduced by 36 percent, most of the domestic support for agriculture is to be cut by 20 percent, and average agricultural tariffs in developed countries are to be reduced by 36 percent. A third decision was related to textiles and apparel. The Multifiber Arrangement that was established in 1960s between about 50 countries had established a quota framework for textiles and apparel. The agreement reached in the Uruguay Round was to move these two sectors out of the Multifiber Arrangement framework into the GATT framework with the agreement to reduce tariffs to zero over ten years. It was estimated that world trade in these products will increase by 34-60 percent by 2005. Additionally, rules regarding dumping and exports subsidies have been revised, and a decision has been reached to abandon the use of voluntary export restraints (VERs), although their use today is legal. Also, the rules related to intellectual property rights have been revised.

The Uruguay Round has been regarded as a success when trade in goods is considered. Unfortunately, the same success was not achieved in the services sector, which has been the topic of succeeding negotiation rounds. Moreover, tariff reduction has not been even across sectors. These include higher tariff rates for agricultural and textile products. Average tariffs by OECD countries on textile and clothing imports from non-OECD countries are as high as 12%. Additionally, despite the lower tariff rates in industrial products, protection is still alive in the form of non-tariff barriers (NTBs). Also, tariff escalation (tariffs increasing according to the degree of processing) vis-à-vis developing countries was not abolished by the WTO. Perhaps most importantly, the two most important sectors for developing countries—agriculture and textile—remain highly protected by developed countries.

Agricultural subsidies in industrial countries have increased during the 1980s. Today, average bound tariffs on agricultural products are still very high—above 40%. Annual agricultural support in OECD countries in 1999 has reached USD 361 billion, which is twice the value of total agricultural imports from developing countries. The current WTO framework allows for the dumping of agricultural products by developed countries, which is another important problem for developing economies. Dumping refers to the practice of charging a lower price for a product that is sold in another country as compared to the price for which that same product is sold domestically. Dumping is reported by a percentage number, where this number reads that the particular product has been exported at an average price x% below its cost of production. Dumping by US for 2002 has been reported as 43% for wheat, 25% for soybeans, 61% for cotton, and 35% for rice. Although dumping is prohibited by Article Six of the GATT, the rules require that countries demonstrate harm to the sector involved, a practice that makes it difficult for poor countries to challenge agricultural dumping. NTBs are also used in the agricultural sector. In early 1990s, about 38% of agricultural imports and 18% of manufactured imports have been subject to NTBs, and these do not seem to be falling.

The disparities between the treatment of manufactured products and agriculture has led to the criticism that the WTO has been focusing on the welfare of developed countries at the expense of the developing world. The costs of the differential treatment of agriculture for developing countries has been high. Stiglitz (2003), for example, makes a strong argument against the current trade system based on the cost to developing countries. The interesting new element in the Doha round has been the rise in power at the WTO of developing countries. While the Doha round is currently underway, it appears that this power shift is putting new pressure on developed countries to consider major reform in long standing protectionist agricultural policies. The three key elements of the latest—Doha—Round regarding the agricultural sector, namely the elimination of export subsidies, the reduction of domestic support, and special and differential treatment, remain to be achieved.

Another topic that developed countries have been seeking is the development of more common standards in the labor market: child labor, health and safety standards in the workplace, hours of work both per day and per week. Common standards related to environmental pollution is another issue that remains to be resolved.

Gains From Trade Liberalization

Developing countries' share in total merchandise trade in the years between 1985-1995 has been only around 22%. Lower tariffs around the world are expected to promote global welfare by increasing the trade volume between countries. Gains from tariff reduction have been estimated in many different papers, and "the most striking feature of [the different] trade models is their ability to project wildly different outcomes when modeling an identical policy" (Weisbrot and Baker 2002:4). On one hand, there is the group of papers that argue that there are large welfare gains from trade liberalization for both developed and developing countries. On the other hand there is the group that is more skeptical about such findings, arguing that costs of liberalization may turn out to be larger than gains especially for developing countries. Below is a selected review of this research avenue.

Among the first group, Goldin and Van der Mensbrugghe (1993) estimate that partial liberalization achieved by 30% reduction in protectionism in agriculture, compared to a base simulation, will generate annual income gains of USD 195 billion in year 2002 (in 1992 dollars), of which USD 91 billion would go to developing countries. Total gains from complete liberalization were estimated at USD 447 billion, of which USD 221 accrues to developing countries.

The 2003 OECD Policy Brief reports that in the worst case, "taking the fully implemented Uruguay Round as a starting point" (pg.4), a 50 percent cut in tariffs overall yields total annual gains of USD 117 billion. In each case gains are pretty much shared equally between developed and developing countries. Similarly, Goldin, Khudsen and Van der Mensbrugghe (2003) report the gains from total merchandise liberalization to be around USD 374 billion for developing countries and USD 246 billion for developed countries in 2013. Around 60 percent of these gains come from a full removal of distortions in the agriculture and food sectors alone.

Goldin and Van der Mensbrugghe (1995) estimate the welfare gains of the Uruguay Round with different scenarios. In four out of the five different simulations that authors have estimated, most of the welfare gain (68-80%) accrues to developed countries. Other research that reports larger relative gain for developed countries is the USDA Agricultural Economic Report (2001). According to their findings, eliminating protectionism in agriculture will result in an annual global welfare gain of USD 56 billion, of which USD 35.1 billion (about 63%) accrues to industrialized countries, and USD 21.3 billion (about 37%)—to developing economies.

The short review of the studies estimating welfare gains from further liberalization makes it necessary to emphasize several points. First, these are estimations based on specific assumptions, and having specific baselines; as such should be interpreted with caution. Second, despite the different findings on how the gains are actually distributed between developed and developing countries, all these different studies agree that in general the countries to gain most are the ones liberalizing the most. Third, although some studies find larger gains for industrialized countries in USD terms, it should be noted that in relative terms, as a portion of GDP, gains to developing countries are much larger when compared to gains accruing to developed countries as a group. Fourth, liberalization is also costly, and some least developed countries are estimated to suffer losses. In each case however, gains are larger than losses. Thus, guaranteeing international community support for these countries can be crucial.

Weisbrot and Baker (2002) emphasize the different costs that developing countries will have to incur with further liberalization of the type promoted by the WTO. Among the more obvious costs they discuss is the loss of government tariff revenues that will have to be compensated by higher taxes, which in turn will lead to a higher deadweight loss (i.e. loss in welfare). Others are the terms-of-trade effect (whereby the relative price of a product may fall as a result of liberalization generating lower revenues for developing countries), the loss of the benefit (lower prices) of subsidized agricultural products to consumers in developing countries, and the fall in prices of products exported by developing countries with the elimination of quotas. Other less obvious costs are the dangers of social and economic instability due to disruptions in agriculture, which are associated with higher unemployment rates and higher foreign exchange reserves. Also, TRIPs, they argue, impose another cost from liberalization since developing countries have to pay large sums of money in terms of license fees and royalties. In sum, the authors argue that it is possible that costs from liberalization exceed gains.

Conclusions and Lessons for the Future

In this study we discussed the gains to be made from free trade by presenting the arguments pro and against free trade, as well as discussing some costs associated with this process. Whether gains or costs related to further liberalization are higher is a heated debate. However, from the existence of hundreds of regional agreements, one tends to conclude that at least on the regional level, gains have been perceived as being larger than costs, and that many countries are aware of these gains. The international negotiations up to this point have been very successful in reducing tariffs throughout the world on industrial products, increasing the welfare of many nations. However, more remains to be done in regards to the services and agricultural sectors, the labor market, and environmental protection. Other protection types besides tariffs (non-tariff barriers) need to be addressed more carefully.

One should also be careful when interpreting the literature on gains from further liberalization. At this point it seems difficult to conclude with contentment that currently proposed new trade agreements will promote welfare in developing countries. The one general point to be made is that economists should be very careful when formulating their models, and policymakers should be careful when using these estimates in formulating their policies.

It is our belief, however, that further enhancement of free trade can lead to further increases in welfare, if ways are found to better incorporate the developing and the least developed countries into this process, and by promoting liberalization by developed countries in sectors most important for developing countries, namely, agriculture and textile. We believe the key to a successful liberalization is that all members’ interests and worries are taken into account very carefully.

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Geneva Conventions

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Introduction

The Geneva Conventions are four treaties governing the protection of the wounded and sick in the armed forces in the field or at sea, prisoners of war (POWs), and civilians. The first Convention was drafted in 1864 by the newly created International Committee of the Red Cross (ICRC) in reaction to events of the Crimean and U.S. Civil Wars. The Conventions were modified and expanded several times in response to changing conditions and experiences of war. In 1949, the four modern conventions were adopted. In 1977, two Protocols designed to address new methods of warfare, greater protection of civilians, and protections during non-international conflicts were created. The Conventions enjoy near universal acceptance, with ratification by over 190 countries. The Conventions' over 85,000 words are the most comprehensive effort to date to codify the humanitarian laws of war and have become the basis for international prosecutions of war crimes. Over time, controversies have arisen over whether Protocol I should be ratified, how to modify the Conventions for a world in which intrastate war has become far more common and brutal than international war, how the Conventions apply to the War on Terrorism, and several current issues of the international system.

Key Rules of the Geneva Conventions

There are four key areas common to the four Conventions. First, they "apply to all cases of declared war or of any other armed conflict which may arise *between two or more of the High Contracting Parties*, even if the state of war is not recognized by one of them" (emphasis added) (Convention I Article 2; II:2; III:2; IV:2). This phrasing means that combatants in wars of indigenous people seeking freedom from colonial rule and most civil wars are not accorded full protection. Second, non-international conflicts are covered briefly, in Common Article 3, which states that soldiers in any conflict *within* a High Contracting Party should be "treated humanely," and prohibits particular acts such as torture and degrading treatment (I:3; II:3; III:3; IV:3). Third, to ensure that the Conventions are respected, Parties should accept the supervision of Protecting Powers or of the ICRC. This provision gave the ICRC unique international standing and reinforced its image as an important neutral intermediary. Fourth, the Conventions divide offenses between those subject to administrative or disciplinary sanctions and "grave breaches" that, as war crimes, require prosecution. Grave breaches include willful killing, torture, extensive destruction of property not justified by military necessity, willfully depriving a prisoner of war a fair and regular trial, and unlawful deportation of civilians (I:50; II:51; III:130, IV:174). If states do not prosecute persons accused of grave breaches, they must extradite them to a court willing to do so. The Conventions therefore serve as part of the basis for the International Criminal Tribunals for the former Yugoslavia and Rwanda (ICTY) and the International Criminal Court (ICC).

The first two Conventions, on the amelioration of the condition of the wounded and sick in armed forces in the field and the amelioration of the condition of the wounded, sick and shipwrecked members of armed forces at sea, are nearly identical in the their provisions. They define protected persons, provide for their treatment, assure the right of families to know the fate of their relatives, and protect relief and medical units.

The third Convention regulating the treatment of prisoners of war first defines who qualifies as a combatant and then, in detail, establishes rules for their treatment. Combatants include "members of the armed forces of a Party to the conflict, as well as members of militias or volunteer corps forming part of such armed forces" (III, 4). To qualify for prisoner of war status, members of militias, volunteer corps, or organized resistance movements must meet four criteria: being commanded by a person responsible for his subordinates, having a fixed distinctive sign recognizable at distance, carrying arms openly, and conducting operations according to the laws of war. If there is doubt about whether these criteria are met, the person is covered by the Convention until his status is determined by a "competent tribunal" (III:5). Any combatant who is captured becomes a POW and is governed by a wide variety of provisions on adequate physical conditions of internment, psychological conditions, contact with Protecting Powers or the ICRC, self-government by prisoners, and repatriation at the end of hostilities. People who do not meet the criteria of combatants are governed by the broader fourth convention on civilians.

The fourth convention on the protection of civilian populations was newly drafted in 1949 and remains the most comprehensive regulation of civilians in wartime. The Convention protects all people who, in the course of a conflict or occupation, are in the hands of an Occupying Power and gives special protection to certain groups such as children under 15, women, and journalists. Civilians do not receive all of the protections given to prisoners of war, but they are guaranteed fundamental rights in areas of life, health, degrading treatment, collective punishments and judicial procedures.

Provisions of Protocols I and II

In 1977, representatives again met in Geneva to clarify or modify certain terms in the Conventions and to deal with new concerns raised by the wars of the previous decades. Many of the changes included in Protocols I and II were not controversial, but there were significant changes. In response to pressure from developing countries, Protocol I makes the Conventions applicable not only to armed conflicts between two Parties of the Convention, but also to "conflicts in which peoples are fighting against colonial domination and alien occupation and against racist regimes in the exercise of their right of self-determination" (Protocol I, 1). Protocol I also modifies the definition of combatants by saying irregular forces are protected if they are under the command of a Party and subject to a disciplinary system that enforces compliance with the rules of war. The requirement of a distinctive sign was dropped and combatants are obliged to carry arms openly only during the military engagement.

Protocol I also merges the humanitarian rules of the Geneva Conventions with laws on the conduct of war included in the Hague Conventions. It states that "the right of the Parties to the conflict to choose the methods and means of warfare is not unlimited" (P. I, 35). The Protocol prohibits the use of certain weapons and projectiles, and requires combatants to distinguish between civilian populations and combatants and to direct military operations only against the military.

Protocol II extends protections for civilian populations included in Protocol I to non-international conflicts. It prohibits certain tactics such as starvation, and displacement of civilian populations unless it is imperative and satisfactory conditions are assured. It protects cultural property and places of worship. It also protects dams, power plants and other areas that, if attacked, would cause severe losses among the civilian population.

Controversy over Protocol

At their drafting, the Conventions drew some criticism from several groups: the Soviet Union, which entered certain Reservations to the treaty; from non-Western regions, which felt they imposed Western standards; and from military officials, who felt they unnecessarily restricted military tactics. These criticisms were relatively minor and the Conventions were still adopted by almost all states. On the other hand, Protocol I generated much more controversy. It was signed but never ratified by the United States and, in 2003, thirty states that are parties to the Conventions are not parties to Protocol I. About three dozen other states entered Reservations when ratifying or acceding. In 1987, President Ronald Reagan sent a letter of transmittal informing the Senate that he would not submit the treaty for advice and consent and calling it "fundamentally and irreconcilably flawed" (The U.S. Decision 1987).

The Reagan administration's views are laid out in his letter and by key advisers, Deputy Assistant Secretary of Defense Douglas J. Feith (Feith 1985) and Legal Advisor of the State Department Judge Abraham D. Sofaer (Sofaer 1986). Their arguments center first on the idea that the Protocol would help terrorists, in particular the Palestine Liberation Organization (PLO), and second on how the Protocol would affect the U.S. military. They argue that, by extending the Conventions to wars against alien occupation and modifying the definition of a combatant, the Protocol would make all national liberation movements be perceived as just, would grant terrorists immunity from prosecution for terrorist acts, and would enhance the international stature and supposed legitimacy of terrorist groups.

The critics, also, argue that Protocol I generates several problems for the military. First, it restricts attacks on certain civilian objects. Military officials sought to clarify that protection for places of worship would be lost if the sites were used by belligerents and that attacks on electrical grids are allowable. Second, the Protocol limits the possibility of belligerent reprisals, in which a state uses or threatens to use a reprisal, such as dropping a nuclear bomb, to coerce its opponent to stop violating international law. Under the Protocol, virtually the only legal reprisals are against enemy combatants, so many tactics would be outlawed. France joined the United States in objecting to this restriction. Third, the Protocol was felt to be too ambiguous and complicated to use as a guide for military operations. Finally, the Protocol raises questions about the use of nuclear forces and weapons of mass destruction by bringing in points from the Hague laws and by protecting civilians.

Supporters of the Protocol, argue that the critics' worries are unfounded and based on misrepresentations of the treaty language (Gasser 1987; Aldrich 1991; Meron 1994). On the terrorism points, the supporters argue that the definitional changes are really a dead letter. Some of the specific circumstances focused on in the Protocol, such as Portuguese colonies and apartheid South Africa, have changed. More, crucially, irregular groups are only protected if they agree to abide by the laws of war. Those laws include prohibitions against terrorism and other attacks on civilian targets, so by definition a terrorist can never be granted POW status and, even POW status does not confer immunity from trial for war crimes. Instead, Aldrich (1991) argues that the changed definitions actually enhance humanitarian compliance and protect civilians, since they make it more likely that insurgent groups will be able to meet the criteria of combatants and therefore agree to abide by the Conventions, which in turn lessens the chance that the government in power will crack down on all civilians indiscriminately.

On questions of military tactics, the supporters point out that military officials were intimately involved in crafting the Protocol and that, where ambiguities and problems remain, the United States could follow the lead of many of its NATO allies by using Reservations to clarify its interpretation of the Protocol. The Protocol supporters argue that, by refusing to ratify or suggest reservations, the United States risks losing its historic role in shaping the customary laws of war.

Extending the Conventions to Non-International Conflicts

Application of the Conventions to non-international events has been controversial since the Conventions' drafting and has taken on extra significance in recent years as the number of intrastate conflicts and their violence has escalated. As Best (1994) recounts, there were two major viewpoints at the drafting conference. One group argued that the conventions should be broadly applied to internal disputes. This group included representatives of the ICRC and others interested in expanding humanitarian law into a new arena, and the Soviet Union and others who saw the issue as a way of complicating matters for the Western colonial powers. The second group argued firmly against extending the conventions beyond international wars. This group included many of the colonial powers, as well as others who argued that extending obligations on the treatment of prisoners of war to those who would otherwise be termed rebels, criminals, or traitors to the state went too far. The issue was settled when the French suggested the compromise of Common Article 3, which acted almost as a convention within a convention by stating that while certain human rights standards were applicable to internal wars, the rest of the Conventions were not unless the parties reached a special agreement. The Common Article was adopted by a vote of 34 to 12; however, most of the developing world was not represented at the conference.

The Common Article 3 compromise was not without its own critics or problems. At the conference, General Oung, the delegate from Burma, argued that the Article might actually incite insurgency and make it difficult for governments to reassert control. He also argued that the major powers had established an extensive series of obligations for the international wars they were most likely to fight, but established few protections for the civil wars less stable developing countries would face. Most crucially, though, the Article did not specify who could declare a non-international conflict to be in progress, so this role reverted to the state involved. In general, it is not in the interests of a state to declare such a conflict since a declaration would formally recognize that their own power was being challenged. Also, while Article 3 states that it does not change the legal status of the Parties, in practice invoking the Article grants a degree of legitimacy to the insurgents. In reality, few states have declared non-international wars and Article 3 therefore has had little practical impact.

The relative decline in the frequency of international wars and increase in intrastate conflicts contributed to the development of Protocol II, designed to add protection for civilians in times of non-international war. Protocol II has not been universally accepted, so Article 3 remains central. Scholarly and legal debate has centered on the applications of Article 3's broad phrase "armed conflict not of an international character." Moir (2002) argues that this is best seen as two questions: 1) When has an action risen to the level of an "armed conflict"? And 2) Where is the line drawn between international and non-international?

The first question traces its origins to the conference debate on how to separate non-international belligerents from common criminals, mobs, or traitors. In his commentary on the Conventions, Pictet (1960) argues for a very expansive interpretation of "armed conflict," so that states are forced to follow basic human rights standards in dealing with almost any civil disturbance. Moir (2002), Draper (1965), Bond (1971) and others argue that Pictet's views are unworkable in practice and suggest various criteria to consider. Many agree that for Article 3 to apply, insurgents must show a degree of organization. There is debate on whether insurgents must exercise territorial control, whether insurgents must also agree to obligations under Article 3, and whether the state must be a party to the fighting or whether Article 3 applies to situations like Somalia where several insurgent factions are battling. In 1997, the Appeals Chamber of the International Criminal Tribunal for the former Yugoslavia (ICTY) provided a new inclusive definition in the case of *Prosecutor v Tadic*. It held that armed conflict exists whenever there is "protracted violence between governmental authorities and organized armed groups or between such groups within a State" (Moir 2002). This definition was used in several subsequent ICTY cases, but it is unclear whether it will be widely accepted by states and still requires analysis on a case-by-case basis.

The ICTY has also addressed the question of when a non-international conflict becomes international. This is a crucial distinction since it determines whether the entire Conventions or only Article 3 apply. A simple solution would be to declare all the events in Yugoslavia to be part of a single international war, but most observers agree that the events are better divided into a series of distinct international and internal conflicts. For particular cases, the court has therefore had to consider whether an international conflict existed at the time of the offenses, whether the victims were in the hands of an occupying power of which they were not nationals since Bosnian Muslims and Bosnian Serbs shared some characteristics but not others, and whether the accused was linked to one side of an international conflict.

The point of whether particular defendants were linked to an international war proved particularly controversial and rested on the question of whether Bosnia Serbs were agents of the Federal Republic of Yugoslavia (FRY), and Bosnia Croats agents of Croatia, or were independent forces engaged in a non-international conflict within Bosnia. For guidance, the ICTY looked to the International Court of Justice's ruling in the *Nicaragua* case that established a tough standard of "effective control" in saying that conflicts between the *contras* and the Nicaraguan government were non-international despite U.S. financing, organizing and training of the *contras*. Trial Chamber rulings held that the evidence from Bosnia did not support the prosecutor's claim of an international conflict. This ruling was criticized by those who questioned whether the Nicaraguan case on state responsibility should be used as a precedent in cases of individual responsibility, and who felt the evidence of unified Serbian efforts was compelling (Fenrick 1999). In the Tadic case, the Appeals Chamber reversed the earlier ruling and found that there was evidence of "overall control" by the FRY, so the defendant could be tried for grave breaches. Sassoli and Olson (2000) argue that, in this ruling, the ICTY is straying from the Continental tradition of restraint in extending the law by using questionable interpretations to blur the distinction between international and non-international armed conflicts.

Conventions and the War on Terrorism

In the fall of 2001, the Geneva Conventions drew new attention during the debate over how the United States should treat Taliban and Al-Qaida detainees held at Guantanamo Bay, Cuba. Top administration officials repeatedly referred to the detainees as "unlawful combatants" and argued that they did not qualify as POWs under the third Convention. President Bush reportedly confirmed this position on January 18 2002 in an unreleased legal decision. The decision apparently rested on a mix of views, but a primary argument was that Afghanistan was not a functioning state during the conflict, so it could not remain a Party of the

Convention and therefore the Taliban could not be its army (Murphy 2002).

Bush's decision was questioned by human rights groups, many international legal scholars, by France and England, who threatened not to transfer captured fighters unless the administration agreed to apply the Conventions, and by Bush's own Secretary of State, Colin L. Powell, who asked for a review of the policy (Seelye 2002; Shanker and Seelye 2002). Many of these critics characterized the Taliban as members of Afghanistan's armed forces and thus to be accorded POW status (Aldrich 2002). For Al-Qaida members, the administration had more support, but some critics pointed out that some Al-Qaida were integrated into the Taliban army and, since they all came from countries that were Parties, they could also be covered under the fourth Convention even if they were not eligible for POW status (Chlopak 2002). At a minimum, the critics all agreed that the administration was required to follow Article 5 of the third Convention that requires a competent tribunal to determine the status of detainees whenever doubt arises as to their status. Powell apparently also argued that following the Conventions would win friends among European allies and would help ensure protection of U.S. soldiers if they were captured (Shanker and Seelye 2002).

On February 6 2002, Bush partially reversed his policy by deciding that while Al-Qaida detainees still would not be covered, the Conventions would be applied to Taliban captives, although none of them would be granted POW status. The administration did not issue a legal defense of the decision, so analysis has centered on a press release and the comments of the President's press secretary, Ari Fleischer. Fleischer's comments indicate that the administration altered its argument and conceded that Afghanistan was a Party of the Convention, but then appeared to hold the Taliban to the criteria for militias in Article 4 of the third Convention. Fleischer argued that the Taliban did not have a distinctive sign or uniform, and they did not conduct their operations in accordance with the laws of war (Fleischer 2002, see also Rabkin 2002). Previously, it generally had been argued by scholars and governments that these criteria only apply to militias and volunteer corps, while members of state armies automatically receive POW status (Aldrich 2002; Wedgwood 2002). The administration also held that Article 5 tribunals were not necessary because there was no doubt about the detainees' status.

Neither of Bush's decisions led to immediate changes for the captives. The United States claimed that they were being held humanely; however, a decision on POW status could have changed matters significantly. The third Convention sets standards for housing, so the open-air cells of the detainees may have been seen as violations. The Convention assures POWs the rights to practice religion freely and to assemble, which would have ended U.S. efforts to keep the detainees isolated. The Convention does allow the questioning of detainees, but carefully regulates the conditions. The Convention guarantees legal rights that would have conflicted with the administration's proposed military tribunals and possibility of death sentences. Finally, the Convention requires prompt repatriation at the end of hostilities, although identifying the end of the War on Terrorism may be difficult.

Looking into the Future

At the time of the Convention's fiftieth anniversary in 1999, many scholars and officials of the ICRC reviewed the lessons of the past to learn how to apply the Conventions in the future (Sandoz 1999; Forsythe 1999; Bugnion 2000). This review continued with a January 2003 meeting jointly convened by the Swiss government and Harvard University's Program on Humanitarian Policy and Conflict Research that brought together experts in the field and representatives from forty countries (Maurer & Bruderlein 2003). These reviews have touched on a wide range of topics, but four are central to both policy application and research agendas.

The conflicts of recent years have shown that there is still far from universal application of the Conventions and that disputes remain over exactly which actions are prohibited. Bugnion, of the ICRC, and many participants in the 2003 conference agree that what is needed is not further Protocols and additional treaty language, but better enforcement and clarification of existing language. Article 52 of Protocol I, which protects civilian institutions from attack, is particularly in need of clarification.

The disputes over detainees at Guantanamo highlight the second key point of needing to clarify combatant and civilian status. Clarification now appears necessary as to whether members of state armies automatically qualify for POW status or whether those armies also have to meet criteria such as having a clear sign and following the rules of law. The definition of "civilian" also needs clarification and it must be decided whether civilians lose all protection if they engage in any military operations. The example of the Taliban shows that there may be need for a third category between protected combatant and civilian.

The ongoing development of technology also presents questions. Nuclear weapons were only in their infancy in 1949, so, despite some Soviet efforts, issues surrounding civilian attacks with nuclear bombs or other weapons of mass destruction were not addressed directly in the Conventions. The increased use of missiles and attack drones in recent conflicts also raises complicated questions of individual responsibility for attacks. There is also a growing weapons technology gap between the advanced states and their enemies. The 2003 meetings began to consider the issues of whether the existence of laser guided missiles and other precise targeting holds advanced states to even higher standards for avoiding civilian casualties and damage, and if it legitimate to employ different standards for two belligerents. Changing communications technology has also raised new problems. The Third Convention protects captives from "insults and public curiosity" (III, 13). The United States vigorously protested al-Jarezeera's broadcast of pictures showing dead or captured U.S. soldiers in Iraq. However, the United States allowed and encouraged television and print newsmen embedded with U.S. troops to show captured Iraqis in hopes that the pictures would discourage Iraqis and lead to mass surrenders. (Cloud 2003, Richey 2003)

The final, but most crucial, point in the reviews addresses the legal mechanisms for implementing the Conventions and punishing violators. Although the Conventions explicitly call for prosecutions of grave breaches, supporters relied for many years on a strategy of dissemination, education, and monitoring to encourage compliance. The ICRC and others worked with militaries around the world to include the Conventions' standards in military manuals and to inform commanders of their responsibilities in ensuring that the rules were followed. ICRC monitoring, enhanced by public and media pressure, led many states to abide by the Conventions. In recent years, though, there has been a new global focus on human rights standards and holding individuals accountable for war crimes. The Conventions are therefore central to the ICTY, the ICC, and efforts by individual states such as Belgium to use the idea of "universal jurisdiction" to try war criminals from around the world. The legitimacy of these courts and their interpretations has not been universally accepted. The division of responsibility between individual actors and the state has not been resolved. The appropriate punishment of individual and state actors remains tangled in disputes over the death penalty and the morality of economic sanctions. Finally, it is not clear whether the threat of punishment will be a significant deterrent and encourage compliance with the Conventions.

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Genocide and Gross Violations of Human Rights

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Introduction

Genocide is the most extreme manifestation of gross violations of human rights and for that reason is considered analytically as a distinct phenomenon. As it is defined in international law, genocide constitutes the willful destruction of a people by means of the direct application of violence or more slowly through the imposition of policies interfering with physical reproduction and the transmission of culture. Gross violations of human rights—excluding genocide—are, nonetheless, serious violations resulting in immeasurable human suffering. For these reasons, genocide and the gross violation of human rights raise a large number of public policy issues, among them some of the most urgent facing humankind.

The analytical distinction between genocide and gross violations of human rights, however, should not allow the relationship between the two to be obscured. Targets of gross violations of human rights are usually people at the disadvantaged end of a hierarchical relationship. They may be a defined racial, ethnic, religious, or linguistic minority, or they may be a colonized or enslaved or formerly colonized or enslaved people. As such, in the eyes of majority groups, they carry a stigma of less than full citizenship, even where formally granted, and face discrimination in the allocation of scarce resources such as education, housing, or employment or poor treatment at the hands of state agents such as the police. By no means do all such groups become targets of genocide; however, the obverse is often the case. Status as different, and especially different and inferior, weakens the social bonds of responsibility of governments, political parties and private sector institutions towards such groups, making it easier for such groups to be scapegoated and eventually targeted for genocide. This is precisely the pattern followed by several major genocides of the 20th century.

Definitions and Definitional Controversies

The mass extermination of a people as a routine accompaniment to war is very old. The earliest case recorded by Frank Chalk and Kurt Jonassohn in their volume The *History and Sociology of Genocide* is the Athenian extermination of the inhabitants of Melos in 416 B.C. (Chalk & Jonassohn 1990). It is only in the 20th century, however, that the mass extermination of people within and without war has been widely viewed as a crime against humanity and given a name. That name is genocide. The term was first used by Raphael Lemkin, a Polish-Jewish émigré who had escaped the Nazis and settled in the United States. Lemkin served on the U.S. staff at Nuremburg and later joined the law school at Yale University. In his 1944 book *Axis Rule in Occupied Europe*, Lemkin coined the term genocide and defined it simply as the ‘destruction of a nation or ethnic group’.

Lemkin worked tirelessly after the war and succeeded in getting the United Nations to adopt a genocide treaty. The United Nations Convention on the Prevention and Punishment of Genocide was ratified on December 9, 1948 and stands as an important document in the evolving body of international law. In the Convention, genocide is defined as the intent to destroy in whole or in part, a national, ethnic, racial, or religious group by a) killing members of the group, b) causing serious bodily harm to members of the group, c) deliberately inflicting on the group conditions of life calculated to bring about its physical destruction in whole or in part, d) imposing measures intended to prevent births within the group, and e) forcibly transferring children of the group to other groups.

This broad definition and its application have come under a number of criticisms and given rise to considerable controversy among specialists. A common objection is that the Convention excludes political groups. Lemkin attempted to include groups singled out for their political beliefs and/or practices, but the Soviet Union objected strenuously, and the reference was removed in order to salvage the remainder of the agreement. Another problem is enforceability. Only governments can take cases to court, and the U.N. as an organization of states has compiled a record of evasion, postponement, and refusal to act on matters of genocide. Standards that have virtues in other contexts—the territorial integrity of states, sovereignty, and non-intervention in the internal affairs of other nations—when applied to cases of genocide result in deadly vacillation and inaction. Scholars are also confronted by the ambiguities posed by the concept of intent because it is difficult to prove, but as Helen Fein points out, while perpetrators of genocide are unlikely to proclaim intent, it can be inferred 'by showing a pattern of purposeful action' (Fein 1994).

For many scholars genocide is a state crime, and they emphasize the central role of the state as the organizer and perpetrator of genocide. Pierre van den Berghe writes that the state has been the primary killer of human beings since its inception 7,000 years ago, and notes that from 1945 to 1980, 75% of the violence committed by states has been directed against peoples within their own borders (van den Berghe 1981). Irving Louis Horowitz not only insists that genocide is a state crime, but in his view, genocide is a crime of the authoritarian state (Horowitz 1999). This does fit the pattern of many 20th century genocides, but van den Berghe whose interest is in state violence, a category including genocide, but broader, disagrees. He insists that state violence, in all its forms, is not limited to any locale or political economic system. Van den Berghe argues that genocide can occur in democracies, especially *herrenvolk* democracies, and he cites Israel, apartheid South Africa, and the United States as examples (van den Berghe 1981).

Leo Kuper introduced another dimension to the study of genocide by considering actions not treated at all by most genocide scholars. Kuper expanded the discussion of genocide to include the Dresden fire bombings of World War II, the deployment of nuclear weapons at Hiroshima and Nagasaki, and U.S. military actions in Vietnam (Kuper 1981, 1985).

Most genocide scholars object to Kuper's extension of scope, and in their public statements argue that these deaths occur from the targeting of civilians in the course of war. Kuper's critics note that he does not include the planned extermination of a people in his definition. The litmus test for Kuper's critics is whether Hiroshima, for example, would have been bombed had Japan surrendered beforehand. The conventional answer is no, yet the work of historian Ronald Takaki indicates that the matter is more complex than previously thought. Takaki argues that during the war not only were Japanese-Americans interned in concentration camps, but Japan and the Japanese people were subjected to high levels of racist dehumanization. This denial of humanness to the enemy—an oft-noted accompaniment to wars and genocides—coupled with U.S. ambitions for post-war political, economic, and military hegemony raises the serious question of whether Japan would have been allowed to surrender prior to the use of nuclear weapons (Takaki 1995).

Other writers have called attention to considerations which further broaden the traditional definition and understanding of genocide and the genocidal process. Some have gone beyond considering the kinds of state actions that qualify as genocide to question whether intentionality and state action are necessary preconditions for genocide at all. Isidor Wallimann and Michael Dobkowski argue that in a world of impersonal market forces and distant decision-making by governments and transnational corporate bureaucracies, an insistence on intent seems almost anachronistic. They point to large-scale processes of destruction that are so systematic and systemic that they appear simply to be normal (Wallimann & Dobkowski 1987).

This perspective has opened the way to interpreting some of the more traditional genocides in radically different ways and to considering horrific but radically different kinds of events as genocides. Native Americans are a case in point. Many, though not all, genocide specialists consider the experience of indigenous North Americans to be less than a clear cut case of genocide because 1) the major cause of death is disease, 2) much of the actual killing is done by non-governmental agents, and 3) some consider intent difficult to demonstrate. Russell Lawrence Barsh dissents by arguing that the emphasis on disease obscures the inter-relatedness of factors. Disease, Barsh stresses, must be considered in the context of military actions and other abuses along with the breakdown of subsistence systems resulting in hunger, starvation, and increased susceptibility to disease and loss of the will to live (Barsh 1990).

The question of the role of the state comes up repeatedly in the case of indigenous peoples because a good deal of the killing is done by explorers, soldiers of fortune, miners, and settlers. Here again we encounter the traditional response that these are not state agents, and, this, therefore, raises questions as to whether such killings are genocides. This response too is over-simplified because there is often collusion between non-governmental actors and the state or, at a minimum, a common understanding that indigenous peoples stand in the way of prevailing notions of progress, profit, and eventual geographical state expansion and revenue. There are also cases of the prior dehumanization of indigenous peoples, which reduces them to a status not worthy of government protection. In such instances there is a need to consider acts of omission contributing to the genocide of indigenous populations (Chalk 1994; Churchill 1997).

Historian Tony Barta, whose concern is the impact of European settlement on the indigenous peoples of Australia, dispenses altogether with the state and intentionality. A genocidal state for Barta is one in which the entire bureaucratic apparatus may officially be committed to the protection of innocents but where, nevertheless, indigenous peoples are subjected to pressures of destruction from a society's commitment to particular notions of development and progress (Chalk 1994; Zerner 2003).

Of all the major genocide scholars, Israel Charny is the broadest and most inclusive in his conception of genocide and responsibility for it. On responsibility, Charny notes that genocide, as currently conceptualized, carries with it no concept similar to the accomplice in criminal law. Charny insists that just such a concept is necessary for the full understanding and prosecution of genocide. He defines accomplices as those who 'assist, prepare, or furnish the mass murderers of the world with the means to exterminate huge numbers of people'. For Charny, scientists who research and design mega-weapons, engineers who oversee the production, businessmen who market them, the 'barons of finance' who benefit from their sales, the government bureaucrats who legally or illegally license the sales of these weapons systems or the material to produce them as well as other complicitous parties are accomplices to genocide (Charny 1994).

Some would argue that Kuper, Wallimann and Dobkowski, Barsh, Barta and Charny have expanded the study of genocide to new levels, but at the expense of theoretical rigor. Helen Fein makes a strong case for rigor. She is concerned that the term genocide has come to be used carelessly to vent outrage or to promote a political agenda. In Fein's view, the term is debased by what she calls 'semantic stretch'. Fein is not engaging in apologetics here. She makes clear her view that the deployment of nuclear weapons at Hiroshima and Nagasaki are war crimes (Fein 1994). Rather Fein argues that without tight theoretically rigorous concepts we cannot distinguish genocide from what she calls life integrity threats such as political terror, torture, rape, slavery, or forced labor. The consequence of this loss of precision is the loss of the very understanding needed to predict genocide before it occurs and to mobilize for international intervention to prevent it when it seems likely (Fein 1994).

Thus the very definition of genocide is contested, and the enforcement of the Genocide Convention frustrated by nation state agendas. Instead of assuming that genocide can have a fixed, definitive definition at this historical juncture, it may be more productive to consider genocide to be a core concept with widely accepted and uncontroversial meanings only at its center. The further we move from that center into the wider historical and semantic field, the greater the ambiguity and controversy we encounter and the less satisfactory efforts to apply hard and fast, necessary and sufficient characteristics of agents, victims, and historical contexts are likely to be. The pressing issue of current genocides and those of the future create a sense of urgency among those who wish to eliminate genocide from the political landscape. In this context of international intervention, Fein is correct in her call for theoretical rigor. At the same time, we need to recognize the existence of events and phenomena that will defy clear classification as genocide or not.

Classical Twentieth Century Genocides

While instances of genocide are replete in recorded history and comprise death tolls in the hundreds of millions associated with European colonial expansion and rule beginning in the 16th century, it is advisable to provide a brief overview of some of the major genocides of the 20th century (Churchill 1997; Hochschild 1990). There are two reasons for this. First, because of the frequency and scale of genocides in the 20th century, it has been called the Century of Genocide. These genocides may be viewed as classical in the sense that they fit the core definition above, i.e. they are willful; premeditated; initiated by states, often authoritarian; involve great cruelty; and result in large numbers of deaths in absolute numbers and as a percentage of the target population. Second, world reaction to the genocides of World War II led to initial international efforts to criminalize genocidal acts and to punish their perpetrators. The cornerstones of these efforts are the Universal Declaration of Human Rights which sanctifies life and, more directly, the United Nations Convention on the Prevention and Punishment of Genocide which criminalizes genocide.

The first genocide of the 20th century was the German genocide of the Herero and Nama peoples of Southwest Africa (now Namibia). The Herero were nomadic herders largely stripped of civil and political rights by their German masters. The indigenous population had lost land and water rights to German settlers and had their land crisscrossed by rail lines from coastal to interior areas. When the Hereros learned of plans to construct a new major rail line and to concentrate the Herero on reservations, they revolted in 1904 and initially recaptured much of their land. The Germans were able to quickly regroup, however. They destroyed most of the Herero force within eight months and attacked Herero and Nama villages. Survivors, including women and children, were driven into the deserts to die. It is estimated that 80% of the Herero and 50% of the Nama peoples died from combat, massacre, thirst, starvation, and partaking of water holes deliberately poisoned by German forces (Bridgman 1981; Drechsler 1980; Sylvester 2003).

The Armenians were an ancient indigenous people of eastern Asia Minor and the southwestern Caucasus who numbered over two million in the Ottoman Turkish Empire on the eve of World War I. They had been subjected to large scale pogroms claiming 200,000 lives from 1894-96 and 30,000 lives in 1909 at the hands of the Ottoman Turkish state. The full force of genocide was unleashed by Ottoman Turkish leaders in 1915 under the cover of World War I. The killings were premeditated and planned, beginning with the arrest and execution of hundreds of Armenian political, church, and intellectual leaders in Constantinople on April 24, 1915. Able-bodied Armenian men who had been conscripted into military work brigades were killed *en masse*. The stage was now set for the extermination of the majority of the community, made up of children, adolescent girls, young adolescent boys, women, and older men. These were ordered to leave their homes and assemble centrally in their communities. They were then sent on forced marches, ostensibly for relocation. In fact, these forced march caravans were moving death camps. Few ever reached their destination in the deserts of northern Syria. Within a short time span the pre-war Armenian population was reduced to less than 100,000.

The reasons behind the Armenian Genocide are closely linked to the dangers of empires in decline. The Ottoman Turkish Empire began losing its European territories as early as 1820s with the independence of Greece and was greatly weakened by the end of 19th century. The European powers foresaw the collapse of the Empire and were hardly disinterested parties in its eventual partition. Ottoman Turkish leaders as well as nationalist dissidents also saw the handwriting on the wall, and in the 1890s a group of young military officers and other supporters founded *Ittihad ve Terakki* (Committee of Union and Progress). This group overthrew the Sultanate and seized power in 1908. Ittihad was gripped by the fear of imperial collapse and turned to an ideology known as Pan-Turkism, or in its more mystical form, Pan-Turanism. The plan was to create a new empire to the east, uniting Turkic peoples running from Constantinople through Azerbaijan and Central Asia to the Chinese border. It was the Armenians, a Christian minority that broke the continuous span of Turkic settlement coveted by Ittihad. This and the pretext of Armenian persecution cynically exploited by the European powers and Russia to meddle in what the Ottomans viewed as their internal affairs sealed the fate of the Armenians (Akçam 2004; Dadrian 1995; Miller 1993).

The Armenian Genocide is significant in several respects. The first is that it occurred during a world war when nations that could and might have intervened to prevent the genocide or cut it short were murderously engaged on the western front. Genocide under the cover of war would be repeated a generation later during World War II.

The second is the German connection. Germany and the Ottoman Empire fought as allies on the losing side of World War I. German troop contingents, and an officer and diplomatic corps were in the Ottoman Empire all throughout the First World War. These Germans were either eyewitnesses to the Genocide or had knowledge of it. The Armenian Genocide was well-known in Germany (Dadrian 1996, Gust 2005). Third, the Armenian Genocide went largely unpunished. There were no international tribunals similar to Nuremberg and the Tokyo War Crimes Tribunal. Neither the architects, organizers, nor the major perpetrators of the Armenian Genocide were tried or punished by any international body for their actions.

The confluence of these factors contributed to what transpired later in

Europe. While Hitler was not stationed in Ottoman Turkey, he was familiar with the Armenian Genocide, and, given his objectives, drew the logical conclusion from it, namely that one could indeed systematically kill very large numbers of people with little need to be concerned about being stopped or even punished. In a speech to his officer corps on the eve of the Nazi invasion of Poland in September, 1939, Hitler said:

"I have issued the command…that our war aim does not consist in reaching certain lines, but in the physical destruction of the enemy. Accordingly, I have placed my death-head formations in readiness—for the present only in the East—with orders for them to send to death mercilessly and without compassion, men, women, and children of Polish derivation and language. Only thus shall we gain the living space (*Lebensraum*) which we need. Who, after all, speaks today of the annihilation of the Armenians?" (Bardakjian 1985)

The mass murder of European Jews by the Nazis is the world's best known genocide. While the decision for the final solution for European Jews was made only in 1941, the actual cornerstone was laid long before with relentless propaganda attacks on Jews in various, often contradictory, forms. One major theme of anti-Jewish scapegoating was to posit an international conspiratorial cabal of Jewish finance capital that sold Germany out after World War I. The Nazi propaganda machine also acclimated the German population to the propriety and normalcy of anti-Semitism, and later extermination, by employing extreme forms of Jewish dehumanization, with frequent use of verminous and bacterial imagery in speech, writing, and graphics.

Jews were arrested in Germany and in German occupied Europe and sent to numerous concentration camps, the most infamous of which were Auschwitz and Buchenwald. These camps were either extermination camps or forced labor camps which few survived (Fein 1979; Hilberg 1961).

The estimated Jewish toll is 6 million killed. The actual toll of Nazi mass murders is much higher. The Roma (Gypsy) people were targeted for extermination and killed in the camps. Soviet prisoners of war were often summarily shot. When we include Polish and Soviet dead, the toll runs into the tens of millions.

Japan followed Germany's path to fascism in the 1920s, spurred by inflation, unemployment, and labor turmoil. Japanese rearmament and then invasion of China were made possible by the militarization of all aspects of the society including the media and the schools. An important component of this militarization was the promotion of Japanese notions racial superiority and the inferiority of other Asian peoples. Manchuria was invaded in 1931 and full scale war with China unleashed by the Japanese in 1937. Estimates of Chinese deaths range as high as 10 million from chemical and biological warfare weapons experimentation and deployment, the pillage of Nanking in 1937, and armed conflicts and massacres through the end of the war. (Chang 1997; Harris 1994; Yin 1996).

The Cambodian Genocide was undertaken by the Pol Pot regime which came to power in 1975 after defeating the U.S. backed government of General Lon Nol. These mass killings are sometimes referred to as an auto-genocide because the victims were Cambodians killed by Cambodians although a disproportionate number of victims were among the Chams, a Muslim minority. The Pol Pot government was driven by an extreme anti-westernism and attempted to create an entirely peasant based agricultural society. The cities were forcibly evacuated, residents killed or driven into the countryside to grow rice. Few persons with professional skills, education, and social status survived although many peasants as well were claimed by the carnage. The killings were finally halted when the Vietnamese invaded Cambodia and drove Pol Pot from power early in 1979 (Kiernan 1998).

The collapse of Yugoslavia and the accompanying mass killings in the 1990s received great publicity as the first genocide in Europe since the Second World War. The media attributed the carnage to the legacy of age old ethnic conflicts. There were residual issues regarding the massacres of Serbs by Nazi-allied Croat forces during World War II and counter-violence by Serb based forces. The root of the conflict, however, is found elsewhere in the demographics of Yugoslavia where lands coveted for titular states were typically highly mixed ethnically. For example, three million of Yugoslavia's eight million Serbs lived in Croatia and Bosnia-Herzegovina. As the country started to come undone in the late 1980s, both Croatia and Serbia came under the control of ultra-nationalists who stoked fear of violence at the hands of traditional enemies. Franjo Tudjman of Croatia sought to gain independence, cleanse Croatia's fascist World War II past, purge thousands of Serb workers from their jobs, and institute constitutional changes that would weaken protection for national minorities. Slobodan Milošovic´ responded by calling for a 'Greater Serbia' and the protection of all Serbs no matter where they resided. Meanwhile both sides armed their partisans. This greatly shortened the road to a war that soon engulfed the Croats, Serbs, Kosovo Albanians, and Bosnian Muslims. These conflicts were accompanied by large scale massacres with the Bosnian Muslims suffering the highest death toll, which ran into the hundreds of thousands (Power 2002; Udovički 1995).

Three-fourths of the Tutsi population was wiped out in the Rwandan Genocide of 1994, over half a million victims in only a few months. The colonial rulers of Rwanda, the Germans and then the Belgians, had considered the Tutsis racially distinct from the Hutus and employed the minority Tutsis as the vehicle for their colonial rule. The Tutsis were favored in government employment, education, and land allocation. In the 1959 revolution, the Hutus rebelled and took the reigns of power. What they established, however, was not a democratic multi-national state that recognized and enforced equal rights for Hutus and Tutsis but an ethnocracy in which the Tutsis were displaced and persecuted in an ethnically polarized state. By 1964 over 300,000 Tutsis had left and settled in neighboring countries. Eventually this Tutsi diaspora became the base for a guerrilla movement operating in Rwanda, and this further eroded the position of Tutsis in the country, culminating in the genocide of Tutsis and also moderate Hutus who refused to participate in it (Power 2002; Melson 2003)

Gross Violations of Human Rights

Unlike genocide where there is an international treaty in effect, the category of gross violations of human rights is less clearly defined. Some consider high altitude bombing to be a gross violation of human rights because it is imprecise and many civilians and much civilian infrastructure are destroyed (Lindqvist 2001; Blum 2000). Others would include torture, either as a punishment or as a means of extracting intelligence.

We can best rely on the concept of human rights to frame a discussion of the gross violation of human rights. Human rights as a concept in international law emerged from the ravages of World War II and is associated with the formation of the United Nations. Eventually discussions produced the International Bill of Human Rights as a standard for the gross violation of rights (Williams 1981). The International Bill is a comprehensive document that specifies practices in violation of human rights as well as positive rights. As examples in the first category, we find a ban on slavery and servitude; torture, cruelty, and degrading punishment; arbitrary arrest, detention, and exile; and arbitrary interference in private home matters. As a sample of positive rights, we find the right to an existence worthy of a human being; the right of self-determination; the right of minorities to the practice of their religions, languages, and cultures; the right of workers to join labor unions and to engage in strikes to protect their interests; the right of workers to reasonable working hours and periodic holidays with pay; and the rights to freedom of movement, equal access to work, and equal pay for equal work. These rights are currently violated worldwide, to a greater degree in some nations than in others, but nowhere adhered to universally and in their entirety. A reasonable measure of the extent of the violation of human rights—and therefore, of the extent of the gross violation of human rights—is to consider the scale of denial of even the basic necessities of life. Worldwide there are over 100 million people bereft of any shelter, nearly a billion illiterate adults, nearly a billion people with diets insufficient to support an active working life, and over a billion without access to safe drinking water. The global failure to meet even these minimum standards is perhaps our best measure of the gross violation of human rights, and these failures raise numerous public policy issues. Among them are issues of the distribution of income and wealth within and between nations, the level of social welfare provisions to the poor and the middle class, and the spending priorities of nation states.

Genocide and Public Policy Issues

Genocide raises a number of public policy issues that include intervention, courts, and trials as well as recognition and denial, memorials and commemorations, and coverage in the media and educational texts.

We begin with interventions, courts, and trials. In *The Problem from Hell*, Samantha Power discerns a pattern of U.S. response to genocide beginning with the Armenian Genocide and repeating itself in Europe, Cambodia, Rwanda, Bosnia and elsewhere. In each instance an American—an ambassador, consular or embassy official, or journalist—reports mass killings which are qualitatively different from the routine deaths associated with war or standard repression and point to a policy of genocide. Dispatches are sent to Washington where they at first languish in the bureaucracy and are then investigated through official channels. Debate ensues as to whether or not the U.S. should intervene, and it is decided that there are no strategic U.S. interests at stake and that no intervention shall be authorized. The genocide meanwhile runs its course at which point the U.S. becomes a major source of aid to survivors.

Power is appalled at this abdication of global leadership and the resulting carnage that is in her view preventable. According to Power, it is only the U.S. that has the military capability and moral authority to prevent or put a stop to genocides, and she campaigns for a more interventionist foreign policy with the aim of stopping what she calls ‘this monstrous crime’. This program, sometimes called ‘military humanism’, however, has come under criticism. Those from the *realpolitik* school of international relations argue that national self-interest should be the prevailing standard of international relations, and they see Power’s program as essentially morally based. Others take the position that humanitarian interventions must be internationally rather than nationally based because they see the U.S. as inevitably self-interested. They prefer international bodies such as the United Nations to lead and conduct any intervention. As evidence for their position, these analysts point to a lengthy history of U.S. political intervention, sponsored coups d’état, and invasions that morally taint the U.S. and realistically make the new imperialism a more appropriate heading than military humanism or humanitarian intervention for U.S. foreign policy (Blum 1995; Chomsky 1999).

There are other reasons to question the basis for U.S. interventions to prevent or halt genocides. The U.N. Genocide Treaty was long and successfully opposed by certain professional associations such as the American Bar Association and the U.S. right wing because it would allegedly compromise U.S. sovereignty. As a result, the U.S. was one of the last nations to ratify the convention, four decades after its passage by the U.N. Furthermore, the U.S. submitted the ratification with a set of conditions called the 'Sovereignty Package' which had the effect of exempting the U.S. from the treaty's application (Churchill 1997). More recently, the U.S. refused to ratify the 1998 Rome Treaty which authorized the creation of the International Criminal Court when ratified by sixty nations. The court was finally established in 2002 but without the blessing of the U.S. which feared the prosecution of war crimes, crimes against humanity, and genocide would bring U.S. officials and military personnel under the Court's jurisdiction.

For the present, it appears that international tribunals, including trials for war crimes and genocide, are limited to proceedings undertaken by victorious forces in wars (Nuremburg and Tokyo after World War II) or tribunals addressing crimes by forces not allied to the U.S. or committed by the U.S. In the latter category are the International Criminal Tribunal for Rwanda and its counterpart for Yugoslavia. Both have been able to place prominent perpetrators on trial despite serious shortcomings in funding, support services, and the inevitable political wrangling that come into play. Exempt from prosecution are the actions of the U.S. in southeast Asia, Central America, and Afghanistan and Iraq or its allies such as Indonesia in East Timor. Major powers, but sub-superpowers, are nearly as likely to be granted exemptions from the law. It is unlikely, therefore, that France will have to answer for its activities in the Ivory Coast or Russia in Chechnya. For lesser nation states, especially where the major powers have neither intense interest (economic and strategic primarily) nor disinterest, institutions such as the International Criminal Court provide a forum for truth-telling and a legal basis for punishment. As such, they may provide sobering moments for leaders of modest states before they take the road to genocide (Sands 2003; Schabas 2004). Therefore, in the present political context it is unreasonable to expect that such institutions as international tribunals and the ICC will prevent all future genocides or that they will successfully try and punish their major perpetrators.

A second group of public policy issues include recognition, denial, commemoration, and treatment in school texts and encyclopedias. In contrast to the 13th century genocider Genghis Khan, who bragged about his exploits in leveling cities as testimony to the superiority of his leadership and forces, the 20th century pattern is denial by perpetrators. With the exception of Germany and its acknowledgement of the Holocaust, the self-contradictory denial 'We didn't do it and besides they deserved it' is the standard refrain of 20th century genocide perpetrators.

Genocides of the 20th century are in various states of denial, though not always in the same form or for the same reason. With the exception of the last Ottoman government prior to the creation of the Republic of Turkey, no Turkish government since 1915 has acknowledged the Armenian Genocide. In fact, the pattern has been one of aggressive genocide denial. All attempts to have the Armenian Genocide recognized by the U.S. Congress, for example, have been actively opposed by Turkey, and U.S. presidents have all joined Turkey in having these resolutions killed, partly in response to Turkish threats concerning military bases on its soil and partly in response to Turkey's NATO membership and its strategic location (Smith 1995).

Denial of the Jewish Holocaust and the Roma (Gypsy) Genocide stem from other causes. No state actively denies either. In the Jewish case, denial originates with a small group of fringe intellectuals, and an even smaller number with some greater standing, along with right wing groups based in anti-Semitism. The deniers hold conferences and publish the *Journal of Historical Review* which they employ to cast doubt on the Holocaust. While it would be an error to ignore or dismiss such sources, they do not currently have a significant impact on public policy or opinion. The genocide of the Roma has been overshadowed by the Holocaust and ignored by governments and researchers alike. This is changing as Roma activists and academics—some Roma, others not—are calling attention to this neglected Nazi extermination (Huttenbach 1999).

In the Armenian and Jewish cases, there are free speech issues concerning the right of deniers to be heard. In the U.S. these rights are constitutionally guaranteed, even though the speech and writings of deniers are deeply offensive to Armenian Genocide and Holocaust survivors and their kin. In parts of Europe where Holocaust denial is a crime, these free speech rights are denied.

Related to the issue of denial are the various commemorations of genocides in the form of museums, public markers, statues, and commemorative sites. We can also include here the treatment of genocides in the press, school texts, and encyclopedias. Turkey has been extremely active in employing embassy personnel in Western states to monitor public references to the Armenian Genocide. It has used letters to the editor, visiting scholars, public protests, and pressure tactics to contest the genocide's facticity. This has been a particular problem for those who have tried to introduce a genocide curriculum into the secondary education program or even to have accurate discussions in the media. The *New York Times*, for example, refused for decades to refer to the Armenian Genocide without qualifying language such as 'alleged'. It is only recently that this policy has been reversed. A potentially wide range of public officials from school teachers and school board members to local government officials all the way up to national legislative bodies and heads of state do encounter claims and controversies over genocides ranging from how to prevent, stop, and punish them to how to frame and teach them, whether or not to officially recognize them, and whether and how to commemorate them. In some cases there will be little or no controversy. In other instances, where pro and anti-intervention forces clash or claimants are challenged by deniers, officials will face situations that can be both emotionally charged and contentious.

With regard to gross violations of human rights, we can conclude that because there are so many instances and types that this matter must be addressed within the broader context of democratic and progressive movements for economic justice and world peace. This would certainly include struggles for peace, progressive taxes, a de-commodified welfare state, trade unionism, economic equality, and development outside the confines of transnational sponsored globalization. This would have to be accompanied by a rollback of class, race, and gender oppression and all of their attendant forms of material and spiritual violence and exploitation. In other words, the International Bill of Human Rights would have to be made and maintained as a living reality in the face of powerful vested interests and enormous odds.

Journals

Holocaust and Genocide Studies
The Journal of Genocide Research

Websites

Amnesty International. amnesty.org
Genocide Watch. www.genocidewatch.org

Human Rights Watch. hrw.org
Minority Rights. www.minorityrights.org
Prevent Genocide. www.preventgenocide.org
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Global Governance

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At a time when most of the world is being affected by a variety of political, economic and social processes subsumed under the rubric of globalization, it is unsurprising that patterns of governance would be similarly transformed. If globalisation is understood as 'a process (or set of processes) which embodies a transformation in the spatial organisation of social relations and transactions… generating transcontinental or interregional flows and networks of activity, interaction, and the exercise of power' (Held et al 1999:16), and if governance is understood as 'all those activities of social, political and administrative actors that can be seen as purposeful efforts to guide, steer, control or manage societies' (Kooiman 1993: 2), then it was almost inevitable that these concepts would come together in an effort to describe the way the contemporary international system functions. The key point that distinguishes *global* governance, as opposed to the traditional national form, is that the purposive component of governance that Kooiman rightly highlights has much more complex, increasingly transnational origins than ever before.

To understand the transformation that has occurred in the way systems of rule and authority operate, the way broadly domestic and international processes interact, and the vast array of new actors that are influencing or attempting to influence political and economic issues in the contemporary international order, we need to explore the way the international system has developed over the last fifty years or so. Consequently, I initially sketch some of the key changes that have occurred in the post-World War II global political economy, before considering the role played by the numerous non-state actors that have become such a prominent part in emerging patterns of global governance. While the picture that emerges is complex, and despite the fact that our conceptualisations of the processes involved remain incomplete and theoretically contested, there is no doubt that the way many of the most important social, political and economic processes are developing is of a different qualitative order than has existed for the preceding four of five hundred years. In short, at both a theoretical and practical level the idea that we live in a world that is shaped exclusively or even primarily by the actions of nation states is no longer supportable and we need new ways of thinking about the way the world works. Global governance offers one way of beginning to think about such issues.

The Evolving International Order

Although there is an important debate about the extent and historical origins of processes associated with globalisation, what we can say is that many of the economic, political and even social processes associated with this idea are of a qualitatively different order at the present time. Although some of these issues are dealt with elsewhere in this volume, it is worth briefly highlighting a number of these changes as they to explain why new patterns of governance may have been to some extent a 'functional' necessity. Put differently, some scholars have persuasively argued that given an increasingly integrated economic system that transcends national borders and political jurisdictions, a degree of transnational cooperation is an inescapable prerequisite for international commerce to operate effectively and securely (Cerny 1995).

The idea that some features of the present, highly integrated global order—such as a stable financial system, a predictable, confidence-inducing business environment, and even the physical environment itself—can only be effectively maintained through the cooperative efforts of formerly separate, nationally demarcated state and non-state actors has generated a scholarly interest in 'global public goods'.

The basic notion here is that some goods or services have qualities that make them 'non-rivalrous and non-excludable' in the jargon; more simply, this means that something like peace or a sustainable environment are essentially collective creations that can be enjoyed by all without depletion (Kaul et al 1999). The problem, of course, is that while we might all agree on the desirability, even the necessity of some types of public goods, developing mechanisms that can deliver them is more problematic and central to the challenge of global governance. This is especially the case when the competitive dynamic that is at the heart of the increasingly ubiquitous global capitalist system is frequently antithetical to collective endeavours. Not only is individualistic behaviour actually encouraged within such a system, but a number of long-term structural changes in the organisation of the global political economy itself, may make collective endeavours inherently problematic.

Many of these changes are well known and can be simply noted. The rise of transnational corporations, remarkable growth of international financial markets and the vastly expanded flows of foreign direct investment, hot capital flows, and portfolio investment, have not simply reconfigured the international economic order. They have also profoundly affected individual states. This transformation is highlighted firstly, by the fact that some private sector companies are now larger economic actors than many individual national economies and secondly, by the disjuncture between the scale of capital flows and national economies. What is equally important to recognise is that this situation, in which private sector driven forces have assumed a more prominent role in managing aspects of the global economy, and in which states are arguably in relative retreat (Strange 1996), has come about as a consequence of specific set of geopolitical circumstances.

The pivotal moment in the emergence of new patterns of global governance occurred in the aftermath of the Second World War under the auspices of U.S HEGEMONY. While the detail of this process is considered elsewhere, the important point to stress is that under American leadership a new international order was systematically and intentionally created. As far as emergent processes of global governance are concerned a couple of points are especially significant. First, it was an order that promoted a form of liberal, free market-oriented economic activity that would ultimately colonise most of the world, and which was designed to encourage greater openness and economic integration. Second, to facilitate and regulate greater economic integration, a number of new intergovernmental organisations were established to help manage the new international order. The so-called Bretton Woods institutions—the World Bank, the International Monetary Fund, and the General Agreement on Trade and Tariffs (later to be replaced by the World Trade Organisation) — represented a new and decisive step on the road to global governance.

The creation of such organisations and the steady evolution of an array of other intergovernmental, quasi-state and private sector organisations has led—in Western Europe, at least—to the consolidation of 'thick' institutional infrastructure that has actually facilitated and permitted new patterns of transnational governance (Amin and Thrift 1994). In many ways, however, the rapid development of cross border political cooperation and institutional coordination that characterises development within Western Europe, and the 'pooling' of national sovereignty that is so characteristic of the European Union (EU), is the exception that proves the rule: in other parts of the world like East Asia, the state remains a much more central player, the private sector is less developed and independent, and national sovereignty is still jealously guarded (Beeson and Jayasuriya 1998). At the outset, therefore, we need to guard against sweeping generalisations about the contemporary 'global' order and recognise that there are important variations in patterns of governance within it.

A couple of further points ought to be emphasised in this regard. First, some states are far more powerful than others, and have a concomitantly greater capacity to influence the way the international system operates. Indeed, European states pioneered a form of global governance during their colonisation of much of the planet in the nineteenth century, a process that paved the way for more recent patterns of interaction and which helps to explain the different styles and capacities with which countries respond to the ubiquitous challenges of globalisation (Hobsbawm 1987). These earlier experiences also serve as a reminder that contemporary forms of governance and globalisation are not entirely novel or unprecedented. However, the second point to stress is that the intensification, depth and complexity of transnational relationships, and the increasingly prominent role on non-state actors means that we inhabit a qualitatively different international order. The international system that emerged in the post-war period highlighted the evermore apparent reality that states were no longer the sole or necessarily always the most important regulators of international economic activity, and that they would increasingly share authority and responsibility with new actors in the international system.

Theorising Global Governance

Before looking at how these new processes of global governance work in practice, it is worth considering how the emerging order has been seen theoretically. A number of prominent scholars have made significant contributions to our understanding of the changing international order, none more so than James Rosenau. In a path-breaking essay written in the early 1990s Rosenau outlined his conception of 'governance without government', or the persistence of an international order that is not solely dependent on the activities of national governments. For Rosenau, global order consisted of three interconnected levels of activity: ideational, behavioural and political.

The ideational level, as the name suggests, is concerned with the way people inter-subjectively perceive the order of which they are a part. The ruling ideas or the dominant values of an era are critical in this regard, as is the capacity to define and produce them in ways that 'naturalise' a particular political and economic order. This is why some Marxist scholars are so concerned with the ideational or ideological aspects of cultural imperialism and hegemony, and the capacity for the leading state *and* non-state actors to manufacture the conventional wisdom or common sense of the day (Agnew and Corbridge 1995). Marxists and critical theorists are not the only ones interested in the role of ideas and their influence on patterns of governance, however. Oran Young, for example, has also made a major contribution to our understanding of the way governance works. Young, focuses on the particular 'regimes' that inform actor behaviour in specific issue areas. For Young (1999:5), regimes are 'sets of rules, decision-making procedures, and/or programs that give rise to social practices, assign roles to the participants in these practices, and govern their interaction'. In this context, regimes are a potentially useful way of capturing the 'horizontal' patterns of governance and authority that characterise the management of issues which are not driven in a 'top-down' fashion, but which involve a range of new actors and forces.

The second aspect of Rosenau's schema is the behavioural or objective level—or, more simply, the routinised patterns of activity that are the conscious or unconscious expressions of inter-subjective understandings. Market-oriented behaviour is, perhaps, the most important example of recurrent activities that are not 'natural', but the pervasive product of particular historical and even geopolitical circumstances. It is no coincidence that Rosenau and other scholars became preoccupied with questions of global governance in the immediate aftermath of the Cold War, when major alternatives to the geographic expansion and ideological dominance of capitalism were decisively eclipsed. The third level of Rosenau's model of global order brings us back to the creation of the post-war order that played such a large part in liberal capitalism's ascension and the prominent role played by the 'formal and organised dimension of the prevailing order' (Rosenau 1992: 15). In addition to the Bretton Woods institutions, Rosenau also recognises the importance—especially during the Cold War period—of security organisations like the North Atlantic Treaty Organisation (NATO) in encouraging particular forms of behaviour at both the individual and inter-state levels, as well as in consolidating a dominant ideological perspective.

More recently, Rosenau has drawn attention to the way responsibility for key decision-making processes has shifted away from the traditional political realm of the nation state, to new actors in the economic and social realms. Such processes have, he claims, been driven by the ending of the Cold War, the pursuit of more representative forms of political organisation, the capacity skilled individuals have to access political processes, and by the global interconnectedness of issues as diverse as the environment, AIDS, and economic regulation that necessarily transcend national borders (Rosenau 1995). Importantly, in a number of critical issue areas *authority* for policy formulation and regulatory responsibility has passed from national governments to non-state actors (Rosenau 1990). To see why this is potentially important, it is necessary to spell out how the system has changed and who the new players are.

Structure and Agency in Global Governance

One way of thinking about governance and the factors that distinguish it under conditions of globalisation is to consider the levels at which it occurs. Robert Keohane and Joseph Nye, who were amongst the first people to draw attention to the increasing degree of 'interdependence' that characterised the international system in the post-war period (Keohane & Nye 1977), have recently suggested that contemporary patterns of governance occur at three different, relatively distinct levels (Keohane and Nye 2000). In an historical context, the most novel level is the supranational, which is compromised of transnational corporations, inter-governmental organisations like the WTO, the IMF and United Nations. 'Below' this is the familiar realm of the nation state, and nationally-based firms and organisations. At a yet 'lower' level are local governments, firms and actors that do not have a national presence. The complex, multi-dimensional interaction between these different levels provides a form of governance, or 'the processes and institutions, both formal and informal, that guide and restrain the collective activities of a group' (Keohane and Nye 2000:12).

One of the 'groups' to have attracted most attention of late, and one that operates at all three levels of Keohane and Nye's schema, is the Non-Government Organisation (NGO). These institutions are analysed in more detail elsewhere in this volume, but given that some observers believe *international* non-government organizations (INGOs) are helping to redefine the way patterns of global governance occur (Slaughter 1997), it is important to highlight briefly a number of their most salient aspects. The most striking feature of INGOs is their remarkable growth: INGOs have increased from about 800 in 1900, to over 4,000 by 1980, leading some observers to see them as an inevitable corollary of the expansion of both the world economy and the inter-state system, and a key element in the emergence of a 'world culture' (Boli and Thomas 1999). Certainly, non-state actors like INGOs have become much more visible and integral parts of the international system, but it is also important to recognise that many of these organisations are small, unable to influence events in any direct way, and may not necessarily support 'progressive' causes (Morris-Suzuki 2000). Greenpeace may be an INGO, but so are a number of right-wing, reactionary and racist political organisations. In other words, we can't assume anything about the nature of causes an INGO might support, or about its capacity to influence events.

It is important to keep these caveats in mind when considering the growth of 'global civil society', which a number of authors assume is both inevitable and desirable. Lipshutz (1992), for example, argues that the rise of global civil society is an inevitable corollary to the apparent decline of the state and a site for the creation of a counter-hegemonic discourse that may challenge the dominance of consumer capitalism. Similarly, in one of the most comprehensive analyses of global civil society yet undertaken, John Keane (2003) is equally enthusiastic about its prospects, and sees it both as a mechanism for the inculcation of peaceful values and as a central component of a new form of 'cosmocracy'. The cosmocracy—'a conglomeration of interlocking and over-lapping sub-state, state and suprastate institutions and multi-dimensional processes that interact, and have political and social effects, on a global scale' (Keane 2003:98)—is broadly similar to Keohane's and Nye's model. What is distinctive about Keane's position is his positive view about the relationship between business and civil society. For Keane, the distinction between the market and civil society is 'artificial', as capitalism effectively structures society. Moreover, business has a functional need for an effectively functioning civil society. In other words, it is in the interests of capitalists to encourage the development of civil society.

Business Interests and Global Governance

While this view of the business-societal relationship might seem somewhat Panglossian, it does acknowledge one pervasive aspect of contemporary patterns of governance: business interests are influential actors in processes of global governance and have assumed an increasingly prominent functional role in shaping critical regulatory outcomes in areas formerly managed by states. What is less often recognised is just how pervasive and integral to new patterns of governance business interests have become. John Braithwaite's and Peter Drahos's (2000) landmark study of global business regulation has detailed just how extensive and influential the private sector now is. In many of the most important areas of transnational commercial activity and regulation—property, trade, telecommunications, food, transportation and the financial sector—'experts' from the private sector have frequently played prominent roles in shaping the regulatory frameworks that govern particular issue areas. Self-regulation by industry, in which the representatives of key businesses and industries develop regulatory regimes and then 'model' appropriate practice through the inculcation of particular norms, is at the heart of the new style of governance in which the private sector plays such a prominent part.

There are a number of examples of important industries where governments have allowed markets and the private sector institutions that inform and mange them to make the regulatory running at the cost of governmental authority. One of the most important industries in this regard is the international financial sector, which has expanded dramatically since the early 1970s and which has the capacity to profoundly influence the autonomy and position of individual governments and the economies they attempt to manage. The regulation of securities markets, for example, is something that is managed primarily by unelected actors from the private sector (Underhill 1995). Equally significant, the credit ratings agencies that play such a crucial role in providing market participants with information are similarly independent of governments and have an increasing capacity to make judgements that directly influence capital and interest rate movements (Sinclair 2001)—judgements that inevitably constrain the degree of policy autonomy available to individual governments, especially those outside to core economies of Europe, Japan and North America.

A more subtle, but highly significant and influential example of the shift to non-governmental modes of regulation can be seen in the increased prominence and independence of central banks. Across most of the OECD countries, central bankers have been given a greater degree of policy-making independence, frequently assuming sole responsibility for interest rate policy. More importantly as far as issues of global governance are concerned, the fashion for granting greater policy independence to central bankers has been consolidated and expanded through the auspices of the Bank of International Settlements (BIS), a forum in which central bankers from the Group of Ten countries help to set the regulatory framework for domestic banking sectors. Although some authors have rightly stressed continuing differences in national banking sectors (Kapstein 1994), as Susan Strange (1998:176) points out 'financial innovation, liberalisation, and sharpened competition between banks and other private enterprises' have steadily eroded the capacity for national governments to independently regulate 'domestic' firms and practices. Indeed, the very nature of the technological and competitive innovations associated with the information economy that the global financial sector epitomises has led some observers to conclude that the era of the national economy and the capacity for discrete national patterns of regulation is definitively over (Korbin 2002).

States and Global Governance

It might be supposed from the increased importance of private sector and inter-governmental agencies in the new global governance that the nation-state is in permanent decline. This view is supported by those authors who draw attention to more generalised features of globalisation, in which states are apparently competing with each other to create 'business friendly' regulatory environments in the hope of attracting inflows of investment, especially the 'direct' variety associated with job creation. Philip Cerny (1996), for example, describes the underlying dynamic of this competitive international environment as 'regulatory arbitrage', and argues that individual governments are complicit in undermining both their own autonomy and the general regulatory standards that govern economic activity across the world.

Wolfgang Reinicke (1998) is more sanguine about the impact of globalisation on the capacity of individual state's to govern, and argues that they can respond proactively to such challenges through 'cooperative competition'. In this formulation, states maintain substantial sovereignty relative to each other through coordinated policy responses to changes associated with the evolution of the global economy. The growth of intergovernmental organisations like the EU, and to a lesser extent NAFTA and the Asia Pacific Cooperation (APEC) forum illustrate how such cooperative strategies might be institutionalised. Significantly, however, Reinicke (1998:61) acknowledges that under conditions of cooperative competition governments 'do not necessarily represent the general public interest'. In other words, even if individual states can retain a degree of authority and autonomy by embracing cooperative strategies and coordinating policy with other states, the overall rationality or guiding principles that inform their actions may have more to do with narrowly conceived business interests than they do with the individual polities they claim to represent.

The anti-democratic potential of governance by unelected officials in key inter-governmental agencies like the IMF or the host of lower-profile but influential organisations that govern many areas of transnational economic activity has long been recognised. This anti-democratic potential has implications that extend far beyond the liberal democracies of the core economies. As David Held (1995) points out, there is "a striking paradox to note about the contemporary era: from Africa to Eastern Europe, Asia to Latin America, more and more nations and groups are championing the idea of "the rule of the people"; but they are doing so at just the moment when the very efficacy of democracy as a national form of political organization appears open to question. As substantial areas of human activity are progressively organised on a global level, the fate of democracy, and of the independent democratic nation-state in particular is fraught with difficulty" (Held 1995:21).

One of the biggest potential challenges to the idea of globalisation in particular and to global governance more generally is that existent patterns of rule, authority, and order are seen to systematically favour the developed world at the expense of the developing nations (Higgott 2000). As Reinicke (1998:227) points out, if processes associated with globalisation are to be sustained, if *global* public policy is to become more reality than rhetoric, 'the governments of developing countries will have to participate in it'. Yet despite the diffusion of authority to a range of new actors, and despite the apparent diminution of the power of states generally, even 'global' patterns of governance exhibit some familiar, hierarchically structured patterns of power that do not bode well for meaningful democratic representation or the effective inclusion of new players.

The More Things Change...?

To understand this apparent paradox, we need to revisit Braithwaite's and Drahos's exploration of global business regulation, for as they point out, even "in the era of information capitalism and the new regulatory state, control from the nation's territory of abstract objects like patents is crucial to building the nation's wealth, as is embedding global principles of regulation that suit the wealth-creators from that state's territory. The resilience of US power that many expected to wane in the 1990s can be understood in terms of the masterful work of the Clinton administration in these areas" (Braithwaite & Drahos 2000:475).

This might seem a somewhat surprising observation at a time when US HEGEMONY has assumed a more unilateral and militaristic style under the administration of George W. Bush, but it is, nevertheless, one that captures something important about evolving patterns of governance. The capacity to shape the ruling ideas and regulatory architecture, the ability to assert influence through nominally independent inter-governmental agencies like the IMF (Pauly 1997), and the possibility that private sector organisations may continue to reflect the perspectives of businesses from specific countries, all entrench the interests of particular countries and groups. While some might prefer to describe the way this more diffuse, multi-level form of power operates in terms of an evolving transnational class that transcends narrowly defied national borders (Robinson & Harris 2000), the salient point is that it is still possible to detect the clear influence of national forces and interests in the way major regulatory processes develop. For example, recent changes in the regulation of patents and copyright, highlighted by the trade-related intellectual property rights (TRIPS) agreements, reflect both the growing importance of the service sector in the American economy, and the capacity of American-based business to influence the US government to place TRIPS on the intentional policy-making agenda (Sell 2000).

It is the persistence of patterns of order that bear the continuing imprint of American power in particular and of 'Western' interests more generally that has led some authors to conclude that—at best—we are witnessing the emergence of a 'global state' that entrenches and builds upon the institutional order created at Bretton Woods in the wake of World War II (Shaw 2000), or—at worst—the pursuit of 'world dominance' by the US and economic interests associated with it (Gowan 1999). At the very least we can say that the post-war institutional order associated with US hegemony has actively promoted a form of neoliberalism and the washington consensus that has suited the collective interests of the developed industrial economies more than it has the developing world. Even the so-called 'post-Washington consensus', which has emerged in response to criticisms from civil society activists and developing country governments, has done little to change this underlying reality. Indeed, it has been persuasively argued that the new preoccupation with 'good governance' reflects a managerialist perspective that is designed to depoliticise debates about development policies (Higgott 2000). From a governance perspective it is also worth noting that some of the key agencies of the international order that the US continues to dominate, such as the World Bank, have been enthusiastic promoters of a particular form of governance and development policies in the non-core countries. 'Good governance', or a policy framework broadly in sympathy with the Washington Consensus, has been at the heart of a reformist template that is in keeping with the consolidation of a liberal international order in which nominally independent inter-governmental organisations are critical agents of change, sources of advice, and mediators of global pressures (Leftwich 2000).

In short, while there may be an increasingly diverse array of agencies, actors and organisations operating under the broad rubric of global governance, and while there is clearly something novel about the way some issues are managed, regulated and organised, there is also something familiar about both the major players that influence crucial political and economic outcomes, and the underlying forces that motivate them. In such circumstances it may be wise to consider global governance, as Craig Murphy (2000: 799) does, as 'more a site, one of many sites, in which struggles over wealth, power, and knowledge are taking place'. As such, it is not as novel as some accounts would have us believe.

Implications and Prospects

Global governance, then, is a rather contradictory phenomenon. On the one hand, the concept of global governance draws our attention to a whole range of new players that either previously did not exist, or existed in such small numbers as to have little presence or impact on patterns of governance. On the other hand, however, we should not confuse novelty and noise for an ability to actually determine political and economic outcomes. One of the most striking features of contemporary patterns of governance is that for all the attention rightly given to the new players, some of the older, more familiar actors remain important. States generally, and the US in particular, still play a central role in underwriting and signing-off on the regulatory frameworks that govern transnational activities—even if the impetus for, and content of, such agreements increasingly emerges from unelected private sector organisations or intergovernmental agencies.

The other familiar face of global governance is its underlying rationality: many writers have drawn attention to the functional necessity for forms of governance that transcend national borders and which provide a degree of certainty for the transnational economic relationships and modes of cross-border integration that have been such central drivers of processes associated with globalisation. This is not to suggest that global governance is simply an inevitable epiphenomenon of underlying economic reality. Rather it is to acknowledge that imperatives associated with an increasingly global form of free market capitalism provide a powerful force for regulatory harmonisation and cooperation.

More troublingly, however, the discourse of global governance, especially when promulgated by powerful business forums and inter-governmental agencies dominated by 'the West', implicitly and sometimes explicitly encourages the idea that effective governance depends upon a particular sort of regulatory architecture, concomitant political practices and economic structures, and a preparedness and capacity to adopt specific sorts of ideas and values (Latham 1999). Whether the increasingly prominent social movements that some authors have identified as part of the 'new multilateralism' will prove capable of challenging the ruling ideas of the era and establishing a counter hegemonic discourse remains to be seen (see O'Brien et al 2000).

What is clear is that the emergence of global governance poses a major theoretical challenge for traditional, state-centric analyses of international relations. Certainly states remain critically important and powerful actors in the international system, but they are cooperating with each other, *and* with a range of new actors in ways that are simply not explicable by examining the actions of states in isolation. It is not simply that some states have never enjoyed the sort of sovereignty routinely and uncritically referred to in much of the International Relations literature (Beeson 2003), but even the most powerful of states are asserting themselves in new ways, and may in fact be consolidating their positions and influence by utilising the supposedly independent institutions of global governance. Global governance, in other words, is a useful shorthand for the new regulatory order, but one that needs careful handling and critical interrogation.

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Global Justice and Solidarity Movement

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Introduction

The 'Global Justice and Solidarity Movement' (GJ&SM) is actually an activist-proposed name for the general wave of protest against corporate-dominated globalisation, against US-sponsored neo-liberalism/neo-conservatism and war, one name for the new wave of radical-democratic protest and counter-proposition. This 'movement of movements' is marked by its network form and communication activity; a matter recognised by friends and enemies alike (Escobar 2003). Moreover, 'it' seems to change size, shape, reach, scale, target and aims according to events.

Like any novel phenomenon, the GJ&SM is easier to characterise by what it is *not* than by what it is:

- It is *not* an international labour or socialist movement, though unions and socialists are prominently involved;
- It is *not* a 'transnational advocacy network' (Keck and Sikkink 1998) though it is much marked by the presence of international and national NGOs;
- It is *not* a reincarnation of the international protest wave following 1968, though Che Guevara icons are still popular, and it includes other clear echoes of the 1960s-70s;
- It is *not* an anarchist movement, though anarchists, autonomists and libertarians are highly active within it;
- It is *not* a nationalist or thirdworldist movement, though nationalist, thirdworldist, and anti-imperialist forces and notes can be clearly identified within it.

It is, on the other hand, not too difficult to identify a rising number of processes which have *provoked* this movement. These include:

- The increasing predominance, in the international sphere, of multinational corporations, and international financial institutions, along with the neo-liberal policies that have been imposed on both North and the South;
- The shrinking of the public sphere and reduction of state social programmes and subsidies;
- The feminisation of poverty, the commodification of women (the sex trade), the simultaneous formal endorsement and political denial of women's and sexual rights;
- De-industrialisation, unemployment and the informalisation of employment;
- The ideology of competitivity as the court of first and last appeal;
- The undermining of market protection (primarily of weaker national economies);
- The simultaneous preaching and practical undermining of traditional structures and notions of national sovereignty;
- The simultaneous creation of new international institutions and regulations, alongside the marginalisation of the United Nations and such agencies as the International Labour Organisation;
- Increasing talk of and the continuing undermining of ecological sustainability; corporate attempts to copyright genetic resources, to genetically modify foodstuffs, to commercialise them and then coerce people into buying them; the continuation and even increase of militarism, militarisation and warfare despite hopes raised by the end of the Cold War;
- The increase in globalised epidemics and threats to the climate;
- The demonisation of immigrants, asylum-seekers, and of Islam and other 'others'.

All these have dramatically raised social tensions, particularly in the South, but also in the East (the ex-Communist world) and even in such model core capitalist welfare states as Canada and Sweden. The pressures have also provoked major conservative, reactionary, religious and ethnic backlashes, of a violent and repressive nature, sometimes internationally coordinated.

Many identify the new protest movements of the emerging century with the North—Seattle 1999, Prague 2000, Genoa 2001, Gothenburg 2001, Barcelona 2002, Evian 2003. They also associate it with the middle-classes, students and youth, who have indeed been prominent within it. So have women, forming around 50 percent at the World Social Forums, though this is little commented on.

But the movement cannot be limited to major protest events, nor to what has occurred since 1999. Already in the 1980s there were urban uprisings against the externally-imposed end of food subsidies. Widespread protests against gigantic and ecologically damaging dam projects, promoted by the WB and local elites, go back to the 1980s and earlier. There were major demonstrations and riots against the poll tax in Britain in 1990. Through the 1990s, there were myriad protests across the South against the euphemistically-named Structural Adjustment Policies (SAPs) in particular, and neo-liberal policies more generally.' (Aguiton 2001, Walton and Seddon 1994).

One major manifestation of US-initiated neo-liberalism has been the North American Free Trade Agreement (NAFTA), which provoked widespread protest in both Canada and Mexico. In the case of Canada, it turned an initial national-protectionist campaign into one of international solidarity, first with Mexico, then with Latin America more generally, leading to the Hemispheric Social Alliance, which included the USA. In the case of Mexico, the launching date of the NAFTA, January 1 1994, was used for the launching also of the Zapatista movement in the severely globalised, marginalised and exploited state of Chiapas, in the South of Mexico (Alianza Social Continental website, Zapatista Index website).

Initially appearing as a classical armed guerrilla movement, based on the discriminated and land-hungry Mayan ethnic communities of Chiapas, the Zapatistas rapidly revealed entirely novel characteristics: an address to Mexican 'civil society', a high-profile internationalism, a sophisticated understanding and use of both the mass media and alternative electronic communications. All can be found in the speeches and writings of its primary spokesperson, Sub-Commander Marcos (Rafael Guillén), a university-educated non-indigene, trained in guerrilla warfare in Cuba. Activities of the Zapatistas, particularly two international *encuentros*, one in Chiapas 1996, one in Spain 1997, gave rise, or shape, to a new wave of internationalism. It had a dramatic appeal to an international left, battered, bruised and disoriented by the decline or collapse of its traditional projects—revolutionary or reformist. Zapatista encounters also inspired at least two significant emanations of the movement, People's Global Action (PGA Website) the World Social Forum (see below).

Other major sources of, or contributors to, the new movement must be mentioned. The rising wave of protest against unemployment, privatisation and cuts in social services gathering steam throughout the 1990s, markedly in Europe. The development of 'counter-expertise' (critical of that of states, corporations and establishment academics), has been widely noted. It is concentrated in international and national NGOs which have honed themselves at a series of UN conferences and summits through the 1990s—notably the 1992 World Conference on Environment and Development, and the 1995 UN Fourth World Conference on Women. We must also note the significance of irreverent, often anarchist-tinted, direct action movements, of customarily internationalist appeal, such as Reclaim the Streets in the UK. A significant international libertarian initiative, related to this kind of national activity, was that of PGA, which held meetings in Geneva, Bangalore and Cochabamba. (PGA Website, Reclaim the Streets Website).

Finally, there came the 'New Social Movements' of the 1970s-80s. Considered as expressing 'identity' more than 'interest', these movements—of women, indigenous peoples, and sexual minorities, or for media democratisation, on ecology and consumption—were noted in the South as well as the North. They brought to public attention hidden forms of alienation, suggested new forms of 'self-articulation' (both joining and expression). As much addressed to the transformation of civil society as of the economy or state, these movements raised issues that the major old international 'interest' movement—that of unionised labour—had long subordinated ignored or marginalised (Waterman 2001).

The rise of the 'anti-globalisation movement' (the most common name), did not so much re-assert 'interest' over 'identity' as surpass the alleged opposition—or even the distinction. Highlighting the increasing power of corporations over states, and of their negative impact on people and people—North, South, East—the movement was as much a challenge to institutionalised labour and the left worldwide as to an international women's movement suffering severe 'ngo-isation'.

It is clear, from yet another name—'anti-capitalist'—that this 'movement of movements' is as much an aspiration as an actuality, as much a becoming as a being. It has, however, passed one major test. When the terrorist attack on New York and Washington occurred on September 11 2001, there was a stalemate in the growing movement in North America (Seattle 1999; Washington DC 2000; Quebec 2001). Yet, with the US-led wars against Afghanistan 2002 and Iraq 2003, a movement often considered to be primarily 'anti-corporate' morphed into the biggest international anti-war protest in history. A *New York Times* columnist stated, February 18 2003, 'there may still be in our planet, two super-powers: the United States and world public opinion'. (Starr & Adams 2003).

The language of the new radical-democratic protest movements is increasingly infecting some of the 50-100-year-old international trade union organisations, such as the recently-renamed Global Union Federations (GUFs). And trade unions, which have 150-200 million members worldwide, are increasingly attracted by the World Social Forum (Aguiton 2001; International Transportworkers Federation 2002).

The World Social Forum (WSF), a high-profile movement event, has been held in Porto Alegre, Brazil 2001-3, and is scheduled for Mumbai, India, in 2004. If the earlier-mentioned events were frequently marked more by opposition than proposition, the Forums have not only been devoted to *counter*-proposition over a remarkably wide range of social issues (with a wide range of significant collective actors). They have also demonstrated that what is shaping up is much more than a Northern, or even a Western-hemispheric, internationalism. The Forum process, moreover, has now reached take-off, with national, regional and thematic forums taking place all over the world. Some of these may be independent of the WSF itself. The WSF has also become both the subject and the site of intense reflection concerning its own significance, nature and future. (Fisher & Ponniah 2002; Transnational Alternatives 2002; Santos 2003; Sen et. al. forthcoming).

Names and Definitions

This movement, as suggested, has many names, these reflecting sometimes conflicting, sometimes overlapping, approaches, theories, strategies and aspirations. These understandings vary from the traditional leftist, the non-traditional leftist, to the innovatory, and even the insistence that this is not a movement but a 'field'. Attempts have been made to capture, or at least conceptualise, the phenomenon under the rubric of 'global civil society'. The ways even sympathetic theorists and strategists try to identify groups or tendencies within the movement is revealing both of their orientation and of the novel nature of the phenomenon.

Thus, Alex Callinicos (2003:14-16) from the UK, whilst admitting that the majority of its activists are *not* anti-capitalist, refers to its 'developing consciousness' as justification for calling it so. He then draws up a typology of anti-capitalism which includes the 'reactionary', 'bourgeois', 'localist', 'reformist', 'autonomist' and 'socialist' (himself identifying with a sub-category of this last type, the 'revolutionary').

Christophe Aguiton (2001) from France, a Trotskyite of another feather, and a leading figure within the WSF, tentatively identifies three 'poles' within the global justice movement: a 'radical internationalist', a 'nationalist', and a 'neo-reformist' one. The first looks beyond both capitalism and the nation-state, the second is a mostly-Southern response, and the third is the kind of 'global governance' tendency also strongly present within the WSF (Global Civil Society Yearbook Website).

Starr and Adams (2003), from the USA, who would be 'localists' in the Callinicos typology, characterise the movement as 'anti-globalisation', and identify as significant 'modes' or 'archetypes' within it, 'radical reform', which is state-friendly; 'people's globalisation', associated with the WSF; and 'autonomy', identified with the ecological friendliness and democratic qualities of freely cooperating communities (their own).

The Portuguese researcher, Boaventura de Sousa Santos (2003), who concentrates on the WSF, suggests its radical implications for the surpassing of traditional sociologies, left strategies and even Western epistemology. He argues that any significant new emancipatory movement cannot be understood in pre-existing terms, and proposes the necessity, in our epoch, of developing a 'sociology of absence' and a 'sociology of emergence'. This is to surpass the sociologies of the existent and apparent, and allow voice to what has been ignored or suppressed. These new sociologies are also necessary to surpass 'conservative utopias', whether of the right or left.

Italian Mario Pianta (2001), considering the movement in 'global civil society' terms, divides responses to neo-liberal globalisation into 'supporters of current arrangements', 'reformists', 'radical critics favouring another globalization', 'alternatives outside the mainstream', and 'nationalist rejectionists'.

Suggestive is that, with the exception of Callinicos, none of the above uses the terminology of Left (Right, or Centre), and that, in practice, each of these understandings cuts across the left-as-we-know-it, the left of a national-industrial-(anti-) colonial-capitalism. Whilst many activists and some internationally-influential left movements do refer solely to this tradition, the question of whether the GS&JM is not potentially surpassing traditional left internationalism is also being raised. 'Emancipation' might seem a more appropriate term than 'left' when discussing today the transformation of society, nature, culture, work and psychology—as well, of course, as that increasingly important but placeless place, cyberspace (Escobar 2003).

The Local, National, Regional and Global

Whilst some writers set up, in oppositional terms, the national and the global, the local and the global, it would seem more fruitful to see these as existing in creative tension, with each of these levels, instances or spaces informed by the other. Or at least needing to be so informed (Massey 1991).

For a meaningful alternative internationalism to take shape a revolution within capitalism, caused by the combination of globalisation and informatisation, was needed. The nature of this alternative may be at least suggested by the world's biggest and most widespread (if unsuccessful) protest demonstration, the anti-war protest of February 15-16 2003. This had been called for at the ESF 2002 and echoed at WSF3. The provocation here was clearly the new kind of global war launched by the most conservative powers in the North. But the coordination of the protest was now largely dependent on dozens of 'alternative' websites and lists. It may have been further supported by traditional anti-war and anti-imperialist elements within the movement, but it would surely have been impossible without the web.

The new localisms and internationalisms of the present day are inspired by the explicit or implicit recognition that 'the nation-state...is at once too large and too small for the range of real social purposes' (Williams 1983:197). What holds these levels, spaces, foci together, in a possibly conflictive but unavoidable tension, is the more-recent recognition, by the Zapatistas, of the necessity for 'a world where many worlds fit'.

Culture, Communication and Cyberspace

Distancing ourselves somewhat from current analyses, claims or prognostications, concerning culture, communication or cyberspace, or aspects, of the new movement (Cyberspace after Capitalism 2003) it is worthwhile tracing the line back to, or forward from, the old internationalisms.

Marx and Engels were excited by the communication impact of national railways and the telegraph as it became trans-European. When in power, Lenin declared that 'Cinema for us is the most important of arts': silent film could communicate across the literacy and language barriers. 20th century Communist internationalism was sensitive to the area of communications and culture, one of its most creative spirits declaring, notably, that 'communications are the nervous system of ...internationalism and human solidarity' (Mariátegui 1923). In the 1920s, the Moscow-based Third International sponsored a multitude of often-innovatory cultural and communication forms, both popular and avant-garde, from Germany to India and Japan.

Leaping forward to '1968', we can note the brilliant poster art, often internationalist in spirit, following the Cuban Revolution, and that generated by Paris 1968 itself. At the same time, however, the widespread hostility of the new left to 'capitalist technology' and the 'commercial mass media', was criticised by Enzensberger (1976). He argued that engagement with the electronic media would allow people to mobilise *themselves*—to become 'as free as dancers, as aware as football players, as surprising as guerrillas'. From this period on we note the development of community-specific local-to-international radio, of 'guerrilla' video groups and computer-communication experiments.

A part of the new social movements of the 1980s-90s retained, and retains, its suspicion of computer-based communications internationalism, and of the internet and cyberspace more generally. More pragmatic spirits simply adopted and adapted each new development, if in an instrumental way. And the more visionary began to see the internet not simply as a tool but as a *space* to be disputed and even as *community creating*. Amongst the most pragmatic have been the union organisations, and many independent labour and socialist internationalists. Amongst the more visionary and experimental have been the Zapatistas and their supporters, some feminists and those coming out of the 'community', 'alternative' and other media movements—themselves descendents of

1968. The best-known expression is the de-centred, multi-media, Indy Media Center, which sprang to life during Seattle 1999, and which now has nodes in such unlikely places as India, Palestine and Russia. (IndyMedia website).

Alongside such new internationalist media practice has gone democratic international media-campaigning, itself traceable back to the thirdworldist (i.e. statist) New World Information and Communication Order (NWICO) of the 1970s-80s. Today this has a more radical-democratic or social-movement orientation. Media and cyberspace activity finds multi-faceted expression within the WSF, partly in official panels, partly in more marginal ones. It may also, however, find expression within alternative or oppositional spaces during the World Summit on the Information Society (WSIS) 2003-5. Such activities, within the UN system, may now be being seen as secondary to activity within the framework of the WSF. (Cyberspace after Capitalism 2003).

Given their low-level of institutionalisation, and of the conventional quest for political power, both the WSF and the GJ&SM have to be considered in cultural and communication terms. But, whereas the movement's protest events have been dramatically networked, and concerned with mass-media and alternative-media address, those of proposition, such as the WSF, have been rather less so, relying on such traditional (new) left forms as the panel and the demonstration.

Conclusion: A Fifth International? Global Governance?

A new internationalism is taking shape and place, though it might be more realistic to put this in the plural, or to distinguish it as 'the new global solidarity'. There will be argument about whether it surpasses the First-to-Fourth Internationals or provides a basis for some kind of Fifth one . However, it is also quite possible that it will reproduce the errors, and failures, of previous internationals. The GJ&SM has not, so far, proven to be a movement much aware of *that* history, which is also part of its *own* history—or at least of its inheritance. Those involved in such debates are, however, likely to agree that a movement that is *not* aware of its history is in danger of repeating it (Löwy 2003).

Whilst some might consider that such a new international might lead to 'a socialist world republic' (words of a German Communist song of the 1920s), or a green, feminist, ecological utopia, others within and around the movement are focussing more on the new legal standards or institutional forms that the movement should aim at. These are inspired, explicitly or implicitly, by parallels with the national liberal-democratic or welfare states of the post-World War Two period (Munck 2002, Monbiot 2003).

Those sharing hegemony globally (the corporations, the US and other OECD countries, the international financial institutions (IFIs), the UN) increasingly recognise and respond to the challenge of the GJ&SM. We may recognise three strategies. The first would be significant concession, as on anti-personnel mines. The second is the incorporation of acceptable NGOs and unions within the IFIs, or the UN's Global Compact (Judge 2001). And a third is outright condemnation and violent repression (Genoa 2001). In so far as the movement includes 'fixers'as well as 'nixers', and embraces a broad range of strategies (from direct action to lobbying), we can expect to see it impacting on global governance in a variety of ways, on a variety of life issues.

It would seem to be realistic to assume that the global hegemons of the present day are more likely to make concessions, as the movement moderates assume, than to commit suicide, as some of its radicals might hope. However, the question must remain open of what new kind of 'global governance', what kind of settlement with (which parts of?) the GJ&SM, this would imply. And of whether, this time round, the social movements will be satisfied, for another 25-50 years, with a more civilised global capitalism, rather than developing their movement into one that is anti-capitalist not only in the eye of the commentator but in the minds and actions of the participants.

Internet Sites

Alianza Continental Social. www.asc-hsa.org/

Global Civil Society Yearbook. http://www.lse.ac.uk/Depts/global/Yearbook/

IndyMedia Centre NYC. http://nyc.indymedia.org/

Peoples Global Action. www.nadir.org/nadir/ initiativ/agp/en/

Reclaim the Streets. rts.gn.apc.org/diary.htm

Social Movements World Network http://www.mov soc.org/htm/social_movements_meetings.htm

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Global Political Economy

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Introduction

It has become something of a cliché to observe that we live in a time of increasing globalisation. Yet to understand what is novel, and also what is unchanged, about the contemporary era, we need to look at the key features of the global political economy in their specific historical context. Before doing this, however, it is important to emphasise that even talking about a 'political economy'—and a 'global' one at that—makes a number of fairly contentious initial assumptions. Consequently, the first part of this essay explains why many observers think it is essential to link politics and economics as two deeply interconnected parts of a complex, and increasingly transnational, whole. Following this, I briefly outline some of the key historical developments that have driven the expansion of the evermore pervasive capitalist system that essentially constitutes the global political economy. And yet, despite the fact that hardly any part of the planet remains unaffected by, or unintegrated with, the global political economy, one of the great paradoxes of the contemporary period is that not only are some parts of the world incorporated into the global capitalist system in very different ways, but there are important and persistent variations in the types of capitalism that predominate in different regions. In other words, the global political economy is characterised by a number of ubiquitous features, but also by some surprising and enduring differences in outcomes and modes of organisation.

Political Economy in Historical Context

In their excellent introduction to theories of political economy, Caporaso and Levine (1992) identify a number of quite distinct conceptions of politics and economics. 'Politics' can refer to a government or more generally to 'the state'; it can refer to the distinction between the public and private sectors; and it can refer to the authoritative allocation of values. More generally, we can think of politics as being associated with the capacity to use power—generally legitimately—to organise and regulate collective social activity in particular ways. In this formulation, states have been and remain the most important actors. However, we also need to recognise that political activities can extend beyond states, involving not just civil society, but even the realm of 'private' individual behaviour and identity. Indeed, one of the consequences of explicitly linking political and economic processes is that we become aware of the complex, interactive, and mutually constitutive nature of these dynamic processes, which have impacts from the macro to the micro level (Hay 2002; Giddens 1985).

'Economics' also has a number of distinct meanings, according to Caporaso and Levine. It can mean economic calculation, or thinking in an 'economic' way about the best way of satisfying unlimited desires from finite resources. This formulation leads to a characteristically 'instrumental' approach to economic organisation and the 'rational' allocation of limited resources, primarily through market mechanisms. Another way of considering economics is as 'material provisioning'. Here the emphasis is on the production of goods themselves and the general satisfaction of human needs, not on the possible 'efficiency' of the process itself. Very crudely, we can think of these two approaches as being broadly reflective of those traditions of economic thought descended from Adam Smith, which claim that 'the market' is the most efficient allocator of resources, and those associated with Karl Marx, which are concerned with the material basis of society and the way economic activity affects social relationships more generally (Muller 2002).

In both of these approaches the role of government or the state is potentially critical as political processes may actually determine the conditions under which economic activity occurs. This is why Caporaso and Levine propose a third way of thinking about economics, in which economics is synonymous with 'the economy' itself. It may seem odd to think of something as familiar as 'the economy' in this way, but it is important to recognise that, even if we can agree on quite where 'the economy' begins and ends in the contemporary era (Bryan 1995), in an historical context, the very idea of a discrete national economy that might be governed and regulated by governments in particular ways for specific purposes is a relatively new idea (Gordon 1991). This conception of the economy as a separate entity reflects both the greater understanding and capacity for management of economic processes that has been developing since the publication of Smith's *Wealth of Nations* in 1776, and the increased specialisation of the economics discipline itself. It is worth emphasising that Smith, Ricardo and Marx, would all have thought of themselves as political-economists and would have been surprised at the current disciplinary separation that is the norm today (Deane 1978).

Thinkers like Smith and Marx considered themselves to be political-economists because the historical development of both the state and economic processes more generally seemed to be interconnected. The emergence of the modern, sovereign nation-state was the result of a long-run historical process in which other less 'efficient' forms of political organisation were gradually eliminated (Spruyt 1996). One of the principal reasons that the state became the dominant mode of political organisation was that it proved to be particularly effective in facilitating processes and relationships that would eventually be described as 'capitalist'. Capitalism proved to be the most dynamic and productive form of economic organisation ever seen, and would give those countries in which it initially developed a decisive and lasting advantage over their rivals. Capital and coercion, as Charles Tilly (1990) pointed out, were directly linked to the dominance of 'the West', the spread of capitalism and the universalisation of the nation-state system as the principal form of international political organisation. Despite this close historical connection between nation-states and the growth of international economic activity, the growing integration of economic and technological processes that transcend national borders has led a number of scholars to make a conceptual distinction between international and global economic processes. Korbin (2002:47), for example, suggests that "an international economy *links* distinct national markets; a global economy *fuses* national markets into a coherent whole" (original emphasis). This is a useful distinction, but as we shall see, one that cannot be drawn too sharply when much of the world is only marginally integrated into 'global' processes and national differences remain significant.

Indeed, the persistence of difference serves as a powerful reminder that there was nothing inevitable about the way the global political economy has evolved, and it is possible to imagine different ways of organising political activity and the production of goods and services. What we can say is that historically the nation-state has proved to be especially well equipped to provide and enforce the legal and institutional framework within which market economies might flourish (Giddens 1985). However, we need to remember that even in Britain, the birthplace of the industrial revolution and the supposed home of *laissez faire* economic policy, the disciplines, practices and individualistic social values associated with capitalism had to be forcibly imposed by a highly 'interventionist' state

(Polanyi 1957). The application of political power to create a particular sort of economic order has been one of the recurring features of the emergent global political economy.

Political Economy Goes Global

Deciding just when—or if, for that matter—political economy became a 'global' affair is a hotly debated issue. Some 'world systems' theorists take the most extreme position on this, arguing that some sort of world-scale economic order has been in place for hundreds, if not thousands of years (Frank & Gills 1993). Of course, in some ways—even if it is only the most basic material and environmental ones—we have always inhabited one world. But what is of greatest interest here is that the gradual emergence of capitalism in Western Europe some four of five hundred years ago inaugurated a process that saw the intensification and extension of economic and social practices that had formerly been highly localised (Wood 1999). At one level, the expansion in the scale and scope of economic activities this period permitted was a function of improvements in technology, transportation and the desire to explore and proselytise. At another level, however, the opening up of the 'new world' and the establishment of colonies in the Caribbean, and the slave trade in Africa, were critically important spurs to the further economic development of Europe itself (Blaut 1993). Indeed, it is important to stress that from the outset, the emerging global political economy was one that conferred important 'first mover' advantages on those countries that developed economically and ultimately industrialised earliest; advantages that have not disappeared and which have arguably been entrenched by the political structure of the international economic order (Beeson & Bell 2005).

There is also a good deal of debate about the relationship between the international state system and the increasingly integrated transnational economic system, both of which consolidated under the auspices of European imperialism, especially during the nineteenth century (Chase-Dunn 1998). Did the inter-state system actually precede colonialism, or was it to some extent a functional response to the 'needs' of increasingly mobile capital? Such questions may never be definitively resolved and will inevitably reflect the theoretical biases of the observer. What matters here is recognising that large parts of Africa, Asia and Latin America were effectively taken over by European imperialists and incorporated—on unfavourable terms—into a hierarchical order dominated by outside powers. It was an international order that suited the interests and needs of 'the West' in general, allowing both the continuing expansion of a dynamic but inherently crisis prone capitalist system, and the consolidation of European political power. For those on the receiving end of the colonisation process the combined impact of such profound economic and political pressures was to transform indigenous institutions of governance, to overthrow established ways of generating and distributing economic assets, and to revolutionise 'the ideas and values that gave meaning to life' (Abernathy 2000:12).

Consequently, the course of economic development in the 'periphery' was frequently, sometimes permanently, skewed to reflect the needs of the expanding and industrialising economies of the 'core' economies of Europe, and later the United States and even Japan. The distinctive patterns of 'uneven' economic development that have been so characteristic of the global economy, in which many countries find themselves at the bottom of an international economic order supplying less valuable commodities to the wealthy core economies at the top, have their origins in this colonial period (Hoogvelt 2001). While there clearly is an international division of labour in which the established industrialised economies of the core tend to produce, valuable, sophisticated products that are associated with high value, high wage activities, while much of the periphery is associated with less valuable, labour intensive manufacturing or primarily production, it is important not to draw this picture too starkly. Not only has the spectacular economic development that has occurred in East Asia in particular cast doubt on static conceptions of endless domination of the periphery by the core, but even within the established core economies, not all economic activity is of high value or sophisticated.

The picture that emerges of the contemporary global economy is therefore complex, and we need to resist the temptation to make sweeping generalisations. Having said that, there are a number of striking features about the current organisation of economic activity across the world that merit highlighting. One of the most important long-run changes has been the rise in importance of transnational corporations. Whereas trade used to be conducted primarily between discrete national economies specialising in different products, now 'trade' frequently occurs within different branches of one company (intra-firm trade) or within one economic sector (intra-industry trade). Firms now have a range of possible strategies with which to access and produce for lucrative consumer markets. One of the key consequences of this has been a dramatic growth of foreign direct investment (FDI) as companies seek to position themselves close to wealthy consumers or gain insider status in valuable markets. Significantly, this has led to a highly uneven distribution of both trade and the increasingly important flows of FDI, the latter having effectively substituted for older style trade relations in many cases (Dunning 2000). Flows of trade and FDI are overwhelmingly concentrated on the rich, developed economies generating some remarkable paradoxes: the U.S., for example, is generally both the largest source *and* recipient of FDI. What this means for particularly disadvantaged areas like sub Saharan Africa, is that they are increasingly marginalised from the global political economy, making development more difficult and raising profoundly important questions about the role of the state in particular and development policies more generally.

It is worth emphasising in this context that there has been a remarkable turnaround in attitudes toward FDI. Whereas once it was associated with 'exploitation' and seen as a potentially unwelcome intrusion into 'national' economic and political activity, now it is avidly pursued by governments across the word as they compete with each other to provide the most 'business friendly' environments (Gill 1998). Whatever the merits of such strategies, it is important to make a distinction between this sort of direct investment in productive activities in the 'real' economy, and the sort of 'indirect' activity associated with portfolio investment, bank lending and other highly mobile, hot capital flows. As far as this last form of capital mobility is concerned, the debates are much more complex (Beeson 2003a), and their association with econoic and financial crises has led many prominent commentators to question their usefulness, especially as far as the developing world is concerned. At the very least, such debates serve as a powerful reminder that the global system is characterised by vast disparities of economic power and differing capacities to accommodate massive flows of footloose capital. It is these sorts of developments that have been central to debates about the role of political power in an international economic order characterised by greater transnational integration and massively increased scale of private sector controlled economic assets (Rodrik 1997).

States and Markets

The conditions in which economic activity has occurred have always been highly dependent on the activities of states. Capitalism has been especially reliant on the effective application of political power to provide a regulatory framework that protects private property, and which legitimates particular forms of social relationships. In a global political economy, however, there are major debates about what the state's role should be. Indeed, there is a basic question about whether the state any longer has the capacity to provide an adequate regulatory infrastructure (Cerny 1995). Many believe that the international system is moving inexorably toward one of global governance, in which the state is simply one actor amongst an array of public, intergovernmental and private sector organisations that assume responsibility or claim authority in a range of areas formerly under the jurisdiction of individual nation-states.

That such a debate should become so prominent over the last few decades is unsurprising. Not only has the scale of transnational flows of capital, both direct and indirect, become so much more extensive and pervasive (Held et al 1999), but states appear to have become less able or willing to 'intervene' in market-centred economic processes. Again, there are important historical reasons underpinning such developments. The apparent exhaustion of Keynesian policies in the 1970s, combined with the collapse of the Bretton Woods system of managed interdependence and fixed exchange rates that was established under U.S. hegemony in the post-war period, all tended to encourage a major reconfiguration in the relationship between state and market power. The remarkable expansion in the size of money markets, for example, meant that financial sector interests enjoyed a form of 'structural' power over governments (Andrews 1994), an influence that was reinforced by the activities of private sector actors like credit rating agencies (Sinclair 1994).

At the same time that political and economic power was being realigned, there was a major change in the sorts of economic ideas that informed public policy, especially in the so-called Anglo-American economies. Ideas associated with neoliberalism and the Washington consensus became increasingly influential, and the sort of activist role for government associated with the Keynesian era became much less fashionable. Some observers argued that these developments in the late twentieth century had caused an unprecedented decline in the power and authority of states as 'a result of technological and financial change and the accelerated integration of national economies into one single global market economy' (Strange 1996: 14). As we have seen, however, although capitalism's global reach and dominant position might be unparalleled, its impact has been highly uneven. Not only is much of the world integrated into global market processes on only the most marginal or unfavourable of terms, but states are frequently not being affected by, or responding to, supposedly global processes in the same way.

Such developments can be partly explained by differences in the relative power of individual states at both the domestic and international level. Different states have different 'capacities' to construct and implement policy, something that is a function of the competence of various governmental agencies in particular and the relative independence of the state from powerful vested interests more generally (Hobson 2000; Polidano 2000). At another level, individual states have profoundly different abilities to influence the international system in general. Put simply, some countries are rule takers rather than rule makers. It is not necessary to subscribe to conspiracy theories to recognise that the international system is dominated by the U.S. in particular and by wealthy 'West' more generally. Even if all nations are either losing power to, or sharing authority with, new intergovernmental agencies like the World Trade Organisastion and the International Monetary Fund, some states are plainly more able to influence their actions than others (Woods 2002). The global political economy, in other words, continues to reflect the interests of the most powerful countries, even when all states are being affected by increasingly universal forces.

Not only do states have different abilities to influence the way the global political economy operates, but the domestic responses and organisational structures of individual states and 'national' economic systems continue to display surprising differences (Berger & Dore 1996; Coates 2000). The organisation of capitalism in France, Germany or Japan continues to display important differences in corporate strategies, industrial relations, and—perhaps most importantly—forms of state organisation and activity. While there is no doubt that long run structural changes in the global economy have encouraged a degree of 'convergence' or greater similarity in the way formerly national political-economies are configured, important differences persist. The regulation of finance capital, for example, the economic sector in which global processes have gone furthest, and which seem least susceptible to government control, continues to show surprising differences even within the sort of liberal forms of capitalism that prevail in Britain and the U.S. (Amijo 2001). Indeed, it is not inconceivable that if the U.S. succumbs to the sort of economic and financial crises that are associated with a lightly regulated finance sector, which have routinely plagued, Europe, Latin America and Asia, then it is possible that states may move to reassert more direct control over the global economy. This is not such a fanciful possibility given that the US has already experienced a speculative boom and bust over the last few years. t is important to remember that the current configuration of the global economy is not simply the inevitable consequence of technological change or inherent economic rationality, but reflects a series of political decisions that allowed such developments to occur and which were primarily driven by the U.S. (Strange 1994).

Future of the Global Political Economy

Absent a crisis of systemic proportions, however, academic and policy debates are likely to continue revolving around the ways in which states acting individually, collectively or in cooperation with other non-state actors can manage the global economy. Although the transnationalisation of flows of trade, capital and even ownership and control structures, have raised important theoretical and practical problems about the status of national economies and the way in which they are managed, states remains critically important determinants of economic outcomes. Indeed, as Linda Weiss (1998) has persuasively argued, the idea that states have become powerless in the face of global forces is something of a myth. However, we need to distinguish carefully between those states that have a capacity to influence domestic outcomes, let alone international ones. Some states clearly do retain the ability to reconfigure domestic relations in ways that offer significant competitive advantages, policy approaches which may allow them to retain distinctive social accommodations like the welfare state (Garrett 1998). Other states, however, may have a limited capacity to assert authority or influence even within national borders (Jackson 1990).

Yet even the most powerful states will have to confront an underlying tension that is central to the political-economic nexus, and which is thrown into sharp relief by an increasingly integrated global order (Brenner 1999). States are necessarily bound to a fixed, geographically delimited space. Capital, on the other hand, is increasingly mobile and unconstrained by national borders. Reconciling the competing influences of what Giovanni Arrighi (1994) describes as the 'logics' of capitalism and territoriality will be one of central challenges for policymakers everywhere in the twenty-first century. The key difficulty facing policymakers at the beginning of the twenty-first century is that systems of order and rule are no longer necessarily coterminous with, or exclusively dependent on, territorially-based power. Consequently, Ruggie (1993:165) argues that territoriality has been 'unbundled', as authority and political power has shifted toward the transnational realm.

It was precisely these sort of developments—greater economic integration and an apparently necessary degree of political cooperation—that brought a political-economy approach back into the foreground of international relations during the 1970s (Keohane & Nye 1977). At that time, greater interdependence seemed inevitable and multilateralism seemed a functionally inescapable part of the global political economy. While such integration may continue to be an important part of the global political economy, it is quite possible that it will occur predominantly at the regional rather than the global level (Hettne et al 1999). As we have seen, not only are trade and investment flows highly concentrated, but they display a strong regional bias. The European Union is the quintessential reminder of just how important regional factors can be in meditating apparently global forces. Evolution of the North American Free trade Area and the growing interest in regionally-based political and economic co-operation in East Asia suggest that this trend is likely to continue (Beeson 2003b).

The future global political economy is, therefore, likely to be characterised by striking paradoxes, major tensions, but important continuities, too. On the one hand, capitalism's dominance as the universal form of economic and social organisation seems assured for the foreseeable future. China's accession to the WTO is emblematic of this reality, and of the end of major alternatives to capitalist hegemony. However, it will be a capitalist system that is characterised by continuing differences in economic structures, social relations and the sort of roles that are undertaken by individual states. It will also be a system that displays striking differences in the capacities of states to act domestically and internationally, and profound continuing differences in levels of economic development as a consequence (Leftwhich 2000). Perhaps the key issue in this regard will be the capacity of the various actors and agencies that effectively constitute the global political economy to address major disparities in wealth distribution and life-chances—disparities that are increasingly seen as fundamental threats to the security of the international system in general (Duffield 2000). If such a system continues to be seen as one in which the wealthy world uses its political power in ways that generate inequitable economic outcomes then this does not bode well for its overall stability or durability—despite the absence of obvious alternatives.

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Global Public Goods

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Introduction

A Global Public Good (GPG) is defined by Kaul and Conceição *et al*. (2003:605) as a "public good with benefits that are strongly universal in terms of countries (covering more than one group of countries), people (accruing to several, preferably all, population groups), and generations (extending to both current and future generations, or at least meeting the needs of current generations without foreclosing development options for future generations)." Kaul and Mendoza (2003:95) propose a "less strict but more useful definition": a good should qualify as "globally public when it benefits more than one group of countries and does not discriminate against any population group." The idea of GPGs—also called International Public Goods in the literature—has emerged in the present context of increased economic openness and market integration called globalisation. Public goods initially uniquely discussed at the national level go global. Globalised markets are in need of an equally globalised supply of goods (the term referring also to services, things or conditions) they need but will not produce.

Looking at the literature one finds a large range of GPGs, including the preservation of the global environment, cultural heritage, controlling global epidemics, conserving bio-diversity, knowledge, peace and security, but also international financial stability or trade agreements that provide the framework of international trade.

The Evolution of the Concept of GPGs

This concept has gained prominence since the United Nations Development Programme's (UNDP) Office of Development Studies started the research project: "International Development Cooperation and Global Public Goods" in 1998, which produced the first seminal book on GPGs co-edited by its director, Inge Kaul (Kaul *et al* 1999a). The basic perception is that—similar to national public goods in the textbook sense—there exist non-private goods and services internationally that are able to create global externalities. Thus, they cannot be easily provided by the invisible hand. The free-rider problem and prisoner's dilemma situations exist. The familiar problem emerges that market incentives are insufficient to secure provision, exacerbated by the absence of any form of global governance comparable to national governments. Obvious examples for GPGs are the protection of the ozone shield, the prevention of global warming and its effects, or the reduction of toxic emissions affecting large parts of the globe. Advancing the concept of GPGs tries to strike the right balance between markets and public activities on a global scale. Regional public goods, such as flood control, can be seen as impure GPGs (Kaul *et al* 1999b:11), while preserving the ozone layer is a pure GPG.

Like on the national level, pure public goods are rare. Sandler (1999) categorises four types of public goods: pure and impure GPGs, club goods, and public goods possessing joint products. All types can be intragenerational or intergenerational, depending on their effects over time. Pure GPGs are defined by nonrivalry and nonexcludability, like national pure public goods. Some global commons, cleaning up ocean pollution or a world court are examples. Impure GPGs yield benefits that are partially rival and/or partially nonexcludable, such as satellite transmission. Sandler (1999) sees club goods as a subclass of impure GPGs. Nations can form clubs to share an excludable public good, such as establishing a common market. The International Telecommunications Satellite Organisation (Intelsat) is mentioned as an example of a private consortium or club providing a device carrying most international phone calls and television networks. As technology to exclude users exists, this example seems not optimal. The trade framework common markets provide for member countries is definitely better. The fourth class are activities yielding two or more outputs that vary in their degree of publicness. Sandler uses "tied foreign aid" as an example. Financing a country's infrastructure it yields benefits to recipients and the world at large.

GPGs can be both final and intermediate, depending on their position in the production cycle. Thus the eradication of polio is a final GPG. The medical and pharmaceutical knowledge on which the polio vaccine is based is an intermediate GPG. Fully in the public domain it can be used as an input for efforts to eradicate polio. Vaccines—which are private goods—are used to produce the final GPG of eradicating polio. National public goods, such as financial stability within a country can have international effects. From the production side many GPGs can be seen as the sum of national public goods plus international co-operation. Even private activities can become GPG-components: using solar energy panels contributes to climate stability.

The IBRD advances another typology, distinguishing between core and complementary activities. The former "aim to *produce* international public goods", the latter "prepare countries to *consume* the international public good that core activities make available—while at the same time creating valuable national public goods" (IBRD 2001:110, original emphasis) The IBRD mentions its own structural adjustment and institutional reform programmes as an example, because they "may also enhance the country's ability to absorb the benefits of international public goods" (*ibid*.). Both activities thus interact in the production and consumption of GPGs. Global peace, for instance, is a GPG. Peacekeeping expenditures are thus defined as core, necessary domestic infrastructure is complementary.

Based on Hirshleifer (1983), Kanbur *et al*. (1999:69ff) classify GPGs by their "aggregation technologies", or by the way they are produced. The authors enumerate four technologies as the most important ones with regard to development, but not the only technologies. They are: Summation, best shot, weakest link, weighted sum.

"Summation" means that each unit adds equally to the good's overall level. Examples are global warming or curbing urban air pollution. In this case any emission adds to the overall effect. All omissions are added, producing together the overall outcome. They are summed up. Nothing is lost, so to say.

"Best shot" describes a situation where the largest contribution or effort determines the overall provision level of a public good. The research team exerting the largest effort typically is successful in curing malaria. Once a cure is found it benefits all. To find it one might be best advised to concentrate efforts because expenditures and efforts of the other teams are irrelevant (obviously, this only holds if the winner has not benefited from research done by the teams that did finally not find the cure). Kanbur *et al*. (1999:71) conclude that "Research moneys and efforts geared to best-shot discoveries should not be dispersed as a form of development assistance." Research should thus normally be done by "donors" themselves rather than financed by ODA to be done in developing countries. The possibility that a developing country may expend the greatest effort and be apt at making the breakthrough is admitted as an exception, though.

In the case of "weakest link" the smallest level—or worst performer—fixes effective GPG-levels. Disease containment is a prime example. The country with the smallest efforts determines the chances to contain or eliminate a disease. A disease may spread again to countries where it was already eradicated, as long as there remains one single country that cannot or does not finance immunisation or prophylactic actions against this disease.

"Weighted sum" is the generalised case of summation, which may be seen as the special case where adding up is done without weighting (or weights of 1). Weighted sum attaches different weights to sub-effects. Acid rain deposition or the fallout of a huge nuclear accident such as Chernobyl affects nations differently. Depending on proximity and the direction of winds, a country might suffer less or more pollution or environmental degradation than another. This typology is to offer policy insights. The weakest link case, for instance, also suggests financing disease control in poor countries.

Pointing out that the concept of GPGs is not as clearly defined as one would wish, Morrissey *et al.* (2002) nevertheless see a broad consensus on what is meant. They define a GPG—calling it International Public Good—as a benefit providing utility that is, in principle, available to everybody throughout the globe. They see a difference between the concepts of GPGs and externalities. The essential feature of GPGs is that the same quantity is available for consumption by all individuals within the spatial range, and this single quantity is also the total amount of the good available. An externality does not refer to quantities but to the interdependence between agents. The authors conclude, however, that the practical implications are the same for the purposes of research and policy, and one cannot distinguish precisely between externality and GPG. Pollution from a production process would for instance be an externality. By accumulating and spreading across borders it becomes a global public bad. Reducing emissions would then be a GPG. Many GPGs provide a benefit in the form of reduced or eliminated risk (or public bad). Morrissey *et al.* (2002) classify GPGs into five "sectors": the environment, health, knowledge, security and peace, and governance. While knowledge and governance enhance capacities, the other sectors are largely characterised by producing benefits from reducing risks.

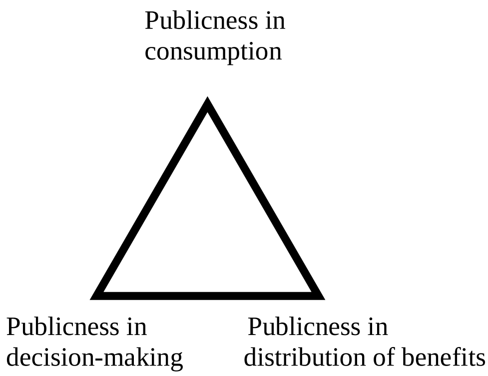
Expanding the theory of public goods Kaul and Mendoza (2003) see a need to re-envision public choice theory by widening its focus beyond state activities. As society can modify the public character of goods, they argue: "in many if not most cases goods exist not in their original form but as social constructs, largely determined by policies and other collective human actions" (*ibid*.:81). This is illustrated through the example of land, a perfect case of rivalry and excludability. Many traditional societies, however, maintain open, nonexclusive grazing or hunting grounds. Some communities still manage land, forests or water as commons. Therefore excludable resources do not necessarily have to be made private and exclusive: "Doing so is a policy choice, and often a societal choice to ensure the sustainable use of certain goods." Similarly, knowledge may be made exclusive and private by patent laws. Pollution permits are sold as new human-made private products. Television has become excludable by techniques to scramble waves and encode transmission. Intelsat is one good example. Seeing GPGs as social constructs naturally implies that the notion of what is a GPG may change together with international perceptions and values. This does not make definition any easier. "It might therefore be tempting *to equate GPGs with fundamental rights*" which, however, might generate greater “confusion in this still-developing field” of GPGs (Directorate-General 2002).

The broader approach according to which the public character of goods is defined and modified by society automatically triggers the question of how these decisions are made, and more generally of political and economic participation. Kaul and Mendoza (2003) therefore propose a new tool to analyse GPGs: the Triangle of Publicness (see Figure 1), formed by three dimensions of publicness, namely

- in consumption, this is the non-exclusiveness of consumption of GPGs across individuals and groups,
- the participatory nature of deciding on which goods to place in the public domain, how much and in what shape to produce them, and on the distribution of benefits among all concerned, and
- the distribution of benefits, the extent to which various groups of consumers of GPGs actually derive benefits (equity).

Ideally, this triangle should be equilateral. The international financial architecture is quoted as an example where the distribution of benefits and decisionmaking are not completely public but consumption is.

Figure 1: The Triangle of Publicness



Source: Adapted from Kaul & Mendoza (2003)

While "a supranational government backed by the power to tax" (IBRD 2001:109) is sometimes suggested as a remedy, this is not the general thrust of the GPG discussion, but rather a call for applying generally recognised governance principles such as transparency, the participation of stakeholders, and equity to the global realm. Internalising the effects of GPGs may, of course, also have substantial distributional consequences. Decisions about which GPGs to produce, how much of them to provide, in what manner; and the production process itself, bring together contributions from many groups, sectors, and countries. A participatory approach is therefore likely to increase the efficiency of providing GPGs.

The concept of GPGs is strongly shaped by the notion of global or international externalities. The absence of any world government providing GPGs in the way national governments have provided national public goods is one problem. It might explain the limited attention, which the production of GPGs has found in literature so far. With the caveat that accurate, comparable data are difficult to find, Kaul and Le Goulven (2003) estimate the ratio between spending on national and global public goods as ranging from 1:200 to 1:400. The lack of a global theory of public finance is certainly another reason for this relative disregard.

Concrete Examples of GPGs

The prevention of global warming is a perfect example of a pure public good. According to the typology of aggregation technologies it is an example of summation. It provides nonrival and nonexcludable benefits. Global warming affects everyone, including future generations. Nevertheless incentives to prevent it are still relatively weak although international co-operation has increased. Collective action problems exist. Short term interests dominate long term solutions. The history of the Kyoto Protocol illustrates this point very well.

The Intergovernmental Panel on Climate Change (IPCC) was formed in 1988 to report on the issue of climate change. Its report triggered declarations and voluntary commitments to reduce greenhouse gas emissions, which have mostly not been fulfilled. The Kyoto Protocol was negotiated and signed by several countries. It would oblige industrial countries to reduce emissions. Ratification was slower. The big setback was the Bush administration's decision not to sign it. Edwards and Zadek (2003:204) see this decision as "undoubtedly rooted in lobbying by the powerful, energy-intensive U.S. business community."

Nevertheless, the Kyoto Protocol’s Clean Development Mechanism, which permits offsetting emissions in the North with projects in the South, has had first effects. ODA started to finance carbon sequestration in developing countries. First indications exist that abatement and investing in environmental cleaning may become a business activity.

Communicable disease containment or eradication was already used to illustrate weakest link technologies. So long as the disease continues to exist, it can spread internationally. Rich countries might be able to contain some diseases, but at a cost. Vaccination can, e.g., protect against polio, thus limiting it to poor countries, which cannot afford the costs of prevention.

Containing diseases is also an example of early international co-operation. Initially, responses remained on the national level. Quarantines were imposed. But leaving measures to each country was soon considered suboptimal. Triggered by a global epidemic of cholera the first international sanitary conference was held in 1851. Already in the 19th century the first international treaty to fight the cross-country transmission of diseases was adopted. After the Second World War the UN's World Health Organisation was established.

Impressive achievements have been made. Smallpox, for instance, was eradicated. But the optimism of some decades ago proved premature. Old diseases have resurfaced and new threats, especially AIDS, have emerged. In many debt-ridden countries the reappearance of diseases believed to have been eradicated was caused by debt management. Substantial budget cuts affecting public health expenditures were demanded by structural adjustment programmes in favour of higher debt service. With money to control them reduced or unavailable, diseases came back.

Global financial stability is also a GPG that may affect countries in very different ways. Financial crises have often spread from one country to the other. However, this phenomenon called "contagion" has always been restricted to developing countries. Mexico's crisis 1994-5 affected other Latin American countries. But neither the US, Japan nor Europe were infected by the crisis. The costs of crises are largely borne by affected countries. Crises damage their economy. Money lent by the IMF carries interest. Especially Asian countries after 1997 were forced to accommodate demands of industrial countries, such as selling off domestic companies to nationals of creditor countries. Differences regarding the effects of financial instability exist, which may explain differences in policy reactions. Industrial countries reacted to the debt crisis by regulating their banking sector. Privileging short term capital flows, however, the regulatory framework of Basle I even increased volatility, contributing to the Asian Crisis 1997. Preventing crises or solving the problem of the debt overhang of many developing countries does not seem to have enjoyed great priority.

Knowledge is defined as a GPG central to successful development by Stiglitz (1999). The state must play some role in its provision otherwise it will be undersupplied. Patent laws illustrate the point that a good's public character can be modified. Stiglitz sees patents as a careful balancing act between gains in dynamic efficiency due to stimulating innovative efforts and static inefficiency from the underutilisation of knowledge or underproduction of goods protected by patents. Therefore he demands international arrangements that strike the right balance between the two. Basic research and fundamental knowledge should not be protected by an intellectual property regime. They therefore require public support.

Security is a prime example of public goods at the national level. According to

Mendez (1999:404) maintaining peace and security internationally is "the quintessential" GPG. It must be provided by international public institutions. Mendez sees the UN as the logical guardian. This calls for more resources and realistic mandates for the UN to allow its peace keeping missions to be successful. Peace keeping should be accompanied by supporting actions such as relief and rehabilitation.

GPGs and International Politics

Arguably NGOs were the first to demand the production of GPGs, notably but not exclusively with regard to the global environment where numerous NGOs have done so.

NGO campaigns have also focussed on the trade framework (Fair Trade initiative), on the field of public health (fighting epidemic diseases), and especially on changes in the international financial architecture. The Jubilee movement demanded a solution to the sovereign debt crisis that requires an innovative change of the present framework: applying the basic principles of US municipal insolvency to sovereign debtors. An arbitration panel, not creditors should decide, especially on how many insolvent debtors can repay. The foundation of the Rule of Law that no one must be judge in their own cause should finally be introduced into sovereign debt management where creditors alone have decided so far.

The need to finance GPGs was perceived by the OECD in the mid-nineties. OECD member countries re-focussed their Official Development Assistance (ODA) substantially. The OECD (1996:5) argued that the future of developing countries will be ever more tightly linked to that of OECD countries. Developing countries will have a more significant "role in preserving peace and stability, expanding the global economy, combating poverty, increasing choices and opportunities and respect for human rights, and achieving sustainable environmental and population balances."

ODA has shifted from helping developing countries to overcome internal problems to addressing common global problems and to pursue common aspirations. Sustainable development expands the community of interests and values necessary to "manage a host of global issues that respect no borders" (*ibid*.:6) such as environmental protection, limiting population growth, nuclear non-proliferation, control of illicit drugs, or combating epidemic diseases. The OECD argues that vital interests at stake have made ODA shift perceptibly away from its old role. Recently, the OECD introduced the new focus “prevention of terrorism” as a relevant development objective. While providing a GPG the development objective of such activities seems difficult to explain.

These new tasks are less developmental in the strict and traditional sense. They are rather tasks of common global interest, remedial action against international externalities. They provide pure public goods—such as flood control, disease eradication, curbing groundwater pollution, global warming—impure public goods (for instance abatement of regional emissions), club goods (for instance irrigation systems), and joint products such as peacekeeping or disaster relief. Issues of global governance, organising legal, economic, and social frameworks on a worldwide scale are addressed. Statements inferring all ODA to be GPGs can be found. Thus the OECD (1996:6) redefined the notion of security: "Everyone is made less secure by the poverty and misery that exists in the world." Suggesting all ODA to serve the purpose of "globalized internal policy" OECD donors declared ODA to be one means to achieve common goals. It should be noted that this violates the OECD's own still valid official ODA definition. This definition demands that the promotion of the economic development and welfare of recipients, not any common interest, have to be the main objective of ODA.

The popularity of the concept of GPGs with donors seems to be caused by so-called "aid fatigue", a disenchantment with the results of ODA on both sides, donors and recipients. The fact that the expected "Peace Dividend" after the Cold War did not materialise seems to be one important reason for recipients. Money no longer needed for weaponry did not flow into financing development. GPGs and common interests now seem to offer a new and different rationale for North-South co-operation. Apparently, financing GPGs is "a palatable kind of aid when donors benefit directly from it" (Kanbur *et al* 1999:88). The French Directorate-General for Development and International Cooperation of the Ministry of Foreign Affairs and the Treasury Directorate, of the Finance Ministry (2002) see ODA in deep crisis. But “partly as a result of the relative decline in geopolitical motivation since the fall of the Berlin wall, the concept of global public goods provides development cooperation with new avenues for analysis and action.”

The document (Directorate-General 2002) speaks of a new role of ODA as "an instrument .... for tackling North-South issues related to the globalisation process." Like the OECD it interprets poverty and inequalities as the "ultimate systemic risk", which would allow us to see much of present ODA activities as providing GPGs. Apart from moral grounds it is argued that aid helps the poor because—from a public good perspective—"we need them to supply environmental, agricultural, economic, etc. goods and services they alone are capable of supplying, and which benefit all of us at the national, regional and global levels."

The question of financing is also discussed by pointing out that current international agreements often contain provisions regarding necessary financial transfers "from richer countries to Southern countries" (*ibid*.), which might be considerable. Tradable emissions rights that could be allocated to the South under the Climate Convention alone are estimated to equal or exceed present ODA volumes. Such transfers could thus be theoretically conceived to "replace traditional ODA" (*ibid*.). Northern unwillingness to fulfil their financial commitments, though, is likely to preserve ODA's leading role in North-South co-operation. This view is corroborated by the fact that international conferences, such as the Montreal Protocol did not leave very clear traces in OECD aid statistics. The document also calls for larger contributions by Southern countries "to the production of GPGs, since they are also beneficiaries of them", which begs the question why they should be more willing to pay than richer Northern countries. Naturally, one could also think of other and new sources of finance, such as international taxes, for instance carbon taxation (IBRD 2001:127), or the Tobin Tax on foreign currency transactions.

At the international conference on Financing for Development in Monterrey in March 2002, Sweden, France and the UNDP proposed an international task force on GPGs. This task force was launched during the Johannesburg Summit on sustainable development on 29 August 2002 (UN 2002).

The UNDP (2002) explains the links between the Millenium Development Goals and GPGs, enumerating eight goals. Three of them (reducing child mortality, improving maternal health, combating AIDS, malaria and other diseases) concern the health sector. People's health, for instance, depends on several inputs having GPG character, such as pharmaceutical knowledge (which could be made “somewhat more public by design”, *ibid*.), the international trade regime regarding pharmaceutical patents, or global disease surveillance. Excessive disease burdens also constitute global public bads spilling over borders, as in some African countries.

Multilateral institutions have also embraced the concept of GPGs, seeing them as a new field of their activities. The IBRD (2001:129) identifies "an enhanced role" of multilateral institutions. International financial institutions are "important as conduits for grant funding". They provide "valuable support" as organisers. The IBRD mentions that it already finances important GPGs and presently administers around 52 per cent of the money of trust funds established to finance GPGs, concluding: "In a sense, international organisations are themselves international public goods."

Quantitative Evidence of Increased Importance of GPGs

Three estimates of the quantitative importance of GPGs exist, all examining whether their share in ODA actually increased. Lacking one precise common definition each estimate used their own. All are largely based on the OECD's Creditor Reporting System (CRS), showing a strongly increased quantitative importance of GPGs.

The first estimate was part of the UNDP's research project in 1998 (Raffer 1999). It defined GPGs―initially still called Global Household Goods―on the basis of official OECD declarations on what they perceived to fit their new paradigm. Two categories were defined, activities depending fully and less on the will of donors. Emergency aid for instance can only be granted if there is an emergency. Naturally, this included activities already financed by traditional ODA, such as projects in the sectors of sanitation or housing, which may well be perceived as mainly in the recipient’s interest. Besides the CRS Raffer (1999) used other sources where available. He concluded that at least two ODA dollars in five had been devoted to GPGs during the 1990s. This figure was considered very conservative due to the restrictive assumptions made. A "jump" at the end of the Cold War is very visible. Financially backing their paradigm shift after the demise of the bi-polar world, the OECD allocated larger shares of shrinking ODA flows to GPGs.

Te Velde *et al*. (2002) differentiate between national and international public goods, the former having benefits accruing largely, if not entirely, to a country's residents. They estimated donors (defined differently to include multilateral institutions separately as well) to have allocated 10 per cent to GPGs during the late 1990s. However, as nearly 30 per cent were allocated to national public goods this result is not that different from Raffer, "who includes as public goods such items we refer to as national public goods" (*ibid*.). Their differentiation reflects a further evolution of the discussion after 1998. Te Velde *et al*. (2002) also exclude items, such as poverty reduction activities. The single most important excluded item is debt relief. It is argued that such expenditures—while they may be included as a complementary activity—have a high degree of excludability and non-rivalness. This may be seen as problematic because many expenditures have this quality, but the good "freedom from sovereign debt burdens" is neither excludable nor rival. Depending on one's view on the effects of a debt overhang, one may see it as a national or an international public good. Including it would increase the share of GPGs of te Velde *et al*. by 10 percentage points. Taking account of differences in definitions—both definitions are plausible—the results are surprisingly similar. In addition to their global estimate, te Velde *et al*. (2002) present national data for donors and some multilateral institutions as well as a regression analysis corroborating that GPG spending has crowded out traditional aid.

Both estimates differ perceptibly from the most conservative estimate by the IBRD (2001), according to which around 20 per cent were allocated to GPGs in the late

1990s. 4 per cent financed core and more than 15 per cent complementary GPGs.

Recording GPGs

Although private charitable foundations do finance GPGs as well, the discussion on GPGs remains mostly connected to aid. Some activities are wrongly recorded as ODA, not least with the intention to boost embarrassingly low ODA figures, some not at all. Occasionally data were provided by the OECD, as in the case of Post Conflict Peace operations. Peace keeping, an important GPG activity, was occasionally recorded, partly but not wholly as ODA. No comprehensive recording of GPGs exists. Because of their growing importance Raffer (1999) suggested reporting and recording GPGs separately and in a way similar to ODA. This could be done by the DAC Secretariat as well. The OECD also publishes data on private aid flows. It could equally record private GPG financing. Recording GPGs as expenditures in their own right rather than ODA, would help establish GPGs more firmly in international governance. It would not change facts, but ODA figures would look even smaller. Therefore strong resistance by donors is likely to prevent it. A nascent OECD practice of informing on non-ODA expenditures with GPG character may be an indication that recording could rather develop in the direction of perpetuating the present unsatisfactory practice of recording some GPGs as ODA and others not.

Conclusion

GPGs have developed as a new and promising field of research and international governance. So far, however, they have remained strongly connected to ODA. One reason is that donors in search of a new aid rationale after the Cold War have quickly embraced this concept. Another reason is that no recording of GPG expenditures exists. This is an incentive to official financiers to subsume them under ODA whenever possible.

Increasingly globalised economic and political structures call for the necessary counterweights against market failure. The concept must be developed further. It must be transformed into a tool of international governance which is part and parcel of international policy and treaties. At present the provision of GPGs still remains fairly unorganised, an option depending on ODA-philosophies and private generosity. Further research should clarify the importance of specific GPGs. Political efforts to establish international targets for GPG-financing are needed. This might lead to an internationally recognised list of important GPGs. Separate recording would be a starting point.

* *For helpful comments I am indebted to Inge Kaul and two anonymous referees.*

Internet Sites:

Global Public Goods. www.globalpublicgoods.org

Global Public Goods Network. www.gpgnet.net

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Global Value Chains

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Introduction

While internationalization refers simply to the geographical spread of economic activities across national boundaries, globalization implies a degree of functional integration between these internationally dispersed activities (Sturgeon 2001). To quote Gereffi (1994:96): "In the transnational production system that characterizes global capitalism, economic activity is not only international in scope, it is also global in its organization".

There are several dimensions to globalization, including the integration of financial markets (Capoglu 1990, Frankel 1994), international competition and trade (Smeets 1990, Krugman and Venables 1995), direct foreign investment (Dunning 1993), international strategic alliances (Budd 1995; George 1995; Bowonder & Miyake 1995), and the integration of production on a global scale (Kogut & Kulatilaka 1994; Gereffi & Korzeniewicz 1994; Sturgeon 1997; Borrus & Zysman 1997). The core of the present article includes two things. The first is intra-firm trade, i.e., the organization of production between parent firms and their subsidiaries. The second is inter-firm trade, i.e. the organization of production within networks of legally independent firms. A study of these organizational forms of production on a global scale permits a critical analysis of mechanisms governing the international division of labour and wealth.

We shall distinguish between global governance and the governance of globalization. Global governance implies the setting up, at the world level, of formal institutions transcending national interests. Governance of globalization, on the other hand, is a product of actors such as national governments, international institutions, firms or even non-governmental organizations; and consists of the formation of rules and norms organizing the space of socioeconomic relations (Serfati 2003). It is more particularly expressed at the level of production structuring on a world scale and refers here to the governance of global value chains.

Problems of Definition

The chain metaphor is used to conceive a systemic approach of the set of activities involved in the existence of a good or service, from its conception to the various stages of its production, to its putting at the consumers' disposal and recycling after use: design, production, marketing, distribution… This type of approach permits to study the interdependences that exist between all the activities contributing to the "life" of a product. The integration of a "vertical" dimension permits to complete the traditional "horizontal" approach. For instance, garment-manufacturing activities are no longer tackled in terms of garment industry within a definite geographical area (international, national or local), but in terms of a garment value chain linking different geographical areas.

The chain of activities approach actually gathers a great number of analyses whose denominations are not always stabilized (see Dicken 1998; Leslie & Reimer 1999; Jackson et al 2006.) The terms commodity chain, *filière*, value chain, and production network are regularly used as relative equivalents. They are yet associated with distinct schools of thought.

Global Commodity Chains

A *commodity chain* is defined by Hopkins and Wallerstein (1986:159) as "a network of labour and production processes whose end result is a finished commodity". Gereffi and his colleagues took up this definition (1994) to found the global commodity chain (GCC) approach. For Gereffi et al (1994), "a global commodity chain consists of sets of interorganizational networks clustered around one commodity or product, linking households, enterprises, and states to one another within the world-economy. These networks are situationally specific, socially constructed, and locally integrated, underscoring the social embeddedness of economic organization". These definitions emphasize the links between specific processes (or segments), represented as 'boxes' or nodes.

For Raikes et al. (2000), these *a minima* definitions are ambiguous as they do not refer to the analyses of economic power peculiar to Wallerstein (1974) and Gereffi. Indeed, the triptych between core-like areas, semiperipheral areas and peripheral areas is at the centre of Hopkins and Wallerstein's (1986, 1994) analysis, which stems from both dependency theory and Braudelian history. Monopoly and competition are key factors. The approach developed by Gereffi adopts, for its part, a renewed vision of world-economic spatial inequalities. It is an analysis in terms of differential access to markets and resources, based on the study of the power exercised by key agents within global commodity chains.

Whereas Hopkins and Wallerstein's analysis is anchored within a historical perspective aimed at deciphering the economic structural changes linked to Kondratieff cycles, the research agenda proposed by Gereffi et al. (1994) sets out to analyse a new generation of global manufacturing. To quote Gereffi (1995:113), "what is novel about GCCs is not the spread of economic activities across national boundaries *per se*, but rather the fact that international production and trade are increasingly organized by industrial and commercial firms involved in strategic decision-making and economic networks at the global level".

Filières and Filières Globales

The French *filière* approach has its origin in the study of contract farming and vertical integration in French agriculture in the 1960s. Inspired by the methods of the Harvard industrial organization current, this approach has more particularly been conceived by INRA researchers (national institute for agronomic research). The methodology proposed by Malassis (1979) consists in analysing the flows, structural adjustments, markets and price formation. For Malassis and Ghersi (1996:149), "the *filière* has two fundamental aspects: its identification (products, itineraries, agents, operations) and the analysis of regulation mechanisms (market structure and functioning, state intervention, planning)". The *filière* approach has then been applied to the analysis of developing country agriculture, especially in Africa, by CIRAD researchers (international cooperation centre for agronomic research and development). The *filière* approach is generally regarded as a simple methodology, which is therefore neutral on the theoretical plane. Yet, we may notice with Raikes et al. (2000) that the approach has successively fed on the contributions of various disciplines: quantitative and anthropological approaches, conventions theory, regulation school and, more recently, new institutional economics. The use of the *filière* notion has long remained relatively restricted to the national level. However, the approaches in terms of *filières globales* have been developing for some years.

Value Chains

It is to Porter (1990) that we owe the introduction of the value chain concept in business economics. That concept is mobilized to study the firms' competitive advantages. The use of the term 'value' lays emphasis on the economic effectiveness of the way the chains of activities are organized, namely the comparison between the costs and value created. To quote Porter (1990, p. 41): "A firm's value chain is an interdependent system or network of activities, connected by linkages. Linkages occur when the way in which one activity is performed affects the cost or effectiveness of other activities”.

The notion of global value chains has, for its part, been mobilized by Gereffi and his colleagues following the criticisms levelled against the use of the term ‘commodity’. For Schmitz (2000), the notion of global commodity chain is misleading as the term ‘commodity’ connotes standardized products while Gereffi’s research is centred on differentiated products. It is therefore the global value chain concept that has finally been adopted. The latter has the advantage of drawing attention on value creation processes along the chain.

Global Production Networks

The approaches in terms of production network set out to emphasize the relational aspect of the activities linked to the life of a product. For Henderson et al. (2002), the chain metaphor does not quite reflect the complexity and the dynamics of the various configurations at work. The various nodes do not only have vertical and horizontal links, but also diagonal ones. A production network is defined as a “nexus of interconnected functions and operations through which goods and services are produced and distributed” (Henderson et al 2002).

However, according to Sturgeon (2001), the notion of chain of activities has to be distinguished from the notion of production network. While the chain of activities refers to the vertical sequence of the various stages of the process that goes from the conception to the consumption of a good, a production network also emphasizes the horizontal links between various economic agents. On that account, some actors belong to several value chains within a production network. So, value chains focus on a good whereas production networks are led to focus more on the relations between the various actors involved, as well as on their respective weight within the chains of activities to which they belong.

The research programmes of these various approaches meet after all and eventually come to join. As Wilkinson underlines (2006:16): “The latter (global production network) represents a determination to take on board the full programme originally proposed by the former (global value chains)”.

Key Aspects of Global Value Chains

From Global to Local Levels

A crucial dimension of the approach in terms of global value chains relates to its spatial scale. Gereffi (1999a) proposes the notion of global value chains in his attempt to analyse specifically the value chains within which the activities are geographically dispersed on a world scale, while being centrally coordinated.

However, value chain analysis at the global level does not exclude the recognition of local specificities. Some economists (Sabel 1989; Shoenberger 1994) excessively emphasize the dichotomy between the global and local approach. On the contrary, within the framework of the global value chain approach, the development of clusters may very well be envisaged as a logical organizational reaction to globalization phenomena so that the local level is not opposed to the global level, but situated within it.

Thus, the works on industrial districts (Piore & Sabel 1984, Becattini 1990), which focus their attention on the tendencies towards specialization at a sub-national or local level, are not incompatible with globalization phenomena. As Sturgeon notes (2001), certain cases of strong local specialization through clusters ensue directly from a reaction to globalization and articulate with the production movement on a global scale. Taiwan’s electronics industry is a good example of this as it concentrates a substantial share of the world electronic components production for computers, in cooperation with the American and Japanese dominant firms, within a very limited area, i.e. the Hinschu Science Park.

The organizational forms of global value chains then refer, on the one hand, to the concept of the firms' "core competencies" and, on the other hand, to the concept of the chain's strategic link. This strategic link is occupied by lead firms which drive the chain, exercising their power. The firms' core competency theory has more particularly been developed by Penrose (1959), Prahalad and Hamel (1990). Prahalad and Hamel (1990) define the firm's "core competencies", or distinctive competencies, as the field of expertise resulting from the harmonization of complex technologies and professional activities. For these authors, the firms which concentrate on their "core competencies" are more successful than those which are vertically integrated or which have diversified in an incoherent way, thus explaining the recourse to subcontracting.

A study of the role and influence of state policies both in exporting and consuming countries also has a place in the GCC approach.

Hybrid Organizational Forms

The activities of a global value chain can be either integrated within transnational companies or divided among various independent firms, linked through contractual or open-market transactions.

To comprehend organizational forms, economic theory traditionally focuses its attention on the dichotomy between market and hierarchy. The development of the new institutional economics has permitted the recognition of hybrid organizational forms, based on contractual relations. In the analysis framework developed by the governance branch, the diversity of organizational forms is explained by the transaction characteristics (Williamson 1985). The various institutional arrangements differ in their abilities to respond effectively to unanticipated unknowns, and the choice of an institutional arrangement responds to an efficiency criterion, i.e. cost minimization (transaction costs plus production costs). Furthermore, this type of analysis stands at the level of a particular transaction, not at the level of the transaction chain necessary for the production and marketing of a product.

The global production network approach goes beyond this restrictive analysis framework by proposing a typology of the forms of cooperation between firms on a global scale. For some network theoreticians (Thorelli 1986, Jarillo 1998, Powell 1990), mutual confidence, reputation and dependence permit to limit opportunist behaviours. For instance, according to the promise model, the existence of common values would permit to maximize joint profits. These positions are closely akin to Granovetter's criticism of the postulates of the new institutional economics. That criticism is mainly based on three assertions (Granovetter 1994:121). The pursuit of economic objectives is normally accompanied by the pursuit of other non-economic objectives, such as sociability, approval, social status and power. Furthermore, economic action is socially situated and cannot be explained by simple individual motives: it is embedded within the network of personal relations more than it proceeds from atomized actors. Finally, economic institutions do not automatically emerge in a form determined by external circumstances: they are socially built. Certain works show that these assertions do not only apply to the local scale (within clusters for instance) or national scale, but may also apply to global production networks (Hughes 2000; Henderson et al. 2002).

From Global Commodity Chain to Global Value Chain

World production is more and more fragmented, that is to say that the physical separation between the various parts involved in the production process has considerably increased, which implies a dispersion of the actors in the production chain (Deardorff 1998, Arndt and Kierzkowski 2001). This disintegration of production goes hand in hand with the integration of trade (Feenstra 1998). Multinational firms are finding it advantageous to outsource an increasing share of their production, so that the production process is now dispersed and is becoming extremely complex. This increasing fragmentation between firms and within different geographical spaces makes us wonder about the coordination modes of production.

Hughes (2000), Henderson et al (2002), Dicken et al. (2001) have insisted on the complexity of inter-firm relationships within such a context. They have shown that the coordination and control modes of production could be established independently of a form of direct ownership over the assets. Gereffi and Korzeniewicz (1994) insist on the relevance of an analysis in terms of global commodity chains, which should not confine itself to describing the transnational arrangements of production through a geographical survey, but should focus its attention on their organizational scope, that is to say on the linkages between various economic agents. In more recent work, the global commodity chain approach has been amended and replaced by the term "global value chains" (Gereffi, et al 2003, Ponte & Gibbon 2005), which focuses on the chain governance issue.

Buyer-Driven/Producer-Driven Diptych

This approach casts new light on the international division of labour and wealth, especially in relation to the way it has been represented in Wallerstein's world-systems analysis. The newly industrialized countries (NICs) of East Asia belie the hegemony of the core over the periphery and pave the way for new analyses.

In fact, the global commodity chain approach was initially conceived to describe the new industrial organizational forms that have emerged at the global level since the beginning of the 1980s, especially subcontracting between American and Asian firms in the garment, toy or automotive industries. Gereffi et al (1994) thus remind that the Ford Escort components were manufactured and assembled in fifteen countries across three continents. Likewise, Hill (1989) underlines that, in the 1980s, the production system of a Japanese car mobilized 170 first-tier, 4,700 second-tier and 31,600 third-tier subcontractors. But the decompositions-reconstructions of a product's value chain have an important impact on the international division of labour, as well as on the spatial inequalities of economic development.

Gereffi proposes to analyse global commodity chains according to three (1994:97), and then four dimensions (1995), with a view to visualising the balance of power. The first is an input-output structure, i.e., in Gereffi's words, "a set of products and services linked together in a sequence of value-adding economic activities". The second is a territoriality, i.e. the geographical expanse over which the chains, from the producers to distributors, stretch. The third is a governance structure, defined as "authority and power relationships that determine how financial, material and human resources are allocated and flow within a chain". And the fourth is an institutional framework. For Gereffi, the analysis of GCC governance structure is central to the understanding of coordination within the transnational production systems. He proposes a governance systems typology of the global value chains that have emerged since the 1960s. That typology distinguishes between *producer-driven* GCCs and *buyer-driven* GCCs (Table 1) (Gereffi 1994). The first is driven by industrial capital, the second by commercial capital. In both types of GCCs, 'key' or 'lead' agents are assumed to coordinate and control the linkages and flow of produce between the other agents of the chain by controlling the strategic activities of the chain, which also are the most profitable.

In “producer-driven” commodity chains, “transnational corporations or other large integrated industrial enterprises play the central role in controlling the production system. This is most characteristic in capital- and technology-intensive industries like automobiles, computers, aircraft and electrical machinery…” (Gereffi 1994:97). Third World independent firms are contracted for the manufacture of advanced products components.

In “buyer-driven” commodity chains, “large retailers, brand-named merchandisers, and trading companies play the pivotal role in setting up decentralized production networks in a variety of exporting countries, typically located in the Third World. This pattern of trade-led industrialization has become common in labour-intensive, consumer goods industries such as garments, footwear, toys, consumer electronics, housewares, and a wide range of hand-crafted items” (Gereffi 1994:97). In this type of commodity chains, Third World independent firms are contracted for making goods that are designed and/or marketed by retailers or branded companies (such as Wal-Mart, Nike and other “manufacturers without factories”). “Buyer-driven” GCCs reflect the emergence of flexible forms of specialization, which may be associated with the post-Fordism period, or even the post- “peripheral Fordism” period (Lipietz 1987), for the Third World countries whose mass production has not been matched by mass national consumption (Raynolds 1994).

This analysis framework has been used as a reference in numerous empirical studies carried out more particularly by researchers at the Institute of Development Studies, Sussex and the Danish Institute for International Studies for various industrial sectors (e.g., automotive, footwear, apparel, electronics, food-processing).

***Table 1.* Features of Producer-Driven and Buyer-Driven Global Commodity Chains**

Features	Producer-Driven	Buyer-Driven
Drivers of Global Commodity Chains	Industrial Capital	Commercial Capital
Core Competencies	Research & Development; Production	Design; Marketing
Economies	Economies of Scale	Economies of Scope
Sectors	Consumer Durables Intermediate Goods Capital Goods	Consumer Nondurables
Typical Industries	Automobiles; Computers; Aircraft	Apparel; Footwear; Toys
Ownership of Manufacturing Firms	Transnational Firms	Local Firms; predominantly in developing countries
Main Network Links	Investment-based	Trade-based
Predominant Network Structure	Vertical	Horizontal

Source: Adapted from Gereffi G. (1999a)

The Governance Issue and Dynamic Analysis

The most recent studies go deeper into the analysis of GVC governance forms. Such is particularly the case of the works carried out by Sturgeon (2001) and Gereffi, Humphrey and Sturgeon (2003).

Sturgeon (2001) identifies three governance styles of production networks: i) authority networks (both in intra-firm networks and in captive networks); ii) relational networks (including agglomeration networks and social networks); iii) virtual networks. On the basis of that work and empirical knowledge of the GCC approach, Gereffi Humphrey and Sturgeon (2003) distinguish five GVC governance types. That typology is based on three theoretical corpuses: transaction cost economics, production networks, and technological capability. It defines three determinants of GVC governance: i) transaction complexity, ii) the ability to codify transactions, and iii) supply-base capabilities. These authors thus distinguish classically between market and hierarchy (i.e. managerial control in descending form) and propose to define three types of hybrid governance: relational governance, modular governance and captive governance (Gereffi et al 2003:5). These five governance modes imply a more or less strong degree of coordination and power asymmetry. See Table 2.

Table 2 - Determinants of Global Value Chain Governance

Governance Type	Transaction Complexity	Ability to Codify Transaction	Supply-base Capabilities	Degree of Explicit Coordination and Power Asymmetry
Market	Low	High	High	Low
Modular	High	High	High	
Relational	High	Low	High	↓
Captive	High	High	Low	High

Source: Gereffi et al. (2003:8).

Market-type governance imposes itself when the quality of the product (or service) exchanged is standard, when the transactions are easily codifiable, and the suppliers are capable of manufacturing the product without the buyers' help. The risks are low for the buyers, either because they have low requirements or because they know that the suppliers are clearly in a position to satisfy them.

"Modular" governance arises when the quality of the product exchanged is specific but easily codifiable, and when the suppliers are in a position to satisfy their buyers' demands. That case sees the emergence of complex information flows codified on the products between the buyers and suppliers. However, the investments necessary for these transactions may be redeployed and do not imply any dependence between the suppliers and buyers.

"Relational" governance characterizes a mode of cooperation between suppliers and buyers which appears when the quality of the product exchanged is specific and is not easily codifiable, and when the suppliers have the competencies necessary for its production. The suppliers and buyers' competencies complement each other and the realization of the transaction requires the exchange of tacit knowledge. For Gereffi et al (2003), this governance type implies a certain degree of mutual dependence between the parties involved in the exchange, which may be regulated through reputation, social or geographical proximity, family or ethnic ties… These authors note that this relation of dependence may also be managed through credible commitment mechanisms or through Williamson's hostage model (1983).

In the case of "captive" governance, the quality of the product exchanged is specific and easily codifiable, like in the case of modular governance, but the suppliers are not in a position to satisfy the demands of their buyers without the latter's help. Their ability to meet specific quality products demand is low. The lead company, that is to say the buyer, exercises a high degree of intervention and control over the activity of its supplier, which thus finds itself in a situation of dependence.

Hierarchy emerges when the quality of the product exchanged is specific and not easily codifiable, like in the case of relational governance, and the buyers do not manage to find competent suppliers. In that case, the buyers acquire direct ownership of the upstream companies or create their own subsidiaries.

Furthermore, trajectories of change are also included in the research programme of GVC analysis.

Income Distribution and Upgrading

Global value chain analysis sheds essential light on the international division of labour and wealth. It gives a picture of the income captured at the various stages of the value chains. The question of upgrading processes in the value chain then becomes central since the captured value added evolves with these processes. GVC analysis thus gives a dynamic vision of income distribution at the international level.

Income Distribution Analysis

The value chain approach presents three major advantages with regard to the income distribution analysis at the international level. Firstly, through the proposed step-by-step itemization of all activities, it gives us the capacity to comprehend the distribution of gains within the chain, thus enabling us to understand the lack of correspondence between the development of activities and the income generated by these activities for some geographical areas. The approach therefore gives a spatial description of the income distributed. Secondly, it provides a detailed description of the links between a region, a state, or a firm, and the global economy. Consequently, it offers a few clues to interpret the evolution of income and the sustainability of the activity, especially in connection with upgrading processes. Thirdly, it also supplies an analysis of the key institutional factors which impact on the choice of specializations. It therefore permits to link the actions which, at the normative level, alter or modify the modes of income distribution and redistribution.

Upgrading Processes

Upgrading processes within value chains constitute an essential issue in the attempt to capture a growing share of the value, which explains why numerous analyses apply themselves to understanding these processes. To quote only a few examples, this problematics has been developed by Gereffi (1999b) on the garment sector, Dolan et al. (1999) on horticulture, Cramer (1999) on the case of Mozambican cashew nuts, and Gibbon (2000, 2001) on cotton and table fish in Tanzania. Requier-Desjardins et al (2004) have underlined that globalization can urge certain actors to develop an upgrading process. These processes have been emphasized, for instance, in the case of Cajamarca cheese in Peru (Boucher & Requier-Desjardins 2002), or in the case of organic quinoa grown on the high plateaux of the Andes (Caceres et al 2007).

Upgrading processes are traditionally analysed either in connection with the firms' core competencies (Hamel & Pralahad 1994), or within a dynamic capabilities approach (Teece and Pisano 1994). The firms' core competencies refer to the activities which create the attributes valued by the final customer (the design of a dress for instance). These competencies are relatively unique in that few competitors have them and they are difficult to copy, thus constituting immediate barriers to entry.

As for capabilities, they result from internal processes which facilitate the acquisition of and access to specific competencies, thus modifying the firm's path dependency. These approaches are nonetheless limited to a firm's situation and do not cover upgrading processes in global value chains.

According to Kaplinsky and Morris (2001:38), four forms of upgrading may be distinguished within global value chains:

Process upgrading: Consists in increasing internal process efficiency, both within individual links in the chain (increased inventory turns or lower scrap for instance), and between the links in the chain (more frequent, smaller and on-time deliveries for instance);

Product upgrading: Consists in introducing new products or improving old products more quickly than competitors. This involves changing new product development processes both within individual links in the value chain and in the relationship between different chain links;

Functional upgrading: Consists in increasing value added by changing the mix of activities conducted within the firm (taking responsibility for or outsourcing accounting, logistics and quality functions for instance) or by moving the locus of activities to different links in the value chain (from manufacturing to design for instance);

Chain upgrading: Consists in moving to a new value chain (for instance, Taiwanese firms have shifted from the manufacture of transistor radios to the manufacture of calculators, TVs, computer monitors, laptops and WAP phones today).

Furthermore, a certain hierarchy of upgrading is often postulated (Gereffi 1999b, Lee & Chen 2000, Kaplinski & Morris 2001), starting with process upgrading, to functional upgrading, to product upgrading, to chain upgrading. The firms' upgrading processes in East Asia actually seem to have followed such trajectory: from an assembling function for a global buyer to a production function under the brand of that buyer, to a design of the product, to the creation of new brands. See Table 3.

Table 3 - Hierarchy of Upgrading

	Process	Product	Functional	Chain
Trajectory	→			
Examples	Original Equipment Assembly (OEA) ↓ Original Equipment Manufacture (OEM) →	Original Design Manufacture (ODM) →	Original Brand Manufacture (OBM) →	Moving chains -e.g. from black and white TV tubes to computer monitors
Degree of Disembodied Activities	Disembodied content of value added increases progressively →			

Source: Kaplinski and Morris (2001:40)

Nevertheless, we should not underestimate the lock-in strategies implemented by lead firms in global value chains. If Gereffi (1999b) underlines that there is a double process of "learning by exporting" and "organizational succession", which enables local industries to develop production capacities that are more sophisticated and of better quality, within shorter periods, and/or to adopt more effective technologies and organizational modes, the functional upgrading process is much more problematical to develop, especially within the framework of captive value chains. While product upgrading and process upgrading are of mutual benefit to lead firms and their subordinates along the chain, such is not the case of functional upgrading, for obvious reasons of competition. Thus, the positioning in the chain and the ability to capture a more or less important share of the value added depends much on the power within the chain and on the dominant actors' strategies. However, Dolan et al. (1999) observe that the less strategic activities, such as packaging and some logistic functions, may be transferred to local industries. Such phenomenon places dominated chain links in lock-in situations where they are in no position to move up the value chain in an attempt to turn towards higher value-added activities.

Concluding Remarks

A new challenge for the research programme on global value chains consists, according to Wilkinson (2006), in integrating the contributions of conventions theory (Orléan, 1994, Ponte & Gibbon 2005), as well as a more extensive vision of networks as proposed by Granovetter (1994) and actor-network theory (Callon 1986, Latour 1987, Law & Hassard 1999, Gibbon 2003). The latter approach broadens the analysis spectrum by integrating non-human beings into the networks and by giving objects a specific place, while conventions theory proposes a unique vision of the principles governing the economic agents' action. Furthermore, the application of such approach to alternatives networks, such as environmentally friendly, organic and fair trade networks, should permit to deepen the understanding of the organizational forms of production on a global scale, in all their diversity, with the integration of the role of NGOs and civil society more particularly.

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Globalization

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Definition of Globalization

Globalization is a term used to express the tendency for the world economy to integrate, not only in respect to markets, finance, technology, and cross-countries' trade and investments, but also in regard to the harmonization of laws and regulations of every day activity (political, economic, social, cultural and ideological). The core of the concept of globalization is that the world displays a strong tendency to become one entity. To be more specific, the term globalization describes the increase in international trade and financial flows that have taken place since 1960, but more so in the post-1980 period.

Although, the term is used extensively in the international bibliography, it is regarded as highly debatable. The growing interest in the concept of globalization increases the probability that the term will be used in contradictory ways. To a certain extent, these views eventually tend to devoid globalization from its true meaning and intent. Thereby doubts about globalization become more profound.

Globalization in its economic form, envisages an interdependent world economic system dominated by global corporations not identified with any individual country and is based on liberalization of international trade, goods and services and the free market. Globalization should not be understood entirely as an economic concept, or simply as a development of the world system, or even as a development of large-scale global institutions but also as an increasing impact of action from a distance on our lives. Hence, globalization encompasses other aspects of life.

Other examples of globalization in motion include the huge and quick circulation and distribution of information through the Internet, mass media, e-mail, fax, and telephony. This international communication network allows the transmission of political and cultural ideology, fashion-trends, and ideas worldwide. Apart from the easier interaction of the intangible components of life, and the reduction of distances through the reduction of time needed to get from one place to another due to the revolution in the means of transportation, globalization facilitates the movements of tangible elements like people or commodities. For example, more and more people are studying abroad, either by physical presence or even by distance through the use of Internet facilities.

Moreover, the growth of the services sectors, especially the ones dealing with knowledge and information, and the rapid growth of a new generation of technology are some of the indicators of the transformation of the global perspective of business operations. Development in technology has lead to a boom in foreign investment and to a degree of openness. Thus, enterprise activity is no longer constrained by national boundaries. Both capital and labor migrate to whatever points on the globe that yield the highest returns. There is labor mobility from markets with a lack of employment opportunities to markets with shortages of labor, especially throughout the European Union. The mobility of capital is almost unrestricted, since in the 1980s and 1990s many countries significantly reduced or even abandoned international capital controls. The international facilitation of economic and financial transactions (the stock market, for example) through electronic means, and the computerized information networks reduced transaction costs and the time needed, to the minimum.

Compared to the international mobility of capital, labor mobility has remained rather steady. This is a reflection of many factors such as the immigration laws, which are still restrictive in many countries as well as of other factors that in the future will possibly be eliminated because the process of such globalization is rapidly accelerating. Migration does not only affect the economic environment of the country, but also the cultural environment, since the culture of the immigrants continues to develop, affected by the new culture, and in turn will affect the culture of the new country.

The past two decades have been characterized by the rapid integration of the financial markets. The Bretton Wood system (1944-1971) had rested on the foundation of closed capital accounts and fixed exchange rates. Thus, financial globalization was not even on the policy agenda at that time and the world functioned with a system of separate national financial markets. However, with the breakdown of the Bretton Woods system in 1971, there was a drastic change. The world monetary system underwent three revolutions all at once: deregulation, internationalization, and innovation. The financial liberalization made possible the improved and faster knowledge of the foreign markets, the development of financial transactions and the emergence of new financial instruments, especially derivatives.

UNCTAD (1996:43) documented that globalization is characterized (a) by the progressive removal of barriers on merchandise trade throughout the period since the Second World War, (b) by the deregulation of financial markets in the 1980s, (c) by the productive processes which are controlled by the MNEs and have become more dispersed geographically, and (d) by the technological revolution which has greatly reduced the costs of information processing and international communications.

Phases of Globalization

Globalization involves steady declines in the importance of the national political boundaries and geographical distance and increasingly complex interdependencies among countries. Globalization can be frightening, stimulating, overwhelming, destructive or even creative. Globalization has its own set of economic rules, its own dominant culture, and its own defining technologies. It forces the integration of people, trade-liberalisation, FDI and financial policies, technologies, markets and economies.

Globalization is not a new phenomenon, but it is just a new phase, something that is much more pervasive, deeper, and different from previous phases. For example, in 1914, at the end of a previous phase of globalization, west European foreign investment was more globally oriented before the First World War than in the 1990s (UN/ECE 2000:7-8). People, goods and services, financial capital, enterprises, technology, ideas, culture and values now move more easily across national frontiers than at any time since the beginning of the First World War. Between 1870 and 1914, the international trade in goods and services was as free as it is today. Although the range of financial instruments that traded internationally was of course much more limited in those days, mobility of people, including international migration, was less restricted during the Gold Standard days than it is today. Moreover, in 1973 exports and imports as a percentage of GNP in most countries were lower than in 1913 due to the fact that international trade had suffered from two world wars and from protectionism induced by the economic slowdown after 1929 (Kleinkencht et al. 1998:638).

The UN/ECE (2000:7-8) argue that: "What is clear from the data is that far from becoming more global, west European trade has become more and more concentrated on the European region itself… the extensive trade liberalization which occurred in eastern Europe and the Baltic states after the revolutions of 1989 has led to a rapid re-orientation of trade away from the former CMEA towards western Europe… Thus the general evolution of European trade has not been towards a more global distribution of relationships but instead towards a more intense integration with close neighboring countries. Interdependence among the economies of the region has strengthened but with the rest of the world it has weakened… In 1914, at the end of a previous phase of globalization, west European foreign investment was more globally oriented before the First World War than in the 1990s." In the period from around 1870 to the beginning of the First World War, economies were relatively open, goods and capital had moved in great quantities and freely across countries, and large numbers of individuals had migrated to far away places with the prospect of gaining better opportunities (Tanzi 2004:525).

However, in the current globalization phase, the world is more integrated than it was in 1940s-1980s, since there was the collapse of the Eastern Bloc, worldwide more countries open their borders and receive FDI flows, and thus, more countries participate in the globalised system. A mapping of FDI inflows indicates the extent to which host countries integrate into the globalised world economy and the distribution of benefits of FDI. Through the comparison of the world's FDI maps, we can conclude that in the year 2000 more than 50 countries (24 of which are developing countries) have an inward stock of more than $10 billion, compared with only 17 countries 15 years ago (7 of which are developing countries). Moreover, the world's top 30 host countries account for 90-95% of the total world FDI inflows/stocks. The top 30 home countries account for around 99% of outward FDI flows and stocks and are mainly industrialized countries (UNCTAD 2001:4-5).

In developing countries and especially in developed countries, globalization has resulted in the increase of foreign direct investment as the share of cross-border capital flows increases. In this way, the role of MNEs becomes more significant. However, the share of FDI is not the same in all countries and the FDI inflows in less-developing or poor countries show little growth or no growth at all. In other words, the distribution of FDI and trade is unequal as only a small number of countries receive the majority of FDI and trade flows.

The pervasiveness of the current form of globalization has much to do with the liberalization of trade, the expansion of FDI and the emergence of massive cross-border financial flows. As a result, competition in global markets is on a rise due to the combined effect of two underlying factors: policy decisions to reduce national barriers in international economic transactions and the impact of new technology. The growth of the services sectors, as already stated, especially those services dealing with knowledge and information, and the rapid growth of a new generation of technology are the most important factors directly connected and supportive of the latest globalization phase. These features, absent in the previous phase, make globalization an established, unstoppable and irreversible process.

The current phase of globalization is much more pervasive, deeper and different from previous phases due to new technologies, the facility and rapidity of the distribution of the information, trade liberalization, reduction of transportation cost of goods, capital and people, and finally due to the "abolishment" of the countries' isolation and the loss of their independence (Tanzi 2004:526). The economies that lag in adopting new technologies cannot participate in the globalization process and their transition to a market economy is hindered. As a result, they lag in economic development and in better living standards. On the other hand, countries with a high level of economic development are either free-open economies or earlier adopters of the transition reforms because economic developments have created healthier conditions for the onset of globalization.

Costs and Benefits of Globalization

The academic community is divided regarding the question of the existence of globalization. Many contend that it is a trend toward integration of the world economy by means of trade and FDI. However, there are others who deny its existence. A third group argues that globalization is a phenomenon that does exist, cannot be stopped, is long lasting, beneficial, brings about greater prosperity, equality, increases living standards, increases the domain of democratic institutions and strengthens the basis for peace as well. Another group accepts that globalization is an established process, unstoppable and irreversible, but although they share the view that it is likely to be beneficial, they are not so certain that this will in fact be the case in the future. Therefore, they are more sensitive to the risks created by social disruption and increased anxiety. Moreover, some view globalization as a reality and argue that it is a phenomenon, not solely a new economic trend but an integration of markets, finance and new technologies which minimize the geographical and cultural distances among people. Furthermore, this phenomenon has its own dominant culture and this is why integration tends to be homogenizing. This sort of events had continually taken place throughout history. The Romanization of Western Europe and the Mediterranean world, the Islamization of Central Asia, the Middle East, North Africa, and Spain by the Arabs, and even the Russian/ Soviet Union impact (Russification) on Eastern and Central Europe and parts of Eurasia, are some examples (Friedman and Ramonet 1999:111).

On the other hand, a group of researchers believes that globalization is a phenomenon which may cause social disruptions, and increased tension among countries. It increases insecurity among large sections of the population and thereby increases inequalities within and among countries. Furthermore, globalization leads to a steady deterioration in the environment. Some others argue that globalization, as well as global strategies are a mere myth, since business dealings carried out by large multinational corporations take place in regional blocks. A government's regulations, differences among cultures, technological advances, have all divided the world into the following three blocks: EU, ASEAN, and NAFTA. Furthermore, managers of large corporations are the driving force of the globalization process which is actually regional and takes place inside the triad blocks (Rugman et al 2001; Rugman 2001).

Rugman et al (2001) analyzed the strategies of specific well-known multinationals such as McDonalds, Coca Cola and Euro Disney in order to prove that these MNEs adjusted their global strategy to fit into the local one. In this way, these companies accept the tastes of the local population and offer services closely related to the local population preferences. Moreover, Moore and Rugman (2003:2) for example argued that the US companies are regional companies and not very global at all. They also mentioned that "if you examine the data on the US 25 largest multinationals it becomes clear that they are what we would call home-region based. Of the US 25 largest MNEs, 22 have more than 50% of their sales in their home region of North America. None of these US MNEs are "global". For example, Wal-Mart has 94.1% of its sales in the North American Free Trade Area; GM has 81%. Indeed, average intra-regional sales for the 185 US MNEs is 77.3% of the total. With well over two-thirds of their sales in North America, these are home-triad based MNE".

Tanzi (2004:526) argued that countries with a less educated population, strong traditions, and more ethnically diverse populations are likely to have difficulties to benefit from globalization. What they need is more time to make the changes and adjustments required by globalization. According to Tanzi, the opposite is true for well educated and more ethically homogeneous populations that are not excessively bound by strong traditions. However, Tanzi (2004:529) added that when globalization makes the whole country richer, it may still generate a lot of discontent if the increase in income is not evenly distributed.

A lot of researchers view globalization as a commitment and desire for a better future. In a sense it will convey optimism and offer infinite possibilities for growth, renewal, and revitalization for every member of the world society. Globalization was created to describe what many felt to be a new and central reality of the times.

Thus, a major debate is going on regarding the question of the benefits and the cost of globalization. On the one hand, proponents of the globalization process who have accepted the globalization process as a reality, maintain that this is a beneficial phenomenon. Since globalization makes all integration processes much easier, in the long run, economic growth and employment are and will be on the highest level. Sometimes, multinational corporations (MNCs) have much more power and money than specific developing countries, although it can be said that their activities in free and open markets can be the best contributors and indicators of the economic progress in these markets. This is a reason that governments ask for FDI inflows and thus, investments from multinationals, offering at the same time significant incentives in order to attract FDI inflows.

On the other hand, the opponents who do acknowledge the globalization process minimize its advantages and emphasize its disadvantages only. They contend that globalization only brings about more poverty as well as inequality among the people worldwide. The gap between the more developed and rich countries and the poor countries deepen. Furthermore, globalization puts under risk the independence of the countries, the employment rate, etc. They also support the idea that global integration, FDI flows, and competition are part of an unfair game.

It is true that there are cases in which globalization tends to increase both insecurity among large sections of the population as well as inequalities within and among countries. It can also lead to a steady deterioration in the environment and in the general quality of living standards. Globalization is also sometimes responsible for increasing poverty, and even, in some cases, for impeding growth. Some countries have largely managed to take full advantage of globalization, receiving the benefits, while others have taken more of its costs. For example, Stiglitz (2003) mentioned that East Asia provides the strongest example in favour of the positive effect of globalization on growth. On the other hand, the global financial crises and their aftermath brought home the dark side of globalization.

Furthermore, the anti-globalists assume that the globalization pressures stemming from the large financial institutions such as the IMF, Worldbank, and the WTO create greater dependency between them and the other developing countries, something not seen since the era of colonialism. Stiglitz (2003:509) added that it is not true that liberalization measures are undertaken voluntarily. He concluded that politicians and governments in power believe that the gains from the liberalization measures outnumber the losses from the consequences of not undertaking such measures.

Evaluation of Globalization

Summarizing both the supporters' and the opponents' arguments for and against the globalization process, we can argue that globalization cannot be classified as either bad or good. It is its evaluation that matters most, because challenges and threats are subject to continuous changes.

Even with the use of statistics, globalization cannot be classified as a bad or good procedure because these statistics are either misleading, inappropriate, or can be read from different dimensions. For example, people that are against globalization argue that the three richest men in the world own more wealth than 600 million people in the world's 48 poorest nations. Of the 100 largest economies in the world, 51 are transnational or multinational corporations. General Motors is bigger than Indonesia. Microsoft Corporation enjoys annual profits of $12.5 billion, while $9 billion would give every child on the planet a basic education. In 1998, the richest country in the world possessed 115 times more per capita income than the poorest. 20% of the richest countries of the world had a per capita income 13 times more than that of the 20% poorest.

The GDP of developing countries as a group grew faster that that of developed and high income countries. Almost a quarter of the world's inhabitants live in poverty (1.2 billion out of 6 billion people live on less that 1$ a day). The richest fifth of the world's population owns 80% of the world resources, while the poorest fifth owns barely 0.5%. Even in the EU, there are 16 million unemployed people and 50 million living in poverty. The combined wealth of the 358 richest people in the world (billionaires) equals more than the annual revenue of 45% of the poorest in the world or 2.6 billion people (Ramonet I., in Friedman et al. 1999). World income inequalities have been rising during the last two or three decades and this trend is sharpest when incomes are measured by market-exchange rate incomes and not by PPP-adjusted incomes (Wade 2004).

On the other hand, people that are in favor of globalization argue that the poorest countries, including 50% of the world population, had a share of world income between 10 and 20% in 1965 as well as in 1997, but that this share was higher in 1997 due to globalization. Over the past 20 years, the number of people living on less than $1 a day has fallen by 200 million, after rising steadily for 200 years (James Wolfensohn, president of the World Bank). The proportion of people worldwide living in absolute poverty has dropped steadily in recent decades, from 29% in 1990 to a record low of 23% in 1998. The best evidence available shows ... the current wave of globalization, which started around 1980, has actually promoted economic equality which in turn provided reduced poverty. Evidence suggests that the 1980s and 1990s were decades of declining global inequality which provided reductions in the proportion of the world's population in extreme poverty. As already stated, the GDP of developing countries as a group grew faster that that of developed and high income countries. However, the absolute gap between a country with an average income of 1000$, growing at 6% and a country with an average income $30000, growing at 1% continues to widen until after the 40th year (Wade, R. (2004)).

In evaluating the impact of globalization, the basic criterion is to look at what has happened to the rates of economic growth (GDP, and GDP per capita in PPP), both globally and across countries. On the one hand, the expanding global markets for goods and services provided new outlets for their exports. On the other hand, the emergence of a global production system and the liberalized investment rules generated new opportunities for their MNEs, increasing their global reach and market power. Moreover, the growth of global financial markets provided expanded opportunities for investments with higher returns in emerging markets. A minority of developing countries reaped significant benefits that have been highly successful in increasing their exports and in attracting large inflows of FDI.

Globalization, Transition, and Foreign Direct Investment

FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration, a goal increasingly recognized as one of the key aims of any development strategy and an increased growth rate. It can be argued that there was a continuous increase of worldwide FDI flows up to 2000 and then a significant decrease afterwards. The dramatic increase in FDI over the last decade was based on the following: globalisation and economic integration, technological improvements in communications, information processing and transportation, new organizational structures and restructuring processes adopted by companies in order to become more competitive and effective, the changing framework of international competition, and finally the deregulation of key sectors such as telecommunications which led to the liberalization of capital flows among countries. On the other hand, major factors are responsible for the dramatic decrease in FDI flows after the year 2000. First is the slowdown in the world economy which has reduced world demand and accelerated the global restructuring process of major MNEs in sectors characterized by excess capacity. Especially in 2001 and afterwards, the decline is reflected by the terrorist event on 11 September 2001 in New York City. The decline in 2001 which was mainly concentrated in developed countries was also a result of a decisive drop in cross-border mergers and acquisitions (M&As). However, on account of a strong increase in FDI flows to developing countries 2004 saw a slight rebound in global FDI after three years of declining flows. At $648 billion, world FDI inflows were 2% higher in 2004 than in 2003. Many factors help to explain why the growth of FDI was particularly pronounced in developing countries in 2004. Intense competitive pressures in many industries are leading firms to explore new ways of improving their competitiveness. Some of these ways are by expanding operations in the fast-growing markets of emerging economies to boost sales, and by rationalizing production activities with a view to reap economies of scale, and to lower production costs (WIR 2005).

The globalization concept implies that a growing share of FDI is worldwide in scope and transition countries, in particular, should attract increasing percentages of FDI. However, this did not happen in reality.

Globalization in terms of openness of the borders, abolition of currency restrictions, liberalization of trade and prices, technological and transportation advances, facilitates decisions for FDI and creates opportunities for efficient, less risky and less costly FDI projects. On the other hand, FDI inflows and outflows by MNEs and the consequent direct and indirect effects of FDI on the host countries' economy may be viewed as a vehicle of globalization. Still there are many countries that opened up their economies to trade and receive FDI inflows. However, as previously noted, the share of foreign direct investment is not the same in all countries and the FDI inflows in less-developing or poor countries show little growth or no growth at all (Bitzenis 2003; Bitzenis 2004). The limited extent of liberalisation reforms or the ineffective transition programs, the increased and high competitive worldwide investment environment, which offers various alternative opportunities to the MNEs, together with the changing opportunities that a country has to offer through time, and the different ways in which MNEs evaluate those opportunities, led us to conclude that globalization and transition reforms can indeed help countries in order to attract FDI flows and to become market economies.

The interest of MNEs is not concentrated on one part of the world constantly, but follows opportunities in different areas (Latin America, the UK and Ireland, Spain, Greece, Eastern Europe, CIS, SE Asia, etc.) at different periods of time. Each host country offers its comparative locational advantages and incentives for FDI (Bitzenis 2004). The MNEs evaluate these incentives and select the most appropriate country for their investment.

From world-wide statistical information, one finds countries with near to zero FDI inflows and simultaneously others that hold a high percentage of the total amount of FDI inflows. For example, there is limited Western investment interest in Central and Eastern Europe (CEE) considering that only 3% of the world-wide FDI outflows reach this region. Since 90% of the world-wide volume of FDI belongs to the MNEs, their attitude towards it, may reflect the nature of the world FDI (Bitzenis 2005).

The CEE region received in the whole transition period (1989-2003) more than $225 billion USD. At the same time, the Commonwealth Independent States (CIS) received around $75 billion USD and the South East European region (SEE) received only less than $40 billion USD. Moreover, the FDI per capita on average, in the transition period in a country from CEE is between $200-500 USD. At the same time in a SEE country the FDI per capita per year is less than $100 USD, with the only exception of Slovenia and Croatia ($250 USD each one). The South East European countries except for Slovenia lag behind most of the other CEE countries since they have not yet recovered economically, neither in GDP nor in industrial output (most of the SEE countries did not even reach the levels of GDP that they had in 1989).

It can be argued that there is a regional concentration of FDI, as can be seen from the examples of Greek MNEs that became dominant entrepreneurs in the Balkan region, the Austrians in Slovenia and Croatia, and the Nordic countries (Sweden, Norway, and Finland) in the Baltic region (Estonia, Lithuania and Latvia). Germany, France, and the UK have become dominant entrepreneurs in the ex-Visegrad countries (Poland, Hungary, the Czech Republic, and Slovakia). Spain has become dominant in Latin America. The UK, France, Germany and the Netherlands have dominated other advanced economies (e.g. Belgium). The USA has dominated Canada and Mexico. Japan has dominated China, and the whole SE Asia, etc. (Bitzenis 2004; Bitzenis 2005). Rugman et al (2001) argue that large MNEs take place in regional blocks, EU, ASEAN, and NAFTA and that the MNEs are shifting from a global strategy to a glocal one (think global and act locally). Moreover, Rugman, A. (2003) concluded that even the 20 most “international” MNEs (those with the highest ratio of foreign-to-total sales) are mainly home-triad based on their activities, as such strategic management of MNEs needs to be regionally focused, not global.

FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration (globalization), a goal increasingly recognized as one of the key aims of any development strategy. In a “truly” global economy that meets the assumptions of neoclassical methodology, there would be virtually perfect substitution between goods, factors of production and financial assets, and MNEs would respond to global incentives and locate their activities wherever they found to be most profitable and without any regard to national jurisdictions. The latest developments associated with the aforementioned features of globalization in conjunction with the technologies of communication led to a boom in FDI and to a degree of openness (measured by the ratio of merchandise trade to GDP).

Many governments and policy makers, especially in North America and Western Europe, as well as MNEs, tend to see the world as one. Hence, open trade and foreign investment supposedly will lead not only to faster growth for the world economy but also to increasing convergence of national incomes across the world. Supposedly again, the developing and transition economies can expect to benefit more than average from increased openness. The normative program in transition economies was therefore to achieve these objectives by giving as full a reign as possible to market forces and reducing the role of the state, and of any form of interference with market forces to a minimum. The globalization agenda in transition economies turns out to be the traditional neoclassical, neoliberal agenda up-dated for a world where geographic distance is alleged to have little significance for business activity. The collapse of communist regimes in the early 1990s weakened the political and intellectual resistance to the enlarged program of liberalization, exemplified by the Uruguay Round of 1986-1994 and the creation of the WTO. Nevertheless, under the abnormal economic conditions of transition, "the proclaimed goal of becoming a developed capitalist state in the mould of Great Britain or France is simply objectively unattainable. It is naive in the extreme to think that the gulf in levels of development and wealth can be bridged with the help of a few salutary laissez-faire prescriptions. If such was feasible, after all, poor and backward countries would have ceased to exist long ago" (Kagarlitsky 1993:88).

According to Obstfeld and Taylor (2002), after the Second World War, the global economy changed. In 1960, taking into consideration the uprising trend of world trade, capital flows moved across national borders. According to the Keynesian view, Post World War II financial markets were very unstable resulting in intervention by the state in economic affairs. By the 1970s, these assumptions were opposed by neoliberalism, which favored monetarism, structural policy, financial liberalization, a free flow of international capital, and a decreased role of the state.

It is argued that the major evidence provided by the inefficiency of government regulations was the collapse of economies with totalitarian regimes. Still, at the beginning of the twenty first century, the financial integration of the economies was disregarded and not considered at all. Thus, the financial crises in Latin America (1994-1995), South East Asia (1997), Russia (1997-1998), Turkey (2000-2001), and Argentina (2001-2002) challenged the benefits of free financial integration. Hence, UN/ECE (2000) argued that although some countries experienced certain benefits in the wave of liberalization, their empirical evidence has proved that higher capital movements were associated with lower growth rates, inefficient resource allocation and income inequality.

Globalization and Alternative Terms

Globalization today is perhaps most usually connected with the rise and power of global markets, economies, and multinationals. There are powerful minorities (superpower multinationals) on the global scale that seek to take full advantages of the market economies. However, there are many people all over the world who consider globalization as an exclusive privilege for the elite or the dominant superpower- the United States of America. Thus, "Westernalisation" may be an alternative term for globalization.

What is perceived as globalization may be interpreted under the scope of the rising influence of western civilization, culture and economic style on the rest of the world. There is a domination of the concept that the western way of life and the western way of economic activities is the most developed and the most appropriate one. There is also a tendency of the less developed, and developing countries to 'look up' to the western model. These ways of thought disguise the overwhelming persistence of western countries in favor of their culture, and globalization, at the expense of the rest of the world. The rapid development in technology, especially in communication related technology, that is usually produced and mainly consumed in western countries has underlined the domination of westernalization.

Still, not the whole globe accepts Western or American civilization as the optimal way of life and if the countries in question could efficiently avoid the economic dependence on the Western countries they would attempt to fight off globalization. The conflicts arise mostly in political issues, which are perceived differently by the various civilizations in terms of culture, ideas, morals, rather than economic issues, which are more or less perceived in the same way by most countries. It can be said that globalization is one thing and American Hegemony another. But it is obvious that the US is promoting globalization further in the way it likes to do. An advantage for the US is the use of the English language in most international transactions and in international computer communication, along with the use of the dollar as a key currency in international transactions. The domination of the US is more economic, military, political and cultural. Moreover, in the last years there is also a domination of the European Union especially after the creation of the Economic and Monetary Union (EMU) and the introduction of the Euro. However, the EU as a trade bloc does not appear to be more integrated with the world economy, as suggested by globalization. Less than 10% of the EU's GDP tends to be exported to non-EU countries. Hence, there has been a clear trend of "Europeanisation" of export and import relations over the past 35 years and the EU seems to be a closed economy (Kleinknecht et al. 1998:641)

Globalization, Neoliberalism, and the role of Multinationals

Neoliberalism is a term used to describe the contemporary forms of worldwide economic restructuring as a result of globalization. Neoliberalism is the economic liberalism which has become increasingly important in the 1970s and onwards. It refers to a political and economic philosophy that rejects government intervention in the domestic economy. Neoliberalism favours privatization, deregulation, free markets, free and increased trade, unrestricted flows of capital, and the expansion of multinationals provided by the end of Cold War, liberalisation, the openness of borders, and thus favours globalization. Neoliberalism is the process of liberalizing national economies to allow the entry of multinational enterprises (MNEs) and to adopt the advice of the World Bank, WTO and IMF.

There is criticism against these international financial institutions that do not promote development, but instead ensure the positions of the developed countries that dominate them. In the opinion of Wade (2004:567), the neoliberal arguments say that the distribution of income among all the world 's people has become more equal over the past two decades and the number of people living in extreme poverty has fallen, for the first time in more than a century and a half. (This is true only when inequalities are measured using the "population-weighted countries' per capita PPP adjusted incomes", then taking a measure of average inequalities, and finally combined inequalities among and within countries). Neoliberalism claims that these progressive trends are due in large part to the rising amount of economic integration among countries, which has made for rising efficiency of resource use worldwide as countries and regions specialize in line with their comparative advantage.

In order to achieve their goals, MNEs from different countries often enter into the so- called cross-border agreements as a complement to the traditional FDI activities. The analysis showed that the number of these agreements has permanently been on the rise (UNCTAD 1997). Most cross-border agreements were concluded within the TRIAD members. Rugman (2003) mentioned that a powerful indicator of triad/regional economic activity is the concentration of the world's largest MNEs in the TRIAD. In 2000, of the world's largest 500 MNEs, 430 were in the TRIAD. The US accounts for 185 of the companies; the European Union (EU) for 141 and Japan for 104. These 500 MNEs account for over 90% of the world's stock of FDI and nearly 50% of the world trade.

The significant role of MNEs and FDI flows is very profound from the fact that world FDI inflows rose rapidly and faster than world GDP and world exports during the last two decades. In particular, world FDI inflows over the period 1991-2000 increased a 4.8 fold as compared to the previous ten year period, and surpassed the 4.5 fold increase attained in the 1970s and the 1980s. The dramatic increase in FDI over the last decade was based on globalization and economic integration, technological improvements and lastly, on the liberalization of various regimes with the abolishment of monopolies, and barriers.

Conclusions

The dramatic increase in FDI over the last decade (in 1990s and after 2004) was based on the globalization and economic integration, technological improvements, as well as on the liberalization of various regimes with the abolishment of monopolies, and barriers.

The globalization concept implied that a growing share of FDI is worldwide in scope and transition countries, in particular, should attract an increasing percentage of FDI. However, this did not happen in reality. It can be argued that there is a regional concentration of FDI which can be seen from many examples.

Globalization, which the transition economies struggled to become part of, in its economic form envisages an interdependent world economic system dominated by global corporations not identified with any individual country. At the same time, the multinational corporations became more powerful, since 90% of the world-wide volume of FDI belongs to the multinationals, their attitude towards it may reflect the nature of the world FDI and the "vehicles" of globalization are only managers from within large corporations.

The limited extent of liberalisation reforms or the ineffective transition programs, the increased and high competitive worldwide investment environment, which offers various alternative opportunities to the MNEs, together with the changing opportunities that a country has to offer through time, along with the different ways in which MNEs evaluate those opportunities, led us to conclude that globalization and transition reforms can help countries to attract FDI flows and to become market economies.

Lastly, globalization is not a new phenomenon, but just a new phase, something that is much more pervasive, deeper, and different from previous phases. Some researchers accept that globalization is an established process, that it is unstoppable and irreversible due to the liberalization of international trade, goods and services and free market, the significant growth of the services sectors, especially the ones dealing with knowledge and information, the rapid growth of a new generation of technology, the high degree of openness, and the huge and quick circulation and distribution of information mainly through the Internet. A major debate is being carried out as regards the question of the benefits and the cost of globalization. However, summarizing both the supporters' and the opponents' arguments for and against the globalization process, globalization can not be classified as either bad or good. It is its evaluation that matters most, because challenges and threats are subject to continuous changes.

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Hegemony

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Introduction

Hegemony designates a process whereby social blocs (states, classes, racial/ethnic, religions, genders, civilizations and their myriad organizational forms) exercise near total supremacy. The term also refers to social processes and myths of progress largely unquestioned, unchallenged or invisible; as well as to styles of life and cultural capital that reproduce the politico-economic and cultural supremacy of ruling groups with a substantial degree of consent. In Antonio Gramsci's (1971:57, 181-182) perspective:

"[T]he supremacy of a social group manifests itself in two ways, as "domination" and as "intellectual and moral leadership". A social group dominates antagonistic groups, which it tends to "liquidate", or to subjugate perhaps even by armed force; it leads kindred and allied groups. A social group can, and indeed must, already exercise "leadership" before winning governmental power...by...posing "all the questions around which the struggle rages...on a "universal" plane...thus creating the hegemony of a fundamental social groups over a series of subordinate groups. It is true that the State is seen as the organ of one particular group, destined to create favourable conditions for the latter's maximum expansion. But the development and expansion of the particular group are conceived of, and presented, as being the motor force of a universal expansion, of a development of all the "national" energies."

The power of these social blocs derives from their ability to represent to a degree the interests of others, and thus on the ideological consent obtained from organic constituencies as well as from those Gramsci (1971:52) called the "subaltern classes," including the belief that the people exercise self-rule. This contrasts with domination based solely on force, albeit combinations of consent and coercion are at the heart of hegemony (Guha 1997; Anderson 1976/1977; Arrighi 1994; Paige 1997). Yet what astonishes observers, such as seventeenth century Scottish philosopher David Hume, writing in his First Principles of Government, is the ease

"with which the many are governed by the few; and ... the implicit submission with which men resign their own sentiments and passions to those of their rulers...Force is always on the side of the governed, the governors have nothing to support them but opinion. 'Tis therefore, on opinion only that government is founded, and this maxim extends to the most despotic and most military governments, as well as to the most free and most popular." (quoted in Chomsky 1991:352).

While Hume's insights are important, his supposition that force is on the side of the governed is incorrect. Rather, hegemony is intimately related to material advantages, including the monopoly of violence in the hands of the state, as well as control over the material means of communication and mental production, the latter especially crucial in democracies (Chomsky 1991:ch12).

Origins of Modern Hegemonies and Global Inequality

Modern inequalities of wealth and power are based on race, class, ethnic and gender divisions between and within states in a world-economy. Ideologies and practices of racism, sexism, classism and Eurocentrism help to reproduce and naturalize these divisions in terms of the inherent biological or cultural superiority/inferiority of hegemonic/subaltern groups (Balibar & Wallerstein 1991; Magubane 1996; Mies 1998). Jared Diamond's (1999) *Guns, Germs and Steel*, demonstrates how the material roots of modern global inequalities lie in pre-modernity, as the intersection of geography and history endowed Eurasia with far more domesticable plants and animals and less barriers to diffusion of these innovations due to its east-west axis than the continents of sub- Saharan Africa, the Americas or Oceana. Such geohistorical advantages provided for different spatio-temporalities of social evolution, with the neolithic revolution emerging in Eurasia several millennia before it did in Oceana, sub-Saharan Africa, or the Americas, endowing the former with greater numbers of animals and plants able to be domesticated, allowing for rapid growth of food surpluses, more deadly germs, steel weapons and strong states (Davis 1997).

These advantages, intersecting millennia later with Western Europe's lack of centralized rule, provided for the growth of armaments and accumulation of capital in the Italian city-states and Northwest Europe not possible in centralized civilizations such as China (Wallerstein 1974; McNeill 1982; Arrighi 1994). Propelled by such geohistorical advantages and the dynamic of interstate competition and capital accumulation, European hegemony—based on the expansion of this region's politico-military-commercial power and its disease pools, including by European white-settler colonization—was achieved through the often violent conquest, enslavement and/or extermination of others (Dehio 1962; Thompson 1992; Arrighi 1994; Wolf 1997).

Constitutive in the rise of West European hegemony, its privileged social groups and state-corporate networks was the emergence of a world-economy based on a tripartite zonal hierarchy of wealth and power, divided into core, semiperiphery and periphery. Here, there were variegated forms of labor control for different commodities and a corresponding inequality in the strength of state machineries (Wallerstein 1974). In the face of intense Western military and politico-economic competition, East-Central, Southern Europe, the Americas and eventually much of the rest of the world were incorporated into this expanding system as semiperipheral and peripheral zones via informal empires or formal colonization. These zones provided foodstuffs and raw materials for advanced Western products. State formation/deformation, corification and peripheralization and related processes of class formation went hand in hand (Berend & Ranki 1974; see Anderson 1974; Downing 1992; Konrad & Szelenyi 1979).

In the Americas, the emergence of coloniality, with its racial-ethnic categories, designated a set of cultural constructs and concomitant material realities (Quijano and Wallerstein 1992). These were reflective of the relational hierarchy of states, classes, gender, racial-ethnic groups and systems of forced and free labor, greatly conditioning the autocratic or democratic trajectories of these regions even after formal colonialism was overthrown (Bergquist 1996:ch.1; Reuschemeyer et al 1992; Anderson 1990). Though large-scale formal colonization of regions such as Africa only came later after centuries of slave raiding, the combined consequences of such violence was no less significant (see Young 1994). These global social structures bequeathed radically unequal systems of civil, social and political citizenship, stratified by race/ethnicity, class, gender, sexuality, nationality and rural-urban divides, forming the basis for successive hegemonic social blocs (Benitez-Rojo 1996; Glenn 2002; Mamdani 1996).

Western Hegemonies and Historical Capitalism

In the modern era, a succession of world hegemonies exercised leadership and governance functions within an expanding system of sovereign states and private firms.

"A state may ... become world hegemonic because it can credibly claim to be the motor force of a general expansion of the *collective* power of rulers *vis-a-vis* subjects. Or conversely, a state may become world hegemonic because it can credibly claim that the expansion of its power relative to some or even all other states is in the general interest of the subjects of all states" (Arrighi 1994:30).

Periods of systemic chaos characterized by intensified demands for a more stable order from both dominant and subordinate groups gave such claims credibility, paving the way for the rise of successive world hegemonies and related systems of global "governance." During what Giovanni Arrighi (1994) calls systemic cycles of accumulation, hegemonic blocs of business and governmental organizations promoted material expansions of the capitalist world-economy. As competition between firms and states increased and profits decreased, the agency that promoted earlier material expansions of trade and production pulled out of these investments and moved into high finance, in a "financial expansion."

Many of the greatest opportunities for profit are found in the financing states during recurrent rounds of interstate competition for mobile capital. During hegemonic transitions, there is a corresponding narrowing of the social foundations of the increasingly exploitative declining hegemon, as financialization and related waves of global class polarization and interstate militarization pave the way for the reconstitution of the global system. The resultant concentration of capital, state power and increased interstate and intercapitalist cooperation ultimately allows for a new material expansion of world trade and production, under the auspices of a newly rising hegemonic power arrayed against the leading territorialist state of the era. During these periods organizational revolutions in processes of state-making, war-making and capital accumulation are spearheaded by rising hegemons. Based on new and enlarged social foundations and endowed with ever-greater capabilities to govern the global system, these powers secured, to varying degrees, monopolies over world production, universal means of payment, and the use of legitimate violence, aided by the development of unequal systems of civil, political and social citizenship (Arrighi 1994; Balibar & Wallerstein 1991; Giddens 1971; Chase-Dunn 1989; Marvin & Ingle 1999; Modelski & Thompson 1996).

Arguably, rising hegemonic powers are relatively more successful than their generally more internally repressive autocratic continental counterparts, in legitimizing their use and control of violence on a global scale, most especially in the eyes of those natural constituencies and often beyond. The Dutch garnered widespread support against Spanish imperial pretensions, the British against that of France and the Anglo-American and allied powers against those of the Axis powers and their allies. Shorn of such legitimizing justifications and the structural supports of which they are a part, violence incites revenge, a mimetic process of violence imitating violence, an integral part of the escalating chaos accompanying hegemonic transitions (cf. Girard 1977; cf. Bailie 1995; Arrighi & Silver et al. 1999).

Modern hegemonies constituted their power on successively broader social foundations. The Dutch were allied with the emerging national states of Northwest Europe, arrayed against the Hapsburg bid for empire. The British led communities of national property holders in white settler states and a tiny group of elites of European descent in newly liberated Latin America, as nationalism was democratized to varying extents and became the basis for imagined communities of the nation. Nevertheless, as a whole, the working classes and peoples of the Third World were by and large excluded from the fruits of British hegemony under its system of Free Trade Imperialism (Semmel 1970). The social foundations of US hegemony—the largest Republic the world had ever seen—stood in start contrast to its European forerunners (Sellers 1991; Williams 1969; Baltzell 1964; Arrighi 1994).

US Hegemony and the Future of the Global System

This double exclusion of workers and the Third World helped undermine British world power, what with the rise of workers movements, the revolt against the West and inter-imperialist conflict. Here the turn to social imperialism and state-corporate management that culminated in World War I provided the model for U.S. hegemony on the enlarged social foundations of the US New Deal "warfare-welfare state" and associated world order. US-led global elites were aware of the role of the unregulated market mechanism and unbound financial capital in the collapse of nineteenth century civilization, global wars and world revolutionary waves (Polanyi 2001; Gardner 1969). Thus, faced with rising labor and anti-colonial movements at home and abroad, power elites created a liberal international economic order replete with governed markets, bringing tangible benefits to select workers in the core and a modicum of state-led nationalist development in the Third World (Arrighi 1990a,b, 1994).

In this promissory note of US hegemony, that of a "global New Deal," full citizenship rights were to be generalized to the core, while development was to allow the world's poorer states to catch up with standards of wealth and the full extension of rights achieved for the largely white male working classes and middle strata of this zone. US military Keynesiansim facilitated the generalization of Fordism in the core, while providing for the containment of US enemies and allies, the latter as semi-sovereign states and regions. The concomitant military power projection capabilities of the US allowed for a global program counterrevolutionary violence to ensure an Open Door for corporate capital in the Third World through the propping up of oligarchic class structures (Borden 1984; Chomsky 1991; Davis 1986:ch5). There were exceptions from this general pattern, notably in East Asia. Nevertheless, the militarization of US hegemony set definite limits on its promise of full citizenship and high mass consumption in the core and promises of real self-determination and national development in the periphery and semiperiphery (Davis 1986:ch5; Jackson 1990). The most important obstacle to realizing these promises was that full citizenship rights—primarily in the core but also in the upwardly mobile semiperiphery—were premised on relational processes of inclusion, exploitation and exclusion that mutually reproduced the oligarchic wealth and power of the world's privileged citizens at the expense of a large number of have-nots in the core countries and non-core zones (Arrighi 1990a,b, 1994; Sen 1999; Davis 1986, 2000; Chomsky 1993).

Nevertheless, the social foundations of US hegemony was its promise of a global New Deal, predicated on reform at home and support for socioeconomic reconstruction and limited forms of nationalist development abroad. Here, the changing balance of public versus private power and capital versus labor that obtained in the Great Depression and World War II allowed for the relative subordination of money capital and the Wall Street-Federal Reserve-Treasury-Bretton Woods nexus to productive-industrial capital throughout the early years of the Cold War (van der Pijl 1984; Davis 1986; cf. Bhagwati 2000). Fixed exchange rates, by limiting large fluctuations in the value of currencies and speculative capital movements, allowed for forms of state-corporate expansion consonant with New Deal politico-economic and social objectives (Gardner 1969; Helliener 1994). Yet following the crisis of US hegemony, detonated in 1968 with the Vietnamese Tet offensive and crisis of the dollar, the US was forced to scrap the Bretton Woods agreements on pegged exchange rates it created after World War II (Helleiner 1994). This shifted the foreign exchange risk burden from public authorities to private corporate firms, compelling transnational corporations to further globalize their operations and states to liberalize their capital controls. This was needed to hedge against fluctuations in currency values by diversifying the geographical location of firms and the portfolio holdings of currencies by states (Eatwell & Taylor 2000:ch.1; Arrighi 1994:310-311; Gowan 1999).

The deep structural origins of this shift lay in the vast militarized material expansion of world trade and production set off by the Korean War boom, which over time generated huge amounts of surplus capital. As global economic and interstate competition heated up in the 1970s and 1980s, holders of surplus capital found outlets for this capital in loans to states and corporate firms, contributing to a vast expansion of financial activities. Combined with deregulation, this led to the hegemony of US-dominated global capital markets over the governance and regulatory capacity of states, as well as their budget priorities. The growing hegemony of the new neoliberal Washington Consensus reflected this cyclical resurgence of finance capital and the bond market, part and parcel of the recomposition of hegemonic social blocs the world over (Bhaghwati 2000; Silver and Arrighi 2000; Gowan 1999; Canterbery 2000; Mahon 1996). US-dominated global financial markets gained ascendancy, finance triumphed over industry and corporations were financialized, as Enron and associated corruption scandals dramatically revealed. Similar developments always accompany speculative bubbles and periods of hegemonic efflorescence (Frontline 2002; Partnoy 2002; Kindleberger 2000; McLean & Elkind 2003; Calomiris & Ramirez 1996; Steinherr 2000; Stiglitz 2003; Arrighi and Silver et al. 1999; Arrighi 2003; Soros 2004).

By the late 1970s and early 1980s there emerged a broad based Anglo-American New Right aiming to uphold the inflated capital values accumulated by the propertied classes and their junior partners (Davis 1986: 302, 157-255). This new white hegemonic social bloc, arrayed against workers, persons of color, the poor and Second and Third Worlds more generally, bore similarities to the old WASP Establishment of the roaring 1920s (Jenkins and Brents 1989; Baltzell 1964; Goldfield 1997; Stiglitz 2003). In the 1980s, and again today, instrumental in welding this bloc together was regressively financed US military expenditures and the speculative profit opportunities for financial accumulation this provided (Davis 1986: part II; Gowan 1999).

From roughly 1979 to 1985, US military spending doubled to some $300 billion annually, funded by fantastically regressive means—borrowing on the capital markets—instead of taxing corporate profits and the wealthy, as when quasi-New Deal limitations on the power of money capital—such as interest rate caps—were in effect. US entry into the competition for money on the capital markets in the context of the Federal Reserve's turn towards high interest rates was crucial for financing the new Cold War and in the cyclical resurgence of high finance but an unmitigated disaster for the Third World. These states borrowed money at variable interest rates during the 1970s for purposes of "development," in a period when the Third World appeared to gain ground on the political, economic and military fronts. In the 1980s these gains were reversed, as debt payments flowed from South to North and terms of exchange and trade turned dramatically against the Third World. Increasingly, the old ideology of development was discarded. Now countries were expected to liberalize, export, cut back social programs and pay back debts as mandated by US-dominated supranational institutions such as the IMF and World Bank (Broad 1988; Gowan 1999; Blackburn 2002; Arrighi 1994). As military spending rose, funds for health, education and welfare were subjected to increasingly radical cuts (Davis 2002:ch. 13).

In essence, the costs and contradictions of US hegemony's unequal system of civil, political and social citizenship undermined the material foundations of the New Deal world order, hastening its liquidation via regressively financed neoliberal militarization. The increasingly regressive debt-financing of U.S. military expenditures through borrowing on the global capital markets, rather than expanding the New Deal world order through taxation on corporate profits and the rich as during the early years of the Cold War, thus led instead to its ongoing demise (Arrighi 1994; Davis 1986; 2002:ch.13; Eatwell and Taylor 2000; Blackburn 2002). The power of speculative finance—mutual, pension and hedge funds, derivatives and so forth—rose exponentially, with devastating consequences, as the Asian economic crisis and subsequent financial crises and related corporate corruption scandals revealed (Gowan 1999; Blackburn 2002; Stiglitz 2002).

Neoliberalism and the ideological hegemony thereof was critical to the temporary resurgence of US hegemony in the 1980s and 1990s, as was the ideology of National Security to which it was related. Indeed, the new Cold War of the end of the twentieth century reinforced the cultural hegemony of neoliberal militarization in the US and elite dependence on it in the twenty-first century as a mechanism of domestic and global hegemony. Crucial to US power elites here are the interrelated goals of preventing the emergence of any possible global rivals to its hegemony, or demands to transfer money from the militarized state-corporate sector to health, education and human welfare hoped for by proponents of a peace dividend. Furthermore, though Perry Anderson (2000) argues that neoliberalism "as a set of principles rules undivided across the globe: the most successful ideology in world history," US power elites, ostensibly their leading enthusiast, contradict the prescriptions of this doctrine in actual practice.

There is a lack of attention to the vast gap between the hegemony of free market neoliberal ideology and the reality of US militarized state-corporate capitalism. Since military spending is ostensibly for security it is exempted from World Trade Organization restrictions against subsidies. Yet such public subsidy of private corporate profit via taxpayer dollars secures funding for high technology industries, giving US corporations great advantages in world markets, while providing the military forces to protect large-scale overseas US investments, strategic resources—notably oil—and related geopolitical alliances (Chomsky 1982 1993; Bromley 1991; Spiro 1999). All countries that successfully industrialized in high value added goods used mercantilist protectionism aided by state power. "Kicking away the ladder" of state assistance in development for other countries merely ensures that they will continue to fall prey to underdevelopment, chaos and/or colonial conquest (Chang 2002).

US hegemony is being reconstituted on increasingly militarized, unilateralist and narrow social foundations, and is seen more and more as simple domination. This was revealed to many after the terrorist attacks of September 11 2001, when US elites seized the opportunity to implement an ambitious grab for greater domestic and global power as part of their Project for the New American Century. Yet on a host of global governance questions, from the regulation of speculative finance, to the International Criminal Court, the Kyoto Treaty, social and economic rights, limiting the militarization of space and pursuing arms control, the US stands virtually alone in opposition. This reflects growing US antipathy toward multilateral solutions and its embrace of unilateralism. US elites now openly declare their right to attack or invade states, as in

Iraq—in defiance of the UN Charter allowing only for self-defense—even in the face of unprecedented global protest.

These protests are part of the resurgence of counter-hegemonic or antisystemic movements, ranging from the overlapping networks of the World Social Forum, global peace and justice activists, to the militancy in the Islamic world brought on in no small part by the combination of neoliberal globalization and militarization, including the US sponsorship of a global jihad against the Soviet invasion of Afghanistan. As global chaos increases and US and global state-corporate power lose legitimacy, the future of hegemony in the global system is increasingly contested. US power in particular rests on fragile financial foundations, as its foreign financed balance of payment deficit nears $3 trillion—roughly 5% of GNP—with claims of foreign investors on US assets coming to some $8 trillion, leading to fears of interrelated crises of imperial overstretch abroad and economic implosion at home (Ferguson 2003; Ferguson & Kotlikoff 2003). Today, as inequalities between North and South, of race, class, nation and gender are challenged, arguably more than ever, and despite the seeming efflorescence of US global power, akin to previous cycles, the future of hegemony is increasingly uncertain (Arrighi, Hopkins and Wallerstein 1989; Soros 2004; Arrighi, Silver et al. 1999; Reifer forthcoming; Chomsky 2003).

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Human Development

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Introduction

Human development, as distinct from conventional development, puts people at its center. It is concerned primarily with the reduction of human deprivation, the creation of human capability, and unleashing "processes that enlarge people's choices" (UNDP, *Human Development Reports*, various years; HDR hereafter). In particular, it is concerned with factors which impede the enhancement of human capability—such as human poverty, illiteracy, and ill-health. "Human Development has two sides: the formation of human capabilities—such as improved health, knowledge and skills—and the use people make of their newly acquired capabilities—for leisure, productive activities or being active in cultural, political and social affairs" (UNDP 1990:10).

Following Mahbub Ul Haq, one of founding fathers of the paradigm in its contemporary form, we can identify four major components of human development: *equity, sustainability, productivity* and *empowerment* (Haq 1997: 16).

Equity is defined primarily as the "equity of access to development opportunities". In prioritizing equity, it rejects conventional development models that are preoccupied with economic growth. While acknowledging the importance of growth, human development emphasizes the *quality* of growth, its distribution, and its impact on people's capacities and choices (UNDP 1990).

Sustainability is defined as the "equity of access to development opportunities for the present and future generations'' In that sense it is a much broader concept than is usually understood, and encompasses more than environmental concerns.

Productivity for human development, unlike conventional development, is not simply a matter of augmenting output (and profit) per worker; rather, it is the attribute by which people can achieve their potential as agents of social transformation.

Empowerment implies the ability to participate in making decisions that can engender such social transformation; in particular, it implies people's ability to affect decisions that determine their lives.

Human development thus rejects conventional approaches which view "underdevelopment" solely as a problem of low national incomes (Sen 1997). Indeed, there exists no *automatic* link between levels of income and the principles of *equity, sustainability, productivity* and *empowerment*. As the first *HDR* stated categorically, "the main preoccupation of development economics should be how such a link can be created and reinforced (UNDP 1990:10).

Identifying an appropriate concept of governance is widely acknowledged to be a key element in this endeavor. Such a notion of governance must avoid the narrowness inherent in concepts such 'good governance', which see the ultimate goal of governance as guaranteeing the efficiency of the market (World Bank 2001-2).

The concept of *humane governance* as developed by Richard Falk is useful in this regard. In contrast to the concept of 'good governance', *humane governance* aims to make governance democratic and participatory; its explicit objective is to redress 'inhumane governance' reflected in five persistent human problems: unfulfilled basic needs; discrimination and denial of human rights; destruction of the environment; the lack of progress in abolishing war; and the various structural impediments to the spread of 'transnational democracy' (Falk 1995).

Falk's framework alerts us to the fact that at its core, humane governance requires a fundamental redistribution of power. In this sense, it is not compatible with conventional development. Humane governance, in order to be realized, must exist in a symbiotic relationship with human development; like the latter, it cannot come about through minor reforms of existing institutions or through the goodwill of governments; both require active contestation of the political space by groups which suffer systematic abuses of power that perpetuate inhumane governance.

Contestations which challenge conventional forms of governance and development are on the increase since the onset of globalization. In a recent example, an organization in Rajasthan, India, the *Mazdoor Kisan Shakti Sangathan* (MKSS) initiated a process of exposing corruption of local government officials through various forms of collective action undertaken by grassroots communities. The reforms that came about as a consequence of this movement furthered, at the same time, governance reforms and human development.

Under what conditions can such a mutually constitutive relationship between human development and governance be unleashed? This is perhaps the central question for human development in these times.

Genesis and Epistemology

The notion of human development, while not entirely new within the genre of critical development theory, acquired a particular currency in the late 1980s—as the highly contradictory consequences of structural adjustment programmes (SAP) in the developing world began to become apparent: "in the 1980s budgets were balanced at the cost of unbalancing people's lives" (HDR 1995:117). SAPs were embedded within a broader set of policy objectives referred to as the *Washington Consensus*. It is amidst the growing awareness about the consequences of the *Washington Consensus* in the developing world that the current approach to human development was formulated. Since 1990, it has been adopted officially by the UN Development Programme (UNDP) as its own approach to development; one key element of the UNDP's involvement in human development is its support for fostering global scholarship on the theme, manifest most notably, in its annual publication, the Human Development Reports (HDRs).

The first HDR (1990) traces the roots of the approach to a diverse range of scholars such as Aristotle, Kant, Petty, Marx, Adam Smith, and John Stuart Mill (HDR 1990: 9). As the HDR argued, despite the diversity of their approaches, each of these seminal thinkers have emphasized the human dimension of economic development in their conceptualization of human progress. However, the *practice* of development has focused entirely on material accumulation and on increasing national income, to the detriment of human development. This critique of the economistic focus of development is indeed a useful one; but many scholars of human development leave unaddressed the structural imperatives from which the accumulationist bias emanates. The most critical amongst these is the link between capitalism and development; as scholars from the developing world have persistently argued, the ambition of elites to establish capitalism in their respective economies have resulted directly in the drive towards accumulation and modernization at the cost of human development.

While authors such as Sen and Haq have pointed out the problematic nature of socialist development in terms of its materialism, they are of the view that free market capitalism, coupled with liberal democracy, may somehow be able to overcome this bias against human development. In this context, we should note that authors such as Sen represent a strand within the human development literature that has its epistemological roots in political liberalism (Sen 1997; Nussbaum 2000). There are several other authors working within the human development paradigm, who are situated outside the liberal tradition. Some of the critical differences between proponents of human development who are epistemologically committed to political liberalism and those who are not concern the notions of inequality (substantive versus formal), the nature of international relations, the importance of political economy and the embeddedness of institutions in political-economic structures (Bagchi 2000; Griffin 2000; Griffin & McKinley 2000).

Unlike conventional approaches, human development treats the gender question as more central to its core conceptualization. As The HDR of 1995, entitled *Gender and Human Development* argued, gender empowerment and gender equality cannot be treated as secondary *effects* of development, but must constitute foundational aspects of development. human development is impossible without gender equality; further, its showed how successes in human development often mask gender inequality.

While the approach has been relatively successful in integrating the gender question, several other important dimensions of inequity remain in its periphery, the most critical being the issues of race and ethnicity. What, for example, explains the differences in levels of human development between black and white populations in the US? Are the human development needs of indigenous populations any different from other social groups? The origins of such differences, especially if they are rooted in historical-structural variables such as colonialism, patriarchy, oppressive majoritarian politics, etc. are not yet adequately integrated into the human development framework.

Another related and controversial question concerns the relationship between culture and human development. Part of the controversy stems from the universalist premise of the approach which argues that human development needs are commensurate across cultures and nations, and between different groups within nations (Nussbaum 2000; Sen 1997). The approach needs to move beyond the irreconcilable debate between cultural relativism and universalism, while not disregarding the importance of culture and in human progress.

Soon after its formalization in 1990, it was argued that in the light of the critical interconnections between environmental sustainability and human development, the broader concept of *Sustainable Human Development* (SHD) was necessary. SHD is defined “as the enlargement of people’s choices and capabilities through the formation of social capital so as to meet as equitably as possible the needs of current generations without compromising the needs of future ones” (Banuri et al 1994: 7).

Definitions and Critical Concepts

A number of critical concepts are associated with the human development approach, namely, the *Human Development Index* (HDI), the *Human Poverty Index* (HPI), the *Gender Related Development Index* (GDI) and the *Gender Empowerment Measure* (GEM).

The HDI is a summary measure of human development. It measures the average achievements of a country in three areas:

- A long and healthy life, as measured by life expectancy at birth.
- Knowledge, as measured by the adult literacy rate (with two-thirds weight) and the combined primary, secondary and tertiary gross enrolment ratio (with one-third weight).
- A decent standard of living, as measured by GDP per capita (Purchasing Power Parity, US$).

The HDI was conceptualized as an alternative to Gross National Product (GNP)—the conventional analytical tool used for measuring national progress. Using a specific methodology, the HDI is constructed for different countries, and using this index, countries are ranked on an annual basis. The cross-national ranking is then published in the *Human Development Reports*. Broadly speaking, Nordic countries rank highly (with Norway ranking the highest) and African countries rank low in terms of their HDI. Contrary to popular misconceptions about Middle Eastern countries, a majority of those countries belong to the high (Kuwait, UAE, Qatar) or medium human development categories (Libya, Saudi Arabia and Iran).

As with all indices, there are methodological problems with the HDI. It does however, provide some evidence for the argument that high national incomes do not ensure high levels of human development; as well, countries with similar levels of national income have significantly different levels of human development. By and large however, there remains a high positive correlation between low income and low levels of human development.

The human development approach has also challenged conventional notions of poverty. As distinct from conventional thinking which equates poverty with income poverty, human development focuses on the *poverty of capability*. "In the capability concept the poverty of a life lies not merely in the impoverished state in which the person actually lives, but also in the lack of real opportunity—due to social constraints and personal circumstances-to lead valuable and valued lives" (HDR 1993:16). This notion of capability has been used to develop the concept of *human poverty* and the *human poverty index* (HPI) which complement the HDI. The HPI is a summary measure which indicates levels of human development amongst the most deprived sections of a community, based on three measures of deprivation: *vulnerability to death at an early age*; *percentage of adults who are literate*; and a *decent standard of living* (which comprises in turn three variables (access to safe water, health services and malnutrition amongst children under five) (HDR 1993).

The critical contribution of the HPI, as for the HDI, has been to reveal the inadequacy of focusing solely on income as a measure of deprivation or development. As the HDR of 1993 showed, reductions in income poverty do not always coincide with reductions in human poverty. More importantly, even when nation-states as an aggregate are able to make considerable progress in human development, the benefits of that progress often do not reach the most deprived of its citizens. This inequity in the impact of progress in human development is captured by HPI. Thus, while the HDI allows us to compare progress *between* nations, HPI allows us to compare progress *within* nations and ascertain how advances in human development are shared by different groups *within the same nation-state*.

In 1995, the HDR focused on another critical dimension of inequality: that between men and women. The Report developed the *Gender Related Development Index* (GDI)—a measure that adjusts the HDI for gender equality in three areas: life expectancy, education and income It is based on the same variables as the HDI but "focuses on the inequality between men and women as well as on the achievement of all people taken together (HDR 1995:72). As the Report pointed out, no country had a GDI measure of 1, implying that inequality between men and women are universal, although significant differences exist. The central conclusion that emerges from analysing human development through the gender lens is that there exist wide discrepancies between country rankings in HDI and GDI, indicating that human development is nowhere able to benefit men and women equally. The Report also developed the Gender Empowerment Measure (GEM), an index which measures the economic and political participation of women.

The HDI, HPI, GDI and GEM taken together comprise a set of concepts that allow us to ascertain progress in human development. The primary advantage of applying this lens is to shift the emphasis of development away from national income, and to assess whether national policies help reduce human deprivation and increase human well-being. As these measures reveal, serious deficiencies in human development remain to be addressed (UNDP Fact Sheet, on the *Millennium Development Goals* 2002), such as:

* 1.2 billion people still live on less than US$1 a day.
* 113 million children do not attend school
* 80 percent of the world's refugees are women and children
* 11 million young children die every year
* More than one billion people still lack access to safe drinking water

In acknowledgement of the ongoing and escalating crisis of human development, the UN Secretary-General adopted the *Millennium Development Goals* (MDG) at the Millennium Summit in 2000. The MDG initiative attempts to monitor and aid the progress of countries in realizing these goals.

Strategy & Practice

The Millennium Goals serve as one indication of the need to improve the practice of human development. Here, the critical issue is to understand why regions, nations and communities show such significant differences in levels of human development.

To answer this question, it may be useful to examine in comparative light, the three cases of Cuba, Sri Lanka and the United States (U.S). The comparison provides a good illustration of both the strengths and weaknesses of the human development approach (See Table 1).

Amongst its greatest strengths is the argument that low national incomes do not necessarily impede human development, if there is political commitment. Cuba and Sri Lanka are two countries which have been known for their achievements in human development, and have low incomes. Further, both of these countries have brought about these achievements under extenuating circumstances: Cuba under an embargo and Sri Lanka in a situation of conflict. It is striking that their achievements in some critical areas of human development compares very well to the U.S, which has perhaps the highest per capita income in the world. A similar argument has been made with respect to Kerala, a state in India, which has been able to consistently achieve levels of human development higher than the rest of the India and many other countries.

Table 1. Human Development Comparisons

	US	Cuba	Sri Lanka
Human development index (HDI) value 2000	0.939	0.795	0.741
Life expectancy at birth (years) 2000	77	76	72.1
GDP per capita (PPP$) 2000	$36,300 (2001 est.	$2,300 (2002 est.)[1]	3,530
Life expectancy index 2000	0.87	0.85	0.79
GDP index 2000	0.97	0.64	0.59
Probability at birth of not surviving to age 40 (% of cohort) 1995-2000	3.9	4.4	5.8
Physicians (per 100,000 people) 1990-99	279	530	37
Probability at birth of surviving to age 65, female (% of cohort) 1995-2000	85.7	84.1	82.8
Official development assistance received (net disbursements) (US$ millions) 2000	n/a	44.0	276.3
Adult literacy rate	97	96.7	91.6

Source: Adapted from UNDP, Human Development Reports, various years; CIA World Factbook 2002.
[1.]CIA World Factbook 2002.

There are of course some major caveats. First, many would seriously discount Cuba's successes because of the absence of liberal democracy. Second, in both countries high levels of human development co-exist with problems of macro-economic growth, such as unemployment and income poverty. Over time, these seem to threaten the sustainability of human development, leading some authors to argue that augmenting incomes is the only long-term solution to development.

Against this claim, the human development approach insists that it is not incomes in the aggregate but its distribution that matters (HDR 1996; HDR 2002). In the U.S. for example, income of the top 1 percent of families was 10 times that of the median family income in 1979—and 23 times in 1995 (HDR 2002:20). Thus, even with its $10 trillion national income, and $32,000 per capita income, 11.7 per cent or 32.9 million Americans were in absolute poverty in 2001; 33.6 million Americans were food insecure, hungry or at risk of hunger (US Census Bureau 2001). The income inequality trends were similar for the U.K and most OECD countries, with the exception of Canada and Denmark, who achieved stability or a slight decrease in inequality primarily through fiscal policy and social transfers. Internationally, the world's richest 1 percent receive as much income as the poorest 57 percent (HDR 2002:20).

We can now summarise. Analysing national incomes from human development perspective reveals the fallacy of conventional development: high income is neither nor sufficient for reducing poverty or deprivation. For the latter, of paramount importance is a clear political commitment to human development and distributive equity (including, but not only), income distribution. How can such a commitment emerge? And, what kind of governance mechanisms are necessary to enforce it at the local, national and international levels?

This leads us to three sets of issues that comprise perhaps the weakest links in the human development approach: that of *agency*; *political economy* and *difference*.

Critique and Future Directions

Agency: The dominant approaches to human development have a problematic conceptualization of agency. *First*, their notion of agency is confined to individual agency; therefore, the emphasis is on furthering liberal democracy and enhancing human freedoms that can unleash individual agency. (Sen 1997; UNDP 2002). However, we must ask whether individual freedom constitutes both a necessary and a sufficient condition for enabling human development. For, as one author argues, "the pathogenesis of unfreedom" arises not out of "accidental features that plague democracy, but out of "constitutive features" of deeply inequitable societies (Bagchi 2000). Once the systematic nature of 'unfreedoms' is acknowledged, the limits of individual agency begin to emerge.

Second, its insistence on individual freedom and agency commits it to a liberal conception of the state (and vice-versa). Can such a state deliver the interventions human development may require, e.g., changing relative prices in favor of human development priorities, enacting structural reforms favoring greater equity, etc. (Griffin 1992)? Likely not, as these interventions are sure to alter existing distributions of wealth and political power -requiring the liberal state to abandon the very class neutrality on which its legitimacy is based. This is a conundrum for which the liberal position offers no solution. There are however more fundamental and well-known critiques of the liberal state which ask if such a conceptualization is valid at all. These questions are highly relevant to human development, and so far, remain inadequately problematized.

Third, there is a tendency in much of the literature to overestimate the potential of international institutions as agents of human development. With the on-going and dramatic reconfiguration of the United Nations—combined with the manifestations of corporate and military power, these expectations seem seriously misplaced. It indicates perhaps the fundamental contradiction of the human development approach: that between the moral discourse of human development and the real world of global political economy (Bagchi 2000).

Political Economy: With some exceptions, political economy remains at the periphery of much of the thinking about human development. At least three inter-related dimensions of political economy are of critical import: *the structure of international relations*; s*tate structures;* and *the realm of production*. Exploration of these inter-related dimensions reveal how social power is exercised and how it constrains human development. While it is crucial to fully acknowledge these constraints, it is important to eschew the deterministic bias that often characterizes political economy analyses. Else we risk undermining the very ethos of human development and its focus on human capability.

Difference: So far, the human development literature has theorized difference within the limits set by the problematic dichotomy between universalism and relativism. This limit needs to be overcome, and the complex interrelations between difference, culture and human development need to be explored. In part, this could be facilitated by a deeper engagement with thinkers from different traditions of human development, such as Ela Bhatt, Paulo Freire, Gustavo Gutierrez, Manfred Max-Neef and others. Further, there are human development practices which emanate from the daily struggles of communities in different parts of the world: these need to be incorporated into the theoretical core of human development. For example, Bangladesh's *Naya Krishi Andolan* (New Agricultural Movement) proposes a model of sustainable human development that has evolved as a grassroots strategy to counter food insecurities unleashed by globalization. It encompasses sets of social relations and governance mechanisms that embody significant alternatives to conventional development.

Common to these traditions of are two critical elements which should be at the heart of the future discourse of human development. First, they conceive of development and governance as *political* projects rather than as a series of *technical* tasks. Thus, human development cannot be "planned" and "administered" by "benefactors" to aid "victims"; neither can it come about without restructuring existing relationships of power: between states, within states, and along lines of gender, racial or other types of difference.

Second, they illustrate distinctive ways of locating and engendering agency. While the nature of agency differs between contexts, the role of collective agency and solidarity, rather than individual agency is the recurring norm.

For the future, perhaps the greatest challenge for human development will lie in its ability to confront the emergence of war, violence, and displacement as a permanent feature of human life. Ironically, much of the hope for human development was pinned on the peace dividend at the end of the Cold War. The possibility of realizing human development, if any, will depend critically on our ability to unleash a virtuous cycle between peace, human development, and humane governance.

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Human Slavery

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No one shall be subjected to slavery or servitude; slavery and the slave trade shall be prohibited in all their forms. *Universal Declaration of Human Rights*, Article 4

Introduction

The League of Nations Slavery Convention of 1926, "to prevent and suppress the slave trade" and "to bring about ... the complete abolition of slavery", defines slavery as "the status or condition of a person over whom any or all of the powers attaching to the right of ownership are exercised" (League of Nations 1926:1-2). This treaty followed three other major initiatives to suppress slavery: the General Act of Berlin of 1885 which addressed slavery in the African colonies of the European states (*General Act* 1885: Article 9); the General Act and Declaration of Brussels of 1890 which dealt with the slave trade by land and sea (*Declaration* 1890:1); and the Convention of Saint-Germain-en-Laye of 1919 which affirmed the "complete suppression of all forms of slavery and the slave trade by land and by sea" (*Convention Revising* 1921:Article 11).

The Brussels Act was the first comprehensive treaty against the slave trade (Anti-Slavery International, no date:9). The United Nations approved a supplementary convention in 1956 that extended the abolition to include debt bondage, serfdom, treatment of married women or women given in marriage as their husband's or parents' property, and assignment of children to work where their labor is exploited (UN 1956). Additional information on the international treaties adopted in the 20th century relating to sexual exploitation, slavery, and trafficking is available from ECPAT International (End Child Prostitution, Child Pornography and Trafficking in Children; see ECPAT 1996:1-22).

Bales (2002:2) most recently supplied a succinct definition of slavery: "a loss of free will and choice backed up by violence, sometimes exercised by the slaveholder, sometimes by elements of the state." The U.N. Commission on Human Rights identifies several contemporary forms of slavery beyond the usual ones, including sale of children, child prostitution, child pornography, exploitation of child labor, sexual mutilation of female children, use of children in armed conflicts, traffic in persons and sale of human organs, exploitation of prostitution, and certain unspecified practices under *apartheid* and colonial regimes. Debt bondage is like traditional slavery because it is difficult to wipe out the debt which is passed on to the bonded laborer's children. Sharecropping is a common way of entering debt bondage (Office of the High Commissioner, no date:1,3).

Slavery robs its victims of their sacred dignity as human beings, a dignity which inheres in the very nature of every human being and is everyone's birthright. Slavery attacks the whole person—body, mind, and spirit—and reduces that person to an object or instrument for someone else's advantage or enrichment. Slavery subordinates one person to another, treating the core social values of freedom, equality, and community with contempt. Slavery scoffs at Kant's second imperative that no one may be used for the pleasure of another human being, no one may be reduced to instrumental value. Slavery denies the affirmation that every human being is due as a person under the commandment of love (John Paul 1994:201).

In the following we present our remarks first on child slavery and adult slavery, then on the reasons this inhuman practice persists, and finally on what is being done to root out this practice.

Child Slavery

"The trusting, innocent, dependent nature of children, coupled with their lack of worldly experience, make them especially vulnerable to entrapment in slavery. For that reason, their enslavement is an even greater atrocity than adult enslavement. Estimating the extent of the various forms of child slavery is quite difficult not just because the practice is clandestine but also because the children are silenced by their own fear and survival needs" (Office of the High Commissioner, no date:1).

ECPAT states flatly that no one knows for sure the number of children who are victims of commercial sexual exploitation worldwide (ECPAT, no date a:1). ILO, however, states that there has been considerable progress in child labor research of late, and "the time is now ripe to update and refine the estimates" (ILO 2002:15). Worldwide there were 352 million children aged 5 to 17 engaged in some form of economic activity in 2000, including work which is permissible child labor. Among those children there were 171 million at work in hazardous circumstances. Another 8.4 million children were involved in "the unconditional worst forms of child labor" including 5.7 million in forced and bonded labor, 1.8 million in prostitution and pornography, 0.6 million in illicit activities, and 0.3 million in armed conflict (ILO 2003, pp.13-14; UNICEF 2002a:8). Extensive research between 1999 and 2001by the Coalition to Stop the Use of Child Soldiers (CSUCS) covering 180 countries and territories revealed that (1) both boys and girls are counted among the 0.3 million fighting in more than 30 countries, and (2) hundreds of thousands of other children have been recruited into regular and para-military service, militia and other armed groups. The youngest child soldier identified by CSUCS was a seven year old (Coalition 2001:1).

A separate estimate (to avoid the problem of double-counting) places the number of children who are trafficked for child labor at 1.2 million (ILO 2003:14). In its *State of the World's Children* report for 2002 UNICEF says that it is *gravely concerned* at the significant and increasing international traffic in children for the purpose of the sale of children, child prostitution, and child pornography (and) *deeply concerned* at the widespread and continuing practice of sex tourism, to which children are especially vulnerable as it directly promotes the sale of children, child prostitution and child pornography (UNICEF 2002b:64; original emphases).

While questioning the reliability of worldwide estimates of the number of children falling victim to commercial sexual exploitation, ECPAT at the same time asserts that reckoning the number of sexually exploited children in a specific country is much easier (ECPAT, no date a:1). In Ghana ECPAT estimates put the number of girls, usually under age 10, who become the property of fetish priests for sexual and labor services in a religious atonement practice known as Trokosi at 4,500 (ECPAT, no date b:3). An estimated 1 million girls work as maids in the Philippines for very low pay and long hours (Anti-Slavery International, no date:15). In Peru roughly one-half of the estimated 1.0 million adult prostitutes are actually children using false identity papers; in the U.S. the number of child prostitutes is put at 100,000 (Beyer 1996:32).

Adult Slavery

Taking the conservative estimate of contemporary slavery expert Bales that there are 27 million persons in slavery worldwide (Bales 1999:8) and removing the number of enslaved children as estimated by the ILO produce a very crude estimate of 10 million adults in slavery. According to Bales, they work in agriculture, brick making, mining or quarrying, prostitution, gem working and jewelry making, cloth and carpet making, and domestic services. In addition, slaves clear forests, make charcoal, and work in shops. In the U.S. farm workers have been locked inside barracks and have labored in the fields under armed guards; enslaved women from Thailand and the Phillippines have been freed from brothels in New York, Los Angeles, and Seattle (Bales 1999:1-33,200). However, even though it recently has become more confident in its estimates of the number of children in slavery, ILO states emphatically that at the present time it is not possible to make reliable estimates of the extent of forced and compulsory labor around the world (ILO 2001, p.102). We therefore fall back on a variety of information sources without being able to attest to the accuracy of the information.

The U.N. in 2000 reported that there were upwards of 200 million migrants worldwide of whom approximately 15 million were smuggled into the country where they presently reside (cited by Richards 2001, p.19). In 2001 between 0.7 and 4.0 million men, women, and children were bought, sold, transported, and held against their will in a form of slavery which is known as "trafficking." (U.S. Department of State 2002:1). Trafficking includes the "recruitment, transportation, transfer, harbouring, or receipt of persons, by means of threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of the person having control over another person, for the purpose of exploitation (which includes) ... prostitution ... or other forms of sexual exploitation, forced labour or services, slavery or (similar) practices ... servitude or removal of organs" (U.N. General Assembly 2001:32).

Smuggling is defined as the "procurement ... to obtain ... a financial or other material benefit, of illegal entry of a person into a State Party of which the person is not a national or permanent resident" (U.N. General Assembly 2001:41).

An estimated 0.5 million women are trafficked into Western Europe every year (UNICEF 2002c:4). About 50,000 women and children are trafficked in the U.S. every year (Anti-Slavery International 2002:124) for the purpose of prostitution, stripping/sexual touching, sweated labor, agricultural slave labor, domestic and other forms of servitude (Richard 2000:50). The annual profits derived from trafficking range from \$3 to \$10 billion (Schloenhardt 1999:23).

Three other bits of information from two especially noteworthy sources are compelling enough to attach to the end of this section on adult slavery. First, ILO reported that "*millions*" of persons throughout South Asia and Central and South America presently live and work under conditions of debt bondage (ILO 2001:vii; emphasis added). Second, the U.N. Working Group on Contemporary Forms of Slavery stated that there are known instances in which the bodily organs of executed prisoners are being exploited for commercial purposes, and U.N. personnel notably peacekeeping forces engage in sexual and other kinds of exploitative conduct (U.N. 2002:2). Third, corrupt public officials at times actually facilitate trafficking and smuggling (Richard 2000:8, 15; UN 2002:1; Bales 1999:245).

Why Slavery Persists

Just as there are two principal parties to the practice of slavery B the person enslaved and one who enslaves B there are two sets of reasons as to why the practice persists. On the part of the person enslaved there is a material need grounded in the unrelieved poverty and dearth of opportunities of that person=s pre-enslavement circumstances, though the linkage between poverty and slavery is neither complete nor direct (see, for example, US Dept of State 2002:1-2; ILO 2001:101; ILO 2002:xii; Strandberg 1999:7). Unmet need pushes that person—if a child, his/her family or guardian may use that unmet need to push him/her—into labor which through deception, force, and violence is exploited, where the poverty continues and a form of bondage may be imposed. Additionally, there is a fundamental human need for work as such which meets the need for belonging and the need to engage in work which is challenging and creative, allowing that human being to develop more fully towards his/her full potential as persons (David 2000:3). The need to belong can be denied effectively by several means including language barrier, physical confinement, and passport seizure. The need for creative work opportunities makes the innocent and naive vulnerable to being duped and deceived by the promises of the agents of slavery (Ryf 2002:49-51). For example, the promise of marriage may entrap a girl into forced prostitution; the enticement of learning a skill or trade may ensnare a boy into domestic servitude (U.S. Department of State 2002:1).

We prefer this framework for addressing the persistence of slavery rather than the more conventional supply/demand or push/pull model because at the very core of slavery, as mentioned previously, is a devaluing of human beings which strips them of their inherent dignity as persons and reduces them to instruments for the illicit and unjust enrichment of others. Bales reports that in Pakistan, India, Mauritania, and Brazil nearly every slaveholder he met and interviewed regarded himself as a businessman. Indeed these agents of slavery were family men and pillars of the community (Bales 2002:4). This objectification of human beings is best described in the language routinely used to characterize the prostitute: "sex object." Objectification, however, is even more common than what is represented by the practice of human enslavement. Millions of other humans are reduced to objects as John Paul warns in *Evangelium Vitae* (p.14) through murder, genocide, abortion, euthanasia, willful self-destruction, mutilation, torments inflicted on body or mind, attempts to coerce the will itself, subhuman living conditions, arbitrary imprisonment, deportation, slavery, prostitution, the selling of women and children, disgraceful working conditions.

Liberation and Rehabilitation

Liberating and rehabilitating children and adults who are held in slavery begin with the recognition that slavery today is a worldwide human tragedy which ultimately reduces to one human being treating another as an exploitable property rather than a human person (UN General Assembly 2001:32, 41). Ryf asserts that governments and law enforcement agencies worldwide are contributing to the spread of trafficking due to a failure to recognize the problem, to outlaw the practice, and to appropriate the necessary funds to enforce anti-trafficking laws. In the United States, $95 million was appropriated for 2001-2002 to combat trafficking but Ryf states that even these resources may not reduce world trafficking to any significant degree (Ryf 2002, pp. 69-70). Bales asserts that programs of liberation and rehabilitation are still in their infancy and no systematic evaluation is presently available. A further complication is that there has been no in-depth social science study of the relationship between the master and the slave (Bales 2002:5).

Nevertheless the practice of enslavement is so widespread today that we cannot use our own ignorance as justification for inaction. For that reason we turn to four international agencies experienced in this area for advice on how to address the problem of human enslavement. Those agencies are Anti-Slavery International, ILO, ECPAT International, and the Office of the United Nations Commissioner for Human Rights. In the following we present selectively those recommendations which have some specificity and which therefore make clear *what* should be done and *who* is to do it.

Based on its own studies, Anti-Slavery International has advanced 45 recommendations relating to government responsibilities in dealing with trafficking. Because there is no prioritization of the 45 proposals, we have selected one recommendation from five of the nine sets of recommendations in order to suggest the scope of governmental action required to reduce trafficking. (1) Persons who have been trafficked should not be prosecuted for acts such as prostitution which were performed while they were being trafficked. (2) Persons who have been trafficked should be informed of their right to asylum and be granted asylum whenever appropriate. (3) The state should provide shelters for persons who have been trafficked. (4) Laws should be enacted which allow confiscation of the assets of traffickers and use of the proceeds of the liquidated assets as compensation for persons who have been trafficked. (5) The state should not force the return of a trafficked person to his/her country of origin when there is evidence that the person may be subject to discrimination, stigmatization, or reprisal (Anti-Slavery International 2002:5-12).

The ILO recommends microfinance and microcredit arrangements which target families at risk of falling into enslavement and which focus especially on women who are key to reducing the number of children who are trafficked. Stronger preventive labor inspection measures, the ILO argues, likely contribute to the elimination of forced labor (ILO 2001:x,102).

ECPAT International has issued a report with numerous recommended actions to protect children. Three have been selected for their specificity. (1) The state should provide a guardian *ad litem* to assist a child who is a witness in criminal proceedings which involve allegations of sexual exploitation of children. (2) Telephone help lines should be made available to children seeking assistance because they have been abused or exploited. (3) An ombudsman, institution, or agency should be appointed to hear and act on complaints from children (ECPAT 1996:15, 18,22).

The Office of the UN High Commissioner for Human Rights has prepared a lengthy list of recommendations many of which are general. Four are selected because they are specific. (1) The state should review its legislation regarding use of the Internet for the purpose of trafficking, prostitution and sexual exploitation of women and children and enact new legislation as required to prevent such abuses. (2) The state should implement measures to prevent and sanction the confiscation of the passports of migrant workers. (3) No girl of primary school age should be employed as a domestic. (4) In depth investigations should be conducted to determine the role of corruption and international debt in fostering slavery (Office of the High Commissioner 1999:3-4).

Slavery in the end is rooted in a culture of death and despair. It will persist as long as humankind clings to those cultural values. It will not be wiped out until humankind embraces the counter-cultural values of life and hope.

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Immigration

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Introduction

Discussions about migration commonly start with a description of flows between developing and developed countries. However, the overwhelming majority of people who move do so within the borders of their own country.

The many questions arising from growing concerns about international migration, however, have few clear answers largely because of the lack of accurate and up-to-date information on international migration. For many countries, there is sufficient information to provide a reasonable basis for the estimation of levels, trends and the analysis of policies of international migration. For some countries, however, information is limited or unavailable.

The commonly supposed motivation of most migrants, internal and international, is to reap gains in the form of higher incomes, better access to education and health, and improved prospects for their children.

Definition of Terms

Migration describes the process of a population moving either across an international border, or within a State and encompasses all sorts of translocations considered to be permanent or semi-permanent (for a list of related terms see United Nations, 1998).

Migration can be intercontinental (across continents), intra-continental (across countries on a given continent), and inter-regional (within countries). The most significant inter-regional migration pattern has been rural to urban movements of population. Clustered derivatives of migration are emigration and immigration, which differentiate on the description of the migrating population's direction. The migrating population emigrates from one area in order to immigrate to another.

There are seven descriptive terms of migration in the literature that occur either from the migrants' origin or destination:

- *Internal/External Migration* characterizes whether residents migrate within or out of the area in question.
- *Emigration/Immigration* characterizes the migrants respectively, according to their country of origin and destination (e.g., the Pilgrims emigrated from England; the Pilgrims immigrated to America).
- *Step Migration* describes a series of shorter, less extreme migrations from a person's place of origin to final destination (e.g., moving from a farm, to a village, to a town, and finally to a city).
- *Circular* or *Return Migration* refers to the voluntary movements of immigrants back to their place of origin.
- *Migration Fields* occur from the clustering of people from a specific region into certain rural or urban areas.

There are also five descriptive terms of migration in the literature associated with the determining factors of the migrants:

- *Involuntary* or *Forced Migration* occurs when a government forces a large group of people out of a region (e.g., due to reasons based on ethnicity or religion).
- *Impelled* or *Reluctant* or *Imposed Migration* occurs when individuals are not forced out of their country, but leave because of unfavorable situations such as warfare, political problems, or religious persecution.
- *Chain Migration* is a series of migrations within a family or defined group of people (the process often initiates with one family member who sends money to bring other family members to the new location).
- *Seasonal Migration* is the process of moving for a period of time in response to labor or climate conditions.
- *Incomplete Migration* is a continuously growing contemporary intermediate category of migration. It

involves cross border commuters and seasonal workers, which can be described as individuals who work in foreign country, but at the same time residing in their own country (Papapanagos, 2004).

There are also five descriptive terms of migrants in the literature:

- *An Emigrant* is a person leaving a country to reside in another (e.g., emigrated from England).
- An *Immigrant* is a person entering a country from another to take up new residence (e.g., immigrated to America).
- A *Refugee* is a person who is residing outside the country of his or her origin due to fear of persecution for reasons of race, religion, nationality, membership in a particular social group, or political opinion.
- An *Internally Displaced Person* is forced to leave his or her home region because of unfavorable conditions (political, social, environmental, etc.) but does not cross any international boundaries.
- A *Migration Stream* is a group migration from a particular country, region, or city to a certain destination.

Appendix 1 provides an overview of the taxonomy which serves as an analytical tool for the discussion of different data-collection systems yielding information on international migration flows.

Theoretical Framework

Migration is the temporary or permanent movement of individuals or groups of people from one geographic location to another for various reasons ranging from better employment possibilities to persecution. While migration is as old as humanity itself, theories about migration are fairly new (Massey et al 1993).

Theory Development

The early attempts range from the “Laws of Migration” (Ravenstein 1885) that were based on purely empirical observations to migration models that used the physical concept of gravity. In the 1950s migration theory changed from the adaptation of physical models to more sophisticated theories. The main idea in the 1950/60s, was that migration occurs as a result of differences in the supply and demand of labour between the rural and urban sector (see Lewis 1954).

During the 1970/80s models were augmented in order to account for further empirical observations (see Harris & Todaro 1970). In addition, other macro-theories started to develop, which considered institutions in more detail.

While the early analyses looked at aggregate data and often saw migration as equilibrating mechanism, the focus since the 1980s has been on more elaborate microeconomic models. These models analyze individual motivations to migrate, but also consider structural community level factors (e.g. poverty). Theories that emphasize purely economic factors fail to capture the broader social framework in which decisions to migrate are taken. To this end, modern approaches link the micro and macro level and also include less economic concepts, for example social capital. The new economics of labor migration developed in the 1980s sees migration as a household decision and contributes to the literature with further and more enriched explanations for this phenomenon, as household decisions are perceived to be made by household members together and for the wellbeing of the family as a whole (see Stark & Bloom, 1985).

Levels of Analysis

Migration theories can be classified into three different approaches. Micro theories focus on individual migration decisions, whereas macro theories look at aggregate migration trends and explain these trends using macroeconomic tools. The meso-dimension lies between the micro and macro, e.g. capital and institutional theory, network theory. Table 1 provides an overview of the theories along these levels, whereas Table 2 looks at the 'push', 'forced' and 'pull' factors involved in migration.

The micro migration theories developed along a push-pull framework at an individual level, which looks at both the supply and demand side of migration (see Lee 1966). Positive and negative factors at the origin and destination push and pull migrants towards (non) migration, hindered by intervening factors, e.g. migration laws and affected by personal factors, e.g. how the migrant perceives the factors.

As the push-pull framework is considered as a grouping of factors affecting migration, without considering the exact causal mechanisms, the neoclassical human capital theory and several behavioral models have enriched the micro migration theory.

Push factors are associated with sending country or home country of emigrants and include unfavorable economic conditions and educational reasons, in which the person is exposed. Push factors become apparent when these conditions in the origin or home country of emigrants become severe and unbearable. Also, there are some forced factors associated with emigration such as political, religion, and social adverse conditions.

On the other hand, pull factors describe pleasant conditions in the recipient country. Noticeably greater wage levels, higher employment rates, better living conditions, more freedom in the recipient or destination country, tend to be pull factors. A resident who is jobless in his country and has the opportunity to find employment in other country is experiencing a pull factor.

The meso level of migration (see Faist, 2000) links the rational individual migration decision models to the structural macro

Table 1. Theories of Migration

Micro	Meso	Macro
Push/Pull factors Neoclassical micro migration Behavioral models Theory of social systems	Social capital theory Institutional theory Network theory Cumulative causation New Economics of Labor Migration	Neoclassical macro migration theory Migration as a system Dual labor market theory World systems theory Mobility Transition
Causes of Migration Individual values, desires, expectancies, e.g. improving survival, wealth etc.	**Causes of Migration** Collectives/social networks e.g. social ties	**Causes of Migration** Macro-level opportunity structure, economic structure (income & work opportunities differentials)

Source: Adapted from Faist (2000)

TABLE 2. Migration Factors

PUSH FACTORS	PULL FACTORS
Low wages, low living standards in home country (poor people trying to escape) Unemployment Educational reasons/lack of university degrees in home countries	High wages and high living standards in destination country Job opportunities in destination country (to undertake a diplomatic service, contract of employment, availability of jobs) Supporting families by sending back remittances Acquisition of skills and qualifications, better quality of studies Cultural, climate or health related reasons Self expression reasons (to become a missionaire, personal relationship, retirement)
FORCED FACTORS	
Natural disasters Genocide, Ethnic cleansing, Wars Political reasons, Dictatorship Religion reasons Abuse problems, social instability, social pressures Criminal justice – not to be arrested	

migration models. Social relations and social capital in households, neighborhoods, communities and more formal organizations help migrants in the migration decision and adaptation process, so they are both a resource and an integrating device. Different social relations imply different social capital, obligations and outcomes. For example, exchange relationships (e.g. between migrant and migration-brokers) are based on weak social ties and usually do not imply solidarity or reciprocity between the parties involved. Social capital can be seen as a resource that is acquired as a result of different kinds of relationships and can be converted into other types of capital (e.g. borrowing money for migration from the neighbor).

The macro migration theories explain migration as part of economic development. Internal migration occurs as a result of geographical differences in the supply and demand of labor, mostly between the rural agricultural sector and the urban manufacturing sector. External migration depends on the desirability of a place based on its social, economic, or environmental situation, often used to compare the value of living in different locations.

Irregular Migration

The term 'irregular migration' is commonly used to describe a variety of different phenomena involving people who enter or remain in a country of which they are not a citizen in breach of national laws. These include migrants who enter or remain in a country without authorization, those who are smuggled or trafficked across an international border, unsuccessful asylum seekers who fail to observe a deportation order and people who circumvent immigration controls through the arrangement of bogus marriages. These different forms of irregular migration are often clustered together under the alternative headings of unauthorized, undocumented or illegal migration (see Global Commission on International Migration 2005).

There are important regional differences in the way that the concept of irregular migration is applied. In Europe, for example, where the entry of people from outside the European Union (EU) is closely controlled, it is relatively easy to define and identify migrants with irregular status. This is not the case in many parts of Africa, where borders are porous, ethnic and linguistic groups straddle state borders, some people belong to nomadic communities and many people do not have proof of their place of birth or citizenship.

The analysis of irregular migration is further hampered by a serious lack of accurate data, making it difficult to identify trends or to compare the scale of the phenomenon in different parts of the world. There is however, a broad consensus that as the number of international migrants has increased, so too has the global scale of irregular migration. For example, between 10% and 15% of Europe's 56 million migrants have irregular status, and each year around half a million undocumented migrants arrive in the EU. In addition, irregular migration is by no means confined to developed countries. Asia is known to have large numbers of migrants with irregular status: up to 20 million in India alone, according to some estimates (see Organization for Economic Cooperation and Development 2009).

Forms of Irregular Migration

The issue of irregular migration is inextricably linked to that of human security. Many people who migrate in an irregular manner do so because their own countries are affected by armed conflict, political instability and economic decline. While they are in transit, migrants who move in an irregular manner often find themselves exposed to danger, or become stranded for long periods of time while en route to their final destination.

In addition, in the case of human trafficking, irregular migration comes together with brutal and degrading types of exploitation. By definition, trafficking is a form of movement in which freedoms become restricted by means of force, deception and/or coercion. Commonly, trafficked individuals are not free to choose to abort the trip, to seek alternative employment once they get to the destination, or to return home.

Last but not least, dual labor markets have evolved in the majority of states: a formal labor market, in which wages, working hours and other conditions of service are regulated, and an informal labor market, dominated by casual workers who do not benefit from such protection. In many parts of the world, certain sectors of the economy rely on migrants with irregular status, who are prepared to work in difficult and dangerous jobs with little security and low wages. Employing migrants with irregular status can be viewed as a form of "insourcing", a strategy used by some employers as an alternative to outsourcing or offshoring when confronted with a need to cut costs and to compensate for local labor shortages. The growth of such employment opportunities has provided an important incentive for people to migrate in an irregular manner. As the global economy becomes more competitive and companies seek to reduce costs further, it is likely that the market for irregular migrant labor will continue to expand, especially in countries where the formal labor market is highly regulated (see Global Commission on International Migration 2005).

Negative Consequences of Irregular Immigration

Irregular migration has a number of negative consequences. When it takes place on a significant scale, and when it receives a great deal of media attention due to rising unemployment levels and endangerment of public safety, irregular migration can undermine public confidence in the integrity and effectiveness of a state's migration and asylum policies (see Global Commission on International Migration 2005). Irregular migration challenges the exercise of state sovereignty and can even become a threat to public security, especially when it involves corruption and organized crime. When irregular migration results in competition for scarce jobs, irregular migration can also generate xenophobic sentiments that are directed not only at migrants with irregular status, but also at established migrants, refugees and ethnic minorities.

Irregular migrants often risk their lives and are subject to exploitation by employers as often they have inferior rights to basic wages, social security and health insurance.

Globalisation and Migration

Population movements have played a vital role in the structural transformation of economies throughout history, thereby contributing greatly to development. Despite the widespread perception that international migration is associated with the rise of globalization and trade in the late 20th century, large-scale long-distance movements were also prevalent in the past, e.g. the ancient Greek-Roman colonialism. However, this form of pro-migration consensus was not to last. Towards the end of the 19th century, many countries introduced entry restrictions. The causes were varied, from the depletion of unsettled land to labour market pressures and popular sentiment. Despite the introduction of these restrictions, estimates from the early 20th century indicate that the share of international migrants to the world's population was similar if not larger than it is today. This is striking given the relatively high transport costs at that time (see International Labour Office, 1936).

Globalization is characterised by an easier movement of capital, goods and services, lower trade barriers and a larger scale of cooperation among countries. Globalization, in conjuction with the development of communications and transportation facilities, the opening of borders, the economic integration, the linearization and openness of markets, has a different impact on migration, increasing significantly migration flows over the last decades (Borjas 1995).

European countries experienced particularly high levels of international migrants since the 1980s, in large part due to their economic growth and political stability. The contemporary annual figure for international migrants is 214 million (3.1 percent of the world's population), without accounting for irregular migrants (see United Nations Development Programme 2009).

The period since 1960 has been marked by a growing concentration of migrants in developed countries. Research indicates that trends in income, population and transportation costs tend to increase movements, which on the other hand is continuously confronted with growing legal and administrative barriers (see United Nations Development Programme 2009).

The socioeconomic effects of globalization on international migration flows can be better detected by policies on the national level. To date, national development and poverty reduction strategies in developing countries have tended not to recognize the potential of mobility, nor integrated its dynamics into planning and monitoring. This in part is due to a range of other pressing priorities facing these countries, from improving systems of service delivery, through building basic infrastructure, to promoting broad-based growth.

The role of migration in Poverty Reduction Strategies (PRSs) is closely related to the socioeconomic effects of globalization on international migration flows. PRSs are of interest since they involve contributions from, or partnerships with, civil society actors, are intended to be based on quantitative and participatory assessments of poverty, and provide a sense of government priorities (see PRS Papers of IMF and World Bank).

Apart from globalization, other factors can also have an impact on international migration flows (see Borjas 1994). Demographic trends, in particular, are expected to continue to play a significant role in shaping the pressures for movement between regions, as we have seen over the past half-century. Climate changes are also likely to come into play, with effects that are much more difficult to predict.

A financial crisis turning into a jobs crisis is also an extra factor. Several variables come into play in order to determine how a financial crisis affects the movement of people, e.g. the immediate prospects at home and abroad, the perceived risks of migrating, staying or returning and the increased barriers that are likely to come into place (see United Nations Development Programme 2009).

Policies on International Migration

Since the emergence of modern states in the 17th century, the international legal system has been built on the bedrock of two principles: sovereignty and territorial integrity. Within this system, which includes a series of norms and constraints imposed by international law, governments police their country's borders and enforce their right to restrict entry (see United Nations Development Programme 2009).

The implementation of national policies that affect levels and patterns of international migration has intensified in the last decade, spreading to all regions of the world. Discussions on issues such as sustained low fertility and population ageing, unemployment, brain-drain and brain-gain, worker remittances, human rights, social integration, xenophobia, human trafficking and national security have led to a re-examination of migration policies and the potential benefits and costs accruing to sending, receiving and transit countries. Over the past decades, the number of governments adopting new measures to influence migration has grown rapidly.

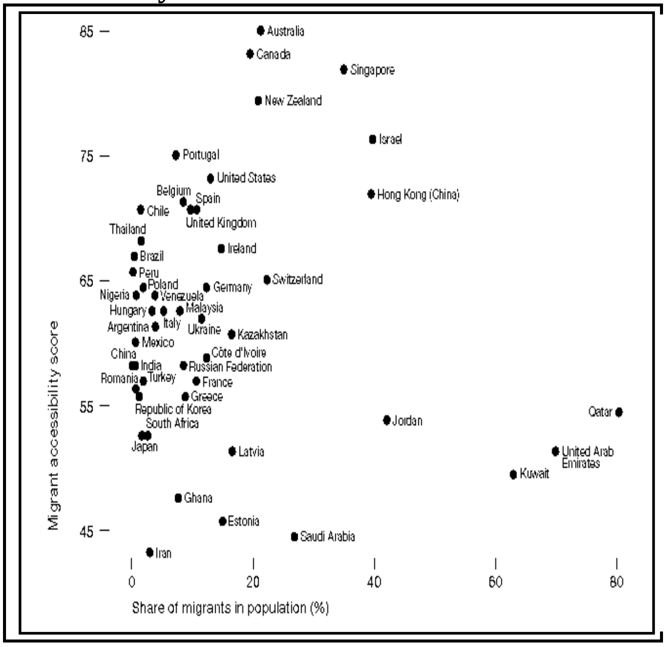
The two most important dimensions of the mobility agenda that offer scope for better policies are admissions and treatment. While policy makers face common challenges, they need to design and implement different migration policies in their respective countries, according to national and local circumstances. Certain good practices nevertheless stand out and can be more widely adopted.

See Figure 1, below, which scrutinizes the relationship between the share of migrants in the population and the degree to which migration has become accessible. Irrespectively of the political regimes and the level of economic development, there is no systematic relationship between various measures of rights and migrant numbers. The Economist Intelligence Unit (EIU) index, which includes a broader sample of developed and developing countries, indicates essentially no correlation between number of migrants and their access to basic rights, suggesting that the various regimes governing such access are compatible with both high and low numbers of migrants.

Immigration Policies

Since the mid-1990s, governments are increasingly reporting that they wish to maintain their levels of immigration and are less inclined to take action to restrict those levels (see United Nations, 2009a). As of 2005, only 22% of countries wanted to lower immigration, down from 40% in 1996. Furthermore, the proportion of countries seeking to maintain the prevailing level of immigration rose from 30% in 1996 to 54% in 2005, whereas the proportion seeking to raise levels remained constant at about 5%. While in 1996 one quarter of all countries had reported no intervention with respect to immigration, one fifth did so in 2005. These mostly include countries in Africa that are experiencing emigration and whose borders are difficult to supervise.

Figure 1: **Foreign-Born Migrants and EIU Accessibility Score in 2008**



Source: Adapted from UNDP (2009)

In 2007, 78% of UN member states viewed current immigration levels as satisfactory, while 17% considered them to be too high and 5% too low. A similar picture emerges when governments were asked to describe their policies. On both questions, governments of developed countries appear to be more restrictive than those of developing countries (see United Nations 2009b).

These patterns indicate a significant gap between the policies that the public appears to favor in most countries–greater restrictions on immigration–and actual policies, which in fact allow for significant amounts of immigration. While greater public opposition towards immigration is associated with higher policy restrictions, there is still a significant gap between the policies desired by most voters and those that are adopted by policy makers (see Facchini & Mayda 2009). While explanations for this gap are complex–as several factors come into play–three explanatory categories can be distinguished (see United Nations Development Programme 2009):

- Opposition to immigration is not catholic as voters often have mixed views. In many countries, concerns about adverse employment or fiscal effects are mixed with the recognition that tolerance of others and ethnic diversity are positive values.
- Organized groups such as labor unions, employer organizations and NGOs can have a significant effect on the formulation of public policies.
- Many governments implicitly tolerate irregular migration, suggesting that policy makers are aware of the high economic and social costs of a crackdown.

Emigration Policies

Countries can limit the exit of nationals from their territory by several means, ranging from formal prohibitions to practical barriers created by fees and administrative requirements. Exorbitant passport fees can make it all but impossible for a poor person to leave the country through regular channels: 14 countries had passport fees that exceeded 10% of annual per capita income (McKenzie 2007). In many countries, a labyrinth of procedures and regulations, often exacerbated by corruption, causes excessive delays and compounds the costs of leaving. Not surprisingly, these exit restrictions are negatively correlated with emigration rates (see United Nations 2009b).

A handful of countries have formal restrictions on exit. These are strictly enforced in Cuba and the Democratic People's Republic of Korea, and are in place in China, Eritrea, Iran, Myanmar, and Uzbekistan. Twenty countries restrict the exit of women, while eight impose age-specific restrictions related to the travel of citizens of military service age (see United Nations Development Programme 2009).

About one quarter of Governments report that they wish to lower emigration, a proportion that has remained virtually unchanged since 1986. Fifty-three countries are concerned about emigration, with four noting their concern about the loss of highly skilled workers and seeking to adopt initiatives to encourage their return. By contrast, 11 countries seek to increase emigration (see United Nations 2009a). The major countries of origin of migrant workers, such as Bangladesh, India, Pakistan, the Philippines, Sri Lanka, Thailand and Vietnam, have established special units to manage worker migration and protect the rights and safety of their migrants abroad (Organization for Economic Cooperation and Development 2009).

Given the importance of remittances for the economies of many countries of origin, their Governments have been implementing policies to increase remittance flows, promote transfers through formal channels, reduce the cost of transfers, and channel remittances into productive investment. The measures taken include tax exemptions on remittance income, improved access to banking services for senders and receivers of remittances, cooperation with countries of destination to allow domestic banks to operate overseas and reduction of duties on goods sent home by migrants (World Bank 2006).

Refugee and Asylum Policies

Several forms of protection are available for refugees, especially for those covered by the 1951 Refugee Convention–which defines the criteria under which individuals may be granted asylum by its signatory countries and sets out their associated rights–and thus under the United Nations High Commissioner for Refugees (UNHCR) mandate. The 1951 Convention relating to the Status of Refugees and the 1967 Protocol are the major international instruments determining policies towards refugees. By early 2006, 143 States had ratified both instruments and another 6 had ratified only one of them (United Nations 2009a).

The rising number of asylum applications in developed countries, particularly since the late 1980s, has led to a succession of policy changes. EU member states have tried to tighten external borders while relaxing internal border controls under the convention implementing the Schengen Agreement (1990) and the Treaty of Maastricht (1993).

Policies to Address Irregular Migration

Governments may return or deport foreigners whose status is irregular. Some Governments have concluded readmission agreements to ensure that foreigners in an irregular status who lack proper documentation validating their origin are nevertheless admitted by countries of origin if they are expelled. Also used are bilateral agreements between receiving countries and those through which migrants transit to ensure the cooperation of the latter in trying to stop the flow.

It is estimated that nearly half of the migrants who enter countries clandestinely do so through smuggling or trafficking (International Organization for Migration 2008). According to the Protocol against the Smuggling of Migrants by Land, Sea and Air, supplementing the United Nations Convention against Transnational Organized Crime, "smuggling of migrants" means the procurement, in order to obtain, directly or indirectly, a financial or other material benefit, of the illegal entry of a person into a State of which the person is not a national or a permanent resident (article 3a). According to the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, supplementing the United Nations Convention against Transnational Organized Crime, "trafficking of persons" means the recruitment, transportation, transfer, harboring or receipt of persons by improper means, such as force, abduction, fraud or coercion, for an improper purpose, like forced or coerced labor, servitude, slavery or sexual exploitation. Those organizing smuggling or trafficking activities range from small-scale operators who provide transport across borders to international criminal networks that provide the full range of services, including counterfeit documentation, transportation and assistance in crossing borders, and housing and illegal employment in receiving countries. Trafficked women, in particular, frequently find themselves forced into prostitution, marriage, domestic work, work in sweatshops and other forms of exploitation.

In addition, in response to rising global turmoil regarding terrorism, Governments have introduced more stringent requirements for granting visas or have imposed visa requirements for nationals of countries that consistently produce unauthorized migrants. Growing numbers of countries are issuing machine-readable travel documents, passports with enhanced security features that are difficult to counterfeit and counterfeit-proof visa stamps, thus making it more difficult to tamper with official travel documents. In addition, Governments are increasingly sharing intelligence on suspected individuals and are enhancing cooperation in border control.

Global Governance on Mobility

Beyond a well-established convention on refugees, international mobility lacks a binding multilateral regime (see Opeskin 2009). The International Labor Organization (ILO) has long had conventions on the rights of migrant workers, but they are heavily undersubscribed. The International Organization for Migration (IOM) has expanded beyond its historic role in the post-war repatriation of refugees towards a more general mission to improve migration management and has increased its membership, but it is outside the United Nations (UN) system and remains largely oriented towards service provision to member states on a project basis. Under the General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO), some 100 member states have made commitments to the temporary admission of foreign nationals who provide services, but these mostly involve short-term business visitors and fixed-term intra-company transfers involving high-skilled professionals.

The lack of multilateral cooperation on migration has been attributed to several related factors. In contrast to trade negotiations, where countries negotiate over the reciprocal reduction of barriers to each other's exports, developing countries are in a weaker bargaining position on the migration front. Most migrants from developed countries go to other developed countries, so there is little pressure from developed country governments to open channels for entering developing countries. This asymmetry, as well as the political sensitivity of the migration issue in most developed destination countries, has led to a lack of leadership from these states in international negotiations. International discussions have also been characterized by lack of cooperation among sending countries. These obstacles have so far defied the best efforts of international organizations and a handful of governments to promote cooperation and binding international commitments (see International Organization for Migration 2008). Further liberalization is currently being canvassed in the Doha Round of trade negotiations, which began in 2000 but have long since stalled.

Impacts at Origin and Destination Country

At places of origin, impacts can be seen on income and consumption, education and health, and broader cultural and social processes. Impacts at origin are complex, context-specific and subject to change over time. The nature and extent of impacts depend on who moves, how they fare abroad and their proclivity to stay connected, which may find expression in flows of money, knowledge and ideas, and in the stated intention to return at some date in the future.

In addition, much attention has been directed to the impacts of migrants on places of destination. A widespread belief is that these impacts are negative. Although this belief is often based on exaggerated and unfounded fears, it matters because it affects the political climate in which policy decisions about the admission and treatment of migrants are made.

Impacts at Origin Country

Migration has increased significantly the past decades and this increase has consequently led to increasing flows of remittances, which can influence positively the economy of the migrants' origin country, as they can be used for investment and business creation or for development projects and can cover the balance of payments deficits. On the other hand, emigration of skilled workers may even promote economic growth in the home countries, since the fact that highly educated emigrants earn much more abroad, make more people in the home country turn to education with the intention to emigrate as well and because not all of them emigrate at the end, this finally leads to an increase of the highly skilled workers in the home country (see Papapanagos et al 2002).

Emigration is sometimes seen as a means to reduce joblessness and enhance economic growth through access to strategic inputs such as increased remittances. Labor emigration can also be helpful in absorbing the increase in labor force especially the unemployed or underemployed people. In overcrowded areas, emigration can provide some temporary relief from unemployment and can ease the high pressure of supply in labor markets. This labor loss has zero opportunity cost.

In addition, emigration can serve as a temporary safety valve against mass discontent resulting from job losses during the transition following economic reform and restructuring (see Papapanagos & Sanfey, 2003). By reducing unemployment, emigration can also decrease the financial burden of welfare benefits. The experiences of a significant number of countries, e.g., Colombia, Mexico, India, Pakistan, Sri Lanka, Greece and Turkey, show that return migration can be powerful factor for modernization, social change and prosperity in home communities. Migrant remittances represent the largest impact of migration on sending areas. If one considers labor as an export, then remittances are the part of the payment for exporting labor services that returns to the country of origin. Remittances can help local community development projects and businesses in the home country. Migrant associations in the host country are increasingly active in pooling migrant funds and raising additional means from external sources to support such projects. The remittances can actually help alleviate poverty in areas of origin of migration. Also, remittances are relatively unaffected by crises and violent conflict and they appear to be more equally spread among developing countries than other capital flows.

The *positive effects* of emigration can be summed up to:

- Remittances effects – rising levels of investment, improved GDP levels and better foreign exchange for the emigrant country due to inflow of remittances.
- Potential to immigrate (e.g. to relatives abroad).
- Speed in transition period.
- Improved skills for returning immigrants.
- Knowledge and technology diffusion.
- Increased productivity.
- Enhanced mobility of workers □ better wages, closeness of wage levels with advanced countries.
- Growing inducement to accumulate human capital due to brain drain.
- Increased global economic efficiency in terms of allocation efficiency.
- Possibility for enhanced financial and trade channels flows between source and destination countries (emigrant and immigrant country).

There is however and the *negative side* of emigration. Remittances are able to increase income and wealth inequalities and even lead to inflationary pressures – especially in the field of real estate (see Appleyard 1989).

Emigration in labor intensive countries may incur a “reduction of productivity” due to the reallocation of the labor endowment. The replacement of emigrants may be with less skillful and competent workers, like in rural and isolated areas where women and children replace the emigrant men of the family. The reduction of productivity levels also leads to retraining, which entails a total higher cost of training. In such cases some countries import labor endowment and become labor-importing and labor-exporting.

The “brain drain”–the international migration of skilled people who have been the subject of considerable educational investment by their own society–has a negative impact on the country of origin, both in terms of knowledge and technology diffusion and levels of productivity. In addition, migration of highly educated workers decreases the attractive levels of human capital for foreign direct investment inflows in the country of origin, and consequently decelerates economic growth.

The positive effects of emigration can be summed up to:

- Lower economic growth and productivity as a result of brain drain.
- Risks from remittance dependency and its inflationary potential.
- Reduction of labor force and consequent lack of skilled and unskilled workers.
- Loss of highly qualified workers and decline of quality in important services.

- Reduction in tax revenues and social security contribution
- Emigrants may instigate rising income differences
- Reduction in the size of regional and local markets.

Impacts at Destination Country

Immigration reduces labor scarcity and the inflationary strain for wages, encourages labor (occupational) mobility, and makes the best of productive capital, so that exports and economic growth are considerably enhanced.

The *positive effects* of immigration can be summed up to:

- Lower production costs enhance the competitiveness of exports. In cases the majority of immigrants are employed at a lower average of the general wage level and without social security charges, production costs are lower.
- The labor supply increases and in relation to changes of labor demand, it halts wages.
- The demand for labor increases as the demographic expansion increases the demand of certain basic consumable goods and services (food, clothes, housing and transportation).
- Public revenue increases both, from direct and indirect taxation.
- Demographic problems threatening the social security system can be countered.

However, the *negative side* of immigration usually receives greater attention. Differences in culture, religion and social norms between immigrants and natives may complicate the process of the immigrants' integration to the destination country. For example, one of the major issues that determine the impact of immigration on public and social welfare is the net contribution, resulting from the difference between the immigrants' contribution (direct and direct taxes, social security, etc.) and receivables (public goods and services).

Immigrants from new EU member states have put pressure on the labour market of the older and more developed EU destination states. More specifically, they put downward pressure on the wage levels of the EU15, while unskilled or low-skilled labour supply expands and the respective labour demand remains stable in the short term (see Iranzo & Peri 2009).

The negative effects of immigration can be summed up to:

- The financial burden of public welfare and social services may increase, which consequently expands cost and public debt.
- Unemployment levels of unskilled and skilled native workers increases.
- Outflow of foreign exchange due to remittances directed to the country of origin (repatriation of income and wealth).
- Potential increase on the levels of delinquency, human trafficking and criminality.
- The oversupply of unskilled labor is able to trigger income differentiation and higher social strains.

Conclusion

International migration is a complex phenomenon. It is increasing in scale, affects almost every country in the world and takes place both within and between regions. International migration involves a diverse range of stakeholders that have different and sometimes conflicting interests, and is increasingly linked with other pressing global issues such as development, trade, human rights and security.

Migration is deeply related with globalization, and the free movement of goods, services, products, capital, ideas, and especially the free movement of labour force. International migration is the outcome of the functioning of labor market with no restrictions or limited restrictions to international movements of labor force.

Given the dynamic nature of international migration, it is essential for policy-making in this area to be responsive and proactive. This in turn requires effective data collection, policy analysis, research, monitoring and evaluation. It is hard to formulate and implement effective policy when it is not clear who the targets of that policy are, how many they are, where they are and what their problems are. And it is simply bad practice not to assess the efficiency, effectiveness and impact of policy.

Finally, there is no clear answer regarding the evaluation of migration since there are so many positive and negative outcomes from migration for the emigrant and immigrant countries. Also, the outcomes are different for low-wage and high-wage countries.

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Related Institutions

International Migration Programme of the ILO, Geneva. A United Nations agency with a constitutional mandate to protect migrant workers.

International Organization for Migration, Geneva. An inter-governmental organization in the field of migration that works closely with governmental, intergovernmental and non-governmental partners.

Migration Policy Institute, Washington DC. An independent, nonprofit organisation dedicated to analysis of the movement of people worldwide.

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APPENDIX 1. Taxonomy of International Inflows and Outflows according to Entry Status

CITIZENS	FOREIGNERS		CITIZENS
OUTFLOWS	**INFLOWS**	**OUTFLOWS**	**INFLOWS**
1. Border workers departing daily or weekly to work in a neighbouring country	Foreign border workers entering daily or weekly to work	Foreign border workers departing daily or weekly to go home	Border workers returning daily or weekly to their home
2. Departing citizens in transit	Arriving foreigners in transit	Departing foreigners in transit	Arriving citizens in transit
3. Departing excursionists	Arriving foreign excursionists	Departing foreign excursionists	Returning excursionists
4. Departing tourists	Arriving foreign tourists	Departing foreign tourists	Returning tourists
5. Departing business travellers	Arriving foreign business travellers	Departing foreign business travelers	Returning business travellers
6. Departing diplomatic and consular personnel (plus their dependants and household employees)	Arriving foreign diplomatic and consular personnel (plus their dependants and household employees)	Departing foreign diplomatic and consular personnel (plus their dependants and household employees)	Returning diplomatic and consular personnel (plus their dependants and household employees)
7. Departing military personnel (plus their dependants)	Arriving foreign military personnel (plus their dependants)	Departing foreign military personnel (plus their dependants)	Returning military personnel (plus their dependants)
8. Nomads	Nomads	Nomads	Nomads
9. Citizens departing to study abroad (plus their dependants)	Arriving foreigners admitted as students (plus their dependants, if allowed)	Departing foreign students (plus their dependants)	Citizens returning from studying abroad (plus their dependants)
10. Citizens departing to be trained abroad (plus their dependants)	Arriving foreigners admitted as trainees (plus their dependants, if allowed)	Departing foreign trainees (plus their dependants)	Citizens returning from being trained abroad (plus their dependants)
11. Citizens departing to work abroad (plus their dependants)	Arriving foreigners admitted as migrant workers (plus their dependants, if allowed)	Departing foreign migrant workers (plus their dependants)	Citizens returning from working abroad (plus their dependants)
12. Citizens departing to work in an international organization abroad (plus their dependants and employees)	Arriving foreigners admitted as international civil servants (plus their dependants and employees)	Departing foreign international civil servants (plus their dependants and employees)	Citizens returning after having worked in an international organization abroad (plus their dependants and employees)
13. Citizens departing to establish themselves in a country where they have the right to free establishment	Arriving foreigners having the right to free establishment	Foreigners departing after having exercised their right to free establishment	Citizens returning from a country where they exercised their right to free establishment
14. Citizens departing to settle abroad	Arriving foreigners admitted for settlement without limits on duration of stay	Foreign settlers departing	Citizens returning after having settled abroad
15. Citizens departing to form a family or join their immediate relatives abroad	Arriving foreigners admitted for family formation or reunification	Departing foreigners originally admitted for family formation or reunification	Citizens returning after having migrated for family formation or reunification
16. Citizens departing to seek asylum	Foreigners admitted as refugees	Departing refugees	Repatriating refugees
17. Citizens departing to seek asylum	Foreigners seeking asylum	Departing former asylum-seekers (not granted refugee status)	Returning former asylum-seekers
18. Citizens departing without the necessary admission permits	Foreigners whose entry is not sanctioned	Deported foreigners	Citizens being deported from abroad

Source: Adapted from United Nations (1998)

International Labour Organization

Joseph Mensah

Headquartered in Geneva, with a membership of 177 nations and a staff of about 1,900 people drawn from over one hundred different countries, the International Labour Organization (ILO) is undoubtedly the leading global institution devoted to the ideals of social justice and human rights concerning labour (ILO 2004; ILO 1996-2005a). More specifically, the organization seeks to improve the living and working conditions of workers by strengthening their rights; by enhancing their employment opportunities; and by offering training and technical assistance to governments, employers, and workers worldwide (ILO 1996-2005a; Lambert 2001). The organization pursues much of its activities through the creation of international labour standards which set thresholds of basic labour rights on anything from freedom of association, the right to organize and to undertake collective bargaining to employment equity and the elimination of child labour. The ILO was established in 1919 as part of the Treaty of Versailles which helped put an end to the First World War (ILO 1996-2005b). The organization was initially an agency of the League of Nations; it became the first specialized agency of the United Nations in 1946, following the demise of the League (ILO 1996-2005b; Morse 1969).

The ILO was founded on sentiments of social justice, human rights, human dignity, family life, and global peace couched in a high dose of humanitarianism. The ruthless exploitation of the working class across Europe, following the onset of the Industrial Revolution—over which notables such as Karl Marx, Friedrich Engels, Charles Booth, and the novelist Charles Dickens lamented in their numerous writings—was becoming increasingly unacceptable by the early 20th century, not only for reasons of humanitarianism, but also of economics and politics (Alcock 1971). For one thing, leading industrialists at the time, including the Welsh textile manufacturer Robert Owen (1771-1853) and the French manufacturer Daniel Legrand (1783-1859), were hardly oblivious of the seeds of mass discontent and civil unrest invariably sown by the growing poverty among the working class in Europe (ILO 1996-2005b; Alcock 1971). Furthermore, many recognized that any major variations in labour cost, wrought by differential labour and employment conditions, had a definite impact on the competitive dynamics of firms and industries (Alcock 1971). Clearly, in the absence of an organization such as the ILO to create standardized labour regulations, it was difficult, if not impossible, to ascertain any semblance of a level-playing field for ‘perfect competition.’ Also, founded as part of the Treaty of Versailles, the ILO was seen as yet another piece of the global peace-puzzle, capable of creating international harmony through social justice, socioeconomic progress, and the fair treatment of labour worldwide (ILO 1996-2005b; Morse 1969). We thus find the ILO noting in the Preamble of its 1919 Constitution that, “universal and lasting peace can be established only if it is based upon social justice; [and that]… the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions of their own countries” (ILO 1996-2005c).

The ILO hosts annual Labour Conferences to craft and adopt various international labour standards. The very first ILO Conference—held in Washington DC in October 1919 and attended by delegates from some 39 countries—was put together with the help of renowned trade unionists such as Samuel

Gompers (1850-1924), the first president of the American Federation of Labor (AFD), and the French socialist politician Albert Thomas who became the first Director (now termed 'Director-General') of the ILO (Morse 1969). In addition to yielding six major labour Conventions, the ILO used this first Conference to develop its parliamentary practices that gave life to its formal Constitution. The post-war era of the ILO began with its twenty-sixth annual Conference held in Philadelphia in 1944. This Conference culminated in the Philadelphia Declaration which has since been appended to the ILO Constitution as a basic statement of the organization's purpose. At present, the ILO Conferences are held every year in Geneva (Galenson 1981; Morse 1969). As a specialized agency of the UN, any member of the UN has the right to join the ILO, provided that country is willing to abide by the principles and objectives set out in the ILO Constitution. The ILO is financed primary through the contributions of members, determined by a formula which takes into account members' ability to pay, using estimates of their respective Gross National Product (GNP) *per capita* (Galenson 1981).

Purpose and Underlying Principles

The aims and objectives of the ILO, as stated in the Preamble of its 1919 Constitution, are to work towards "the regulation of the hours of work including the establishment of a maximum working day and week, the regulation of the labour supply, the prevention of unemployment, the provision of an adequate living wage, the protection of the worker against sickness, disease and injury arising out of his employment, the protection of children, young persons and women, provision for old age and injury, protection of the interests of workers when employed in countries other than their own, recognition of the principle of equal remuneration for work of equal value, recognition of the principle of freedom of association, the organization of vocational and technical education and other measures" (ILO 1996-2005c).

These objectives were revamped by the Philadelphia Declaration of 1944 with additional goals, which, *inter alia*, seek to promote full employment and increased living standards across ILO member States; facilitate the employment of workers in occupations in which they have a sense of satisfaction of giving the fullest measure of their skills, and have the ability to make their greatest contribution to the common well-being; provide facilities for the training and transfer of labour; and promote effective recognition of the right of collective bargaining. Other goals include efforts to extend social security to provide basic income and medical care to all in need; provide adequate protection for the life and health of workers in all occupations; provide ample nutrition, housing, and facilities for recreation and culture; enhance child warfare programs and maternity protections; and to foster equality of educational and vocational opportunities to all workers (ILO 1996-2005d).

In addition to these, the Philadelphia Conference was used to reaffirm the fundamental principles of the ILO, which essentially posit that freedoms of expression and of association are essential ingredients for progress; that, poverty anywhere is a threat to progress everywhere; and, that, all human beings, regardless of race, religious conviction, or sex, have the right to seek their material and spiritual well-being under conditions of freedom and dignity (ILO 1996-2005d). Clearly, the ILO has a very broad mandate, covering nearly all aspects of the working life of labour. It is therefore not surprising that the ILO has occasionally run into jurisdictional conflicts with other international organizations, notably the

United Nations Economic and Social Council (ECOSOC) and the United Nations Industrial Development Organization (UNIDO), in matters concerning (inter)national labour practices (Galenson 1981).

Organizational Structure

The basic organizational structure of the ILO is rather simple. It is made up of three main bodies—the International Labour Conference (the Conference), the Governing Body, and the International Labour Office—each of which operates in a tripartite framework, which is more or less unique to the ILO. The Conference, also called the International Parliament of Labour, is the main legislative forum of the ILO (Galenson 1981; Morse 1969). The Conference meets in June of each year in Geneva for three to four weeks. Every ILO member State is entitled to four delegates at this annual Conference in a 2+1+1 formula—two delegates representing the government, one representing employers, and another one representing workers. These delegates are accompanied by their respective technical advisors. Each of the Conference delegates has one vote, and it is not uncommon to find delegates from the same country voting differently on issues (Galenson 1981). Besides discussing and adopting various international labour standards, the Conference elects the Governing Body; approves the ILO budget; provides policy directions for the ILO's future operations; and adopts the organization's biennial program every two years.

As with the other ILO bodies, the Conference works through a number of tripartite committees, notably among which are the Selection Committee, which nominates the members of other ILO committees and prepares the Conference schedules; the Credential Committee, which prepares the particulars supplied by member States to designate persons who are entitled to represent them; and the Committee on the Application of Conventions and Recommendations, which deals with the modalities for applying the various international labour standards in member States (Galenson 1981; ILO 1996-2005e).

The Governing Body is the ILO's executive body, charged with the responsibility of coordinating the activities of the organization into an overall program of action (Morse 1969; Galenson 1981). The Governing Body meets thrice a year and takes decisions on ILO policies; elects the Director-General of the ILO; approves draft programs; prepares the ILO budget for submission to the Conference; and supervises the financial affairs of the ILO (ILO 1996-2005f). The Governing Body has 56 titular members (28 governments, 14 employers; and 14 workers) as well as 66 titular deputy members (28 governments, 19 employers; and 19 workers).

As with the Conference, the Governing Body conducts much of its activities through tripartite committees which include the Committee on Freedom of Association; Programme, Financial and Administrative Committee; Committee on Legal Issues and International Labour Standards; and the Committee on Employment and Social Policy. Others are the Committee on Sectoral and Technical Meetings and Related Issues; the Committee on Technical Corporation; and, more recently, the Working Party on the Social Dimensions of Globalization (ILO 1996-2005f; ILO 1996-2005i).

The permanent secretariat of the ILO is the International Labour Office in Geneva, which handles the daily operations of the organization. The Office employs some 1900 officials, some of whom are permanent staff, while others are contract workers. The bulk of the ILO staff is stationed in the Geneva office, but some are in the ILO Regional and field offices scattered across the world.

Among other things, the Office undertakes field missions; conducts research; and prepares ILO documents and publications. The Office is headed by the Director-General of the ILO, who is the executive head and, consequently, the most important person in the entire organizational hierarchy.

The Director-General, who is elected for a five-year renewable term, represents the organization to the outside world, appoints the staff, and acts as the liaison between the Governing Body and the Office. The ILO has been headed by nine persons since its creation in 1919, including Albert Thomas of France (1919-1932); Harold Butler of Britain (1932-1938); John Winant of the United States (1939-1941); Edward Phelan of Ireland (1941-1948); David Morse of the United States (1948-1970); Wilfred Jenks of Britain (1970-1973); Francis Blanchard of France (1973-1989); Michel Hansenne of Belgium (1989-1999); and Juan Somavia of Chile, (1999 to present) (ILO 1996-2005g).

Ironically, notwithstanding its anti-discriminatory pronouncements and talks of gender equity, not even one of the ILO Directors-General has been a woman, and with the notable exception of the recent appointment of Juan Somavia of Chile, all the Directors-General have been from the North—either from Europe or the United States, to be precise. While it is not implausible to speculate that perhaps no woman (or a person of colour) has ever qualified or applied for the Director-General position, this state of affair is still problematic, to put it mildly. For the ILO to take more than 75 years to be able to entice, prepare, or otherwise appoint, a person from the South, and virtually forever (at least up to this point in time) to find a qualified or interested woman to lead the organization, is to give 'ammunitions' to critics who could raise charges of disingenuousness on the part of the organization, in this regard.

ILO Activities

Generally the ILO pursues its goals through the adoption of various labour standards by way of majority decisions at its annual Conferences. The ensuing labour standards take the form of ILO Conventions and Recommendations. The former are international treaties on specific labour issues, subject to eventual ratification by ILO members for their implementation, while the latter—usually dealing with the same issues as the former—provide broad, legally non-binding guidelines which help orient the policies of ILO members towards its principles and objectives. Voting at the ILO Conference is done using the one person-one vote principle.

Even though ILO Conventions and Recommendation are adopted by majority decisions at the Conferences, not all governments voting for them at the Conferences end up ratifying them in the end. In addition to the Conventions and Recommendations, which are more formal, the Conference and other ILO bodies often come up with a range of codes of conduct, resolutions, and conclusions, which are merely intended to serve as informal normative guidelines and, thus, not recognized as international labour standards by the ILO Constitution (UNESCO 1998; ILO 1996-2005h).

Following the ratification of ILO Conventions is the legal obligation on the part of member States to implement them. The ILO enforces compliance with its labour standards through the use of three basic tools commonly dubbed the *sunshine*, *carrots*, and *sticks* approaches, entailing supervision, technical assistance, and disciplinary actions, respectively (Elliott 2000). The ILO has various supervisory mechanisms, the leading among which is the *regular system of supervision*, stipulated by Article 22 of the 1919 Constitution, by which each member is required to provide annual reports on the "measures which it has taken to give effect to the provisions of Conventions to which it is a party." These government reports are examined by the independent, impartial Committee of Experts on the Application of Conventions and Recommendations, which then forwards its findings to the tripartite Conference Committee on the Application of Standards, to which government representatives are routinely invited to answer specific questions.

There is also the *special system of supervision*, by which complaints could be brought by industrial association for employers or of workers (e.g., under Article 24) against members for infringing upon ILO Conventions. From time to time, the ILO uses its *ad hoc supervisory mechanisms*, involving Conference and Governing Body resolutions, Director General's Reports, special studies etc. to help draw attention to important issues regarding the implementation of international labour standards in member States. The ILO also has the option of invoking its Article 19 to request members to explain why they have not yet ratified a particular ILO Convention and to describe the measures they are taking under their national laws to achieve the goals of the Convention. In addition to the preceding supervisory mechanisms, design primarily to enhance members' transparency (or sunshine) vis-à-vis their commitment to labour standards and conventions, the ILO provides a host of technical assistance (or carrots) to members whose capacity to enforce ILO Conventions are undermined by a lack of internal technical and financial resources—examples of ILO technical assistance are provided in the next section in conjunctions with our discussion of the organization's activities over the years.

Unsurprisingly, the ILO, like other international organizations (e.g., WTO), rarely uses the 'sticks' approach to enforcement, and relies mostly on its sunshine and carrots tools. In fact, Articles 33 of the ILO Constitutions which empowers the organization to take punitive action against members was never used until March of 2000 when the Governing Body invoked it for the first time against Myanmar (Burma), following that country's long-standing flagrant refusal to comply with the ILO's prohibition against forced labour (Elliott 2000). Among other things, ILO member States were urged by this invocation to review relationships with Myanmar to ensure—by way of economic or any other actions/sanctions—that the latter does not take advantage of such relationships to perpetuate its system of forced labour. Arguably, it is the shrewd combination of these sunshine, carrots, and stick approaches, coupled with the ILO's impartial expert reviews and its time-honored principle of tripartism, which accounts for the organization's success (UNESCO 1998; ILO 1996-2005h; ILO 1996-2005i).

…Over the Years

The ILO has some 185 Conventions and 195 Recommendations (by October 2005) covering a wide variety of labour issues. Quite expectedly, the focus of ILO's activities has shifted from time to time to reflect emerging trends in the global economy and their concomitant labour needs. The very first ILO Conference (held in Washington, DC in 1919) yielded six Recommendations and six Conventions on a number of labour concerns, including the eight-hour work day and the 48-hour work week (Convention 1); unemployment insurance (Convention 2); maternity protection (Convention 3); limits to night work by women (Convention 4); minimum wage (Convention 5); and protection of young people from night work (Convention 6) (ILO 1996-2005j). During its second Conference—held in Genoa, Italy, in

1920—the ILO extended much of its 1919 Conventions to cover working conditions at sea with three new Conventions: C7-Minimum Age (Sea) Convention, 1920; C8-Unemployment Indemnity (Shipwreck) Convention, 1920; and C9-Placing of Seamen Convention, 1920 (ILO 1996-2005j). It was also around the same time that the organization initiated its publication program, with the production of the *Official Bulletin*, containing records of ILO actions; the *International Labour Review*, documenting empirical and theoretical studies on labour issues; and the *Legislative Series*, carrying translations and reprints of important labour laws.

David Morse, the longest-serving Director General of the ILO, noted in one of his Frank Pierce Memorial Lectures at Cornell University in 1968 that, by as early as 1922, opposition was mounting against the ILO from critics who believed the nascent organization was going too far too fast with its "boundless enthusiasm and explosive energy" (Morse 1969:13). Calls to restrict the organization's powers, to reduce its budget, to limit its production of Conventions and Recommendations, and to curtail its publications, coupled with tensions between employers and workers and soaring unemployment at the time, created deep pessimism at the ILO headquarters. No wonder the twelve ILO sessions in the early inter-war period, from 1922 to 1931, yielded only 15 Conventions—thus, less than the number of Conventions adopted in the first three ILO sessions (Morse 1969:13-19).

During the Great Depression of the 1930s, the burning issue on the ILO Conferences' agenda was, quite naturally, unemployment, for which the organization sought to reduce the hours of work to help spread the miniscule available work to as many workers as possible, but to no avail, due to opposition from employer groups. Nonetheless, the issue of unemployment featured in one way or another in ILO forums till the outbreak of the Second World War in September 1939. Harold Butler, who had the unenviable task of heading the organization during the Great Depression (from 1932 to 1938), was bent on broadening the ILO membership base, not only to include emerging nations of the developing world, such as Egypt (which eventually became a member in 1936), but also the United States, which refused to formally joined the ILO because of the organization's ties with the League of Nations with which the United States adamantly refused to associate (Galenson 1981).

With the onset of World War II in 1939, John Winant, the then Director-General, managed to move the ILO office to Montreal with the help of his friend McKenzie King, the then Prime Minister of Canada (Morse 1969). As alluded to by Morse (1969) and Galenson (1981), US President Roosevelt, who was exceptionally sympathetic to the cause of the ILO, turned down Winant's plea for the United States to host the ILO during the war period for fear of a political backlash from the strong isolationist camp in the United States then. With a very small staff and equally meager budget, the ILO was compelled to suspend its labour standard-setting work after its 1941 session in New York City to concentrate mainly on technical missions to the emerging nations of the developing world.

"The period after the Second World War," writes Steven Oates (2001:94), "was the most fertile of all," with much of the ILO Conventions feeding into major UN declarations and *vice versa*. The now famous Universal Declaration of Human Rights, adopted by the UN in 1948, for instance, enjoyed such symbiotic links with several ILO Conventions, including C87, Freedom of Association and Protection of Rights to Organize (1948); C98, the Right to Organize and Collective Bargaining Convention (1949); and C100, Equal Remuneration Convention of 1951 (ILO 1996-2005j). Not only that, with the 1944 Declaration of Philadelphia, the ILO was able to fortify its ideals, by, for instance, broadening the concept of 'freedom of association' to include the right to bargain collectively; by replacing its call to protect workers against sickness, accident, and old age with the more comprehensive and affirmative ideal of social security to provide not only income but also medical care; and by reinforcing its aim of preventing unemployment to embrace the broader ideals of full employment and of contributing to higher living standard (Morse 1969).

The Civil Rights Movement of the 1960s, coupled with the growing number of newly independent nations from Africa and other parts of the developing world—and the attendant increase in ethno-racial diversity and shifts in global balance of power—threw the ILO into considerable political turmoil. For instance, the Apartheid regime in South Africa was fiercely challenged by many new member States from Africa, under the leadership of Nigeria, culminating in the eventual withdrawal of South Africa from the ILO in 1966 (Alcock 1971; Morse 1969). Similarly, Portugal's labour abuses in her African colonies, notably in Angola and Mozambique, were challenged by Ghana; Israel's policies towards Arabs were equally rebuked by Arab nations, led by Iraq; and United State's military adventurism in Vietnam came under constant critical fire from the likes of Cuba and the Soviet Union at various ILO forums. No wonder, the United States—which did not formally join the ILO until as late as 1934 under President Roosevelt, eventually withdrew its membership in 1977 (for two years). The US cited various reasons for withdrawal, including an alleged disregard of due process; blatant politicization; and the abuse of tripartism by the Soviet Union and other Eastern Bloc nations (Alcock 1971; Galenson 1981).

Surprisingly, the ILO did not only weather the storms of the 1960s and beyond, but managed to enact several noteworthy Conventions, including C117, Social Policy Convention of 1962; C120, the Hygiene Convention of 1964; C124, Medical Examination of Young Persons (Underground Work) Convention of 1965; C136, the Benzene Convention of 1971; and C143, Migrant Workers Convention of 1975 (ILO 1996-2005j). Faced with growing economic hardships in many newly independent nations of the developing world, the UN declared the 1960s as its very first Development Decade with UN Resolution 1710 (XVI), adopted in December 1961 (UN 2005). The ILO seized the opportunity to intensify its technical cooperation in the developing world, by, among many other projects, assisting in vocational training, rural development and employment policy planning in Costa Rica; labour management, vocational training, and rural development in Peru; social security and manpower planning programs in Malaysia; and management training, rural development, and factory inspection programs in Kenya during that time.

Since the 1980s, and more so in the 1990s, the ILO has turned its primary attention to solidifying its foundational principles to help it deal with the social impacts of contemporary globalization, culminating in the creation of the ILO Working Party on the Social Dimension of Globalization in 1994 and the eventual enactment of the well-received ILO Declaration on Fundamental Principles and Rights at Work in 1998.

While rooted in the basic ideals of the 1919 Constitution and the 1944 Declaration of Philadelphia, this new Declaration seeks to address the labour-related angst of economic globalization in a more focused and comprehensive manner. And with this new Declaration, the ILO is evidently making a visible contribution to the many contemporary high-profile global discussions on the social effects of globalization, including the 1995 World Summit for Social Development held in Copenhagen and the 1996 Ministerial Conference of the World Trade Organization held in Singapore.

The Declaration of Fundamental Principles and Rights at Work embraces four enduring principles of the ILO: *(a)* Freedom of association and collective bargaining; *(b)* elimination of forced and compulsory labour; *(c)* abolition of child labour; and *(d)* the elimination of discrimination in employment and occupation (ILO 2004; ILO 1996-2005k; Kellerson 1998). These four principles are contained in the following eight core ILO Conventions, respectively: Freedom of Association and Protection of the Right to Organize Convention (C87) of 1948 and Right to Organize and Collective Bargaining Convention (C98) of 1949; Forced Labour Convention (C29) of 1930 and Abolition of Forced Labour Convention (C105) of 1957; Equal Remuneration Convention (C100) of 1951, Minimum Age Convention (C138) of 1973 and, more recently, Worst Forms of Child Labour Convention (C182) of 1999; and Discrimination (Employment and Occupation) Convention (C111) of 1958 (ILO 1996-2005k; Kellerson 1998). As Trebilcook (2001) points out, the Declaration has helped bring greater focus to ILO operations; enabled the ILO to mobilize external resources in support of its core principles; and, more importantly, enhanced the popularity of these core principles, even in countries which have not yet ratified the individual Conventions. Moreover, the Declaration has reinforced the interdisciplinary approach to problem-solving at the ILO, by bringing Conventions on many different subjects together under one umbrella (Trebilcook 2001).

Globalization and the ILO's Agenda for Decent Work

The accomplishment of the ILO is simply remarkable. It has remained true to its goal of promoting basic human rights and improving the working and living conditions of workers, with any opportunity it gets. Over the years, the ILO has worked tirelessly to enact and enforce several labour regulations and standards worldwide. And with its International Training Center in Turin, Italy, the ILO has provided a wide range of educational programs for over 90,000 men and women drawn from virtually all corners of the world, since the center's creation in 1965 (ILO 2001). In a similar vein, the ILO's International Institute for Labour Studies in Geneva has offered opportunities for policy research and public discussions on major labour- and employment-related issues to ILO constituents—i.e., workers, governments, and businesses.

The publication activities of the ILO have been equally impressive. In addition to the reputable *International Labour Review*, which is now published in three languages—English, French, and Spanish—the ILO produces the *Yearbook of Labour Statistics*; *the World Employment Report*; *the Key Indicators of the Labour Market;* and the four-volume *Encyclopedia of Occupational Safety and Health,* which is currently in its fourth edition (ILO 2001). Moreover, the organization has a long-standing history of technical assistance and cooperation with its member States, especially those of the developing world. Working through its extensive network of offices across the world, the ILO has assisted in the training of small- and large-scale entrepreneurs; the development of workable social security systems; the establishment of rural cooperatives; and the training of workers and trade unions in matters of occupational safety, health, and collective bargaining, among many other initiatives. And more recently, several industrial and financial companies, as well as some NGOs and trade unions (e.g., the London-based Transport Salaried Staffs Association and SOLIDAR—the Brussels-based independent international alliance of NGOs) are using the ILO Core Labour Standards to either initiate, or strengthen, their corporate social responsibility (CSR) and ethical investment programs.

While basic, labour-related human rights, such as the right to freedom of association and of collective bargaining, are enshrined in a number of international declarations (e.g., the Universal Declaration of Human Rights of 1948; the UN International Convention on Civil and Political Rights of 1966; and the UN International Convention on Economic, Social and Cultural Rights of 1966), there is no denying that these rights find their most comprehensive stipulations in ILO Conventions—hence the latter's popularity among CSR programs and ethical investment funds worldwide.

Notwithstanding these accomplishments, there is a growing realization that the organization has to do more in the light of the socioeconomic turbulence and uncertainties wrought by contemporary globalization, and the attendant changes in employment patterns, labour markets, and labour relations worldwide (Stalker 2000). Indeed, many believe that the sentiments of basic human rights, social justice, and collective social responsibility, which have long been the mantra of the ILO, are severely threatened by the globalization-induced economic restructuring that have been underway. Since the early 1980s, neo-liberal economic policies, including trade liberalization, privatization, and financial deregulation, have changed, if not undermined, the basic relationships between the ILO constituents. For one thing, these policies have accorded market forces—spearheaded mainly by multinational corporations and multilateral financial institutions such as the World Bank and the IMF—far more power than ever before, thereby weakening the power and independence of not only workers and employers, but also of governments in the process. Who can deny that the benefits of globalization are more volatile and uneven than first anticipated, accruing only to a very limited extent to regions and people who need them most (Stiglitz 2003; Parisotto 2001).

In 1999, with due cognizance of the socioeconomic uncertainties engendered by globalization, the ILO identified four "strategic objectives," using the theme of *decent work*, to help maintain its focus on improving the living and working conditions of workers. These 'strategic objectives' include efforts to: *(a)* promote the attainment of labour principles and standards; *(b)* create better opportunities for men and women to secure decent work; *(c)* broaden the coverage and improve the effectiveness of social protection for workers; and *(d)* strengthen the mechanism for social dialogue between governments, employers, and workers (ILO 1996-2005l). As the ILO rightly puts it "in an uncertain world, an organization must have a clear sense of its objective and strategies. Tactics and specific activities may have to be adjusted quickly to meet changing circumstances, but this should be done with a clear sense of purpose" (ILO 1996-2005l). With this new theme of *decent work*, the ILO is not merely aiming to create more jobs through its programs (e.g., the InFocus Program on Skills, Knowledge and Employability), but also to facilitate the creation of jobs of 'acceptable quality.' That, 'acceptable quality' jobs may vary from place to place is readily acknowledged by the ILO. However, at the end of the day, the organization hopes to use its *decent work* agenda to generate more and better jobs than before (ILO 1999).

The ILO has made the prevention of child labour one of the key ingredients of its decent work initiative, given its well-founded conviction that child labour prevents many children from acquiring the skills and education they need to secure a decent work in adulthood. In particular, the organization has mounted an intensive global campaign for the ratification of its Worst Forms of Child Labor Convention (C 182), which prohibits the use of children under 18 for illicit activities such as drug trafficking, prostitution, and the production of pornography; bans the employment of children in hazardous environments where they could be exposed to toxic chemicals, dangerous machinery, and extreme noise etc; and prohibits the use of children for forced labour, slavery, and armed conflicts (ILO 1996-2005j). A similar global campaign is underway for the ratification of the Minimum Age Convention of 1973 (C138), by which the ILO compels its members to "pursue a national policy designed to ensure the effective abolition of child labour and to raise progressively the minimum age for admission to employment or work to a level consistent with the fullest physical and mental development of young persons" (ILO 1996-2005j).

Another area which has received renewed interest under the decent work agenda is gender equity. It is reasoned that "while both men and women are affected by these trends (i.e., globalization and economic restructuring), women are more vulnerable" because of the growth of female-headed households worldwide—a phenomenon attributable in part to recent increases in intra-/inter-/, and trans-/national labour migration (ILO 1999). The ILO now has a Bureau for Gender Equity, charged with the responsibility of mainstreaming gender concerns in all of ILO's programs. This bureau—which reports directly to the Director General—undertakes gender-specific interventions, using gender analyses which may focus on women or men only, or on both sexes, depending on the particular issue at hand (ILO 1999). Arguably, there is no better way to secure decent work than to revamp the provision, coverage, and effectiveness of social security programs. And this is exactly what the ILO aims to accomplish with its recent Program on Economic and Social Security in the Twenty-first Century, under which it is urging member States to make provisions for a wide range of contingencies, including health care, income security, old age, invalidity, unemployment, injury, maternity, and death.

While the ILO seems to be in sync with the employment demands of the 21st century, much of its future success would depend not only on the continued support of its member States, from which it derives the bulk of its operating funds, but also on how well it is able enforce its standards, while at the same time adjusting its operations to the ever-changing needs of labour. In the final, though, the organization's credibility in all these matters would depend on "balancing the need to show that [it] is willing to confront larger and more powerful nations [and not only small, poor ones such as Burma] with a pragmatic concern for the limits of ILO leverage and the costs of picking fights it knows it cannot win" Elliott (2000:7). Also, the organization needs to make the withdrawal of obsolete Conventions and Recommendations a regular part of its operations (Oates 2001). The Governing Body's move to space out the requirement for annual reporting—first to every two years, and then to every 5 years, except for Conventions of great importance, where the two-year reporting requirement would remain—is also a step in the right direction. This would invariably reduce the administrative burden on both the ILO and the member States.

Better still, a system of reporting in which each member produces just one report each year, detailing all relevant information on ILO Conventions, as suggested by Oates (2001)—instead of the current situation where members report on individual Conventions separately—is worthy of serious consideration. Additionally, the ILO needs to put more resources into the development of timely, reliable, user-friendly, socially-relevant, and internationally comparable database among its member States. The need for the organization to streamline its methodological standards for variable definition, periodicity, spatial scales, and basic unit of analysis/measurement cannot be over-emphasized here.

Tripartism—the backbone of ILO operations—enjoys widespread acceptance and respect among member States and international organizations, and for good reasons. There is perhaps no better way for discussing employment and labour issues than in a forum consisting of governments, employers, and workers. In addition to helping trade unions and employer groups assert their independence (from each other and from the State), tripartism clearly offers unique insights into labour and employment issues. And it is not unreasonable to contend that labour standards produced by way of tripartite negotiations stand a far better chance of being implemented satisfactory (given the representations of labour, business, and government interests at the formulation table). At the same time, unless conscious efforts are made to strengthen the autonomy of trade unions and employer groups, vis-à-vis their dealings with the State (and now with transnational corporations, in this era of globalization), tripartism—and, implicitly, the ILO—would steadily loose its sway.

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Introduction

Conceived at the United Nations' Monetary and Financial Conference in Bretton Woods, New Hampshire, in July 1944, the International Monetary Fund (IMF or the Fund) was formally established in 1945 when 29 governments signed its Articles of Agreement. It began operations in 1947 with a membership of 44 countries (Peet 2003; Dreher 2004; IMF 2005a). Today with a membership of 184 countries, a staff of about 2,700 people drawn from some 141 countries, and a total capital subscription (or quota) of $327 billion (as of February 2005), the IMF is arguably the most powerful supranational financial institution in the world (IMF 2005b).

Like the World Bank and the World Trade Organization (WTO), the IMF was created by the West—with the United States, and to some extent United Kingdom, in the lead—to help promote peace and prosperity through international economic stability and cooperation. Communist countries were originally excluded from the organization until 1972 when Romania became a member, with China following suit in 1980. The most significant expansion of the IMF, however, occurred in 1992 when Russia and thirteen other Former Soviet Republics joined the organization (Rourke 1993).

The main impetus for the IMF's formation was the belief that both the Great Depression and the Second World War were caused, at least in part, by the international monetary instabilities, if not chaos, that characterized the decades of the 1920s and 1930s. Consequently, as originally conceived, the IMF was to maintain financial stability by granting short-term loans to countries experiencing balance of payment crisis. However, its mission has grown and undergone some adjustments over the years, all of which have given it enormous power and influence over the economies of many countries in the developing world. A corollary of this unbridled clout is the common tendency among many intellectuals, policymakers, and civil society organizations, *inter alios*, to blame the IMF—and, to some extent, the World Bank and the WTO—for nearly all the economic problems of the so-called Third World.

Objectives

According to its Articles of Agreement, the IMF has six main objectives:

"(i) To promote international monetary cooperation through a permanent institution, which provides the machinery for consultation and collaboration on international monetary problems.

ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability and maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with [an] opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members" (IMF 2005c).

Clearly, the IMF's primary functions are to foster global monetary cooperation, secure financial stability, promote international trade, and advance sustainable economic development among its members (Peet 2003; Butkiewick and Yanikkaya 2005). Thus, the organization deals mainly with policies that have a bearing on macroeconomic performance of its members, including those relating to budget deficit, trade deficit, monetary policy, and inflation.

Governance and Organizational Structure

Technically the IMF is part of the UN system, but its governance and organizational structure are different. The highest decision-making body of the IMF is the Board of Governors, made up of one governor and one alternate governor for each member. The Board of Governors, which normally meets once a year, delegates the day-to-day decision-making of the organization to the Executive Board, which meets several times each week at the IMF headquarters in Washington, DC. The Executive Board is composed of 24 Directors, who are either elected or appointed by individual member countries or a group of them, and a Managing Director, who is assisted by various Deputy Managing Directors. Selected by the Executive Board, the Managing Director serves not only as the chief of the IMF staff, but also as the chairperson for the Executive Board. The IMF also has five area departments, including those for Africa, Asia and Pacific, Europe, Middle East and Central America, and the Western Hemisphere. In addition, the organization boasts of several functional and special service departments, such as finance, legal, fiscal affairs, policy development, research and statistics, and monetary and financial systems departments at its headquarters, together with a number of information, liaison, and support service departments and institutes (IMF 2005d).

While voting on the Executive Board of the IMF is somewhat weighted on the basis of members' capital subscription, it is important to note that, as with the World Bank, each member is given 250 'basic votes' to alleviate some of the voting inequities wrought by the disparities in capital shares of its members. At the same time, there is no denying that the IMF, like the World Bank, is still overwhelmingly controlled by the rich countries of the North. At present (as of September 2005) the United States alone has as much as 17.08 percent of the total votes on the Executive Board—this, together with Japan's 6.13 *percent*, Germany's 5.99 percent, France's 4.95 percent, and United Kingdom's 4.95 percent, takes up more than a third of the total available votes on the Executive Board. Conversely, the more than forty Sub-Saharan Africa countries in the organization, for instance, have only about 5 percent of the total votes, and the situation among Latin American and Asian countries is not any better, with the notable exception of Saudi Arabia which has 3.27 percent of the total IMF votes (IMF 2005e). We must note, even if parenthetically, that efforts by oil-rich Saudi Arabia to increase its capital subscription and, consequently, its voting power, in the 1970s proved unsuccessful—suggesting that quotas, once established, are kept fairly stable, and that capable, up-and-coming countries have difficulty procuring larger IMF shares.

To promote international currency stability, the IMF, in 1969, created its Special Drawing Rights (SDRs) to support the Bretton Woods fixed exchange rate system which was clearly faltering at the time, due to dramatic weaknesses in the value of the US dollar upon which the system relied for fixed convertibility into gold. Balance of payment problems in the United States—emanating from intense global competition, high cost of American foreign adventurism (especially with regards to the Vietnam war), double digit inflation, etc.,—undermined the confidence of the international community in the US dollar (Rourke 1993), which was then pegged at a rate of $35 per ounce of gold within the Bretton Woods system. The value of one SDR was initially pegged at 0.888 grams of gold, which was then equivalent to one US dollar. After the eventual collapse of the Bretton Woods system of fixed exchange rate in 1973, with the introduction of floating exchange rates, the SDR was redefined as a basket of key international currencies, which today consists of the average value of the following four currencies: the Euro, the yen, the British Pound Sterling, and the US Dollar (IMF 2005f).

In addition to serving as the unit of account for the IMF and other international organizations and, consequently, the denomination for IMF quotas, SDRs supplement existing official reserves of IMF members. Strictly speaking, the SDR is neither a currency nor an actual claim on the IMF; rather, it serves as a potential claim on the freely usable currency of IMF members. SDR holders can obtain freely usable or 'hard' currencies in exchange for their SDRs either through a voluntary exchange between members, or through the IMF designating members with strong external financial positions to buy SDRs from members with weak external positions (IMF 2005f). As of the end of February 2005, the IMF had a total of SDR 213 billion, which translates to about US$327 billion. The United States alone held SDR 37 billion, or a quota of 17 percent, which gives it 17 percent of IMF votes (IMF 2005g).

IMF Operations

As the preceding suggests, the IMF procures its funds primarily from the contributions of its members by way of their capital subscriptions (or quotas). Members are required to pay a quarter of their quota in 'hard' or readily convertible international currency, such as the US dollar or the yen, and the remainder in their own national currency (Peet 2003). In addition to these quotas, the IMF derives some funds from internal sources, especially from interest on its loans and from two main supplementary borrowing arrangements: *(a)* the General Arrangements to Borrow (GAB), established in 1962 with eleven members, including the Group of Ten industrialized nations and Switzerland; and *(b)* the New Arrangements to Borrow (NAB), set up in 1997 with 25 participating nations. The IMF could procure as much as SDR 34 billion from these two borrowing arrangements per year if need be.

The IMF relies on three main mechanisms—surveillance, technical assistance and lending or financial assistance—to pursue its expressed goal of promoting international financial stability. IMF surveillance entails regular dialogue with, and policy advice to, its members. Data and insights from these exercises inform the IMF's regular assessment of global and regional development performances and trends captured in its well-known *World Economic Outlook* and the *Global Financial Stability Report*, published twice a year. To boost members' ability to design and implement effective economic policies, the IMF provides (free) training and technical assistance in such areas as banking, fiscal, monetary, and exchange rate policies to its members. Members experiencing balance of payment problems can usually approach the IMF for financial assistance. Often a policy program design by the IMF together with the authorities of the borrowing nation allow for the immediate withdrawal of the first 25 percent of the nation's quota, or the "first credit tranche"—originally deposited by that same nation in hard currency or gold—on fairly liberal borrowing terms. Should this amount becomes insufficient, the country can then negotiate for more resources, or for the purchase of "upper credit tranche," in hard currency; such purchases normally come with stringent conditionality set out in the various IMF loan facilities and arrangements, which include the following seven:

(i) Stand-by Arrangements (SBA): This facility allows members to borrow funds to correct short-term balance of payment problems. SBAs are normally given for a period of 12 to 18 months. For members with no outstanding credit obligations, the first 25 percent of the SBA is normally subject to very liberal conditions or what the IMF calls "first credit tranche conditionality." Beyond the first tranche, the terms get more stringent, and the borrowing nation is required to provide more substantive justification.

(ii) Compensatory Financing Facility (CFF): Created in 1963, this facility is to help members cope with temporary balance of payment difficulties attributable to exogenous shocks, such as shortfalls in their export earnings or a sharp rise in the cost of their imports. To qualify, the borrowing nation needs to show that the problem is, indeed, temporarily, and that it is the result of factors beyond its control. At first, only shortfalls in merchandise exports were eligible for the CFF, but it was expanded in 1979 to cover tourist services and workers' remittance, and broadened again in 1981 to include excess cereal import cost.

(iii) Extended Fund Facility (EFF): Established in 1974, the EFF is used for mid- to long-term financing of countries in need of structural economic reforms. It works under the assumption that balance of payment difficulties have some structural origins that require long-term structural economic changes to fix. EFF is normally granted for a period of three years, with the possibility of a year's extension. Access to EFF is subject to a limit of 100 percent of the borrowing nation's quota.

(iv) Poverty Reduction and Growth Facility (PRGF). Created in 1999 to replace the erstwhile Enhanced Structural Adjustment Facility (ESAF), the PRGF provides low interest loans to low income members of the IMF embroiled in protracted balance of payment difficulties. Eligibility for the PRGF is based on members' *per capita* incomes; as of March 2005, a total of 78 members were eligible for assistance under this facility. Qualified countries are allowed to borrow up to 140 percent of their quota, at an annual interest rate of 0.5 percent, starting 5.5 years and ending 10 years after the fund's reimbursement. The switch from ESAF to PRGF was a result of intense criticism of the IMF's Structural Adjustment Programs. As the name suggests, the IMF hopes to use this facility to promote its poverty reduction initiatives in the developing world.

(v) Supplemental Reserve Facility (SRF): Established in late 1997, the SRF provides additional short-term loans, at a relatively higher interest rate, to members experiencing balance of payment problems as a result of sudden, disruptive loss of market confidence in their economies and the consequent outflows of capital and pressure on their reserves and capital accounts. Russia, South Korea, and Brazil are among the countries which have used this facility in the past.

(vi) Contingent Credit Lines (CCL): This facility was created in 1999 to (potentially) help prevent the spread of capital account-driven crises and to serve as a buffer for members with strong economic policies to ward off balance of payment problems created by international financial contagion. The eligibility criteria for the CCL were

rather stiff: Among other things, in theory, the borrowing nation needed to pass an assessment of its economic policies by the IMF, and be prepared to pursue what the IMF considered to be satisfactory economic policies. The facility was, however, allowed to expire in November of 2003, because no member used it, as it potentially labeled them as being “in contagion”.

(vii) Emergency Assistance for Natural Disaster: This facility is to assist countries dealing with balance of payment problems arising from sudden, unforeseeable natural disasters such as flood, hurricane, and earthquake. To qualify, the borrowing nation has to provide a statement of policies that it intends to pursue with the fund, and be prepared to cooperate with the IMF in an effort to find durable solutions to its balance of payment problems. In 1995, this arrangement was extended to cover post-conflict situations (IMF 2005h).

Collaboration with World Bank and other Institutions

The IMF and the World Bank are generally seen as sister institutions, not only because both are part of the United Nations and were conceived at the same Bretton Woods meeting—hence their composite name, the Bretton Woods institutions—but also because they actually share a common goal of enhancing the living standards of people in their member countries. To attain this unitary goal, they routinely take up complementary roles, with the IMF focusing more directly on aberrations in the global financial system and balance of payment problems, and the World Bank dealing mostly with long-term economic development and poverty alleviation initiatives. The two institutions undertake several joint programs, especially since 1989 when they signed a joint concordant to formally solidify their cooperation. Among other things, the IMF and the World Bank coordinate their country assistance programs with regular meetings between their staff; conduct parallel and sometimes joint country missions; launch joint development initiatives, such as the ongoing Heavily Indebted Poor Countries (HIPCs) program and the recent Financial Sector Assessment Program; and engage in high-level coordination involving annual meetings between the Board members of both institutions.

Perhaps nowhere is the collaboration between the IMF and the World Bank more evident than in their Structural Adjustment Programs (SAPs)—recently revamped by the IMF into the Poverty Reduction Growth Facility (PRGF). In this regard the IMF provides short-term loans to help resolve the borrowing country’s balance of payment problems and, consequently, stabilize its macroeconomic situation, in preparation for adjustment-proper from the World Bank (Easterly 2005; Stiglitz 2003). The Bank, for its part, offers long-term financial and technical assistance targeting sectoral reforms, physical and social infrastructure projects (e.g., roads, hydro-electric dams, hospitals and schools) and, more recently, capacity-building, democratic governance, and anti-corruption initiatives in the borrowing country. The IMF is generally seen as the senior and more austere sibling, or the “bad cop” in this relationship—to borrow the common North American law enforcement jargon. As Robert Biel (2000 p. 235) describes it, the division of labour between the Fund and the Bank could be likened to that between two policemen (cops) interrogating a crime suspect, with the bad cop (i.e., the IMF) acting overtly brutal and overbearing, while the good cop (i.e., the World Bank) acts more friendly towards the suspect, telling the suspect how he is working in his or her interest—all in an effort to get the suspect to open up or sign the necessary papers. No wonder the Fund has been the main target of most of the rowdy SAPs-riots, until recently when it replaced its SAPs initiatives with the PRGF, following the Asian crisis of 1997.

Besides the Bank, the World Trade Organization (WTO) is the other institution with which the IMF collaborates very often—this is hardly surprising, given the two institutions' shared belief in what amounts to 'trade determinism' (Dunkley 2004:3). For instance, the Fund participates in several WTO committees and working groups and *vice versa*. Also, the WTO is required to consult the IMF on a number of issues, especially those concerning balance of payments, currency convertibility, and monetary reserves, given the latter's observership status at the former. Additionally, both institutions routinely coordinate some of their international trade-related technical assistance to nations. And, as with the Bank, the Fund maintains regular contacts with the WTO at the highest level, with the Managing Director of the Fund and the Director General of the WTO holding regular discussions on matters of common interest. Today, so powerful have the Bretton Woods institutions and the WTO become in exerting command and control in the affairs of the developing world that some critical development theorists now attribute—albeit sarcastically—divine and religious authority to them by way of such phrases as "supranational clergy" (De Rivero 2001) and the "unholy trinity" (Peet 2003). This is how De Rivero (2001:54-56) puts it:

"Today the IMF and the World Bank have acquired supranational powers to dictate and supervise the economic policies of any developing country, affecting for good or evil the daily life of every one of its citizens, without becoming accountable to anyone…such virtually exclusive dedication to the underdeveloped countries, along with the submissiveness of their governments, has transformed the IMF and the World Bank into a powerful and illuminated supranational high clergy."

In addition to the World Bank and the WTO, the Fund collaborates with several other agencies, especially those in the UN systems, including the UNICEF, ILO, UNCTAD, UNDP, WHO, and FAO, depending on the particular issue at stake. More recently, with mounting criticisms over the lack of grassroots input in its programs, the Fund has embarked on initiatives to smoothen its dealings with civil society organizations, such as faith-based associations, labour unions, NGOs, and community development organizations, through meetings, seminars, and workshops.

IMF Conditionality and Structural Adjustment in the Developing World

Most loans granted by the IMF are subject to conditionality that the borrowing country is obliged to follow to help remedy the situation that caused the balance of payment problem for which it is seeking IMF financial assistance in the first place (IMF 2005i). Over the years, loan conditionality—which only became part of the IMF Articles of Agreement in the late 1960s—has become a medium by which the IMF monitors, regulates, and controls the economic policies of developing countries. Until the early 1980s, IMF conditionality focused mainly on macroeconomic policies. But since then it has become more comprehensive, more austere, and many—including Biel (2000), Hoogvelt (2001), Stiglitz (2003), Dunkley (2004) and Chan and Grabel (2004)—would argue, more ideological, to include issues of democratic governance and institutional and market-oriented reforms couched in terms of 'neoliberalism' and the 'Washington Consensus.' The latter is a term coined in 1990 by John Williamson of the Institute of

International Economics to stress the near-religious adherence to free-market principles by the IMF, World Bank, the United States government and other Washington, DC-based institutions in their dealings with the countries of the South (De Rivero 2001:56; Khor 2001:73). Generally, governments of borrowing countries—nearly all of which are now from the developing world—are required, if not coerced, via IMF (and World Bank) conditionality to reduce their involvement in their respective national economies, by promoting 'free trade,' financial liberalization, privatization, public sector contraction, and the removal of government subsidies on utilities and social services such as healthcare and education.

The IMF now has many protocols for monitoring and assessing compliance to its loan conditionality. For instance, it uses *phased disbursement* techniques to ensure that the borrowing country adheres to loan conditionality before successive installments of loans are paid out. And with its *prior actions* package, the IMF ensures that a country agrees to take specific actions before it approves the loan. In a similar vein, it expects the borrowing country to meet a host of quantitative and structural *performance criteria*, some of which are measured by way of quantitative and macroeconomic indicators, while others are assessed by way of qualitative measures and targets, before subsequent disbursements are made. Finally, the Fund relies on a comprehensive *program review* protocol to evaluate the overall progress of its loans (IMF 2005i). The economic austerity engendered by IMF conditionality—most notably by currency devaluations, wage freezes, public sector job retrenchments, and the removal of subsidies—has been a long-standing source of popular discontent and violent riots across the developing world, as the next section would show.

IMF Riots

Clearly the IMF uses its loan conditionally to compel borrowing nations not only to take what the Fund considers to be the necessary measures to correct their balance of payment problems, and thus be in a position to pay off their debts, but also to help promote neoliberal reforms that would reduce the state's involvement in the economy. Beneath it all is the problematic assumption, on the part of the IMF and its supporters, that "Third World" countries would develop if (and, perhaps, only if) they abandon anti-market, state-driven economic models and adopt Western capitalist principles, which open up their economies to free trade and foreign investment. The IMF generally acknowledges that some of its loan requirements are austere, but generally insists that they are mere short-term 'growing pains,' justifiable for the long-term economic gains that await the borrowing nations through trickle-down economics (Stiglitz 2003).

Since the late 1970s when IMF conditionality became stringent, it has drawn massive, often violent, protest across the developing world. While some of these upheavals are directed towards national governments for accepting IMF loans and their attendant conditionality, others are orchestrated by national governments themselves either to pressurize the IMF to relax some of its requirements or to use the IMF as a scapegoat for their own economic mismanagement. Still other such demonstrations are organized by civil society organizations, students, labour unions, and the like, against both the national government and the IMF on the premise that these two entities colluded, in camera, to bring about the ensuing austerity.

'IMR riots,' as they are often called, usually begin as "food or bread riots," with people opposing sudden price increases in food items such as bread, flour, and sugar, sometimes within the context of a broader popular discontent over government cutbacks in jobs, wages and the provision of basic utilities. One of the well-known, and oft-cited, IMF riots occurred in Egypt in January 1977 when President Anwar Sadat bowed to the IMF pressure to cut subsidies that resulted in retail price increases of about 50 percent for commodities such as flour, fuel, and cigarettes. Several people were killed, as the Egyptian army put down the consequent violent riot. The government eventually recanted on the drastic cuts and used a more gradualist approach which saw the cuts extended over time, with the help of a Stand-by Arrangement from the IMF and a $US1 billion loan from Saudi Arabia and Kuwait (*The Economist,* January 22 1977:59).

Morocco run into a similar situation in June-July of 1981, when the Democratic Workers' Confederation in Casablanca mounted a rowdy protest against the government's decision to eliminate subsidies on staple food items, upon the insistence of the IMF, for a US$1.2 billion loan to help Morocco deal with its balance of payment deficit. The removal of subsidies caused the price of sugar, for instance, to increase by 37 percent*;* flour by 40 percent*;* and butter by as much as 76 percent (*The New York Times*, July 4 1981; Peet 2003:88). The estimated fatalities from this riot ranged from a low of 60 deaths, from government counts, to more than 600 deaths, from the estimates of the opposition Socialist Movement. Even though the Moroccan government publicly took responsibility for the price increases, the protest was directed as much to the IMF, which was blamed to have coerced the government behind the scenes. Like the situation in Egypt, the Moroccan government was forced to roll back the price increases, as living conditions in the country worsened. Many other African countries, including Côte d'Ivoire, Ghana, Niger, Nigeria, Uganda, and Zambia, have, one time or another, come under the spell of 'IMF riot' over the years. But it would be a mistake to assume that these upheavals are somehow confined to Africa—they are virtually ubiquitous across the developing world.

In fact, one of the very first massive IMF riots took place in Argentina in 1976, when workers in Cordoba went on strike against the government for freezing their wages to help lower its expenditure and the rate of inflation, in fulfillment of an IMF conditionality for a loan which the government sought to offset increased costs of oil imports (*New York Times* March 9 1976). Similar strikes have occurred in many other Latin American and Caribbean countries, including Bolivia, Mexico, Brazil, Ecuador, Jamaica; and in Asian countries, such as the Philippines, Indonesia, and Malaysia.

Since the 1988 mass protest at the annual meeting of the IMF and the World Bank in West Berlin, where delegates were greeted with anti-IMF and World Bank graffiti on the Brandenburg Gate, these protests have become increasingly international in character, targeting not only the high-profile meetings of IMF (and World Bank and the WTO), but also the various annual meetings of the G7/G8 and G10 nations. Thanks to the internet-enhanced organizational skills of contemporary social resistance movements, NGOs, and civil society organizations, these high-profile meetings have become the focal points of the enduring *dialectical* tensions between the North and South. Dialectical is used decidedly here, as the North-South struggle is hardly along a simple, clear-cut geographical faultline. Indeed, many of the issues involved in the struggle, especially those relating to the influence of transnational corporations; structural adjustment programs; neoliberal globalization; environmental sustainability; labour abuses; poverty alleviation; and the fight against HIV/AID, are of concern to protesters in the South as much as they are to those in the North. Also, several of the anti-IMF, World Bank and WTO riots (*a-la Seattle*) are organized, or at least spearheaded, by resistance movements based in the North, working in collaboration with their allies and chapters in the South, due primarily to the acute dearth of financial wherewithal among organizations and protesters in the latter.

There are now several (inter)national social resistance movements which consider their opposition to the IMF and kindred supranational organizations, in particular, and to neoliberal globalization, in general, as their *raison d'etre*. Notable examples are the Third World Network based in Penang, Malaysia, and its affiliate the Third World Network-Africa, based in Accra, Ghana; the Press for Change Movement in Kenya; The African Women's Economic Policy Network based in Kampala, Uganda; the Development Group for Alternative Policies, headquartered in Washington, DC; and the World Development Movement, based in London, UK.

'The New Imperialism'

Over the past decade or so, the IMF, together with the World Bank and the WTO, has become a central focus of the global North-South tension. At the heart of this discord is a concern among many critics who see the Fund as an instrument of command and control, deployed by the North to dominate the South in what amounts to a "new imperialism" (Harvey 2003; Biel 2000) or "*re*colonization" (Hoogvelt 2001:181). Critics contend that the IMF-(co)-sponsored Structural Adjustment Programs (SAPs)—which have recently been changed into the Poverty Reduction and Growth Facility (PRGF)—were nothing more than a ploy to siphon-off financial and material resources from the South to the North, through a dogmatic adherence to trade liberalization, export promotion, stringent debt service conditionality, currency devaluation, financial deregulation, and many other related economic principles, espoused within the Washington Consensus. This is how Robert Biel (2000:236) cast his understanding of this grand maneuver:

"There is an element of a new kind of planning inherent in SAPs. Neo-liberalism constantly asserts that a command economy is less efficient than the market, but this is just propaganda to undermine the possibilities of a social dialogue about what such planning could achieve. The problem for international capitalism is not economic planning *per se*, but the fact that, if this is done by the state, the latter will tend to become a repository of a significant amount of the value which the exploiters cannot lay their hands on directly. But if the allocation of resources were done directly by a sort of plan orchestrated by international institutions [e.g., IMF], there could be efficiency in gains without these risks."

In a similar vein, De Rivero (2001:57-58) laments that: "After more than twelve years of applying adjustments and reforming their markets, the great majority of Latin American, Asian and African countries are still trapped in the purgatory of neoliberal reforms, and have not managed to break free from the sins of unemployment and poverty. Their raw material exports do not fetch profitable prices, their debts continue to be a heavy burden…and productive transnational investments are not forthcoming."

Another leading critic, the Australian economist Graham Dunkley, concludes his recent opus *Free Trade: Myth, Reality, and Alternatives* (2004) with the indictment that 'free trade' is basically a myth. In his words: "the reality is that today's worldwide trust for free trade and globalization is a pro-business, ideological, politically motivated movement which ignores the extensive and 'non-consensual' economic, social, environmental and cultural costs of these policies" (p. 221-222). Richard Peet arrives at virtually the same conclusion when he writes under the pithy subheading "Questioning Faith" in his *Unholy Trinity* (2003:103) that "For us this means that the IMF adheres to neoliberal economic thought in the production of policy prescriptions on grounds of faith, rather than the foundation of proven science."

Homologous SAPs-related criticisms of the IMF (and the World Bank) have emanated from a number of predictable and not-so-predictable sources over the years. The formidable list of critics includes leading economics professors, such as Robert Rowthorn of Cambridge, Paul Krugman of Stanford, and Paul Streeten of Boston University; Nobel prizewinners for economics, such as Maurice Allais and Joseph Stiglitz; public intellectuals like the pre-eminent geographer David Harvey, the linguist Noam Chomsky, and the political economists Susan George of the Transnational Institute in Amsterdam. That is not all, reputable investment bankers of Wall Street, such as Felix Rohatyn, Warren Buffet, and George Soros; religious and philanthropic organizations, such as the Ecumenical Council of Churches, the Latin American Episcopate, and Oxfam; and even UN agencies, such as UNICEF and UNDP, have all criticized the IMF for its adjustment programs in the South (De Rivero 2001; Dunkley 2004).

Many trace the growing powers of the IMF, first and foremost, to its voting formula, which effectively gives the rich countries of the North, notably the United States, United Kingdom, France, Germany, and Japan, overwhelming clout in the organization, with the numerous country of the South relegated to the background. It is important to note, even if parenthetically, that all of the past and present Managing Directors of the Fund have been Europeans, as a result of a 'gentlemen's agreement' between the US and the Europeans, by which the former, in turn, nominates the head of the World Bank. The list of the Fund's Managing Directors over the years, at least for didactic purpose, includes Camille Gutt of Belgium (1946-1951); Ivar Rooth of Sweden (1951-1956); Per Jacobsson of Sweden (1956-1963); Pierre-Paul Schweitzer of France (1963-1973); H.J. Witteveen from the Netherlands (1973-1978); Jacques de Larosière of France (1978-1987); Michel Camdessus of France (1987-2000); Horst Köhler of Germany (2000-2004); and Rodrigo de Rato of Spain (2004-present) (IMF 2005j). Recently, the US-Europe 'gentlemen's agreement' has received sharp criticisms from the other IMF members, as a result of clumsiness and problems in recent nominations. Some opponents of the IMF also insist that with its nearly exclusive focus on the development problems of the South, the IMF has tactically diverted critical attention from the fundamental issues underlying the inequities of contemporary global capitalism and neoliberal globalization. Routinely listed among these fundamental matters are issues surrounding the capital speculation market; agricultural subsidies in the North; the lack of accountability on the part of transnational corporations and even the IMF itself; and unfair terms of trade for primary commodities in the world market.

A corollary of the North-South imbalance in bargaining power is the growing concern that the IMF interferes with the domestic affairs of its Southern members with its stringent loan conditionality. Even allegations of the Fund undermining the basic sovereignty of Southern countries abound in the available literature (Hoogvelt 2001; De Rivero 2001, Dunkley 2004; Chomsky 2001;

Stiglitz 2003; Barber 1996). So is the attack that the IMF's loans, and their attendant conditionalities, are aimed at perpetuating the subjugation of the Southern members (Rourke 1993). Opponents are equally critical of the Fund's apparent disingenuousness in compelling the poor, powerless countries of the South to embark on policies, such as balanced budget and reduced import, that even rich countries of the North could hardly accomplish (Rourke 1993).

The common criticism that IMF-induced cutbacks in subsidies and jobs sow seeds of popular discontent and instability in many developing countries is not hard to fathom, given the numerous 'IMF riots' noted above. The works of some critics, such as the sociologist Ankie Hoogvelt and political scientist William Reno, go even further to suggest that SAPs-related anti-corruption initiatives of the IMF are partly responsible for the civil wars in parts of Africa, in particular. Hoogvelt (2001, 188), for instance, observes that:

"In its efforts to get the state budget under control, the IMF has even negotiated with governments to subcontract tax collection to foreign firms. But this manner of reining in rent-seeking state and its officials dissolves the patrimonial glue that holds the society together. It brings about fragmentations as erstwhile clients are forced to seek their own benefits independent of the central authority. This hastens the collapse into warlordism."

A similar attack is readily discernable from Reno's analysis of the civil war in Sierra Leone, where he notes that the elimination of rent-seeking opportunities through structural adjustment did weaken state apparatuses and undermined state-civil relations in the country (Reno 1995).

As with all controversies, there are those, especially IMF (and World Bank) staffs, who argued contrapuntally by singing the praises of SAPs in such countries as Ghana and Uganda, in particular, and of free-market enterprise in general (Devarajan, Dollar, and Holmgren 2001). Additionally, some champions of the IMF are quick to note that the Fund does not force any country to borrow or adopt its policies, and that it is the leaders of these Southern nations who ultimately decide on whether to take the Fund's loans or to leave it. Fair enough, but given the Fund's exclusive focus on the development problems of the South over the last three decades or so; the acute powerlessness of the Southern members in the operations of the Fund; the growing list of conditionality and protocols for surveillance and compliance; and yet the increasing poverty and debt-burden in the South, it is not unreasonable to attribute some blame to the Fund, just as in the interest of a balanced attribution of culpability one could plausibly blame the mismanagement, corruption, and leadership problems of the South for some of the economic development woes in that part of the world.

Since the Asian financial crises of 1997—which led to sharp declines in the currencies, stock markets, and other asset prices of countries such as Thailand, Indonesia, South Korea, Hong Kong, Malaysia, and the Philippines, and later rippled through the global financial market with major contagion effects in Brazil, Russia, the United States, and many other countries—IMF (and World Bank) initiatives, especially those relating to financial deregulation under SAPs, have come under intense scrutiny and criticism. Many critics blamed the IMF for the Asian crisis, on grounds that the organization encouraged the so-called Asian 'tigers' not only to liberalize their financial sector, but also to peg their respective national currencies to the US dollar and to maintain high domestic interest rates in a move to attract foreign capital for their 'fast track capitalism.' This, critics argue, exposed the

Asian countries to excessive speculative capital investment under an equally excessive regime of financing/banking deregulation, which led to overinvestment in the short-term, high-yield, high-risk sectors of the economy. In 1998, mounting anger over the Asian crisis compelled no less an entity than the US Congress to debate, quite spiritedly, on whether or not to authorize an additional funding of some $18 billion to replenish the IMF, whose funds were virtually depleted by the multi-billion-dollar bailouts engendered by the Asian crisis and its aftermath.

The debate culminated in the establishment of the International Financial Institutions Advisory Commission by the US Congress in 1999 to report on the activities of the IMF, the World Bank and other international institutions (e.g., the Inter-American Development Bank, the Asian Development, the African Development Bank). Among other things, the Commission's final report (commonly known as the *Meltzer Report*, after the Carnegie Mellon University economics professor, who chaired the commission) called for a comprehensive review of the financial procedures of the Bretton Woods institutions. It also recommended that the IMF restricts its lending to the provision of short term, collateral-based, high interest loans to emerging economies, while the World Bank focuses mainly on grants, as against loans, for poor countries, with the two institutions avoiding duplication as much as possible.

With its efficiency—and, to some extent, its credibility—long under the microscope, the IMF has begun to take a critical, reflexive look at its operations, with new programs for change. One such initiative is the replacement of its erstwhile Enhanced Structural Adjustment Facility, with which most of its SAPs were funded, by the current Poverty Reduction and Growth Facility (PRGF). This shift occurred in 1999, following intensive internal evaluation of IMF operations in response to criticisms and negative public perceptions of the organization. With the PRGF, the IMF is now making poverty reduction a centerpiece of its operations in developing countries, and also moving away from its dogmatic adherence to neo-liberalism to an emerging post-Washington Consensus paradigm, which places more emphasis on capacity building, democratic governance, transparency, public participation, and the mobilization of social capital, civil society, and diasporic resources. Also, the IMF seeks to use the PRGF to assert greater country ownership of its programs.

Another important program in this regard is the Heavily Indebted Poor Countries (HIPCs) initiative, which was first launched in 1996 as HIPCs I in response to massive public outcry and some 'internal' advocacy (led by James Wolfensohn, the then President of the World Bank) over the debt-service overload on poor countries. Under the provisions of HIPCs I, the IMF and the World Bank—working with the donor community—hope to reduce the foreign debts of poor countries to manageable levels. The initiative was augmented in 1999 under HIPCs II—mostly in response to demands by *Jubilee 2000* (J2K)—to make poverty reduction the main priority of HIPCs. To date, HIPCs package worth some US$32 billion has been approved for 27 poor nations, 23 of which are from Africa (IMF 2005k). The Gleneagles Declaration of 2005, is yet another program by which the IMF and the World Bank—after some discernable foot-dragging—are working with the G7 (or G8 minus Russia) to write off more than US$40 billion worth of Africa's foreign debt in support of the continent's fight against poverty and the scourge of HIV/AIDS.

It would be nothing short of a grand omission to discuss the IMF's recent image-, credibility-, and efficiency-building initiatives without mentioning the establishment (in 2000/01) of its Independent Evaluation Office (IEO), charged with the responsibility of "enhancing the learning culture of the IMF...; helping to build the IMF's external credibility by underdaking objective evaluations in a transparent manner; …and promoting greater understanding of the work of the IMF" (IMF 2001:1). The growing dialogue between the IMF and various (inter)national civil society organizations is also part of the IMF's newfound appreciation for the need to listen to, and learn from, the public. In the final analysis though, the IMF would continue to be embroiled, perhaps justifiably, in a cloud of negativity, unless it is able to help reduce poverty and deprivation to perceptibly low levels in the developing world—after all, that is what it purports to do with its new lending facilities, the Poverty Reduction and Growth Facility.

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Lender of Last Resort: International

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Introduction

The consolidation of the position of the Bank of England as the regulator of the monetary and financial system in Great Britain after the 1844 Sir Robert Peel's Bank Act, led to Walter Bagehot's (1873) defence of the lender of last resort (LOLR) function. The famous Bagehot principle—'lend freely at a high rate against good collateral'—was indeed an extension of the advice given by Henry Thornton (1802) during the bullionist debates.

The LOLR is directly related to the role of a central bank during a financial crisis. The idea of an international lender of last resort (ILOLR) is more recent, and Charles P. Kindleberger (1978) may be considered the main defender of the idea, even though Keynes's original plan for Bretton Woods did foreshadow some of Kindleberger's ideas.

This entry will first discuss the development of the LOLR in domestic markets, and its extension to international markets. It will then discuss whether an international LOLR is needed in light of the recent international financial turmoil, and whether the International Monetary Fund (IMF), the Bank of International Settlements (BIS) or some other institution would be better equipped to perform the ILOLR function. Finally, the lessons from the series of international financial crises for the need (or not) of an ILOLR are evaluated.

Lender of Last Resort

As we already said, Walter Bagehot—the famous nineteen-century editor of The Economist—suggested that the Bank of England should in a situation of crisis in financial markets lend freely to those that had collateral. The interest rate should be punitive, i.e. high to avoid overuse of the LOLR facility by financial markets. The LOLR function would then solve problems of liquidity, and should not be used to rescue insolvent economic agents. For that reason only those agents with collateral—which were not insolvent—should receive help from the monetary authority.

These rules were effectively put into place in Great Britain during the late nineteen-century, in particular after the Overend Gurney Company failure in 1866, when the Bank of England actually accepted its role as LOLR (Bordo 1990). For example, when the Barings Brothers house overextended itself in Argentinean Bonds and almost went bankrupt in 1890, the Bank intervened, since Barings failure would put in risk the whole City.

In the US after the demise of the Second Bank of the United States during the Jackson's administration there was no monetary authority, and, hence, no LOLR. Towards the end of the nineteen-century the House of Morgan acted informally as a LOLR, but the arrangement was certainly precarious. The Federal Reserve Board (Fed) was created in 1913 to a great extent to serve as a LOLR after the 1907 panic. In recent years the most famous intervention was associated with Long Term Capital Market (LTCM) rescue coordinated by the Fed in 1998. Bordo (1990) suggests that in the UK, the US and other developed countries, there is historical evidence showing that the classic LOLR function has been effective in reducing financial instability.

The conventional view, on should note, is that financial markets are efficient (Malkiel 1973) and, hence, runs on banks and other institutions are relatively rare. In that sense, the LOLR function is a tool that should be used rather infrequently. Asymmetric information in financial markets, which generate imperfections in the interbank lending market are seen as the main reason for a LOLR.

The main problem in the application of the classic LOLR function is how to distinguish between illiquid and insolvent financial institutions. Also, it is important to characterize whether the failure of the institution in question will have systemic effects—leading to additional failures—or will be self-contained.

Goodhart (1999) argues that the notion that a central bank can distinguish between illiquidity and insolvency in the time frame of a crisis is a myth. In fact, he suggests that the fact that a financial institution voluntarily demands the intervention of the monetary authority implies that it should be treated as insolvent. In other words, only an insolvent institution that is unable to obtain funds from other source will demand the help from the central bank.

In this case, the monetary authority should extend the LOLR to save insolvent institutions, instead of just illiquid ones as suggested by the classical LOLR doctrine. Goodhart also emphasizes that the ability of the central bank to engage in the LOLR activity is ultimately limited by its ability to lend, and, hence, is constrained by the taxing capacity of the State.

Minsky (1986) exposed a different view of the functioning of financial markets, one that would lead to a different perception about the need for a LOLR. Minsky divided the finances of economic agents in three groups, namely: the hedged that could pay principal and interest on its debt out of income flows; the speculative, that could repay interest, but not principal; and the Ponzi, that could pay neither.

Further, Minsky (1986) argued that the development of Keynesian policies—with its automatic stabilizers—in the post World War II period created a safety net that made economic agents more complacent with indebtedness, and with more fragile finance structures. As a result the economic system became more vulnerable to real and monetary shocks. In contrast to the conventional view, financial markets in a Minskian perspective are prone to crisis. As a result, central banks are forced to act as lenders of last resort more or less on a regular basis. In other words, the monetary authorities accommodate the monetary needs of the economic system. The Minskian view is similar to the real bills doctrine—exposed by Adam Smith—to the views of Thornton, and the Banking School, and to the more recent horizontalist views exposed by Nicholas Kaldor and Basil Moore (Rochon & Vernengo 2001).

The reaction against the increasingly accepted importance of the LOLR function came from the so-called free banking doctrine. Initially advocated by Friedrich Hayek the school found in Dowd (1988) its most forceful advocate. The proponents of free banking negate the need for any monetary authority and, as a result, the need for a LOLR. The belief is that a system without a central bank would promote risk averse behaviour among financial institutions, and lead by itself to amore stable financial market.

A general problem associated with the LOLR function that is accepted by defenders and critics alike—even if there is a divergence regarding its importance—is the question of moral hazard. That is, the fact that the monetary authority acts as a LOLR may lead to more reckless behaviour and to financial crisis prompting the LOLR to be abused. Critics believe that moral hazard in itself constitutes a severe indictment of the LOLR activities, while defenders tend to argue that regulation of financial agents' activities may reduce the abuse of LOLR interventions. Further, defenders tend to believe that LOLR interventions are a second best solution, but no other alternative is available. Finally, one should add that defenders of the LOLR function believe that systemic risk—the risk of a financial crisis affecting most, or even the whole, financial system—is a justification even in the face of moral hazard problems.

An International LOLR?

It is clear that no international lender of last resort *strictu sensu* has ever existed, since no international monetary authority ever existed. However, Kindleberger (1973) suggested that the monetary authority of the hegemonic power has in effect acted as an ILOLR in several periods, maintaining international financial stability. In other words, even though there is no international currency, the central bank of the most widely used currency can act as an ILOLR. In this respect, the Bank of England could be seen as the ILOLR during the classic Gold Standard period roughly from the 1870s until the World War I. The Bank of England stabilized the system by acting as the lender of last resort, ensuring the coordination of macroeconomic policies, and providing counter-cyclical long term lending.

The central role of the City of London as the financial center of the world allowed the Bank of England to manage the international monetary system. The London City could lend long and borrow short, functioning as the banker of the world. Whenever the exchange rate fell to the gold export point, an increase in the bank rate would avoid the outflow of gold. The command over gold flows was asymmetric, since changes in the interest rates of other countries had less effect than the Bank of England's discount rate.

Kindleberger (1973) argues that the instability of the inter-war period was related to the absence of a benevolent hegemon that could act as the ILOLR, England being incapable and the US unwilling to take this role. In particular, in the series of financial crises that occurred in Austria, Germany and France in the wake of the depression, the Bank of England was too weak to come to their aid. It was only after the war and the Bretton Woods agreement that a new hegemonic power would be able and willing to act as the world's ILOLR.

The Bretton Woods system, however, was less than perfect in terms of providing international liquidity for distressed financial institutions and countries. In particular, most of the costs were imposed on deficit countries rather than on the surplus countries, a situation that Keynes criticized in his proposal for reorganizing the world's international financial system Davidson (2000). In fact, Keynes favoured the creation of an International Clearing Union, a sort of world central bank that would oversee the creation of international credit.

During the Bretton Woods period the institution designed to provide liquidity in cases of distress was the International Monetary Fund (IMF), which, however, was not equipped to be a central bank for central banks. In that sense, as noted by Fisher (1999), the IMF has undertaken certain ILOLR functions in concert with other institutions. The IMF's inability to create high-powered money with international acceptance meant that is role as an ILOLR could be limited at best (Capie 1998). This problem was only partially addresses by the creation of Special Drawing Rights (SDRs) in the late 1960s. Recently the mega speculator George Soros proposed a SDR plan that would imply the issuing of 21 billions of SDR (roughly US$27 billion), doubling the current stock to fund international assistance (Soros 2002).

Although not originally thought with that purpose, the SDR proposal would enable the IMF to act as an ILOLR. However the possibility for such a proposal to be accepted by the key countries within the IMF is extremely unlikely, even if the IMF has expanded the scope of its activities and has moved closer to an ILOLR position in recent years.

Originally the IMF only provided temporary loans to resolve balance of payments problems using the traditional stand-by loans in which conditionality was limited. The first time that the IMF experimented with conditional lending was in a stand-by arrangement for Peru in 1954, which was made conditional on Peru promising too keep its exchange rate stable and sustainable.

In the 1960s a new credit line for countries with temporary shortfalls in exports was introduced, the so-called Compensatory and Contingency Financing Facility. In the 1970s the IMF introduced a Trust Fund to lend to poor countries at low interest rates that after several changes was renamed in 1999 as the Poverty Reduction and Growth Facility. In 1975 the Extended Fund Facility for countries with structural payments problems was implemented. This framework remained relatively unchanged until the Asian crisis, when the role of the IMF started to be discussed more intensively.

Two new credit facilities were implemented, namely: the Supplementary Reserve Facility (SRF), and the Contingent Credit Line (CCL). SRF provides a contingent short term line of credit for countries pursuing strong IMF approved policies. This facility could be drawn upon in times of need and would entail market interest rates along with shorter maturities and the facility might be accompanied by appropriate private sector involvement.

The SRF credit line results from IMF responding to demands from the richest countries, and deciding to impose even greater demands for countries with economic difficulties who requested aid parcels that surpassed their limits at the IMF. Now, when a country surpasses its limits and requests more aid, it must go through this special mechanism called the SRF. Through the SRF, the country will incur greater costs and shorter deadlines for payment. In these cases, the IMF demands detailed reports about the situation of the country and an evaluation of the sustainability of its debts.

This toughening of standards had been requested by the rich countries since the Asian crisis in 1997, when the resulting turbulence resulted in unrestrained international financial speculation that led many countries to insolvency, which contributed to a great rush to the IMF in search of help. Arguably, this assistance is backfiring for many nations who lose their sovereignty and remain with little chance to have an economic policy that meets the needs of their people.

The CCL is designed for countries that do not run the risk of a balance of payments crisis of its own making. That is, if a country may get into trouble because of contagion, even when fundamentals are seen as appropriate by the IMF, then they could apply for CCL assistance. CCL was clearly designed as a result of the new view according to which balance of payments crises can be self-fulfilling and have no connection with underlying fundamentals.

Conditionality for CCL is, as much as in the case SFR, stringent. First, countries are expected to have no need for IMF resources, and fundamentals (fiscal balance, economic growth, inflation, international reserves, and current account balance) must be positively assessed by the IMF staff. Constructive relations with international financial markets and a commitment to adjust policies to international standards are seen as essential in reducing future contagion problems. Also, one must note, commitment to CCL is short term, and funds would be made available for up to one year.

All in all, even though the IMF has moved closer to an ILOLR position, it falls short of it. Resistance to—as we will discuss later—makes it less likely that an extension of ILOLR activities by the IMF may increase in the near future. However, other alternatives to the IMF do exist.

Dollarization—seen not only as the adoption of the dollar, but more generally as a tendency towards fewer currencies—has been seen as a solution for several problems from inflation to and foreign exchange risk to stagnation (Vernengo 2004).

One question that is not often raised with respect to dollarization is that by promoting the use of the same currency across borders it would facility the development of an ILOLR institution. This is certainly the case in Europe, where the adoption of a common currency means that countries in the European periphery would have access to liquidity provided by the European Central Bank (ECB). On the other hand, dollarizing countries in the rest of the world—particularly in Latin America, e.g. Ecuador, El Salvador, Panama—will most likely still depend on the IMF and other multilateral organizations.

Eatwell and Taylor (2002) suggest that the only way to reduce international financial crises is to create a new World Financial Authority (WFA), which would fall short of being a world central bank. The WFA would, in fact, act as clearing house for information, and a regulator of financial markets, as much as the Security Exchange Commission regulates the securities market in the US. The proposal implies that the Bank of International Settlements (BIS) should be the springboard for the WFA. The preventive activities of the WFA by reducing financial instability would in effect diminish the need for an ILOLR.

Critics of ILOLR activities, as much as critics of domestic LOLR action, point out that moral hazard is the main problem to be dealt. However, as noted by Fisher (1999), "moral hazard is something to be lived with and controlled, rather than fully eliminated."

Lessons from Recent Financial Turmoil

In December 1994, after a decade of external liberalization that culminated in the North American Free Trade Area (NAFTA), Mexico was hit by the so-called Tequila crisis. Several important players in Wall Street were deeply committed to Mexican assets, and the then Treasury Secretary Robert Rubin—a Wall Street man himself—believed that systemic risk demanded an ILOLR intervention. However, the size of the bailout meant that the IMF could not go alone and that an American rescue package would be needed.

Pressure in the American congress against what was seen as a Wall Street bailout paid by taxpayers meant that some alternative had to found. The solution came from a little known Exchange Stabilization Fund (ESF), and a package designed by the then under secretary of the Treasury Lawrence Summers.

The Exchange Stabilization Fund (ESF) holds more than $40 billion that is at the disposal of the US Secretary of the Treasury for use in foreign exchange intervention and ILOLR operations (Henning 1999). Its use in the Mexican rescue package of 1995 displayed the Clinton administration willingness to act as an ILOLR. The ESF has been deployed in Brazil and in several Asian crisis countries as well.

The IMF intervened in all the subsequent international financial crises in East Asia in the second half of 1997, in Russia in August 1998 and in the Brazilian crisis of January 1999. However, by then critics of the ILOLR approach argued that several of the crises that followed the Tequila one were caused by moral hazard, and that the IMF was making things worse.

The Meltzer Commission—named after Allan Meltzer, a monetarist economics professor at Carnegie-Mellon University—was established to analyse the role of the international multilateral institutions. One of the main conclusions of the report was that the IMF should be reduced in size and scope and should return to the classical practice of acting as a 'quasi' (sic) lender of last resort to solvent emerging economies. In particular, the report argued that middle income countries should not be bailed out by the IMF since they would have access to international financial markets. This position seemed to have support within the emerging administration of George W. Bush, and would have serious implications for the next middle income country to get in trouble.

Argentina had been a role model of external liberalization for more than ten years. It was generally acknowledged as an example to be followed by other emerging countries (Dornbusch 1997). However, ever since the Tequila crisis the Argentinean economy had stagnated. The problems were not altogether unpredictable. A fixed and overvalued exchange rate was used to stabilize domestic prices at the price of increasingly unsustainable current account deficits. Everything was fine while international financial markets lent money, but after the Tequila and Asian crisis only a domestic recession could help reduce the current account deficits.

The expectations of devaluation increased considerably. A small change in expectations was all that was needed to get investors running for the exit. In December 2001 the IMF refused to extend part of a loan, since Argentina had not complied with conditionality. The result was the default, and then devaluation, increased recession, and eventually the fall of the administration.

It is not clear cut that the change in the IMF behaviour is associated with the criticism coming from conservatives in the US, or whether the new Bush administration had a direct role in making the IMF less prone to act as an ILOLR. However, it is clear as Michael Mussa (2002)—the ex-chief economist at the IMF—claims that the IMF must learn from the Argentinean debacle if it intends to keep a relevant role for the international community.

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Microfinance

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Introduction

Microfinance has gained much attention from various social activists, business-people, academics, national governments plus multinational organizations such as the UN, the World Bank and the Asian Development Bank. Having a close link with the unbankable classes of population, microfinance gives a promise to fight against global poverty. The United Nations declared 2005 as the International Year of Microcredit, from which an increase in worldwide access to microfinance is expected to contribute to the Millennium Development Goals. The promise was further increased when the founder of the Grameen Bank, Dr Muhammad Yunus, received the Nobel Peace Prize in 2006.

The microfinance movement begun to emerge in the 1960s, when developing nations actively engaged in agricultural modernization through delivering subsidized credit to poor farmers. However, the result of such credit programs was disappointing in terms of massive default, mistargeting, and failing to increase the income of the poor. As a response, by the mid-1980s the 'Ohio School', as they came to be known, promoted a demand-side approach. Unlike subsidized credits, this approach proposes that microfinance programs should be client-responsive and not supply-driven processes. This approach also emphasizes that saving mobilization should be seen as equally important as providing loans to the poor. Savings have a dual function of ensuring loan repayments in the absence of collateral, and as sources of funds to enhance lending capacity of microfinance institutions (MFIs).

Since the early 1990s, the microfinance approach has advanced toward the importance of commercial-based practices of microfinance institutions (MFIs). Microfinance commercialization can be undertaken through transformation into banking-type MFIs, as in the successful metamorphosis of microfinance NGO, PRODEM into Banco Solidario (BancoSol) in Bolivia in 1992 (Ledgerwood and White 2006). The successful performance of the BRI-unit system in Indonesia also supports the advantage of having commercial-based practices of MFIs. Nowadays, the commercialization approach has gained much support from many microfinance scholars and practitioners, including international donors such as The World Bank and Asian Development Bank. This approach has become a mainstream development practice of microfinance operations across countries. In 2000, for instance, about 39 microfinance NGOs were transformed into commercial microbanks covering Bolivia, Colombia, Dominican Republic, Mexico, El Salvador, Peru, Cambodia, India, Bangladesh, Mongolia, Nepal, Pakistan, the Philippines, Uganda, Kenya and South Africa (Fernando 2003).

Definitions and Objectives

The term microfinance has been differently articulated by microfinance scholars and practitioners. The narrow definition of microfinance refers to microcredit schemes to poor people. As Lashley (2004 p.86) states, microfinance is "lending small amounts of money for enterprise development to achieve a sustainable rise in incomes above the poverty line". Such a definition ignores two important aspects of microfinance: saving services and loans for consumption purposes. In dealing with poor clients, saving mobilization is perceived important to ensure the repayment of non-collateral loans. Microcredits are not only utilized by the poor to finance production activities, but also to smooth consumptions in response to sudden falls in incomes due to sickness, death and harvested failures.

At a broader level, Christen et al. (2003 p.6) state that microfinance refers to as the provision of banking services to lower classes of the community covering the very poor, moderately poor and low-income people. Microfinance clients are not just micro-entrepreneurs, but a whole range of poor clients who utilize financial services to manage emergencies, acquire household assets, and finance social obligations. Microfinance services thus go beyond microcredit to include savings and transfer services. Microfinance also refers to as 'an industry' because it covers a wide range of institutional providers, including the microfinance unit of commercial banks, microbanks, pawnshops, microfinance NGOs, credit cooperatives, and a variety of informal MFIs such as rotating savings and credit associations (ROSCAs), moneylenders, landlords, traders, friends, and neighbors providing small-scale loans to poor people. These MFIs have different operational characteristics in terms of scale, method, targeted clients and sources of financing. They also operate in different regulatory environments. While financial services of microbanks should comply with prudent banking supervision and regulations, moneylenders and ROSCAs operate without formal legal structures.

Providing financial access to poor clients is the core objective of microfinance operations. The ultimate target is to reduce poverty. In this regard, MFIs should accomplish the triangular objectives of (a) maintaining operational profitability, (b) deepening outreach, and (c) enhancing the welfare impact of microfinance on poor people. The profitability objective means that microfinance practices should generate sufficient profits to cover operational costs of serving poor clients. Failure to generate profits will lead to the bankruptcy of MFIs. Apart from maintaining profitability, MFIs should deepen their financial services to a number of poor people; the outreach objective of microfinance. It follows that greater access to microfinance can improve the welfare of the poor. Yet, studies on the impact of microfinance on poverty alleviation result in mixed conclusions. For instance, a study of MFIs in Bangladesh by Khandker (2003) reveals that microfinance can reduce extreme poverty. In India microfinance programs are found to increase the income of poor clients above the poverty line. In Thailand Kaboski and Townsend (2005) point out that microfinance services accelerate the asset growth of poor clients, and help them to smooth household consumption. In Bolivia Mosley (2001) has found that microfinance reduces poverty through the growth of incomes and assets of poor clients. However, Coleman (2002) reveals that microfinance has no impact on asset and income of the poor clients in Thailand. The positive economic impact of microfinance is greater for non-poor than the poor clients. Duong and Izumida (2002) reveal poor people face various difficulties to access microcredit in Vietnam. Amin et al. (2003) show that microfinance tends to exclude very poor clients, but it is successful at reaching the better-off poor. Datta (2004) argues that microfinance programs tend to exclude the poorest of the poor, as they are deemed to be risky borrowers.

Heterogeneous Clients of Microfinance

Microfinance clients are heterogeneous in many respects. In terms of income, microfinance clients can be classified into three types. The first is very poor clients with incomes near or below the poverty line, such as landless laborers of farm and non-farm activities. Because they have low and unstable incomes, they utilize microfinance services to mainly finance household consumption. The second is not-so poor clients who have incomes at or slightly above the poverty line. They include petty traders, small-scale manufactures, and low-level government officials. This group of clients utilizes microfinance services to support production and consumption. The third group is the non-poor clients consisting agribusinesses owners, landlords, small traders, and medium-level government employees. Having higher levels of education, permanent incomes, and collateral, they often demand greater loans and financial services, and are more likely to be clients of microbanks.

Microfinance clients also have heterogeneous motives in utilizing financial services. Apart from financing production, access to loans facilitates the poor to smooth consumption. It is evident that the poor utilize loans to avoid household financial distress due to unpredictable shocks such as death, sickness, and laid-off. However, the utilization of microfinance services is also motivated by the willingness of the poor to improve human and social capitals. Access of the poor to finance can improve human capital through fulfilling the basic needs of wellbeing such as primary health, nutrition and child education. Access of the poor to finance enhances income, fixed assets, female participation, and cognizance of the importance of education and nutrition. Empirical evidence indicates that microfinance programs help poor mothers improve the education and nutrition of children (Pitt at al. 2003).

It is increasingly recognized that the demand of microfinance is motivated by the willingness of the poor to build up social capital through enhancing social networks, friendship and maintaining familial relationships. Building up social capital is vital as the capacity of the poor to engage in self-insurance is limited by low income and assets. When incomes are low, saving capacities of poor people diminish as does asset diversification. Poor people, then, rely on informal risk-sharing arrangements such as ROSCAs, and reciprocal lending among relatives, neighbors and friends, in order to access microfinance services. In emergencies, such as the urgent need for medications, borrowing from friends and neighbors) can act as a ‘liquid insurance substitute’ for the poor. Such reciprocal lending and borrowing among poor households are the way they respond to the financial exclusion from banks, while insurance market and social safety net are lacking.

However, the heterogeneous clients of microfinance imply that poor people do not have the same access to finance; they face financial constraints of varying degrees. While some poor borrowers are fully served by microbank loans, many others are marginally and fully constrained. Following the prominent work of Stiglitz and Weis (1981), this phenomenon is widely recognized as a problem of credit constraint in microcredit markets. In the microfinance literature the term credit constraint refers to as a condition when unsatisfied financial demand exists because microbanks are unwilling to serve poor borrowers at a given rate of loan interest. This definition emphasizes that the problem of credit constraints emerge from the supply side, as microbanks cannot precisely recognize the creditworthiness of poor borrowers. Gathering information on the creditworthiness of the poor is problematic due to the heterogeneous nature of their business, inseparable production and consumption activities, and the poor lacking appropriate accounting reporting and insufficient collateral. As a result, microbanks have no incentive to serve poor borrowers through raising interest rates. The logic is that at higher rates of loan interest lenders face adverse selection problems in the sense that mostly ‘risky’ borrowers are willing to borrow, while ‘safe’ borrowers are driven out of credit markets. Hence, there will be high interest rates above market clearing equilibrium, leading to unfulfilled demand for loans. As such, microcredit supplies are rationed constraining financial access of the poor.

However, the problem of credit constraints involving the world poor can also arise from the demand side. In the absence of credit insurance many poor borrowers with sufficient collaterals do not apply to microbank loans because they are unwilling to take the risk of losing collateral (e.g., farmland). A lack of entrepreneurship can be due to subsistence production discouraging the poor from taking the risk of gaining loans from microbanks. The poor are also reluctant to apply microbank for loans due to low levels of education, leading to incomplete knowledge of banking procedures. Because of having limited knowledge of banking procedures, the poor can face unpleasant experiences at microbanks. Microbank lending officials often lack incentives to help the uneducated poor to understand the term and conditions of the loan contract. As such, microbanks are said to be *psychologically and socially* far removed from poor clients.

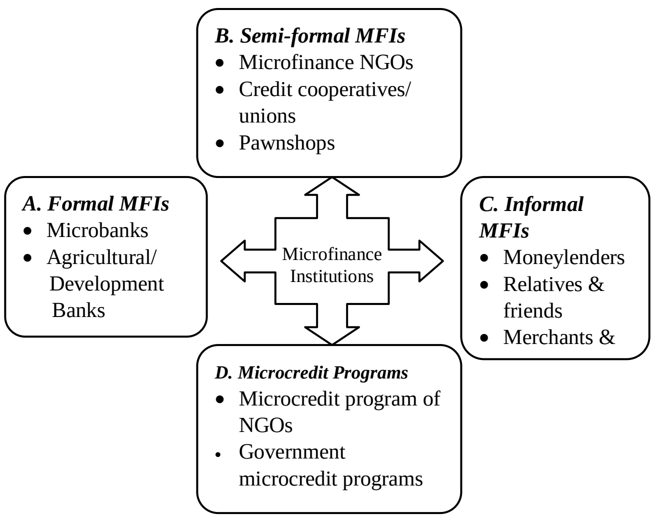
Heterogeneous Microfinance Institutions

MFIs are heterogeneous covering a wide array of institutions. Figure 1 differentiates between four types of MFIs: formal, semi-formal, informal and microcredit institutions. Formal MFIs include microbanks, and microcredit units of commercial banks and development banks. Financial services of formal MFIs are subject to all relevant laws including banking supervision and regulations. Microfinance services of semi-formal MFI are subject to relevant laws, but they are excluded from banking supervision and regulations. They include microfinance NGOs, credit cooperatives and pawnshops. Informal MFIs consists of various institutions, including lending from kin, friends, neighbors, moneylenders, and rotating saving and credit associations (ROSCAs). Microcredit systems include various microcredit programs of NGOs and the government.

The financial authority of developing countries often gives a special license to microbanks specialized in microfinance services, such as the Bank Perkreditan Rakyat (BPR) or people’s credit banks in Indonesia, the Philippines Rural Bank, Nigerian Community Bank, Ghanaian Rural Bank and Chinese Rural Credit Cooperatives. Many developing nations also have established state-owned development/agriculture banks, specifically to promote agricultural production. These are often used by the government to deliver microcredit programs to the poor, such as the Bank for Agriculture and Agricultural Cooperative (BAAC) in Thailand, as well as the Vietnam Bank for Agriculture Development (VBARD). Moreover, commercial banks have become more active in microfinance business since the late 1990s. They include private and state-owned commercial banks providing financial services through microfinance units to micro and small-scale clients. For instance, the largest private bank in Sri Lanka, the Hatton National Bank Limited (HNBL), began to establish microfinance business units by the late 1990s. The State Bank of India, the largest bank in India, has provided microcredit schemes through establishing self-help groups of small borrowers in rural and urban areas. In the global context, the Deutsche Bank of Germany has actively supported microfinance movement through setting Microcredit Development Fund in

1998. The Dexia Bank supported MFIs through a microfinance foundation called the Blue Orchard. ABN AMRO in collaboration with the Acción international has set up microcredit units, ABN Real *Microcredito* in Brazil (Ferro 2005).

Figure 1. Heterogeneous Microfinance Institutions



In the category of semi-formal MFIs, microfinance NGOs are at the forefront of providing financial services to poor clients. They are often officially licensed as non-bank financial institutions, such as credit unions, cooperatives and village banks. Microfinance NGOs have gain momentum across developing countries since the 1980s. The World Bank's survey of MFIs in 1996 revealed that about 73 percent of total MFIs worldwide were registered as microfinance NGOs, while commercial banks and microbanks accounted for less than 10 percent. More recently, CGAP (2004) reveals that the loan portfolio of microfinance NGOs has reached to 33.0 percent of total outstanding microloans worldwide.

Microfinance NGOs can be sub-divided into three types. *The first* is global NGOs with a special focus of promoting microfinance around the world through their branches and affiliates. These NGOs include the Acción of Latin America, Pride Africa, Foundation for International Community Assistance (FINCA), Oikocredit, Food for the Hungry in Uganda, Kenya and Ethiopia, the International Network of the Grameen Bank replications, the Opportunity International Networks covering Zambuko trust in Zimbabwe, TSPI in the Philippines, UGAFONDA in Uganda, and others.

The second is global NGOs that have microfinance programs along with other social and empowerment activities, including Unitarian Univerasalist Congregations, Catholic Relief Services, Plan International, World Vision, Christian Children Fund, Save Children, CARE, and ActionAid. These NGOs have undertaken microfinance programs in parallel with social, religious and empowerment missions across developing countries.

The third is various national/local NGOs, among others, including the Center for Agriculture and Rural development (CARD) in the Philippines, SEWA in India, BRAC in Bangladesh, PRODEM in Bolivia, AKSRP in Pakistan, PRODEM in Bolivia, CORPOSOL in Colombia, K-REP in Kenya, and the Center for Self-help Development (CSD) in Nepal. The national NGOs have successfully promoted microfinance activities with other social missions, such as female empowerment, education of the poor, plus technical assistance for micro enterprises and poor households. BRAC in Bangladesh is widely recognized as the pioneer NGO in combining microfinance services with many other social empowerment programs.

The local NGOs range from very small NGOs to large microfinance NGOs. Many well-established local NGOs have provided considerable microfinance services to poor people in developing countries, such as the Alexandria Business Associations (ABA) in Egypt, Bina Swadaya in Indonesia, and Pradan in India. However, there are also a large number of very small NGOs providing microfinance activities at local levels: provinces, districts and villages. They engage in empowerment activities through providing microfinance services to poor people in expectation of gaining funds from international donors.

Informal MFIs such as moneylenders and ROSCAs remain an important source of finance for poor people across developing countries. The poor utilize informal finance because they are often excluded from banking services. Formal banks face informational problems because their financial services are far from the social networks of poor clients, and hence fail to gather information about the creditworthiness of the poor. Banks also face enforcement problems because the poor often fail to provide sufficient collateral to secure loan repayment. Unlike commercial banks, however, informal MFIs can overcome informational and enforcement problems through linking loans with social networks of the poor. Lending provisions to kinship groups, ethnicity, locality, and trade-credit linkages lead informal MFIs to a greater capability for overcoming informational and enforcement problems in lending to the poor than banks.

Two types of informal MFI have been widely reviewed in the microfinance literature: moneylenders and rotating saving and credit associations (ROSCAs). Moneylenders are distinguishable into two types: commercial and non-commercial moneylenders. Borrowing from socially close lenders within the moral economy such as friends, neighbors, and relatives relate to non-commercial money lending. They usually discharge interest rates on loans to poor borrowers. However, the socially close lenders consider the norms of friendships and reciprocity as they seek to access similar loans in the future.

On the other hand, commercial moneylenders charge very high interest rate on loans. Such commercial moneylenders lend money only to people they have information about concerning creditworthiness. However, lending to those they have less information remains possible if punitive actions against defaulters are feasible. As the poor lack physical collateral, moneylenders often link loans with other complementary transactions such as labor utilization contracts and commodity supply. In trade-credit linkages, for instance, moneylenders provide loans to poor borrowers in exchange of the right to purchase the growing crop. The aim is to minimize the risk of loan defaults, and secure commodity supplies with reasonably low prices.

Moneylenders often have a considerable bargaining vis-à-vis poor borrowers due to the latter's limited access to other sources of finance. Potential punishment, such as the exclusion of future loans to default borrowers also reinforce the patron-client relationship between moneylenders and poor borrowers. As such, moneylenders can sustain monopolistic power in microcredit markets, allowing them to generate positive returns on lending.

Despite borrowing from moneylenders, poor people have long established self-help groups of financing such as rotating credit and saving associations (ROSCAs). ROSCAs remain an alternative financing arrangement for poor people across developing countries. They operate across countries under different names, such as *cheetu* in Sri Lanka, *chit fund* in India, *susu* in Ghana *tontines* in Senegal, *njangis* in Cameroon, *pasanakus* in Bolivia, *hui* in Taiwan, *kye* in South Korea, and *arisan* in Indonesia (Besley et al. 1993). ROSCAs are primarily akin to savings, as such money is saved for future consumption on durable goods. It cannot be seen as an insurance against unpredictable risks because obtaining the fund of ROSCA may not be coincident with the members facing financial difficulties. However, ROSCAs may be effective in meeting predictable life-cycle needs such as child education. As the membership of ROSCAs is voluntary and without collateral support, mutual trust, friendship and reciprocity within dense social networks play a vital role in minimizing the risk of violating the ROSCA agreement. It has been found that ROSCA memberships are mostly among those who know each other well, such as kinship groups, neighbors, and co-workers. As a result, they can minimize informational problems by exploiting face-to-face connections to effectively select good among bad members. Possible social exclusion for defaulters can also enforce membership commitment, leading to the low default rate of ROSCAs.

Lastly, microcredit programs remain an important player in the microfinance industry. The government microcredit programs include requirements of commercial banks to provide small-scale loans to the rural poor, government credit guarantees, cheap loans to poor farmers, and the like. Most microcredit programs are subsidized, due to the high cost and risk of lending to poor farmers. Funding subsidies mostly come from the government budget, and soft loans from international donors (e.g., the World Bank and ADB). The subsidization can take the form of interest rate subsidy and administrative supports to loan providers (e.g., banks), as well as loan forgiveness programs. Non-governmental organizations (NGOs) have also made substantial contributions to microcredit programs to the poor. Similar to government programs, microcredit NGOs deliver cheap loans to poor people. However, worldwide evidence indicates that microcredit NGOs result in better performance than the government credit programs. The classic examples are PRODEM in Bolivia, K-REP in Kenya and BRAC in Bangladesh.

Importance of Social Capital

Considerable attention has been given to group lending methods in reviewing the link between social capital and microfinance practices. The worldwide success of group lending of the Grameen Bank is said to be a prominent microfinance innovation, providing access of the poor to finance. Nowadays, the group lending method of the Grameen Bank has been replicated in 30 countries across many continents. 30 out of 50 states in the United States have implemented group lending programs, although they take various forms to suit local conditions (Armendariz de Aghion and Morduch 2005). In group lending, a small number of poor people (usually five to ten) form a group; a small loan firstly given to two members; then to another two until all group members receive loans. The cycle of lending continues so long as loan repayments are sustained. If one member default and group members do not pay-off the debt, all group members cannot obtain future loans. This feature gives incentives to group members to monitor one another. As such, social capital in the forms of interpersonal relations and connection within a group of poor borrowers can create *social collaterals*, substituting the lack of the poor to physical collateral. This collateral substitute benefits MFIs through enhancing the self-enforceable capacity of group members to repay their loan.

Social collateral can result in high loan repayments of group lending methods in two ways. The first is through face-to-face interaction generating self-selected mechanism in forming the group. Here, information flows embedded in personal interaction among poor borrowers help to inform the creditworthiness of one another. As a result, they will select themselves, into a homogeneous group of low risk borrowers. The logic is that when the formation of group lending is based on intimate knowledge of group members, screening 'good' among 'bad' borrowers will be more effective than when made directly by lenders. The second is the role played by peer pressure and sanctions to increase the loan performance of the group. This can be undertaken through implementing joint-liability principles, through which lending to individual members of the group is mutually guaranteed by all members within the group. As loan default of one member can reduce access of other members to loans, it creates peer pressure against potential free-riding behavior and imprudent use of loans. Social collateral in the forms of peer pressure and sanctions can thus enforce repayment discipline of group members. They also benefit lenders through decentralizing screening and monitoring efforts within the group (Karlan 2007).

However, lending to the poor on the basis of social collateral does not only emerge within group lending methods. As has been previously emphasized, moneylenders have successfully provided individual loans in parallel with building up close relationship with the poor. Such lending practices of moneylenders has been incorporated into an individual lending method of the BRI-unit that lead to the success of microfinance programs in Indonesia. Similar to moneylenders, the success of small loan size of BRI-units is largely associated with the short-term period maturity (less and equal to 12 months) and frequent loan installments. In the screening process, the application procedure is designed as simple as possible through filling out the form which requests a brief description of clients' borrowing history, loan purpose and allocations. The proactive screening process is done by lending staff visiting the workplace and home of poor borrowers. Information about the creditworthiness of poor borrowers is also gathered from neighbors, relatives and community leaders. The community leaders can act as co-signer or witness to provide moral pressure for the borrowers to repay their loan. Treating the borrowers with friendly, helpful and respectful manners help to develop and sustain close relationships and loyalty of clients with the bank, providing incentives to prudently manage the loans (Robinson 2002).

Commercialization—Outreach Nexus

Commercialization has become the mainstream approach to microfinance. In the literature, it refers to implementation of market-based principles in microfinance (see, Charitonenko et al. 2004, Ledgerwood and White 2006). Pro-market principles mean that the expansion of MFIs should be a result of profit-driven operations rather than subsidies. To become a commercial entity, MFIs should follow sound banking practices, be operationally efficient and disciplined. The ultimate target is to achieve sufficient profits, so as to cover operational costs of MFIs. Concerning operational sustainability, profitability is said to be a prerequisite for microfinance expansion to serve poor clients.

Commercial-based practices of MFIs are said to be rational for three reasons. Firstly, the efforts to alleviate global poverty through microfinance require a massive scale of perations. The Consultative Group Assist the Poorest (CGAP, World Bank) estimates that the worldwide demand for microcredit will be about US$90 billion in 2025. This is far beyond the capability of international donors and national governments. MFIs are required to tap funds from commercial sources. As such, the financial business of MFIs should be profitable, efficient and without subsidy (CGAP 1995). Secondly, MFIs cannot rely in large measure on funding subsidies from governments. Reliance on funding subsidies discourages MFIs to mobilize savings, and fails to improve operational efficiency. The continuous supply of subsidy is also constrained by limited funds from government and donors. Thirdly, the proponents of commercialization argue that the profitability focus of MFIs does not conflict their social mission of serving the world's poor.

There is a fear, however, that the commercialization approach will push the heterogeneous nature of MFIs into a homogenously commercialized industry. The heterogeneous characteristic of the industry is preferable for meeting the needs of the poor. The commercialization approach also makes microfinance practitioners uneasy because the relaxation of subsidies will lead some donors to withdraw funding support to MFIs. Many believe funding subsidies are necessary to accomplish the social mission of MFIs. A new-style subsidization approach has thus emerged which proposes that subsidies support microfinance innovations. Such innovations aim to achieve low operational costs and risks of providing financial services to poor people (Morduch 2006).

It is also worth noting that operational contradictions occur in microfinance business. A trade-off potentially exists between the profitability and outreach objectives as focusing on profitability can discourage MFIs from providing small-scale loans to poor clients. The logic is that operational costs of managing small-scale loans to a large number of poor borrowers are significantly higher than serving one large loan to non-poor clients. A trade-off also potentially exists between the outreach objective and the welfare impacts of informal loans to poor clients. This is the case as micro-scale loans are often used to finance household consumption rather than production. Loans for consumptive purposes have little income-generating effects, and hence fail to increase the welfare of the poor. Furthermore, a contradiction can occur between the profitability objective and the welfare impact of microfinance finance on the poor. Such a contradiction arises as MFIs often maintain profitable operations through setting considerably high loan interest to poor borrowers. Combined with frequent loan installments (e.g., weekly), the high loan interest can put downward pressure on the income of the poor. Maintaining profitable operations of MFIs can thus potentially have a low impact on the welfare of poor people.

However, there are potential synergies between operational profitability and outreach of MFIs to serve poor clients. Achieving profitability can lead to a greater capability to provide financial services, particularly saving facilities to poor people. Operational profitability is vital as few will put faith in unprofitable MFIs. There is evidence that business acumen and financial performance of BRI-units lead to the successful mobilisation of savings from poor clients across rural areas of Indonesia. Moreover, a potential synergy also arises between the achievement of profitability and the welfare impact of microfinance to poor clients. For instance, attempts to achieve profitability encourage MFIs to improve the quality of financial products. As result, MFIs can anticipate the poor demanding more sophisticated financial services. Having access to more advanced financial services can lead the poor to expand production, enhance social and business networks, and finance expenditures necessary for human capital improvement, such as child education and nutrition.

Empirical evidence in Indonesia shows that access to microbank loans facilitate child education and confidence in dealing with others. Child education benefits the poor in two ways. Firstly, it provides more advanced knowledge of production to the parents, perceived vital for business expansion.

Secondly, it provides information about the borrowing procedure of banks, facilitating greater access of poor parents to formal finance. Access to microbank loans contribute to confidence in dealing with other people, providing a basis for the poor to expand business and social networks. Having wider social networks benefit the poor through the marketing of their products. The ultimate result is that it can improve income and reduce financial difficulties. This is the case as loans from microbanks are used to support production rather than financing household consumption.

Conclusion

There are heterogeneous clients and institutional providers in microfinance. The poor clients are heterogeneous in terms of income, motive and constraints in utilizing financial services. Apart from financing production, the utilization of microfinance assists the poor in smoothing consumption and supporting the accumulation of both human and social capital. The use of loans to finance social activities indicates a desire of the poor to maintain social networks. Heterogeneous clients also implies that poor people face several constraints to microfinance access due to the remoteness of rural areas, plus low levels of education, income and assets. As a result, MFIs face information and enforcement problems in serving poor clients. Consequently, microfinance markets are segmented as different MFIs have a diverse capacity and strategy to deal with such problems.

In many cases, formal MFIs, such as microbanks, prefer to set lower interest rates than semi-formal and informal MFIs. Being operationally far from the social networks of poor clients, they often impose collateral requirements on them to enforce loan repayments. Microbanks also tend to penetrate not-so-poor segments because these people can provide loan collateral, higher income, and accounting reports. In contrast, semi-formal and informal MFIs have a tendency to set higher rates of loan interest, as they expend more resources maintaining close relationships with poor clients. Being operationally close to the social networks of clients, these MFIs can provide non-collateral loans to the poor.

Microfinance stimulate scaled economies, help to reduce poverty and promote social change. However, it also presents problems, such as the commercial bias eschewing the very poor. Whether subsidies help MFIs deepen outreach or inhibit operational efficiency are puzzles. Operational profitability and deeper outreach are the core contradictions of microfinance. Maintaining profitability often results in larger loans, higher interest rates and a preference to serve non-poor clients. Formal MFIs are regularly unwilling to serve very poor people as this reduces profit. To avoid such problems perhaps subsidies are needed to support microfinance innovation to reduce high operational costs of serving poor clients.

Acknowledgement:

I wish to thank Phil O'Hara and the anonymous referees for comments and assistance with the material analyzed in this paper.

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Middle East Political-Economic Integration

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Definition of Middle East

The definition of the region known as the 'Middle East' is not universal. The definition used in this article is the one provided by Cleveland (2000) and Held (2000), which is used on the latest maps published by the National Geographic Society, Department of State, Central Intelligence Agency, John Bartholomew map agency and other international agencies. Accordingly, Middle East includes the sixteen countries in the region from Egypt through Iran in the east, and from Turkey to the Arabian Peninsula in the south: Bahrain, Cyprus, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Turkey, United Arab Emirates (UAE), and Yemen.

Note: Dark borders include Middle Eastern nations, names in rectangles. These are drawn by the author. Source: adapted from http://www.lib.utexas.edu/

The majority of the countries in the Middle East are Arab, with the exception of Cyprus, Israel, Iran, and Turkey. The term 'Arab' as used in this study, on the other hand, incorporates both Middle Eastern and Northern African Arab countries. Although the major topic of this study is political-economic integration in the Middle East, at times, Arab integration is an essential part of the story. However, the broader study of Arab integration is beyond the scope of this paper, and thus it is incorporated here only to the extent that is deemed necessary.

What Is Regional Integration?

What do we mean by regional integration? One can distinguish between three levels of integration, political integration being the highest (Zartman 1999). Political integration requires that states commit at reducing national sovereignty in favor of the regional bloc. The second level, what Zartman calls developmental integration, would correspond to economic integration where larger markets promote larger trade volumes. The third level is diplomatic cooperation, which is "characterized by momentary acts of unity that are not necessarily expected to endure" (Zartman 1999:171).

Why do countries seek regional integration? El-Erian and Fisher (2000:70) provide three reasons for countries to seek greater regional integration obtained via a survey conducted by the OECD: obtaining economic welfare gains; promoting the region's collective political bargaining power in global issues; achieving other non-economic national goals, such as security. Historically, there have been two main motivations for regional Arab integration: one is political, originating from the ideology of Arab nationalism, and the other is economic, based on endowment complementarity across the region.

Complementarity across the region arose from the fact that oil-rich economies were rich in capital, but poor in land and labor.

Other countries like Egypt and Syria that had land and labor lacked capital. Moreover, regional integration would enable the exploitation of economies of scale. Changes in world trade have also reinforced the need for regional integration, since they revealed the danger of falling exports as an adverse substitution effect of regionalization. Some of the regional integration in the Middle East has been achieved with a third motivation: security. The many conflicts existing in the area at any point have made the establishment of unities or organizations attractive to some states.

When are countries more likely to succeed in their attempts at regional integration? Factors such as geography and culture play an important role, however similarity in economic and political systems, and sharing common political goals are the most important factors that will promote integration. In the Middle East, as we will see, the absence of these important factors has limited the success of regional integration. The rest of this article will display that we can hardly speak of political integration in the Middle East. We will see that diplomatic cooperation is the most widely experienced form of integration, and that many steps have been undertaken towards some form of economic integration.

The article starts with a discussion on political integration in the Middle East, where the foundations of the United Arab Emirates (UAE) and Yemen are presented. This section also discusses the establishment and collapse of the United Arab Republic (UAR). The next three sections discuss economic integration with its different attempts, failures and limited success throughout history. Then, the main reasons for the limited regional integration in the Middle East are presented with a discussion on the possibilities for greater integration in the future. The last section concludes.

Before moving on with the section on political integration, however, the reader needs to realize that drawing the line between economic and political integration can sometimes be tricky since the two are intertwined. Obvious attempts on political integration are discussed first, and the sections afterwards emphasize economic integration. However, one should be aware that political incentives are part of economic integration. Economic integration is a pre-requisite for political integration, however at the same time the lack of political commitment on the part of the different states sets constraints on economic integration. Thus, any type of economic integration does in the broader sense incorporate the political factor.

Political Integration in the Middle East

There have been some attempts at political integration in the Middle East, some successful, others not. Among the attempts of political integration that have failed, the main one is the United Arab Republic. Two successful examples are the United Arab Emirates, and the Republic of Yemen.

The United Arab Republic (UAR) was founded in 1958 when Egypt and Syria decided to become a single country. One of the main factors leading to the formation of the UAR has been the common stand taken by the two countries against the pressure coming from US and UK to join military alliances dominated by developed nations (Al-Sayyid, 1999). Other important factors contributing to the fusion of the two countries have been the charismatic leadership of Nasser, and the shared culture and history. With the integration there was a single president, a single assembly, a central government, a uniform political system and uniform economic policies. Attempts at integrating the two armies did not succeed because of the perceived bias in favor of

Egyptian officers. Attempts at harmonizing administrative and social services, especially education, were not successful either, partly due to resistance from Syrian officials. No attempts were undertaken at harmonizing monetary and fiscal policies, each country continued to have its own currency, central bank, and fiscal system. Even in the areas that integration took place, it was generally the case that Egyptian officers were higher in number, occupied higher ranks, and monopolized key ministries. This imbalanced integration combined with the disappointing performance of the UAR in the two most important sectors for Syria, agriculture and commerce, planted the seeds of disintegration. In 1961 Syria seceded from the union. It is being emphasized that a federation between the two countries would have enabled Syrians to manage their own country and would have given them more power within the union. Although initially the UAR was thought as a federation to materialize gradually over five years both by the Syrian and the Egyptian sides, accumulating political mistakes prevented this form of governance from getting realized.

One of the current countries in the Middle East, the United Arab Emirates (UAE), was established in 1971 as a federation between seven sheikhdoms: Abu Dhabi, Dubai, Sharjah, Ra’s al-Khaimah, Fujairah, Ajman and Umm al-Qawain. There are three factors that have contributed to the success of this ultimate political integration: its diverse population structure with only about 15 percent being nationals, the traditional society structure, and the uneven distribution of wealth (Heard-Bey, 1999). The federation had a loose nature that reflected the geographical, political and social diversities of its states. Its constitution was formulated to be in force for five years only, and it did not give much role for representatives of the population. Furthermore, it lacks any provisions for enforcing regular meetings of the Supreme Council of Rulers, the entity that approves all legislation. This provisional constitution is by any means an “incomplete and weak document” (Heard-Bey, 1999: 136). However, it has been this nature of the constitution that has made the foundation of the federation possible. In the year celebrating the twenty-fifth anniversary of the federation, despite the efforts of young UAE nationals, this provisional constitution was accepted as the permanent constitution. The main reason for the UAE to survive for such a long time is seen in the strength of its political style, based on compromise, tolerance and patience. Its main weakness is that its success or failure ultimately depends on the leaders of the member states. Time has not been regarded as an important factor in settling disputes and conflicts, however this may become an important obstacle in the face of an urgent decision (Heard-Bey, 1999).

The Republic of Yemen (ROY) was formed in 1990 between the Yemen Arab Republic (YAR) and the People’s Democratic Republic of Yemen (PDRY). The YAR and PDRY were created in 1962 and 1967 respectively and each followed a very different political path, one forming a republican state, and he other following a Marxist-Leninist regime. The unification between the two countries was achieved through a democratization of political life. The elections in 1993 were relatively free and fair, however, they were followed by a political crisis and a civil war threatening the unity. In fact, the years following the unification in 1990 were full of conflict and border wars. In the years after the civil war, the republic was characterized by financial reforms, and economic and political instability. The second round of elections was held in 1997, which was relatively more successful that the first one. The unification of the two republics was inspired by an ancient idea of Yemen as a country, and it was at the same time obstructed by the very distinct nature of the two economies. As Burrowes (1999) points out, Yemen as a unity will most probably continue its existence since it has endured many turbulent periods, however the question is whether and to what extend democracy will continue to prevail in this country.

Why and What Type of Economic Integration in the Middle East?

Economic integration can take many different forms: economic unions, common markets, customs unions, free trade areas, or preferential trade arrangements (PTAs). The lowest degree of economic integration is PTAs. With PTAs member countries apply more favorable trading conditions among themselves, which may include lower tariffs, quotas etc. A higher degree of economic integration is the free trade area, in which trade among member countries is tax-free. The next level is customs unions, where members of the union share common trading conditions with external countries. In common markets the movement of goods and capital is free, though movement of labor is still limited, with member countries sharing the same market conditions. Economic unions represent the highest level of economic integration, where countries share a single currency and labor moves freely between member states.

Economic integration can result in mutual gains for all the countries involved, by ways of exploiting the economies of scale from larger markets, comparative advantage arising from pooling resources, higher mobility of resources, and higher bargaining power. Economic integration seems to be the natural answer to the limitations faced by many Middle Eastern countries, because most are small countries with limited resources for self-sufficiency.

In general, the engine for regional economic integration has been trade in goods, as was the case with the European Union, East Asia, and the North American Free Trade Agreement. Labor movements are generally the final and most controversial part of economic integration. Regional integration in the Middle East, however, has taken a very different form (Shafik 1999). There have been many attempts to establish more favorable conditions for trade in goods, almost all being unsuccessful. As of 2001, intraregional trade in Middle East accounts for about 12% of total imports and exports (Gulf News 2001), the major share being dominated by three oil-rich economies: Bahrain, Saudi Arabia, and the United Arab Emirates. Part of the explanation for the low intraregional trade is the composition of imports and exports. Exports of the area remained dominated by primary products, and petroleum and petroleum products in particular, which constitute about 90% of total exports for the Gulf countries. Imports, on the other hand, are mainly constituted from food, capital goods and manufactures. Thus, the composition of trade has not been very favorable for enhancing intraregional trade. Despite the low intraregional trade in goods, the Middle East has a unique regional integration, one based on free labor movements within the region.

The different development policies adopted by oil-rich and poor Arab countries is seen as a different explanation for the intensive labor movements, as well as the low intraregional trade in the Middle East. In general, oil-rich countries adopted outward-oriented development strategies, which enabled them to import the domestically demanded good from any other country in the world. Their poorer neighbors that had the potential to meet regional demand for different products, on the other hand, adopted import-substitution policies, which eliminated the potential for achieving quality and cost comparable to the world markets. Moreover, these import substitution policies encouraged the production of capital-intensive products, therefore resulting in high unemployment rates. Thus, for these countries labor migration has provided a very convenient mechanism for exporting their unemployment problem. It should also be mentioned that remittances were an important source of income for these economies. Moreover, the laws regulating labor migration were much more favorable than those governing trade in goods in all Arab countries.

In sum, the first and most successful element of economic integration in the Middle East has been labor movements. Is this a desirable pattern of integration in the region? Labor importing countries gain from the production of immigrant workers, but they suffer from the costs incurred for political and economic stability, and from long-run dependence on foreign labor. Labor exporting countries, on the other hand, gain from lower unemployment rates and remittances, and they lose the external benefits from domestic production. Moreover, whether migrants gain new skills during their employment abroad is not very clear since it depends on the specific job requirements. The most important long-run problem for labor exporting countries can be the postponement of the economic reforms necessary to create jobs at home (Shafik 1999).

The attempts at establishing a wider regional economic integration including trade in goods will be discussed further below together with the main reasons for the failure of most, however one wonders whether this lack of regional integration in the Middle East is something typical of the region. Or have Arab nations experienced some type of integration at some point in the past? And if yes, what contributed to its demise? Below follows a brief journey throughout history providing answers to these questions.

Regional Integration in the Middle East from the 17th through the 20th Century

Regional integration includes both economic and political linkages. Until the sixteenth century the large population of the Arab-Islamic world was being connected by a unique trade and transportation system. The main characteristic of the relationship between different social groups has been mutual dependence and trust. The region was characterized by prosperity, harmony and stability. Local governments realized that trade provided economic prosperity, and therefore they supported trade facilities and they tried to provide all necessary conditions for its further expansion. As such, trade and transportation were responsible for the movement of both people and knowledge. Thus, this system was the main way in which the whole Arab-Islamic region was integrated among themselves and with the rest of the world. Of course, it also enabled the use of comparative advantage. It is important to emphasize that the unity, which characterizes the Arab-Islamic world at that time was based not on political unity, but on common market. Therefore, conflict between countries did not affect their trade relations.

This economic, social and cultural unity of the Arab-Islamic world in the sixteenth century is in a very sharp contrast with the lack of unity in the Middle East today. The rest of this part will try to explain the main phases, which contributed to this huge change. Afterwards, we will concentrate on the main ways in which the Middle East countries worked for the resurgence of this unity and what factors contributed to the failure of most of these attempts.

Zahlan (1999) concentrates on European technological advances as the main factor contributing to the dismantling of the "integrity, unity, and coherence of the Arab world" (Zahlan 1999:259). He has divided this dismantling process in four phases. The first phase is triggered by the introduction of the Portuguese technological advances in navigation in 1498. Arabs failed to acquire the technological capabilities necessary to compete with Portuguese ships. Between 1620 and 1670 the English, Dutch, and French established the East Indian Company, which controlled armies, markets and finances. Soon the Arabs could no longer compete, and the East Indian Company eliminated long-distance trade between Arabs. By the middle of the seventeenth century Arabs started importing goods from Europe. The two other main technological developments contributing to the dismantling of the local trade and transport systems were the introduction of the railway system, and the construction of the Suez Canal.

The second phase contributing to the breakdown of Arab unity was triggered by the industrial revolution, which led to the destruction of many industries. The textile revolution, the steam power, petroleum production, chemistry, electric power, construction technologies, management systems are a few to name. All new technology was adopted in a dependent way, resulting in huge debt accumulation.

The third phase of technology dismantling has been the direct occupation of Arab countries by European countries, during which decisions were made by occupying forces. This had two main economic consequences for the colonies. First, it developed very tight relationships between the colony and the metropolitan. Second, it imposed constraints on any intraregional economic integration (Owen 1999).

The fourth phase started with political independence. The elites that came to rule the countries did not have any training or knowledge about the "requirements and implications of science and technology which had become so central to the industrialized world in the late twentieth century" (Zahlan 1999:268). Technology continued to be imported together with the maintenance, consulting and contracting services. Another problem has been the creation of the "artificial boundaries" between states.

Similar to the practices in other developing countries, Middle Eastern countries adopted different development policies. More importance was given to university education, however this has not been able to stop the brain drain. There has been emphasis on research and development, but it has been limited to applied subjects. Technological dependence has been a major constraint on the development of R&D capabilities. Moreover, the pace at which technology diffuses in the region has been very slow, the main reason being the lack of policies to encourage the establishment of domestic consulting and contracting firms (Zahlan 1984). The main conclusion of the technological advance argument for the lack of economic integration can be summarized as the inability of Arabian countries to develop a science and technology system and effective science policies. Moreover, in formulating their development policies every country has tried to solve their issues by their own, there has been almost no cooperation in any field that would result in greater gain for all countries involved.

Regional Integration in 1900s and 2000s

Arab attempts to establish regional economic integration before the oil era are generally seen to have proceeded in two stages (Owen 1999; Diab 1963; Musrey 1969). The first stage began in the early 1950s at the meeting of the Arab League's Economic Council (founded in 1945) with the ratification of the Treaty for Joint Defense and Economic Cooperation by Egypt, Jordan, Lebanon, Syria, Saudi Arabia and Yemen (North). The Arab League has later come to incorporate other Arab countries, and today it has 22 members (including some Arab countries in Northern Africa). At this point the emphasis has been on cooperation, which was less demanding than "integration" and as such accommodated the preferences of the different Arab governments and intellectuals. Tariffs on agricultural products and minerals were abolished and the movement of people and capital was eased. Barriers to trade in manufactures remained in place.

The second stage began in the late 1950s, when the emphasis shifted on establishing a "unity": the Arab Common Market. In 1958 the League's Economic Council established an agreement to have five states—Egypt, Jordan, Kuwait, Morocco, and Syria—move towards unified economic policies and legislation. In 1964 the five states signed the treaty establishing the Arab Common Market on 1 January 1965, and abolishing all restrictions between the member countries by January 1974. Later the treaty was ratified by all countries except Kuwait. However, reducing restrictions proved extremely difficult, and the establishment of a common external tariff was lagging. After four rounds of discussion the notion was completely abandoned.

The increase in oil prices in the 1970s raised huge revenues for the oil-exporting Middle East countries. This had many impacts on the region, which have been widely discussed. The most striking ones are the increase in the flow of capital and labor between states; and the establishment of new Arab banks, funds and development agencies. Another striking fact was that very small part of this capital flow was channeled through these new establishments. Most labor movements and capital transfers were unplanned and unpredictable. However, the higher revenues created a positive atmosphere leading to the formation of many specialized regional organizations and joint projects, and hence the "Joint Arab Economic Action" (JAEA) (Sayigh 1999). However, this promising trend of increase in cooperation in the 1970s was weakened by the loss of Nasser, Egypt's charismatic pan-Arab leader. With the treaty between Egypt and Israel signed in 1979, Egypt was no longer the driving force for Arab nationalism. Later, other countries signed unilateral agreements with Israel, which further contributed to the fragmentation in the Middle East (Jordan in 1995; Turkey in 1996). In fact, "the one constant factor in the Eastern Mediterranean from 1948 to 1977 was the solidarity of the Arab alliance against Israel (McLaurin et.al. 1982:13). Nassar's death marked a shift in the Middle East from cooperation to fragmentation. All countries became self-centered around their national issues. Of course, one should not forget the contributions of the two gulf wars and the Iraq-Iran war of 1980-88, as well as the Palestine-Israel conflict. Moreover, the fragmentation and the regional conflict were also proliferated by 'intrusive powers' that had interest in terms of weaponry sales and increasing dependency on external political support (Ismael & Ismael 1999:140).

In the 1980s there were three sub-regional bodies formed within the JAEA, two in the Middle East area: the Gulf Cooperation Council (GCC) formed in 1980, and the Arab Cooperation Council formed in 1989. In 1983 the members of the GCC—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates—approved the Unified Economic Agreement, which involved goals of achieving economic equality among the citizens of the member states, narrowing the differences between economic policies, linking infrastructural facilities, establishing joint projects, standardizing certain laws and procedures, and taking a common stand to non-member states. All of these components, although at different stages, are still far from being fully implemented. However, the GCC has proven its survivability. The existence of common interests, and the big amount of common resources committed towards integration are keeping the GCC very much alive. In fact, it may be argued that “the organization is approaching a threshold stage of implementing a common agenda of social and economic policies” (Abdulla 1999:152). Priess (1998) investigates any future prospects for expansion of the GCC. According to him, “The GCC is relatively stable with its current membership. This is easily explained: the Gulf monarchies have a great deal in common, including common threats to their security in a very tough neighborhood. Yet the demands for expansion continue” (Priess 1998:24). There have been some political reforms in the Gulf states which have been pushing for widening the GCC membership. The one way for the GCC to expand, however is to accept a wider view, “one with a slightly more inclusive identity and an expanded membership” (Priess 1998:25).

What type of an integration does the GCC represent? As Abdulla (1999) discusses, it is difficult to classify the GCC as an institution representing political or economic integration, or a military alliance. The GCC is not a full-fledged security community either, although achieving more security has been one of the reasons for its establishment. It basically lacks the authority and means to override national policies and provide security to its member states. However, if anything it can be classified as a “fairly loose and heterogeneous security community” (Abdulla 1999:157) that works on the basis of cooperation rather than legal merger. The biggest problem that the GCC faces is that over time most of its members became more oriented towards national problems. There are big differences in views and capabilities of the member states: not all are oil exporters, not all are rich, not all are monarchies, not all are traditional, and they are also very different in terms of size, geography, demographic composition, level of education, level of development, political and economic aspects, and military capabilities. Thus the real challenge for the GCC is to contribute to further cooperation and integration in the face of these differences that have become more apparent over time. In fact, probably these differences explain why integration has not been forthcoming.

The Arab Cooperation Council was formed between Egypt, Jordan, Iraq and Yemen as a response to the GCC. However, this institution has not been able to reach the level of the GCC, and it has been practically dead since Egypt and Iraq faced each other as enemies during the Gulf War.

Because these sub-regional blocs did not help in promoting trade much, in 1998 the Arab Free Trade Area (AFTA) was established between eighteen Arab states. By 2008, it will lead to the gradual elimination of all tariffs and other barriers to trade. Over the long run it is expected to lead to larger foreign direct investment due to its larger scope compared to smaller regional organizations. The greatest success of the AFTA so far has been the annual reduction in tariffs by member countries by 10% (Zarrouk 1998 provides a detailed discussion on the program adopted by the AFTA members). The increase in inter-Arab trade to 12% in 2001 has also been attributed to the AFTA (Gulf News 2001). However, the effects of its establishment in other areas have remained negligible so far.

There are many other Arab specialized organizations, like the Arab League Educational, Cultural, and Scientific Organization; the Arab Labor Organization; the Arab Agricultural Development

Organization; the Arab Fund for Economic and Social Development; the Arab Industrial Development Organization; the Arab Authority for Agricultural Investment and Development; and the Arab Monetary Fund. All of these have developed and carried out extensive programs, however many have remained on shelf. Most of these lack financial resources and have faced constraints from government authorities, the last factor being seen as the main reason for the delays and limits of developments in productive sectors.

There has also been a development of many joint projects and companies involving Arab governments and the Arab private sector. The Arab Fund for Economic and Social Development, and the Arab Monetary Fund mentioned above have played a major role in the transfer of funds between Arab countries.

Some intellectuals have argued that sub-regional formations impose constraints on a larger scale regional integration. Others have seen them as more efficient and practical than the League's generally over-ambitious targets and purposes, as well as providing "an essential intermediate stage between narrowly defined single-country concerns, and a too-broad regional concern that encompasses the whole Arab region and thus becomes unmanageable" (Sayigh 1999:240).

Political-Economic Integration Analyzed

This section will provide an analysis on the limited regional integration in the Middle East, both economic and political.

Economic integration depends on the potential of static and dynamic gains for the countries involved (Fawzy 2003). The conditions important for static gains to be realized are high degree of complementarity between countries offering more room for trade creation, large number of countries in the club allowing for larger markets and greater economies of scale, geographical proximity reducing transportation costs and thus encouraging trade. To have larger dynamic gains, on the other hand, openness to trade is crucial since it results in greater competition, thus larger efficiency gains, and less potential for trade diversion, and less opposition to integration.

As emphasized in many studies, Middle Eastern countries have low degree of complementarity (Awartani & Kleinman 1997, El-Erian 1996, Fawzy 2003, Ismael & Ismael 1999). Thus, gains from trade could be obtained through the development of the industrial base of individual countries, and diversification and specialization. When the number of potential bloc members is considered, it is in general the case that large and wealthy countries do not have the incentive to join because they are unsure about future returns. Small and poor countries, on the other hand, have the fear of being marginalized. Thus, gains from integration will be distributed unevenly, and this increases opposition to integration. It was argued above that geographical proximity is expected to result in lower transportation costs, and thus promote trade. Most countries in the Middle East are close to each other, however there are factors that hinder trade—high protection through tariffs, non-tariff barriers, import substitution policies, and lack of transportation infrastructure (The lack of transportation and communication infrastructure is most evident from the fact that Arab intra-trade is generally in the form of cross-border trade Zarrouk 1998.) All these factors have created an environment that does not favor integration, since it means loss of revenue for the government, and loss of profits/business for the private sector. It is also the case that the private sector that is so important for integration is very limited in the area. Most industries are dominated or regulated by the government.

The review of factors contributing to higher static and dynamic economic gains reveals that the economic incentive for integration in the Middle East is very limited. Ebbers (1999) finds that there are high bilateral trade indices within the region, however low multilateral indices, limiting the possibility of static gains. The author finds a high diversity index, indicating low homogeneity in the region. Taxes on international trade are very high leading to the expectation of problems when forming a free trade area or customs union. Kubursi (1999), on the other hand, sees the "Arab disease" (the dependence on oil as the single most important source of revenue) as the most fundamental problem faced by the Arab nations. This disease has resulted in the overvaluation of the currencies in the region leading to low exports and high imports, thus damaging the domestic production capacity. High oil revenues have generated external dependency, and have reduced incentives for diversification, productive capital investment, promotion of exports, and high domestic savings.

In terms of political incentives for regional integration, three factors play an important role: political willingness to integrate, establishment of regional institutions, and the acceptance of a regional leader. Political willingness to integrate will be high if the benefits of integration—the enhancement of leader's chances of retaining political power, is greater than its costs—loss of sovereignty. Because most governments in the Middle East are not elected, integration is not expected to provide them with any benefits. In fact, integration may be even harmful for their political power.

The establishment of regional institutions, whose rules and policies are above the national ones, is very crucial for integration. The main responsibility of these institutions is to monitor compliance by member states and enforce regional integration rules and policies. These can also assume the role of regulating the compensation of states loosing from integration. Despite the numerous regional institutions at work in the Middle East, none of these are effective in terms of monitoring and enforcing regional integration. Even the Arab League lacks the authority to override national policies.

It is the case that the Middle East lacks a regional leadership. Egypt played such a role for the Arab region in the 1950s and 1960s, however this role declined with the peace treaty signed with Israel in 1978. These Camp David Accords disconnected Egypt from the rest of the Arab cooperation efforts. This gave start to other separate agreements between countries, which reoriented the participating countries away from Arab regional integration. One could argue that economic cooperation is more of a political issue rather than an economic one (Drake 1999). Drake points out that one of the main constraints standing in the way of greater regional integration is the fear of 'asymmetrical interdependencies', stemming from the Arab skepticism concerning Israel's intentions. Perceptions about integration in the Middle East include Israel at the center using its economic and political power to extract most economic welfare gains and overtaking their connections within themselves and impeding any future cooperation. These fears are supported by Israel's view on cooperation, which is aimed at regional multilateral cooperation based on bilateral relations with Israel. Drake argues that a realization of Middle East cooperation including Israel will depend on two things: first on the perceived fairness of any agreement; and second, on how Israel deals with the Palestinian issue, since many Arabs use this as a prototype of how well they may expect to be treated by Israel under regional cooperation.

Other factors that have contributed to the low level of integration in the Middle East, as mentioned above, are the two gulf wars, the Iran-Iraq war and the Israel-Palestine conflict. Yet another factor contributing to the disintegrated nature of the Middle East is offered by Ismael and Ismael (1999): the 'unnatural' borders between the countries that are not based on any natural geographic, ethnic, linguistic or religious grounds, but were drawn by Britain with the aim of preventing any unity of Arabs. Issawi (1970) also points out to the importance of the large part played by foreigners in the economic development of the region as one of the factors responsible for the low level of integration.

Some argue that globalization stands in the way of regionalization, while others argue that it promotes regional integration. Bolbol (1999) investigates Arab regions relations with the EU and WTO and argues that the European Mediterranean Initiative (EMI) is not a good idea for Arab countries, but joining the WTO is, since the WTO can promote Arab countries' integration into the world economy. Galal (2000) argues that liberalization and closer ties with the EU (PTAs) will generate higher economic incentives to integrate with their neighbor countries because of greater liberalization and competitiveness, although this is an empirical question. On the other hand, it may result in greater protection in the region, less political capital to invest in multilateralism.

Arab economies are in a restructuring process to diversify their exports into sectors other than primary products, which could generate future comparative advantage among region's countries (Bolbol 1999). However, economic incentives are not enough for integration. It is very important that country leaders follow through with the commitments. This will be the case only if they find the agreements to be desirable, feasible and credible. Similarly, Fawzy (2003) argues that there have been some economic reforms leading to trade liberalization, and especially relations with the EU are expected to promote regional integration. The reforms promote the private sector and limit the government engagement in production-related activities. The involvement of the private sector may also help in building the transportation infrastructure that could promote regional integration. On the political front, although the current regimes don't have any particular interest in regional integration, at the same time they are aware that this can provide them with greater bargaining power in the world. Globalization and regionalization occurring throughout the world create an interest for Middle Eastern governments to engage in further regional integration.

The main advice provided in most of the literature is that Arab states should work together and investigate any new arrangements for common interests before joining them (Al-Imam 1994; Al-Khawli 1994; Kubursi 1999). Moreover, domestic and regional efforts should go hand in hand. Domestically, states need to promote liberalization, deregulation, and structural reforms regarding private investment, and they need to reinforce regional trade and finance initiatives. Regionally, states need to establish mechanisms for the compensation of losses in integration, strengthen the regional institutions, harmonize regulations, improve transportation and communication and continue towards greater integration, for which the existence of a regional leader may prove crucial (El-Erian & Fisher 2000; Fawzy 2003; Limam & Abdalla 1999; Zarrouk 1998).

In sum, we may agree with Schulz et al (2001:268) in their argument that "regionalization is not as a rule a 'stumbling block', but not necessarily a 'stepping stone' either". What is important is that prospects for any regional integration need to be backed by economic and political incentives.

Concluding Remarks

We have discussed political and economic integration in the Middle East today and in the past. We have also presented the incentives for larger regional integration and the factors responsible for the low level of integration in the area today. What about the future? Many studies point out that the recent developments in the area are promising and many others emphasize the factors that are important for a more successful future regional integration. I wish to finish with a quote from Kubursi (1999:316) that summarizes the factors important for a successful regional integration in the Middle East by drawing lessons from other regional integrations around the world: "Arab economic integration programs will work best when they proceed slowly and cumulatively, preferably starting with sectoral arrangements among a symmetrical and contiguous grouping of countries. These arrangements also require that trade creation objectives supercede or go in hand with trade diversion, a compensation mechanism to smooth the adjustment process in the weaker economies, and a democratic process that involves the wide participation of the population at large in its support. They will be sustainable when efficiency considerations do not subordinate equity concerns since membership is likely to expand and solidify when member countries feel that they are treated fairly; when investment liberalization is an important plank of trade liberalization; when there are chances for redeployment of industry and wide-range intra-industry trade and specialization; when external forces are accommodating, and when a principal member(s) has a strong political commitment to its success."

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Military-Industrial Complex

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The distinction between industries with interests in either war or peace goes back as early as Aristophanes and forms part of the basis for the notion of the military-industrial complex warned of by US President Eisenhower (Hartung 2001). Modern military-industrial complexes go back to the beginnings of modernity and have always been central in technological innovation, socioeconomic development and global expansion and conquest (McNeill 1982; Mumford 1934; Lane 1979; Adas 1990, 2006; Diamond 1997; Parker 1996). Indeed, as William McNeill (1982:70) notes, "the arms race that continues to strain world balances in our own time descends directly from the intense interaction in military matters that European states and private entrepreneurs inaugurated during the fourteenth century." During this period the Italian city-states engaged in a sort of "military Keynesianism" where military spending stimulated demand. Yet then as today these economic expansions were limited by "permanent leakages of effective demand to other jurisdictions, by cost inflation, and by other redistributive effects of ever-increasing military expenditures which drove down the willingness of capitalist strata to tax themselves or be taxed" (Arrighi 1994:38).

Though tracing back to the beginnings of European overseas conquest via technologically advanced gunpowder empires, the military-industrial complexes of today have their most recent origins in the late 19th century (McNeill 1982; Adas 1990, 2006). Here, states sought to incorporate workers into overseas expansion through social imperialism and the construction of military-industrial complexes (Reifer & Chase-Dunn 2003). The term itself is potentially misleading as historically commercial, financial and corporate interests as a whole have often been implicated in what might be more accurately termed military-corporate complexes (Weber 1978:917-920; Hobson 1965; Arrighi 1983; Reifer 2002).

The escalation of military competition and colonial conquest from the late 19th century on that led to global wars generated military-industrial complexes of greater than ever magnitude in countries such as the US, Germany, Britain, Japan and Russia (McNeill 1982; Lindqvist 1996; Samuels 1994; Snyder 1991; Edgerton 1991a,b, 2006; Krause 1992; Misa 1995; Kaldor 1981; Noel-Baker 1972). During this period, military Keynesian demand stimulus lifted economies out of depression and so became a model returned to by some in the post-World War II era. As for the most formidable of these, the US and the Soviet Union, as E.P. Thompson once remarked, they didn't merely have but were military-industrial complexes.

Many mainstream analysts assert that the US military-corporate complex is geared solely towards geopolitics and security considerations, here upholding what Noam Chomsky (1982) refers to as the almost anthropological taboo against investigating the role of private corporate power in US society. Yet as Chomsky (1993) and others argue, the Cold War and the military-industrial complexes on which they were predicated was a uniquely militarized form of a much more basic North-South conflict whose origins go back to the very beginnings of the modern world-system (Reifer 2006a). Here, notwithstanding free market mythologies, Europeans and their settler offshoots organized global commerce, trade and production in conjunction with the use of military force, so as to shape the global market for their own advantage, as Adam Smith (1776) noted in *The Wealth of Nations* (Arrighi 1994:19; Braudel 1984). Indeed, it was in Western Europe and its settler offshoots, in contrast to the Chinese tributary system and the super world-economy of the Far East with its free markets, where the fecund synthesis of violence, profits and power through the construction of military-corporate complexes led to global conquest (Arrighi 2007).

In the US, the military-corporate complex, adumbrated in the 19th and 20th century, notably during World War I, became the model for the remaking of the global system on new and enlarged social foundations under US hegemony. Here, the entry of corporate dollar a year men into government to run the wartime economy ensured that public policy conformed closely to corporate interests (Reifer 2002). Consolidated in the passage of the National Security Act in 1947, which created the CIA and the independent air force, having evolved out of the Anglo-American strategic bombing policy that resulted in the bombing of cities with conventional and atomic bomb and onto which nuclear weapons were grafted, this military-corporate complex mushroomed during the Korean War and the long Cold War that followed (Sherry 1987; Davis 2002; Kotz 1988; Markusen & Yudken 1992; Cumings 1990). C. Wright Mills (1956, 1958) highlighted here the central role of corporate lawyers and investment bankers in overseeing the broad needs of America's form of militarized state-corporate capitalism (Bird, 1992; Shoup & Minter 1977; Isaacson & Thomas 1986; Reifer 2002).

What developed in the US from roughly the late 19th century onward is what can be National Security State Corporate Complex (NSSCC), denoting the changing and contradictory fusion of private corporate power and public state bureaucracy (Reifer 2002). After World War II, the US resuscitated the former Axis powers – (West) Germany, Japan and Italy, the three founders of the anti-Comintern pact, all of whom had been the recipients of large scale US investment in the interwar period. The US also provided for their protection, including through schemes of offshore procurement whereby the US purchased weapons and other supplies from West Germany and Japan, thus reconstituting them as the regional workshops of Asia and Europe while containing both enemies and allies, the latter as "semi-sovereign states." The attendant Cold War superpower rivalry was crucial to securing US global hegemony. Military spending, a form of public subsidy of private profit, here served as the fount and matrix of US high technology industry, related geopolitical power projection capabilities and attendant global military alliances, while providing global economies of scale for the military-corporate complex (Chomsky 1991; Markusen & Yudken 1992; Flamm 1987, 1988).

Indeed, what William Borden (1984, 1989) has called "international military Keynesianism" played the primary role in the militarized material and financial expansions of the world-economy during the Cold War starting with the Korean War boom (Arrighi 1994, 2007). Here, balance of payment, balance of trade and balance of power considerations were all interlinked (Borden 1984; Leffler 1992). Equally important, fear of Communism and the related expansion of the US military-corporate complex globally allowed power elites to carry out campaigns of state-corporate repression against popular democratic movements, while incorporating select parts of US and allied labor movements as junior partners in US overseas expansion (Chomsky 1991; Stephan-Norris & Zeitlin 2003). All this crucially served to limit the power of the US labor movement and universalistic spending on health and social welfare (Rathbun 1996; Jansson 2001; Buhle 1999; Davis 1986). For as *Business Week*

(1949:19-20) noted “the prospect of ever-rising military spending acts…as a ceiling on the ambitious social-welfare projects that the Truman administration has its heart set on. … [T]here’s a tremendous social and economic difference between welfare pump-priming and military pump-priming…Military spending doesn’t really alter the structure of the economy. It goes through the regular channels. … But the kind of welfare and public spending that Truman plans does alter the economy. … It creates new institutions. It redistributes income.”

The incorporation of citizens as junior partners in the overseas expansion of the military-corporate complex and associated warfare-welfare state became the US substitute for social democracy, a crucial ingredient in what is referred to as American exceptionalism (Lichtenstein 1995; Jansson 1991). Here, recurrently, more ambitious programs of social reform were subordinated to the expansion of the military-corporate complex and pursuit of primacy (Lichtenstein 1995; Davis 1986, 2002; Reifer 2007a). Military spending became a form of welfare for corporations and upper-class constituents, while providing lucrative employment for sections of the largely white male working class. At the same time, Cold War military spending provided the military forces to contain US enemies and allies while implementing a global policy of counterrevolutionary violence to ensure an Open Door for US capital, under the auspices of promoting modernization, development and freedom and opposing totalitarian communism (Reifer 2006a,b,c; Simpson 1994, 1999; Vanaik 2007; Klare 1972, 1989).

Military spending was much preferred by US elites to other forms of social expenditure as it was possible to get it from Congress and moreover helped to deflect a vibrant labor movement seeking universalistic social provisions and greater race, class and gender equality at home (Lipsitz 1994; Borden 1984; Lichtenstein 1995). Thus, instead of pursuing universalistic social provisions in tandem with efforts at organizing workers across lines of race, class and gender, organized workers were forced to negotiate private welfare provisions tied to firms, propped up by a permanent war economy. The US military-corporate complex thus played an integral role in maintaining the racialized and gendered structures of the stratified warfare-welfare state and the overseas expansion of US state-corporate power at one and the same time. The political-economic and social effects of this military spending has in turn been integral to the development of hegemonic social blocs - as with the rise of the New Right and associated right turn of the Eastern Establishment - that has served to ensure high levels of military spending and related policies of overseas intervention, while driving cuts to social programs (Davis 1986, 1990, 2002; Jansson 1991; Gordon 1994,a,b; Boies 1994; Reifer 2007a; Reifer & Chase-Dunn 2003).

In the US, a focus on National Security threats has long been seen as a way to get the electorate to focus on the need for greater military instead of using funds for social needs. Military spending in both superpowers was used to maintain the political and economic power of elites at home and abroad (Chomsky 1991; Evangelista 1999; Jones 1991; Reifer 2007a; Nichols 1993). In the US, more ambitious programs of domestic and overseas social reform, from the New Deal to the Alliance for Progress to the Great Society or promises to rebuild New Orleans after Hurricane Katrina, are thus continually stymied by spending on the military-corporate complex and war. Noting this reality, civil rights, anti-war activist and nonviolent revolutionary Martin Luther King, Jr. spoke out against the Vietnam War, arguing that the bombs being dropped in Indochina were also exploding in the ghettoes of America. As the legendary best-selling hip-hop rapper of all time, Tupac Shakur expressed it more recently: "got money for war but can't feed the poor". Money for the Iraq war – expected to cost over $2 trillion - has led to yet more cuts to cities and disaster preparedness other than terrorism in the US, with race-class inequalities, notably between suburbs, edge cities, and urban ghettoes widening, as Hurricane Katrina dramatically revealed (Bilmes & Stiglitz 2006; Reifer 2007a).

Already by the late 1960s and early 1970s the growing costs of the US military-corporate complex and associate warfare-welfare state had led to increasing leakages of US dollars to stateless offshore markets, undermining US control over world money. This prompted US elites to scrap the Bretton Woods agreements on pegged exchange rates that it had created after World War II, and which had been integral part of the expansion of social citizenship throughout the core, as well as in the periphery by providing for a modicum of state-led development in the Third World (Eatwell 1993; Reifer & Chase-Dunn 2003).

Simultaneously, the US turned to rely on the militarization of regional client states to uphold US interests in the Persian Gulf and Middle East. The resultant financialization and militarization of the global system, however, ushered in the rise of the Sunbelt based New Right and the right turn of the Eastern Establishment, especially after the Islamic revolution in Iran and Soviet invasion of Afghanistan (Davis 1986; Trubowitz 1998; Greider 1987; Arrighi 1994).

This right turn ensured that President's Carter and Reagan gave the capitalist strata the best of both worlds, doubling military spending from roughly $150 to $300 billion but financing it by fantastically regressive means, through borrowing, instead of by taxing corporate profits and the wealthy through progressive income taxes, as when New Deal limitations on the power of money capital were in effect. Thus, whereas earlier rounds of military spending in a productivist mold had a strong redistributive effect, these new rounds of neoliberal militarization through regressive borrowing on the global capital markets radically increased domestic and global inequality (Reifer 1990, 2007a; Phillips 2003). The US rise in interest rates, essential to the borrowing necessary to finance the new Cold War and an integral part of the military and monetarist counterrevolutions, led to a pronounced increase in US and global inequality, as much of the 2nd and 3rd worlds, which had borrowed money at variable interest rates for development, was brought to its knees (Arrighi 1991, 1994; Milanovic 2005). Ultimately the vast US escalation of military competition through borrowing on the global financial markets helped lead to a collapse of the Soviet empire and the break-up of the USSR (Arrighi 1997).

Neoliberal militarization helped vastly expand the global capital markets while reconstituting US power on increasingly narrow social foundations, as military Keynesianism and the financial overaccumulation its regressive financing allowed for welded together the New Right have-coalition (Davis 1986; Silver & Arrighi 2000). At the same time, the voracious demands for low-costs inputs for the US military-corporate complex and associated warfare-welfare state combined with the crisis of US power in Vietnam to facilitate the rise of first Japan and now Chinese-led East Asia. Here, the US now confronts a region whose relatively low production and protection costs poses a true challenge to US world power (Arrighi 2007).

Given that the military-industrial complex in the Soviet Union and the US served both domestic and geopolitical purposes, it is not surprising that exaggerated intelligence estimates served as crucial justifications for aggressive arms programs and military postures, in what often became self-fulfilling prophecies (MccGwire 1987; Chomsky 1991; Johnson 1997; Jones 1991; Leffler 1992; Nichols 1993). Here, the ideology of National Security, with its myths of empire and attendant secrecy, provided for the growth of military-industrial complexes in both superpowers and the external interventions that recurrently threatened to erupt into all out thermonuclear war (Udall 1998; Ellsberg 1981; Trachtenberg 1999; Schaeffer 1990; Klare 1989; Chomsky 1991). Yet despite their similarities, the US and Soviet military-industrial complexes differed radically in their investments, with the US pioneering the computer-satellite-telecommunications-media revolution while the Soviet Union invested heavily in tanks, increasingly irrelevant with the development of high-tech anti-tank technology by the US (Herspring 1990; Nye & Odom 1996; Reifer 2005a). Thus, while US investments ultimately were commercially quite profitable, Soviet investments both undermined its capacity to keep up with the military-technological revolution, decreasing its security and generating an increasingly assertive proletariat that in another irony of history became the gravedigger of historical communism instead of historical capitalism (Arrighi 1990).

With the emergence of Gorbachev and his dramatic announcement to scale back some half a trillion troops, roughly 10,000 offensive tanks and 500 tactical nuclear weapons in Eastern Europe (along with withdrawing from Afghanistan), military deployments which along with Stalin's brutality at home and abroad had served to confirm some of the worst fears of the Cold Warriors and western publics, along with the later revolutions of 1989 which led to the dissolution of the Soviet Empire in Eastern Europe, many hoped for a global peace dividend. Yet the US decision to respond to the Iraqi invasion of Kuwait with force rather than long-term sanctions in the 1991 Gulf War washed away these hopes.

Then following the Gulf War and Soviet collapse in the early 1990s merger mania among military companies, orchestrated largely by Wall Street investment bankers, corporate lawyers and Pentagon officials, resulted in a pronounced military dependency among surviving firms, again helping to ensure high levels of military spending (Markusen 1998, 2003, 2004). An especially notable trend revealed here has been the "increasing role of financial capital in the arms industry"(SIPRI, 2007). Today, the US retains its lead role in military spending and global arms sales. Some half a trillion alone is to be spent by the US on the world's largest ever arms production deal, the Joint Strike Fighter, with some 4500 aircraft. And as the US arms become increasingly commercialized, with US arms exports increasing from roughly 20% "of domestic military procurement" to some 70% in 1999, the US is once again helping to create the very threats it seeks to purportedly defend against (Flamm 2005:4; Reifer 2005b; Markusen 2003, 2004). A telling example of threat creation is the Anglo-American arming and support for Iraq's Saddam Hussein in the 1980s as a counter to the Islamic revolution in Iran during the long Iran-Iraq War (Mantius 1995; Friedman 1993; Gowan 1999). Similarly, the US organization of a global Sunni-led jihad against the Soviet invasion of Afghanistan—designed in part to compete with Iran's Shia revolution, helped in the rise of Al Qaeda and a global network of radical political Islamists. Subsequently, the terrorist attacks against the US in 2001 were used as an opportunity by US elites to embrace a program of global militarization already underway (Kaldor 2002; Reifer 2006d, 2007b).

Bruce Jackson is paradigmatic the new power elites of the US military-corporate complex today. A former Pentagon official under Reagan and Bush, before going into investment banking at a top Wall Street firm, between 1993 and 2002 Jackson was director of Strategic Planning for Lockheed Martin, the world's largest arms maker. Here, Jackson headed up the Committee to Expand NATO, where the firm cashed in on arms acquisitions by new NATO members, which as estimated by the Congressional Budget Office (1996) may run up to $100 billion or more. In 2000, Jackson was a George W. Bush delegate, heading up the Foreign Policy Subcommittee of the Republican Platform Committee. Jackson also played a role in the lead-up to the Iraq war, serving as the Chairman of the Committee for the Liberation of Iraq (2002-2003) and on the Board of Directors of the Project for the New American Century, many of whose members became leading figures in the Bush administration.

In the 1990s of course, the US intervened aggressively in the Balkans, arguing as after the failure to find any weapons of mass destruction in Iraq that it was guided by humanitarian motivations, though leading dissident voices saw instead an attempt by the US to secure continued global dominance (Chomsky 2001; Wallerstein 2006; Ali 2000). Today, the US continues with its expansion of NATO, placing military forces in newly independent East and Central Europe, as well as in the Middle East and Central Asia, while Russia is doing its part to maintain its own access in its near abroad (Lachowski 2007).

The US is currently negotiating bilaterally with Poland the Czech Republic on deploying elements of the Star Wars systems there, upsetting many in the European Union who dislike the bypassing of NATO. The deployment of Star Wars in the former Soviet satellite states would grant the US military their biggest military bases yet in states that were once part of the Soviet's Warsaw Pact alliance. The former Soviet president Mikhail Gorbachev was quoted recently as saying that US plans for new military deployments in the region were "all about influence and domination in Europe," as much of East Central Europe returns to its original Third World role, against which, along with the other backward states in the periphery, it had earlier rebelled (NYT 4/18/07: A4; Berend 1996). And during the 2007 G8 Summit in Germany, Russian President Putin warned of a new Cold War arms race, indicating that Russia might be forced to respond to US programs that appear to aim at a first-strike preemptive capability by retargeting European states with nuclear weapons (Steinbruner & Kaufman 1997; Lieber & Press 2006a,b, 2007a,b; IS 2006; FA 2006; RAND 2003).

The latest demonstration of the power of the military-corporate complex can be seen in the US invasion of Iraq and the so-called "war on terror." Jane Mayer's (2004) notes Cheney's role in planning for the invasion of Iraq, citing a "National Security Council document, dated February 3, 2001, well before the terrorist attacks of that September. The top-secret document, written by a high-level N.S.C. official, concerned Cheney's newly formed Energy Task Force. It directed the N.S.C. staff to coöperate fully with the Energy Task Force as it considered the "melding" of two seemingly unrelated areas of policy: "the review of operational policies towards rogue states," such as Iraq, and "actions regarding the capture of new and existing oil and gas fields." Documents from Cheney's Energy Task Force which reportedly worked closely with the major US oil, gas and military-energy engineering construction firms dated March 2001, included "a map of Iraqi oilfields, pipelines, refineries and terminals, as well as 2 charts detailing Iraqi oil and gas projects," and a document titled "Foreign Suitors for Iraqi Oilfield Contracts" (Judicial Watch 2006).

These findings would seem to confirm the important work of Jonathan Nitzan and Shimshon Bichler (1995) who argue that US elites seek to control the Middle East and to ensure relatively high prices for oil, including through at least a modicum of instability and military dependency seen as necessary to ensure a lucrative flow of petrodollars into the coffers of the oil giants and the arms-related manufacturers. Moreover, drawing on the important work of Polish economist Michal Kalecki (1990, 1991) Nitzan and Bichler show that US military dependent firms have much higher than average profits relative to the Fortune 500 as a whole, thereby increasing their power within the US and world society, pointing here to a "weapondollar-petrodollar coalition between the principal military contractors and the petroleum companies." Here, the Anglo-American states exchange military protection for petrodollars, which are recycled back into Anglo-American financial institutions, Treasury Securities and high-technology military firms (Spiro 1999; Bill 1988). Furthermore, leading financial analysts have shown that aerospace firms, a cyclical industry crucially dependent on military spending, are also much more dependent on loans from money-center banks than most other Fortune 500 companies, thus ensuring a community of interest between these corporations and the states that buy their armaments (Hulbert 1982:39-46, 89-92; Bill 1988).

Representatives of the major oil, energy-construction, military and financial firms are prominent in President Bush's administration, perhaps to an even greater extent than in those previous (Briody 2003; Caldicott 2002). And of course, a major beneficiary of the war is the firm Vice President Dick Cheney headed. In the early 1990s, Halliburton was paid millions of dollars to do a study on privatizing military services, which its report did indeed advocate, not surprising as it is one of the prime beneficiaries of this outsourcing, including by providing services in occupied Iraq (Mayer 2004). This was part of a broader trend of course, of the privatization of the military, including through the rise of private military/mercenary firms composed of corporate warriors, tens of thousands of whom are serving in Iraq. These firms, operating in virtually every continent, are increasingly taking over core aspects of the military-corporate complex and their role is crucial in deciding the outcome of wars, notably in Africa, as depicted in the recent Hollywood film, *Blood Diamond*.

From 1994-2002, the Pentagon entered into over 3,000 contracts with private corporate military firms at a value of over $300 billion. As of July 2007 private corporate contactors, now totaling some 180,000 persons in Iraq, surpassed the 160,000 US troops there. Moreover, increasingly US intelligence functions themselves are being outsourced to private corporations. Although financial and corporate interests have long been closely associated with the intelligence community, the privatization of intelligence today arguably institutionalizes to an even greater degree than heretofore the fusion of private corporate interests in the making of public policy (Hersh 1992; Aldrich 2001; Weiner 2007). Today, according to the Office of the Director of National Intelligence, some 70% of the US intelligence budget, rising by double digits annually since 9/11 and comprising tens of billions of dollars, goes to private corporate contractors. Personnel from military-corporate firms such as Lockheed Martin and Booz Allen Hamilton – whose head of Defense Programs, former National

Security Agency (NSA) director in the 1990s Mike McConnell, recently became the US National Intelligence Director – have reportedly been completely incorporated into the analytical divisions of the US intelligence community. Functions of these private corporate firms include helping to prepare the President's daily brief to reportedly comprising the majority of personal in the CIA's National Clandestine Service (Singer 2003; NPR 7/13/07; LAT 7/4/07; Avant 2005; Hillhouse 2007).

The National Security Agency today is also reportedly run largely by private corporate firms as is the work of the Department of Energy and the National Nuclear Security Administration, which runs the US nuclear weapons complex. And of course, aerospace, arms firms and other corporations providing private military, engineering-construction and intelligence services to the US, and the larger Wall Street financial community to which these firms are often tied, donate tens of millions of dollars to political candidates, thus acquiring even greater influence over foreign and military policy, as the line between public and private becomes increasingly blurred (Shorrock 2007; Los Alamos Study Group 2006; Markusen 2003, 2004). Moreover, such influence appears to be increasing as this publicly funded private corporate sector grows, with the private military industry's annual revenues expected to increase from some $100 billion to over $200 billion by 2010, raising profound concerns about global governance of international violence and democratic accountability (Schreier & Caparini 2005:5; Singer 2003). What these trends illustrate is how increasingly the rise of private actors in global governance in the areas of trade, production and finance through multinational corporations is also leading to the breakdown of the state monopolization of violence. This has led to an increased awareness of the extent to which a market in organized violence through mercenary and corporate actors has long been the rule in the global system, from ancient times to the present, while the nationalization of militaries and state monopoly of legitimate violence now appears to have been but a brief interlude.

Intelligence agencies have long formed crucial components of the military-corporate complex and thus it is not surprising that they largely played the role demanded by the neoconservatives in the Bush administration in the lead up to the US invasion of Iraq (Bamford 2004). Subsequent to the invasion, leading analysts at the CIA, notably Paul Pillar (2006) spoke out on how they "bent with the wind" in producing deceptive intelligence estimates to garner support for the war, with the US media generally uncritically and enthusiastically repeating official lies (Isikoff & Corn 2007). Although many believe that such subservience by the intelligence community and the corporate media is new, it has in fact long been essential in war scares and related military buildups (Evangelista 1981/1982; Kofsky 1993; Reifer 2005b,c; Herman & O'Sullivan 1989). Indeed, a number of the leading neoconservatives such as Paul Wolfowitz and Richard Perle, themselves disciples of legendary Cold warriors such as Dean Acheson, Paul Nitze and Alfred Wohlstetter, from the time of the fight against the Anti-Ballistic Missile Treaty, played crucial roles in these intelligence wars for some thirty to forty years.

In the 1970s, Richard Perle and many of his disciples and allies, notably Paul Wolfowitz, worked for Washington Senator Scoop Jackson, one of the many godfathers of the neoconservatives and also known as the Senator from Boeing. Wolfowitz (recently fired as head of the World Bank) and Perle - who served as President George W. Bush's

Deputy Assistant Secretary of Defense and head of Bush's Defense Policy Review Board, respectively - played major roles in garnering support for the US invasion of Iraq and had earlier been central in the ending of détente and the birth of the new Cold War from the 1970s. They did this through the infamous Team B which gave a right wing critique of the CIA's estimates of the Soviet threat – here working with their counterparts in government such as Ford Defense Secretary Donald Rumsfeld, and Chief of Staff Dick Cheney, seeking then as now to override Constitutional limitations on Presidential power and restore the Imperial Presidency. Team B in turn helped lead to the rebirth of the powerful Committee on the Present Danger (CPD), now reconstituted yet a third time in the aftermath of 9/11 (Cahn 1998; Boeis 1994; Sanders 1993; Çurtis 2004).

In the 1990s, Perle and his disciples and colleagues led or were actively involved in a host of military-corporate foreign policy think tanks and official study groups from Frank Gaffney's Center for Security Policy, to Rumsfeld's Commission too Assess the Ballistic Missile Threats to the US and related Rumsfeld Space Commission, all of which play major roles in continuing support for Star Wars, to the Project for the New American Century, whose members would go on to great influence in the 2nd Bush administration, as had members of the CPD in the Reagan and Bush administration's earlier (Hartung, 2003; Frontline, 1988). And in 1992, Paul Wolfowitz, serving under Secretary of Defense Cheney, was the primary author of the infamous Pentagon document that laid out vision of US primacy stretching into the 21st century, arguing the US should seek to prevent regional powers from trying to assume a more active regional or global role (Layne 2006).

US elites see continued security threats as a way to ensure military spending for high technology development and as a justification for a global network of military alliances and bases. Today, for example, the Pentagon is working on its own more advanced internet, the Global Information Grid (GIG), that aims to give "a God's-eye-view" of future battlefields; estimated to costs hundreds of billions of dollars, a new consortium formed in September 2004 to work on the project "includes an A-list of military contractors and technology power-houses: Boeing; Cisco Systems; Factiva, a joint venture of Dow Jones and Reuters; General Dynamics; Hewlett-Packard; Honeywell; I.B.M.; Lockheed Martin; Microsoft; Northrup Grumman; Oracle; Raytheon; and Sun Microsystems" (NYT, 11/13/04: A1, B2; NYT, 6/19/05: 1, 11). The US gains additional advantage here from its pursuit of primacy here as the high military spending needed for such efforts are exempt from WTO rules against subsidies. This US public subsidizes high technology via Pentagon spending, a form of militarized state-corporate capitalism via mercantilist military-corporate cartels, while "kicking away the ladder "for developing countries who are supposed to abide by free market rules (Chang 2002; Markusen 2004). At issue here is not merely profits but rather the intersection of violence, profits and power. For a healthy US military-corporate complex is seen as ensuring the US the mobilized technological capacity and related geopolitical power projection capability that both secures US control over world oil and hence maintains security and resource dependency among the vassals (Brzezinski 1997).

Yet whereas during the Cold War the US had promoted development in East Asia, tolerating restrictions on foreign direct investment and capital flows, since the collapse of the Soviet Union, US advantages in the realm of security have been as an instrument with which to open up emerging economies to speculative capital flows, as in the 1997/1998 Asian crisis (Gowan 1999; Cumings 1998). As Jagdish Bhagwati (2002) argues, just as there was a military-industrial complex there is now a Wall-Street-Treasury complex. Neglected here is the fact that the dominance of today's Wall Street-Treasury complex is secured in substantial part through the US military-corporate complex, as the US lock on global security is used to shape the global order to the advantage of the US (Gowan 1999).

Even before September 11, 2001, the US was moving to pursue an aggressive foreign and military policy. One important change here was a historic reorientation of America's global force structure away from Europe and towards the Asia-Pacific in general and China in particular. As a RAND (2001:13-15) report, close to administration thinking noted, the "most fundamental question … is whether Japan will continue to rely on U.S. protection", going on to express concern about a rapprochement between China and Japan, which it said would "deal a fatal blow to U.S. political and military influence in East Asia." Similar to the very beginnings of the West's violent entrance into Asia, US policy in Asia today aims to use military superiority as a way of ensuring that dense regional trade links serve to prop up Western violence, profits and power, rather than increase the autonomy of the Asian region. And yet, increasingly, US strategy appears to be leading to a steady erosion of US centrality in the global political economy, especially relative to Chinese-led East Asia (Arrighi 2007).

The recently closed US-India nuclear deal, seen by many as a serious blow to the Non-Proliferation Treaty which might set off a new nuclear arms race in Asia, as US Pakistani ally General Musharaff recently warned, is widely seen as part of Washington's strategy of supporting the rise of India as a great power as a counter to a rising China. At the same time, US firms are hoping to cash in on the deal by supplanting Russia as the largest supplier of weapons to India, one of the top military spenders and reportedly planning to spend some $10 billion in the next five years on major weapons purchases. East Asia has spent some $150 on arms from 1990-2002, with China, Japan and South Korea accounting for some 75% of this, as the rising wealth of the region fuels a series of bilateral arms races (Umbach 2005).

While the US is the largest military-corporate complex today, the European Union and countries such as Russia, China, Taiwan, Israel, South and North Korea, and India and Pakistan all have their own versions of military-industrial or military-corporate complexes, fueled by regional conflict and divided states (Klare 1991; Burrows & Windrem 1994; Gaddy 1996; Slijper 2005; Hayes 2006; Siddiqa 2007). Many of these complexes are tied in with military firms in other states as well as foreign aid, with the US funding tens of billions of dollars in arms acquisitions largely from the US, customized by local Israeli firms, for Israel (SIPRI 1997b:401-402). And then there are private arms dealers such as Viktor Bout (Farah & Brown 2007). It should be noted that here are radically important differences among states with some such as China, with its technologically inferior military-industrial complex─and despite its willingness to sell arms globally and support proliferation of nuclear technology─having apparently adopted a minimum deterrence strategy (Bitzinger 2005; Lewis 2007; Burrows & Winderm 1994). This has encouraged some leading mainstream security analysts to hope that China might head a coalition of states pursuing cooperative security and greater global equality and so lessen the "appreciable risk of ultimate doom" that the US pursuit of primacy arguably heightens (Steinbruner & Gallagher 2004a,b).

Today, the US pursuit of primacy and related global insecurity is thought by many to be having pernicious effects. Recently, the head of the International Atomic Energy Agency warned of the danger of virtual nuclear states, arguing that unless a new path towards nuclear disarmament was embraced, the world could end up with 20 to 30 states that could develop nuclear weapons in a short period instead of the 9 there are today (ABC 2006). And with the US reserving its right to use nuclear weapons if necessary, including possibly against Iran's nuclear facilities, along with its assertion of the unilateral right to invade or attack select countries to prevent them from acquiring nuclear weapons or in the name of fighting terrorism, the proliferation of nuclear weapons to US adversaries is now being increasingly used to justify US intervention and arms sales abroad. Yet ironically, whereas the US administration voiced the knowing falsehood that Iraq was tied to Al Qaeda and was reconstituting its nuclear program, there was a country closely tied with terrorist networks which not only did have nuclear weapons but was in fact serving as a nuclear Wal-Mart to regimes across the world, namely America's close ally Pakistan, a theme that reemerged strongly in the 2007 Presidential debates, as did the question of US nuclear first-use against Iran (Corera 2006; Isikoff & Corn 2007). The US invasion of Iraq – a decidedly secular dictatorship hostile to Al Qaeda – and US-supported Israeli invasion of Lebanon, rather than stemming the tide of radical political Islam, appears to have dramatically increased support for these groups (Gerges 2005, 2006). Iraq has now become a destination for foreign fighters from countries such as Saudi Arabia while Hezbollah and Hamas, which recently took over the Gaza Strip, are increasingly heroes to many across the globe due to their resistance to the US-supported Israeli invasion of Lebanon and over forty year occupation of Palestine.

The overwhelming weight of social scientific evidence indicates that most suicide bombing in the world is related to the combination of real or perceived military occupation and religious differences between the occupier and the occupied. The invasion of Iraq and perception of a general US-led war against the Muslim world seems to be generating an even more radical pan-Islamic response, replete with the proliferation of suicide terrorism, which had earlier been largely a form of national secular resistance to military occupation. The growth of suicide terrorism, in turn, serves to justify more funds more military-corporate complexes in state after state from the US to the Middle East to South Asia (Pape, 2006; cf. Moghadam, 2006; Hafez, 2007; Reifer, 2006d).

Today, the growth of military-corporate complexes in the Middle East is proceeding apace, with the US planning on a $20 billion dollar arms deal to majority Sunni countries such as Saudi Arabia and allies, along with an increase in military aid to Israel over the next decade to roughly $30 billion, some $9-10 billion over previous aid packages, as well as over $13 billion Egypt, another Sunni ally of the US (NYT 7/28/07:A1,6). At the same time, more countries in the region are turning to nuclear power plants that may be later used to produce nuclear weapons, this in a world with tens of thousands of nuclear weapons are left over from the Cold War. In the US alone, spending on nuclear forces during the Cold War came to some $5 trillion and is rising once again as the US seeks to build a new generation of nuclear weapons. As for the annual US military budget, narrowly defined, it is expected to come to some $650 billion for 2008, though its true cost is considered by some to be near $1 trillion annually (Schwartz 1998; Lawyers Committee 2007; Higgs 2007). The nuclear arms race and related military-industrial complexes of the Cold War period and thereafter has also left an awesome legacy of ecological devastation. Global military establishments still today the largest emitters of the greenhouse gas omissions that cause global warming, with the Pentagon being the single largest consumer of oil in the world (Klare 2007; Davis 1993, 2002; Makhijani et al 2000). The redirection of ever-greater resources towards military-corporate complexes and militarization takes away desperately needed funds for poverty reduction and the real sustainable human development needed to reverse global warming, while arguably increasing the global violence that ultimately risks short-term catastrophe as well as the long-term survival of the human species (Dreze & Sen 2002; Haq 1999; Steinbrunner & Kaufman 1997). Moreover, US-led state-corporate globalization and neoliberal militarization today is arguably central in maintaining “the climate of injustice” between the global North and South that plays an important role in preventing the greater equality and related increased global cooperation necessary to reverse the catastrophic effects of global warming (Roberts & Parks 2007).

In recent decades there has been a growing body of scholarship on the military-corporate complex, its relationship to universities, the role of military spending in the rise of new regions, the military-media-entertainment complex as well as the role of lying, secrecy and the manipulation of “intelligence” in generating support for foreign policy. Most recently, the role of the media in promoting what Ed Herman and Noam Chomsky call the “manufacture of consent” for the invasion and occupation of Iraq has become increasingly apparent with the failure to find the much touted weapons of mass destruction in Iraq, not to mention any links with Al Qaeda other than those created by the US invasion and occupation (Isikoff & Corn 2007; Reifer 2005b). Some of the most notable recent works on military-corporate complexes and/or alternative visions of cooperate security include the writings of Paul Ceruzzi (1989, 2003), Mike Davis, (1986, 2002), Paul Forman (1987), Randall Forsberg (1984), Mary Kaldor (1981, 2002), Chalmers Johnson (2007), Ann Markusen (2003, 2004), Lewis Mumford (1964, 1966), David Noble (1977, 1984, 1985, 1993) Christopher Simpson (1994, 1999) and P.W. Singer (2003).

Yet given the general neglect of the constitutive role of preparations for violence in socioeconomic and political development, there is a serious lack of comparative work on military-industrial and/or military-corporate complexes and the National Security States that spread—often with US help throughout Latin America and East Asia—their changing social foundations and combinations of public and private corporate power. To be sure, gains are being made, for example by scholars integrating the role of security threats and the construction of military-corporate complexes into accounts of developmentalist states, regional change, and global inequality (Eckert 1996; Edgerton 1991; en-Woo 1991; Woo-Cumings 1999; Reich 1990; Trubowitz 1998; Davis 1986, 2002; SIPRI 2007).

It should be noted too that military-industrial and military-corporate complexes have not gone unchallenged, as evidence by the anti-Vietnam war movement, the global anti-nuclear movements and the worldwide demonstrations of February 15, 2003 against the US invasion of Iraq (Bennis 2006; Habermas 2007). These movements for global peace and justice and the related growth of the World Social Forum may help steer the world away from the catastrophes of centuries previous, when national elites, by playing upon deeply felt sentiments of nationalism, patriotism, and feelings of superiority convinced their respective subjects and/or citizens to participate in colonial conquests and then to join in the mass slaughter of World War, the latter effectively destroying and splitting much of the worker's based world socialist movement (Arrighi 1990).

It is to be hoped that renewed attention towards these issues will provide more compelling accounts of the historic centrality of military-industrial and military-corporate complexes and thus perhaps make a contribution towards the evolution of more adequate global governance. Long ago President Eisenhower reportedly indicated "that he would like to see some social scientists brought into our security planning to study how long civilization can take these weapons developments" (quoted in Evangelista 1999). With greater scholarly insight, awareness and global action perhaps the tendencies of the human species towards large-scale organized violence and revenge may be circumscribed so that a more peaceful and just type of world society may evolve (Reifer 2007b).

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Millennium Development Goals

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Introduction

The eight Millennium Development Goals (MDGs) compel the world community by 2015 to:

1. Eradicate extreme poverty and hunger;
2. Achieve universal primary education;
3. Promote gender equality and empower women;
4. Reduce child mortality;
5. Improve maternal health;
6. Combat HIV/AIDS, malaria, and other diseases;
7. Ensure environmental sustainability; and
8. Develop a global partnership for development.

These goals address the fact that the improvements in the living conditions have been uneven and slow in much of the developing world (UN 2000; IMF et al 2000).

The United Nations (UN) Millennium Project (2005), directed by Jeffrey Sachs, considers the MDGs to be the world's most broadly supported, comprehensive, and specific poverty reduction targets ever. It estimates that their achievement by 2015 would lift more than 500 million people out of extreme poverty, i.e. poverty that kills, save the lives of 30 million children and 2 million mothers, provide safe drinking water to 350 million more people and sanitation to 650 million more people. Hence, the achievement of the MDGs by 2015 would mean a significant global welfare improvement in terms of human dignity. The achievement of the MDGs is seen as going half-way towards the final goal of poverty elimination. Extreme poverty can be cut in half by 2015, in order to be substantially eliminated by 2025 (UN Millennium Project 2005).

The MDGs enjoy a wide support in the world community. They reflect the Millennium Declaration, adopted by the 189 member states of the UN in September 2000, which emerged out of cooperation between the Organization for Economic Cooperation and Development (OECD), the UN, the World Bank, developing countries, and non-governmental organizations (NGOs) (Deverajan, Miller, Swanson 2002). OECD (1996) provided the basis for such a global partnership approach, whose origin was a meeting in 1995 of the development ministers of the OECD Development Assistance Committee (OECD/DAC). Hence, the MDGs emerged out of an initiative of the world's most developed countries, stressing the necessity of a partnership between the developed world and the developing world. The European Union (EU), which provides more than half of worldwide official development assistance (ODA), expresses a full and continuing commitment to the MDGs, and both the community and most member states have shifted their development policies to focus on the achievement of the MDGs (EC 2005a,b).

The International Monetary Fund (IMF), OECD, the UN, and the World Bank had jointly established the principles for assessing progress towards the achievement of international development goals through quantified targets for each goal and a set of indicators for measuring progress (IMF OECD, UN, and the World Bank, 2000). The MDGs consist of seven social and environmental goals linked to eleven quantified targets and a goal for partnership in development with seven targets aimed at improving opportunities for developing countries in the global economy (UN 2001).

The eighteen targets of the eight MDGs are (UN Millennium Development Project 2005):

Goal 1: Eradicate extreme poverty and hunger:

- Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one US dollar a day;
- Target 2: Halve between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2: Achieve universal primary education:

- Target 3: Ensure that by 2015, children everywhere, boys and girls alike, will be able to complete a full course of schooling;

Goal 3: Promote gender equality and empower women:

- Target 4: Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015;

Goal 4: Reduce child mortality:

- Target 5: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate;

Goal 5: Improve maternal health:

- Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio;

Goal 6: Combat HIV, malaria, and other diseases:

- Target 7: Have halted by 2015 and begun to reverse the spread of AIDS;
- Target 8: Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases;

Goal 7: Ensure environmental sustainability:

- Target 9: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources;
- Target 10: Halve by 2015, the proportion of people without access to safe drinking water and basic sanitation;
- Target 11: Have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers;

Goal 8: Develop a global partnership for development:

- Target 12: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system;
- Target 13: Address the special needs of the Least Developed Countries (LDCs);
- Target 14: Address the special needs of landlocked developing countries and small island developing states;
- Target 15: Deal comprehensively with the debt problems of developing countries in order to make debt sustainable in the long term;
- Target 16: In cooperation with the developing countries, develop and implement strategies for descent and productive work for youth;
- Target 17: In cooperation with pharmaceutical companies provide access to affordable essential drugs in developing countries;
- Target 18: In cooperation with the private sector, make available the benefits of new technologies, especially information and communication technologies (ICT).

These targets involve important policy problems, such as global governance, microfinance versus poverty reduction strategies, aid effectiveness, and trade and development.

Global Governance: Do the MDGs Imply Global Central Planning?

The core issue is what social organizers are assumed in the achievement of the MDGs and the associated targets. Boulding (1978) mentions three social organizers in societal evolution: the threat system, the exchange system, and the integrative system, stressing that all societies have combined these three systems into a specific bonding structure. They can be seen in the light of Hayek's (1973) distinction between *nomos* (rules of spontaneous order) and *thesis* (rules of organization) that govern *kosmos* (the grown order, a spontaneous order) and *taxis* (the made order, an organization), respectively. *Nomos* governs both the integrative system and exchange system, while *thesis* governs the threat system. Boulding (1978) points out that integrative structures are crucial to exchange, while Hayek (1979) argues that the exchange society and the guidance of the coordination of the division of labor by market prices require diffusion of certain gradually evolved moral beliefs.

Coordination is a matter of communication through money in the form of market prices, or language, in the form of words. Hayek stresses the crucial role the price system has for coordination in the market order, which uses competition as a discovery procedure. Knowledge is dispersed and the function of the price system is to communicate information, making efficient use of the knowledge of many people (Hayek 1945). Competition operates as discovery procedure in the wealth creating game of the market order (Hayek 1976). Boulding (1978) points out that language is essential to form images of large, complex, and integrated systems unknown from personal experience, which are important for the genesis of human artifacts. He argues that the heritage of intellectual, affectional, moral, and symbolic "chromosomes" in the human mind matters to the dynamics of the integrative system. As Searle (1999) argues, all institutions but language require language or language-like symbolism. Money provides through market prices language-like symbolism in the economy. Both money prices and language are used in decentralized coordination, a bottom-up approach, which is consistent with the virtuous free-market economy of economic personalism.

The moral and cultural institutions of society induce the free market to be a moral instrument for human development, because it achieves self-realization by entering into genuine community, while the small-group order creates a distinction between self-interest and selfishness (Santelli et al 2002). The small-group order of civil society gives what Heyne (1985) calls the personal elements upon which rule-coordinated capitalist societies are founded. As Boulding (1978) argues, integrative structures, based upon group identification that emerges out of individual images of personal identity and identity of others, are crucial to exchange, because exchange requires a small amount of benevolence. Furthermore, Boulding (1973) points out that exchange often evolves out of reciprocity, which has integrative aspects, lacking in exchange. He defines reciprocity as mutual grants that are formally uncoordinated two-way transfers, in contrast to exchange, which is a formalization of reciprocity through contracts. However, the aim of achieving the MDGs may induce centralized coordination, a top-down approach.

Deverajan et al (2002) argue that goals are meaningful, only if they are well defined and measurable, agreed by those who set the strategies and appropriate the resources to pursue them, and attainable under some plausible scenario. The associated targets of the MDGs provide a shared meaning of the MDGs themselves. Well defined and measurable targets open up for using the language-like symbolism of money, i.e. coordination through market prices. Nevertheless, appropriability of resources and attainability of the MDGs remain open issues.

According to Deverajan et al Swanson (2002), it is difficult to calculate the resources needed to achieve the MDGs and necessary to calculate the cost at the country level, because institutions and policies are crucial to the effectiveness of financial assistance. Acknowledging the speculative exercise of estimating the aggregate costs of achieving the MDGs, they estimate the achievement of MDG1 to cost an additional 54 to 62 billion US dollars in foreign aid per year and the achievement of MDG2-7 to cost an additional 35 to 76 billion US dollars per year, trying to account for interdependencies between them. Their assessment involves both money prices and language as means of communication. The images of good institutions and good policies that imply lower costs in terms of money have to be shared through communication by means of language. Yet, this still means decentralized coordination.

However, the EU contribution to the MDGs suggests a more centralized kind of coordination. The EU contribution to the MDG1-7 involves poverty reduction strategies, food security programs, more ODA to basic education and a stronger focus on national education sector programs, contributions to UN agencies and global initiatives reducing child mortality and fighting HIV/AIDS, tuberculosis, and malaria, etc. (EC 2005b). The European Commission stresses the crucial role given to policy coherence, pointing at Sweden's policy for global development and the Netherlands' policy coherence unit as good EU examples. This stress on policy coherence may induce central planning as a coordination device, and thereby a centralized, top-down approach to address externalities.

Concerning infrastructure and health, there are externalities. Leipziger *et al* (2003) argue that the MDGs are useful tools as broad objectives with multidimensional combinations, such as water and sanitation with information on hygiene practices. More generally, infrastructure interventions should be combined with public action to promote health knowledge, according to Jalan and Ravallion (2001). Leipziger *et al* (2003) focus on child health to tackle several of the targets of the MDGs. They find that GDP per capita is an important determinant of child health outcomes, partly through the reduction of malnutrition, and that an infrastructure index has a strong and significant impact on child mortality. Access to water reduces mortality, while access to sanitation and good flooring matters to malnutrition. Leipziger *et al.* point out that the impact of infrastructure on child mortality increases with education. Hence, there are significant policy externalities that warrant a system approach.

For health, which constitutes three of the eight MDGs, Travis *et al.* (2004) argue that stronger health systems are crucial to achieve these three MDGs and are concerned about the current lack of focus on systems strengthening. They point out that the drive to produce results for the MDGs has led many stakeholders to focus on their disease priority first with the implicit assumption that specific interventions would yield a generally strengthened system.

As problems arise when several, vertical subsystems result in duplications, distortions, and distractions, Travis *et al.* (2004) take a system-wide perspective, where one or more root causes are tackled to get significant, sustainable long-term improvements in coverage and quality of care. Disease or service specific strategies are, according to them, unlikely to bring about the improvements in health systems needed to achieve the MDGs. However, they also point out the need for multicountry studies to assess the relative importance of context and facilitate more robust generalizations on systems strengthening. This implies that health systems are complex systems rather than a set of specific strategies aimed at parallel objectives. In terms of Hayek (1973), they should be understood as *kosmos* (grown, spontaneous orders) rather than *taxis* (made orders, organizations).

Bottom-Up Microfinance versus Top-Down Poverty Reduction

As an EU contribution to the MDG1, German development aid promotes microfinance, in terms of ongoing projects in financial cooperation as well as technical cooperation with the aim of making microfinance institutions more professional and thereby reduces the dependence on informal money lenders (EC 2005b). Microfinance clearly represents a decentralized, bottom-up approach relying on the local knowledge of the poor themselves. Balkenhol (2005) argues that microfinance institutions should be supported, because they provide income security and risk management for the poor more effectively than any other providers and extend the market. However, he points out that subsidies in microfinance has to be organized carefully to avoid distorting the market, involving subsidies to intermediaries rather than to clients.

According to Dunford (2006), the objectives behind microfinance are microenterprise development by providing financial inputs and services for four areas of development. The first is for informal-sector entrepreneurs, innovation, and investment promotion by offering credit as both incentive and enabler. The second is for consumption-smoothing by providing poor families with relatively inexpensive credit. The third is for women's participation and building of social capital. And the fourth is for financial system development. Dunford (2006) finds that microfinance offers opportunities to contribute to the achievement of MDG1-7, primarily through its direct effect on poverty.

Essentially, microfinance contributes to human capital by using the fragmented, local knowledge of the poor, whom microfinance enables to participate in the market process. This induces learning through communication by the means of the price mechanism, but emerges out of reciprocity and the integrative structures of civil society. Interestingly, microfinance has been particularly successful in Bangladesh. Dunford (2006) points out that microfinance contributes in a major way to the achievement of the MDGs in Bangladesh. Based on the World Values Survey 1999-2002, Inglehart *et al* (2004) finds that Bangladesh is only second to Vietnam when it comes to doing unpaid voluntary work in local community actions. Hence, there are strong integrative structures in Bangladesh that sustain the market-based solution of microfinance to poverty reduction. As Boulding (1973) points out, exchange is a formalization of reciprocity, which he defines as mutual grants, thus highlighting the importance of civil society.

Nevertheless, the UN Millennium Project (2005), directed by Jeffrey Sachs, stresses a centralized, top-down approach. It asks for adoption of bold development strategies to meet the MDG targets by 2015, called MDG-based poverty reduction strategies, which should anchor the scaling up of public investments, capacity building and domestic resource mobilization, and ODA. By acknowledging that with only a decade to go, progress towards the MDGs varies, the UN Millennium Project actually highlights that attainability is a problem. For example, the proportion of undernourished is falling slowly in most regions of the world, but rising in some of them, while the reduction in child mortality has declined and even reversed in some countries. In addition, environmental degradation has characterized all developing regions. The UN Millennium Development Project tries to resolve this attainability problem through global central planning.

The reasons it gives for shortfalls in achieving the MDGs provide an explanation.

The UN Millennium Project (2005) mentions four reasons: governance failures, poverty traps, pockets of poverty, and areas of specific policy neglect. Comparing the first two will suffice to illuminate why a centralized, top-down approach is chosen. The first one is consistent with the decentralized bottom-up approach. Governance failures, such as failure to uphold the rule of law, pursue sound economic policy, make appropriate public investments, and protect basic human rights, are seen as creating obstacles to the private sector as engine of growth. However, the second one clearly reflects the centralized, top-down approach chosen. Poverty traps presumes that well-governed countries may remain poor, because governments lack fiscal resources and the capital stock is too low.

Easterly (2006) criticizes Jeffrey Sachs's poverty trap hypothesis and finds that is loses out decisively to the economic freedom explanation of progress. While the poverty trap hypothesis says that poor countries have low growth and rich countries high growth, he finds that a high value of economic freedom relative to initial income indicates that the income potential is high. In particular, Easterly finds that once you control for economic freedom, aid has a negative, significant effect on growth. As he points out, economic success is uneven and unpredictable, and economic freedom permits decentralized search for success, using the rapid feedback of free markets.

Along the lines of economic personalism, free-market economics is a moral instrument employed for human betterment, where moral and cultural institutions of civil society soften the market (Santelli *et al* 2002). According to this line of thought, economic freedom is a necessary component of the common good, which promotes human flourishing, and a prerequisite for the dignity of the human person. Yet, economic freedom cannot be imposed from above. As Easterly (2006) correctly argues, economic freedom grows gradually through bottom-up searching for effective piecemeal reforms, not through a top-down imposition of a "market plan", such as Jeffrey Sachs's "shock therapy" for transition economies.

Privatization of water services may provide a case in point. Galiani, Gertler, and Schargrodsky (2002) find that privatization of water services decreased child mortality by 5-9 percent, the effect being largest in poorer areas. In particular, they establish a robust result that privatization of water services reduces death from infections and parasitic diseases. Similarly, Ostrom (2000) points out that farmers craft their own irrigation systems, illustrated by a stylized bargaining game, and achieve better and more equitable outcomes than any national agency, which lacks awareness of the social and physical capital created by the farmers themselves. As she argues, these farmer-made irrigation systems are viable, because they are based upon local knowledge regarding their construction and maintenance, and upon the skills of the local farmers in crafting required institutions.

Consequently, the MDGs are well defined and measurable, and widely agreed on, but appropriation of the required resources is problematic and the calculation of the costs of complex systems with substantial externalities is difficult. The greatest problem, however, is the attainability of the MDGs, which has induced a top-down, centralized approach, according to which the MDGs are to be achieved through central planning, although microfinance promises a bottom-up, decentralized approach, which will use the local knowledge of the poor. Essentially, the attainability problem highlights the dichotomy between the top-down, centralized approach of the poverty trap hypothesis and the bottom-up approach of economic freedom.

Aid Effectiveness

The negative effect Easterly (2006) finds aid to have on growth, once you control for economic freedom, suggests that aid effectiveness is a crucial policy issue. The quality of aid in terms of growth impact will influence the costs of attaining the MDGs. The European Commission (EC 2005a,b) stresses the importance of improving the quality of aid. As aid has to be more predictable, EC (2005a) proposes a contract that assures a minimum-level of aid in a medium-term perspective plus performance-based aid. In addition, EC (2005b) stresses coordination of donor policies, harmonization, and simplification of donors' procedures, strategies, and activities. This means common cost norms in the EU, but also informal networks among EU members, such as the Nordic+ countries (Denmark, Finland, Ireland, the Netherlands, Norway, Sweden, and the United Kingdom) and the Visegrád countries (the Czech Republic, Hungary, Poland, and Slovakia).

The Nordic+ countries endorsed a joint action plan on harmonization, while the Visegrád countries contribute to more coordinated and effective development assistance, according to EC (2005b). Given the great importance of the EU to the world's total ODA, these steps towards harmonization, coordination, and simplification as well as predictable aid may improve the quality of aid and aid effectiveness. However, the focus is upon what the donor countries can do for the recipient countries, thus neglecting what the recipient countries can do for themselves.

The importance of economic freedom is not considered. Given the crucial role played by human creativity in the humane economy of economic personalism (see Santelli *et al.*, 2002), this neglect of economic freedom in the recipient countries in the context of aid effectiveness is problematic. After all, the quality of institutions and policies in recipient countries has a strong impact on aid effectiveness. Deverajan, Miller, and Swanson (2002) find the saturation point beyond which aid has no growth impact to vary between 6 and 30 percent of GDP for developing countries with the worst and the best quality of institutions and policies, respectively. As Easterly (2006) argues, economic freedom makes the bottom-up searching for effective solutions possible. This will influence the quality of institutions and policies, since local knowledge may constitute human capital of great value.

Yet, although the EU neglects economic freedom, it stresses the importance of good governance and full respect for human rights as fundamental prerequisites for development, which are lacking in Africa (EC 2005b). Based on an asset index, as measure of well-being, including household durables, characteristics, and human capital, Sahn and Steifel (2003) find that among twelve African countries, rural poverty rates decline at a pace that is greater than or equal to the linear trend required to realize MDG1 only in Ghana and Madagascar. However, when using log-linear projections (diminishing gains) instead, they find this target to be unlikely to be reached.

Among the twelve countries that represent 46.3 percent of sub-Saharan Africa's population, for which Sahn and Steifel have data for at least five of the MDGs, Ghana and Madagascar are the only two countries to achieve two of the MDGs. While Ghana, Madagascar, and Niger have witnessed improvements in five of the MDG1-7, they observe only improvement in one of MDG1-7 for Burkina Faso. In terms of the Economic Freedom in the World (EFW) Index for 2004, Ghana had rating 6.3 (rank 68) together with Belize, Bulgaria, Kenya, Philippines, and

Tunisia, while Madagascar had rating 5.8 (rank 90) together with Fiji, Guyana, Haiti, and Senegal (Gwartney and Lawson, 2006). This should be compared to the ratings 8.7 (rank 1) for Hong Kong and 2.8 (rank 130) for Zimbabwe. According to Gwartney and Lawson's (2006) EFW Index, the most free sub-Saharan country, in 2004, was Botswana with score 7.1 (rank 35), followed by Mauritius with score 7.0 (rank 40), and Zambia with score 6.8 (rank 48). Hence, the lack of economic freedom is a problem in Africa.

As Sahn and Stifel (2003) use data based on surveys conducted in the late 1980s and the 1990s, it is necessary to consider the change in economic freedom. Botswana and Mauritius are not included in their sample. However, for Ghana, Madagascar, and Zambia, Gwartney and Lawson's (2006) Chain-Linked Summary Index that allows for comparisons over time shows that the score changed during the 1990-2004 period by 3.9 for Zambia, 1.1 for Ghana, and 1.9 for Madagascar. In 1990, Zambia had a lower degree of economic freedom than Ghana and Madagascar. Sahn and Stifel's (2003) findings, where Zambia is found to be unable to achieve any MDG can, thus be explained in terms of economic freedom. Even if sub-Saharan Africa's economic freedom was low in 2004, there are signs of improvement compared to the very low economic freedom in 1990. We can, therefore, at this stage only expect slight improvements in the achievement of the MDGs.

As far as MDG1 goes, the proportion of people living on less than one dollar a day in sub-Saharan Africa remained virtually unchanged during the 1990-2002 period: 44.6 percent in 1990, 44.0 percent in 2002; to be compared with Eastern Asia: 33.0 percent in 1990, 14.1 percent in 2002; and South-Eastern Asia and Oceania: 19.6 percent in 1990, 7.3 percent in 2002; two parts of the world which have already achieved the 2015 target (UN 2006).

Concerning MDG 4, the under-five child mortality rate in sub-Saharan Africa declined from 185 per 1000 live births in 1990 to 168 per 1000 live births in 2004, which is modest compared to the decline in Latin America and the Caribbean: from 54 per 1000 live births in 1990 to 31 per 1000 live births in 2004; and Northern Africa: from 88 per 1000 live births in 1990 to 37 per 1000 live births in 2004 (UN 2006).

Nevertheless, Seabright (2004) points out that the rich countries today had in 1860 per capita incomes between Ghana and Romania today, while the infant mortality rate of Ghana and Romania today is lower than it was in today's developed countries in 1860. This achievement can be attributed to the steady, sustained progress in hygiene, nutrition, and waste disposal, but also to the worldwide diffusion of medical knowledge (Dutta and Seabright, 2002; Seabright, 2004). As Seabright argues, globalization has brought remarkable benefits to humanity. Countries with relatively low economic freedom may benefit from economic freedom elsewhere, as a consequence of globalization. Hence, one would expect aid effectiveness to improve through globalization.

As important causes behind the poor quality of aid, the UN Millennium Project (2005) stresses ad-hocery in multilateral aid and short-termism in bilateral aid. Multilateral organizations compete for donor government funding to implement small projects rather than supporting country-scale plans and budgets, while bilateral aid tend to be highly unpredictable, focusing on emergency aid rather than investments, long-term capacity, and institutional support. The UN Millennium Project concludes that the problem with aid is how and when aid has been given, to which countries, and to which amounts. As a remedy, it proposes a set of measures that reflect its centralized, top-down approach:

- confirm the MDGs as concrete operational targets;
- differentiate donor support according to country-level needs;
- support a 10-year framework to anchor 3-to-5-year strategies;
- coordinate technical support around the MDGs;
- strengthen the UN Development Group and the UN Resident Coordinator;
- set ODA levels according to proper needs assessment;
- deepen and extend debt relief and provide grants rather than loans;
- simplify and harmonize bilateral aid practices to support country programs;
- focus on overlooked priorities and neglected public goods.

The experimental search for gradual improvements through the market process that is institutionalized in microfinance is not given any consideration. The measures proposed are essentially centralized, top-down and reflect a reluctance to rely on what Seabright (2004) calls coordination with nobody in charge, which humans achieve when they interact with their neighbors in a network. As Seabright argues, the great experiment launched ten thousand years ago in elaborate task-sharing between genetically unrelated strangers was made possible by development of cultural capabilities. In particular, he stresses social institutions, many of which have grown by experiment or as a by-product of human action, because institutions build trust. Now, with globalization, environmental degradation, and arms proliferation, he argues that the great experiment requires trust-building institutions among nations that constitute the foundation for a marketplace of nations. Concerning MDG8—the development of a global partnership for development, this implies an experimental process conducted through continuous interaction in the marketplace of nations rather than the design of a global plan.

The untying of aid, in which the EU is involved, makes aid more efficient, lowers administrative burdens, and increases ownership of the developing countries (EC 2005b). Untying of aid is fundamental in establishing a marketplace of nations, since it opens up for experimental search through trial-and-error by means of competition among goods and service providers. This should be contrasted with the monopolistic rights given to domestic firms of the donor country when aid is tied. Simultaneously, donor countries are stakeholders in the progress of their recipient countries.

In order to establish a market order of aid among nations, untied aid must be given in proportion to expected progress of the recipient countries. This may be institutionalized as performance-linked bonuses on top of the minimum level of aid or rolling three-year commitments, as proposed by the European Commission (EC2005a). The idea of making a massive scale-up of ODA conditioned on the good governance and absorptive capacity of the recipient country has been proposed by the UN Millennium Project (2005). In the marketplace of nations, ODA should, thus, be viewed as a market for development funding, where donors, as stakeholders, supply funds in exchange for progress of their recipient countries.

Trade and Development

Participation in global exchange is a prerequisite for the achievement of a high level of economic development. Active participants will reap the benefits of the international division of labor, or task-sharing, through specialization according to relative comparative advantage. Bauer (2000) points out the crucial role trade plays in economic development and the possibility for developing countries to become developed through trade with the West, as core of the developed world. He argues that personal aptitudes and motivations, and social mores are more fundamental than access to markets. Hence, the most crucial policy objective is to promote the evolution of appropriate cultural and institutional foundations of production capabilities. Openness to foreign trade provides for an evolutionary selection mechanism. As Bauer points out, trading activity is crucial to economic progress, while foreign capital contributes to economic development.

The UN Millennium Project (2005) considers trade reforms as complementary to other parts of development policy. It focuses on improved market access and terms of trade for low-income country exports through increased investments in infrastructure and trade facilitation. The focus is upon overcoming the supply-side barriers of the developing countries, but includes special and differential treatment. This would weaken the market process by preventing market prices from performing their function of conveying information, thus making the capital structure more inefficient. Consequently, their supply-side capabilities will be worse with special and differential treatment, because the market feedback mechanism will be disturbed. EU trade policy toward Africa reflects the same neglect of competition as a source of progress. The European Commission stresses that trade at the service of development means that the development challenges of Africa should be taken into account and that market building will precede market opening (EC 2005a).

This means that markets will be designed with a weak market feedback mechanism, because market prices will be prevented from conveying information to African markets. The market economy is an evolutionary process and market building and market opening must go hand in hand. A developmental state creates stakeholding in economic growth, but may also lead the continuous skills upgrading process. However, this requires Singaporean free trade rather than Mauritian heterodox opening with segmented trade liberalization (see Small Nation Viability).

Concluding Remarks

The appropriability of resources and attainability of the MDGs are the underlying policy problem of the MDGs. The attainability problem seems to induce a centralized, top-down approach, although there is a decentralized, bottom-up alternative in microfinance that uses the local knowledge of the poor. The market mechanism can be put in service of development. Aid must be viewed as a market for development funding. Similarly, market building and market opening must go hand in hand. The failure to adopt the decentralized, bottom-up approach will make the attainability problem even more severe.

Internet Sites:

Millennium Development Goals. mdgs.un.org
Microcredit Summit. microcreditsummit.org
Millennium Campaign. www.millenniumcampaign.org
Millenium Goals. www.un.org/milleniumgoals
UN Millenium Project. www.unmillenniumproject.org

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Monetary Unions

Malcolm Sawyer

Introduction

Money is generally defined in terms of three functions, namely medium of exchange (or means of payment), store of value (or of wealth) and unit of account. These functions clearly relate to interactions between people and those who use a particular money could be said to form a monetary union. It is usually, but not universally, the case that the people using a particular form of money are in geographical proximity. Of more significance is the observation that the geographical territory over which a particular form of money is used often coincides with a nation state. Goodhart (1998), for example, speaks of 'the close relationship between sovereignty and currency areas, a relationship that tenaciously persists through the course of the creation, and break-up, of federal states' (p.14). In a similar vein it can be readily observed that when political unions are dissolved, the dissolution of the monetary union usually follows (cf. Table 1 below).

We begin by a consideration of this broad coincidence between political and monetary unions. However the main interest of this paper concerns the case where monetary union does not involve political union (though some degree of political association is generally involved). Although similar considerations are often involved, it is helpful to distinguish three forms of monetary association between countries. The first arises where a number of nation states share a common currency by mutual agreement and operate it through cooperative institutions, and this is full monetary union. The best-known example of this being the recent creation of a European single currency (the euro) now (2007) adopted by 13 countries. Others include the East Caribbean Central Bank (ECCB) in operation since 1983 covering eight island economies with a combined population of around 550 thousand and the Francophone countries of West Africa in the CFA.

The second is the adoption of the currency of one country by another and where the adopting country has no input into the monetary policy of the currency. The best-known examples here would be dollarisation where countries such as Panama, El Salvador and Ecuador have adopted the US dollar as the currency. The term dollarisation will be used for this though it is a more general phenomenon. For example, the currency of a large neighbouring country had long been adopted by a number of small European countries (Andorra, Monaco, San Marino and Vatican City) succeeded by their adoption of the Euro, and the use of the Swiss Franc by Lichenstein.

The third is the use of a currency board. Under a currency board arrangement the Central Bank of the country concerned continues to issue the domestic currency but the extent of the issue is limited by the amount of the specified foreign currency which the Central Bank holds. Recent examples here include Argentina which tied its peso on a one-for-one basis with the dollar (until the collapse of the arrangement in 2002) and Bosnia (which initially linked with the DMark, and then euro when that replaced the DMark).

Money, Transactions Costs and the State

Two perspectives on the emergence of money have been advanced and some consideration of them helps to inform the debates over monetary union. These two perspectives can be given variously labels and we use M-approach and C-approach (Goodhart 1998), and these are briefly discussed in turn.

The M in M-approach can stand for metallist which stresses the physical nature which money has often taken (e.g. gold). It can also stand for Menger, a major author advocating this view of money (Menger, 1892). This approach views the emergence of money in terms of the reduction of transactions costs and to reduce the difficulties, notably the double coincidence of wants, associated with barter. This approach has an evolutionary aspect : numerous economists have sought 'to construct models showing how the private sector could evolve towards a monetary economy as a function of a search for cost minimization procedures within a private sector system, within which government does not necessarily enter at all' (Goodhart 1998:4).

The other C-approach has been labelled the Chartalist approach. It argues for a strong link between the State and the emergence of money and the form which money takes in any particular society. The State has two particular and strong influences on what is regarded as money as a general accepted medium of exchange. The first is that the State imposes taxation and when doing so what the State is willing to accept as payment of taxation. The second is that what counts as legal tender and what can be used to discharge debts is set down in law. 'Chartalism … posits that money (broadly speaking) is a unit of account, designated by a public authority for the codification of social debt obligations. More specifically, in the modern world, this debt relation is between the population and the nation-state in the form of a tax liability. Thus, money is a creature of the state and a tax credit for extinguishing this debt. If money is to be considered a veil at all, it is a veil of the historically specific nature of these debt relationships. Therefore, Chartalism insists on a historically grounded and socially embedded analysis of money' (Tcherneva 2006).

These two views on money have quite different implications for the understanding of the formation of a monetary union. The M-view stresses an evolutionary view of money, whereby the form which money takes (the 'money thing') changes over time in response to transactions costs and technology. The evolution from 'physical money' (e.g. gold) to 'fiat money' would be understood in terms of reductions of costs. From this perspective, a monetary union is a further evolution of money which is to be understood in terms of the reduction of costs, notably transactions costs otherwise involved in changing currencies. The Chartalist view would focus on the role of the State in the decisions on the adoption of a particular money, its role in the acceptance of money as payment of taxes, and the money as legal tender. The formation of a monetary union is then viewed in terms of a set of political decisions by the States involved as to what they accept as money for payment of taxes etc..

Optimal Currency Areas Considerations

Much of the recent literature on monetary union has been dominated by the notion of an optimal currency area (OCA). This literature can be seen to start by asking the question as under what conditions is it desirable for two economic areas (this could be countries, regions within countries etc.) share a common currency rather than having separate currencies. In the article which launched this literature, Mundell (1961) raised the question in terms of whether, for example, California and New York State should share a common currency, or whether it would be desirable for say a Western dollar (used in Western parts of USA and Canada) and an Eastern dollar (Eastern parts of USA and Canada).

With separate currencies there are costs of trade between the two economic areas arising from the transactions costs of exchanging one currency for another—these range from the costs charged by banks and others to exchange currencies through to the uncertainties associated with fluctuating exchange rates. These costs hamper trade and would then seem to reduce gains from trade. But having separate currencies means that the relative value of the currencies (that is the exchange rate between them) can be changed whereas under a common currency that is clearly not possible. In the event that one economic area receives a positive ‘shock’ (e.g. discovery of valuable natural resources) and the other does not, then the area with the positive shock can adjust to that in part by an increase in its exchange rate. Conversely an area receiving a negative shock (e.g. downturn in demand for its exports) could adjust to that by a decrease in its exchange rate. In effect, a country suffering a downturn in demand for its exports can respond to that by lowering prices, and it would do that through a decrease in its exchange rate. This would help to offset the downturn in demand, which helps to maintain demand and thereby economic activity in the country concerned (though the decline in the exchange rate would tend to reduce the living standards in the country concerned).

With a single currency the possibility of exchange rate change is obviously removed, and the OCA literature has focused on the alternative routes through which two (or more) economic areas in a currency union could adjust to changes in their economic circumstances (e.g. faster productivity growth in one area than in the other, decline of an industry in one area). The OCA literature has focused on three features which could provide an alternative adjustment mechanism. By extension if these three features are present (at least some effective subset of them) between economic areas then those areas would form an ‘optimal currency area’. The three features are:(i) factor mobility and openness of markets; (ii) relative price flexibility; and (iii) fiscal transfers within the monetary union.

The general idea is that an economic area receiving a negative shock (or worsening economic performance) could adjust to that through a movement of the factors of production (labour, capital), notably an outward movement of labour. Alternatively (or additionally) the price of the products which it produces could fall thereby encouraging demand for its products (and this would be comparable to a devaluation of its currency if there were still separate currencies). A policy response could come from fiscal transfers towards the area in question to cushion the effects of the negative shock. These fiscal transfers would generally operate within a single political entity but in general do not arise between political entities.

The OCA approach could be viewed as a positive theory, that is to delineate the conditions under which currency areas would develop. In the presence of factor mobility, price flexibility and fiscal transfers over two or more economic areas, then a single currency area would tend to emerge. It can also be viewed as a normative theory, that is delineating the conditions under which a currency area should develop.

As already noted, a country is often closely linked with its currency, and joining a monetary union will often be viewed in terms of some surrender of political sovereignty. The formation of a monetary union appears to reduce economic sovereignty. A monetary union entails a single central bank, and the implementation of a common monetary policy. Monetary policy can take a variety of forms, e.g. attempts to control the growth of the stock of money, but generally involves the setting of a key policy interest rate. Thus across a monetary union, there is likely to be a common level of interest rates. Monetary policy by its nature will be a uniform policy across the monetary union. But monetary policy is often seen as a major macroeconomic policy and is generally the major policy particularly in the context of a monetary union. The other major policy, namely fiscal policy, operates through taxation and public expenditure, and that can only be operated at the level of the monetary union if there is a corresponding political authority which levies taxes, undertakes public expenditure and can run an unbalanced budget.

The use of monetary policy raises three major questions for the countries involved in a monetary union. First, which authority sets monetary policy? In a monetary union there has to be a single monetary policy, whether this takes the form of targeting the money supply or more usually setting the key interest rate (e.g. the discount rate, the 'repo' rate). The authority will usually be a central bank which will set the rate of interest at which it will provide Central Bank money to the banking system. It then appears that the operation of monetary policy has moved from the national to the supranational level.

Second, what objectives are set for and pursued by monetary policy ? Should the objective be the control of inflation ? which would be in line with the recent world-wide trend towards inflation targeting. Or should the Central Bank be pursuing a wider range of objectives, including low unemployment and sustainable growth?

Third, there may well be differences in the economic structure and economic conditions between countries of the monetary union, and the interest rate appropriate for one country may not be the one appropriate for another, giving rise to the 'one size fits all' problem. That type of problem would be diminished to the extent that the countries forming the monetary union have similar economic structures and have correlation between their economic conditions. But it does mean, for example, that if there are differences in the inflationary experience between countries then the appropriate interest rate may differ between countries and also that the nominal interest rate set by the supranational Central Bank will translate into different real interest rates.

It is difficult to think that there can be persistent differences in the rates of inflation between countries forming a monetary union. If there were, then prices in the country experiencing higher inflation would rise relative to others, and the products which they produce and sell would become price uncompetitive over time. The demand for their products would fall, leading to a decline in production and employment. But maintaining inflation in line with that in the rest of the monetary union can have substantial costs. A country which is prone to inflation and appears to require high levels of unemployment and/or low levels of capacity utilisation to restrain inflation would be condemned to high levels of unemployment.

The formation of a monetary union clearly requires that a number of currencies are replaced by a single one, and hence that there is an exchange rate established between the previous currencies and the new one, and also amongst the previous currencies. The nominal exchange rates between the previous currencies become locked for all time, though the real exchange rate may change as the relative price levels change. A monetary union based on inappropriate exchange rates will face difficulties. The monetary union between West Germany and East Germany alongside the political union would appear to be based on a much over-valued East German mark (relative to the West German mark) which left much of East German industry uncompetitive.

Stability of Monetary Unions

A brief indication of the experiences of some monetary unions is given in Table 1 (see Chown 2003 for a comprehensive discussion). The first set of monetary unions whose experiences are summarised have the feature that monetary union occurred in the context of political union. In the case of the United States, the political union long pre-dated the monetary union in the form of the Federal Reserve. These monetary unions are long-standing (with the exception of the German one dating from 1990, and now superseded by the Economic and Monetary Union of the EU). These contrast with the second set of examples where a monetary union dissolved when a political union collapsed. These examples provide support for the Chartalist view that there is a very strong link between monetary union and political union since the political entities which came from the collapse of previous political union (e.g. the countries formed from the break-up of Yugoslavia) quickly introduced their own currencies, and the currency adopted was a decision implemented by government, and could not be seen as a gradual evolutionary change arising from changes in transactions costs. The monetary union between Great Britain and Ireland dissolved over a half-a-century, starting from the independence of Ireland from Great Britain in 1922 through a form of currency board (legislated for in 1926 and beginning operation in 1928), a one-to-one linkage between the pound sterling and the Irish pound to a floating exchange rate between the pound sterling and the punt (as the Irish currency was relabelled), and subsequently the absorption of the punt into the euro.

TABLE 1 MONETARY UNIONS

(a) Still Surviving but with Political Union

British monetary union between England and Scotland	From 1707
Zollverein (German Customs Union) leading to German political union	From 1818
Italian monetary union	From 1861
US Federal Reserve system	From 1913
German unification	From 1990

(b) Failed Once Political System Collapsed

Roman monetary union*	286-301
German monetary union	1857-1918
The Soviet system	1917-1993
Yugoslavia	1919-1992
Czechoslovakian Republic	1919-1994

* Emperor Diocletian reforms Roman coinage, thereby creating the first single currency union.

(c) Failed Once Economic Links Collapsed

British monetary union between Great Britain and Ireland	1926-1979

(d) Still Surviving without Political Union

Belgium—Luxembourg union	From 1923
West and Central African CFA Franc Zone*	From 1948
Eastern Caribbean Currency Union**	From 1983

* CFA: (Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Ivory Coast, Mali, Niger, Senegal and Togo); previously linked to the French franc, since 1 January 1999 to the Euro.

** This Union includes: Anguilla, Antigua and Barbuda, Commonwealth of Dominica, Grenada, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and The Grenadines.

(e) Temporary Monetary Unions

Latin monetary union*	1865-1926
Scandinavian currency union**	1873-1921
East African Currency Area	1922-1977

*This Union included: France, Belgium, Italy and Switzerland; Greece and Bulgaria joined in 1867. The link changed from silver to gold in 1878.

** This Union was established between Denmark and Sweden in May 1873 (both almost joined the Latin Union but eventually did not because of the Franco-Prussian War of 1870-1871). Norway joined in October 1875.

(f) Other Currency Pegs

Gold standard	1870-1931/36
Bretton Woods	1944-1973
European Exchange Rate Mechanism	From 1979

Source: Adapted from *The Financial Times* (23 March 1998) and Pentecost (1999).

The next two examples provide contrasting experiences. First, a group of long lasting monetary unions which have stood the test of time and which have not involved political union.

The CFA (*Communauté Financière Africaine*) franc, previously pegged to the French franc and now the euro, has been in use in the French colonies of West and Central Africa since 1945 and its convertibility is guaranteed by the French Treasury. The Eastern Caribbean Currency Union has survived for over 20 years without political union. But it does link together eight small island economies with a combined population of just over half a million.

Second, there was a group of monetary unions which did not involve political union, survived many decades but eventually dissolved.

European Economic and Monetary Union

The most recently founded and probably the most widely known and discussed monetary union is that of the European Economic and Monetary Union (EMU) which came into existence in January 1999 with the irrevocable fixing of the exchange rates between the currencies of the 11 countries involved (latter growing to 12 with the entry of Greece) and the introduction of the Euro as a 'virtual' currency (used for financial transactions). This was followed in January 2002 with the euro as a fully fledged currency replacing the 12 national currencies. In January 2007 Slovenia joined the EMU.

The 12 countries involved were members of the European Union (the three other countries at the time, Denmark, Sweden and the UK not joining, and subsequently the European Union expanded in May 2004 by a further ten countries and in January 2007 another two). The 12 countries initially involved had a combined population of 300 million and a level of economic output which is rather smaller but of the same order of magnitude as that of the United States. The size and economic power of the EMU and the linkages of other currencies, formally or informally, to the euro offered the prospect of the euro developing into a world currency alongside (or even replacing) the dollar. A euro widely used in international trade and finance could bring seignorage gains to the EMU. The enthusiasts for EMU saw one of the major aims as being 'to reinforce Europe's monetary stability and financial power by:

Ending, by definition, any possibility of speculation between the Community currencies;

Ensuring, through the economic and financial dimension of the monetary union thus established, that the new currency is largely invulnerable to international speculation; and

Enabling the euro to become a major reserve and payment currency.' (European Parliament Fact Sheet 2006)

The present European Union started in 1957 under the Treaty of Rome as the European Economic Community, commonly referred to as the Common Market. It developed in terms of the number of countries who were members in a number of stages from the original six to 15 in 1995 and subsequently to 25 in 2004, and then to 27 in 2007. It also developed in regard to the degree of integration between the national economies. The aim became to achieve a full integration between these economies and measures such as The Single Market Act of 1986 which sought to remove non-tariff barriers by the end of 1992. The single currency could be seen as a further measure to remove a barrier to trade. National currencies meant transactions costs of changing one currency into another and the potential change in the exchange rate between currencies (even though policies such as the Exchange Rate Mechanism sought to stabilise the exchange rates, this was still only within bounds and a change in the central exchange rate was still possible).

The Maastricht Treaty (formally The Treaty of the European Union signed in February 1992) provided convergence criteria which were intended to be met by those seeking to join the euro. These criteria were:

- Average exchange rate not to deviate by more than 2.25 per cent from its central rate for the two years prior to membership;
- Inflation rate was not to exceed the average rate of inflation of the three community nations with the lowest inflation rate by 1.5 per cent;
- Long-term interest rates not to exceed the average interest rate of the three countries with the lowest inflation rate by 2 per cent;
- Budget deficit not to exceed 3 per cent of its GDP;
- Overall government debt not to exceed 60 per cent of its GDP.
- National central banks to be 'independent'.

These 'convergence criteria' were in the event not fully met by the countries who joined the Euro (see Arestis, Brown and Sawyer Chapter 3), which supported the view that the Euro was more a political than an economic project. Even so, the 'convergence criteria' indicate what was deemed necessary for a successful launch of a single currency. Some are perhaps self-evident: similar inflation and interest rates since it can be expected that a single currency area will have a single interest rate (set by the European Central Bank in this case) and similar inflation rates. Others are less obvious and these reveal the ideological economic analysis which lay behind the euro.

The arguments for inclusion of budget deficits in the convergence criteria appear to have come from a desire to exclude 'profligate governments' for membership of the Euro and the idea that one country's budget deficit may adversely affect other countries. The argument here would be that a budget deficit leads to a higher interest rate in the country concerned, and that higher interest rate spills over into other countries. But the choice of 3 per cent of GDP for the limit for the budget deficit was never explained: why 3 rather than 2 or 4 (or indeed any other number).

Under a currency union there will be one central bank which is the issuer of the currency, and the monetary policy of the currency area operated by the Central Bank. The attitudes towards monetary policy and the role of Central Bank arise from specific economic analyses. The form which monetary policy takes, e.g. control of money supply, use of interest rates, reflect views on whether money supply can be controlled, whether interest rates have a significant effect on demand etc. The advocacy of independent central banks has come from a view that politicians, being democratically accountable, cannot be trusted to make economic decisions through the danger of adopting policies which reduce unemployment at the expense of future inflation. The 'independence' of national Central Banks and then of the European Central Bank followed from the fashion during the 1990s for independence of Central Banks.

These features have continued. The European Central Bank has been established as an independent body with a complete separation between the monetary authorities (that is the ECB), and the fiscal authorities (in the shape of the national government). Article 107 of the amended Treaty of Rome states that 'When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member

State or from any other body.’. This would appear to preclude the co-ordination of fiscal and monetary policies for it would require the ECB to be influenced by national governments and others and to pursue objectives other than price stability.

The Stability and Growth Pact (SGP) has sought to impose a tight fiscal regime on countries with a maximum budget deficit of 3 per cent of GDP and a budget in balance or surplus over the business cycle. The absence of a fiscal authority at the eurozone level (comparable to the ECB) which could run budget deficits (or surpluses) means the absence of supranational fiscal policy. The limits on budget deficits reflect a pre-Keynesian view on the requirement for a balanced budget (in this case over the course of the business cycle) and the impotence of fiscal policy. In practice this budget deficit limit has not been enforced.

The emergence of the euro has often been discussed with reference to the OCA considerations listed above. The evaluation of considerations such as factor mobility is not straightforward as the OCA approach does not indicate how mobility is to be measured nor does it indicate how much mobility would be sufficient for an OCA. The USA has been used as a benchmark in light of the similarity of size of the USA and the eurozone (in terms of population, geographical area and GDP). On that basis it has generally been concluded that factor mobility is lower within the eurozone than in the USA (notably labour mobility through issues of language, qualifications etc.). A particular notable omission in the context of the Euro Zone is the virtual absence of fiscal transfers. In the USA, there is a substantial Federal budget (of the order of 20 per cent of GDP) which operates to effect fiscal transfers through the tax and expenditure system (in part because a proportional or progressive tax system will raise more revenue in high income regions). In contrast, the European Union budget is around 1 ¼ per cent of GDP, and has to be in balance. Thus there is neither the opportunity to have a fiscal policy nor can there be substantial transfers between regions.

Currency Boards and Dollarisation

A monetary union involves a number of sovereign states coming together to have a single currency, and it can be viewed as a co-operative arrangement with the creation of a supranational currency. A currency board or dollarisation involves a country giving up some or all of its powers over a national currency but without any involvement in the monetary policy of the currency adopted. As seen above the Economic and Monetary Union of the EU places control of interest rate in the hands of the European Central Bank, and though this has been created as an ‘independent’ body, the countries involved are represented through the governors of the national central bank being on the board of the ECB and involvement in the appointment of the governor of the ECB. In contrast, a country adopting, say, the dollar has to accept the monetary policy of the Federal Reserve, and specifically the interest rate which it sets. A country adopting a currency board has to ensure an sufficient inflow of the relevant currency into the reserves of its Central Bank.

The attraction of a currency board, particularly in a country which has been subject to high rates of inflation, appears to be that it places substantial limits on the ability of its Central Bank to ‘print money’ as it can only issue local currency to the extent to which it holds foreign currency reserves. A monetarist interpretation of inflation whereby increases in the money supply feed through to increases in prices would view this limit on the Central Bank’s money creation powers as an effective way to bring down inflation. The existence of a Currency Board may well generate anticipations and expectations that inflation will be under control and such favourable expectations would make the control of inflation less difficult.

Although the currency board arrangements appear to place limits on the issue of Central Bank money, this need not place limits on the ability of the banking system to create money. By far the larger part of what is generally regarded as money in industrialised economies will take the form of deposits with the banking system. When banks grant loans, bank deposits are thereby created, and the banking system can expand the stock of money.

A country adopting a Currency Board is also adopting a fixed exchange rate for their currency vis-à-vis the reserve currency. The well-known issues of maintaining a fixed exchange rate then arise. The 'inconsistent trinity' principle states that only two of the (i) complete free capital mobility, (ii) independent monetary policy and (iii) fixed exchange rate are mutually compatible. On that basis, a country adopting a currency board has to forego one of the first elements, and the usual one to go in the independent monetary policy. The interest rate of a country adopting a currency board will be dictated by the requirement to maintain the fixed exchange rate between that currency and the currency to which it has tied its fate.

Dollarisation involves the adoption of another country's currency, and hence an acceptance of that country's monetary policy over which the country concerned has no influence. This loss of an independent monetary policy under dollarisation provides both its attraction as well as the downside. The downside is the loss of control over interest rates and monetary policy. Further, the country which is dollarised has to have an inflation rate which is similar to that of the USA (as indicated above), and to ensure that there are sufficient dollars in circulation. The attraction of dollarisation particularly for a country which has a history of high rates of inflation and interest rates (in nominal and real terms) is the view that it will bring much lower inflation and interest rates. By tying one's own currency to another currency or by adopting another currency, it appears that inflation will be in line with inflation in the country of the currency adopted. But a failure to do so in the end is likely to spell disaster. A persistently higher inflation in a country leads that country's exports to become uncompetitive, generating balance of trade problems. Argentina's attempt to lock its currency (peso) to the dollar during the 1990s ran into this problem as its currency became clearly overvalued, followed by crises in the early 2000s.

The value of the dollar changes against other major currencies and it can be readily observed that there are major swings in the exchange rates between major currencies (e.g. dollar, euro, yen) of the order of +/- 25 per cent. A currency whose value is tied to the dollar will find its value against other currencies fluctuating as the dollar exchange rate against those currencies fluctuates. The effects of the economy of the currency concerned may be profound. Its trading pattern will be typically different from that of the United States, and the fluctuations in its exchange rate will impact on its imports and exports, and thereby on output and employment. As the value of currencies go up and down, sometimes the effects can be favourable but at other times unfavourable.

Conclusion

Monetary unions have had a long and chequered history, as illustrated in Table 1. The OCA literature suggests that a successful and sustainable monetary union requires considerable convergence in economic performance and integration between the members of the union. For example, the inflationary pressures and the resulting inflation rates have to be similar across the members for otherwise those members with relatively high inflation will find the prices of their goods and services rising relative to others. The ability or otherwise of the members to successfully adjust to changing economic conditions is an important consideration, and needs to be supported by adoption of appropriate economic policies. The formation of a monetary union means some shift in the location of decision-making over monetary policy and interest rates (though it is debatable how much effective independence a small country has over its monetary policy). The governances issues relate to the representation of area interests in the decision-making process (which is clearly absent in the case of dollarisation), to the nature of the policies pursued by the Central Bank and whether they are supportive of high levels of economic activity, and the ways in which convergence and integration between the members of the monetary union are to be supported by fiscal policy operated at the level of the monetary union.

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Non-Government Organizations

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Introduction

Non-government organizations (NGOs) have two working definitions. The first official and more narrowly definition includes those organizations registered by the UNITED NATIONS with consultant status without being registered as governments or member states. The second, broader, and working definition of NGOs includes all organizations that are not part of local, state, federal, or international governments.

Contemporary issues surrounding NGOs are not limited to their relationship to the United Nations. For example, while NGOs are supposedly generally independent both from governments and business, actual conditions are often more complex. Likewise, despite their reputation as progressive, grassroots representatives of 'the people,' real NGOs are too diverse and complex to fall under any single label, political or otherwise.

This is not to say that defining NGOs is an act in futility. A review of NGO governance and structure, its relationship with civil society, and the range of potential activities certainly highlight the diversity of NGOs today, but it also reveals overall themes and key tensions faced by all NGOs. These themes include the increased role of communications and coalitions in NGO development, simultaneous pressures for democratic governance and greater efficiency, and rising prominence, especially in the fields of environmental politics and peace-building.

Background and Overview of NGOs

The roots of NGOs go back to 1945, when the United Nations (UN) gave Consultative Status to certain NGOs in Article 71 of Chapter 10 of its Charter. Via the United Nations Economic and Social Council (ECOSOC), NGOs can apply to one of three categories of Consultative Status, allowing them to participate in UN conferences and deliberations. These three categories vary in the amount of power and scope bestowed to the NGO in United Nations decision-making. NGOs can also register with the Department of Public Information (DPI) in order to participate in the Human Rights Commission and Sub-Commissions, but this route remains largely unknown to many NGOs, especially those from developing countries.

The number of official NGOs has grown dramatically over the past six decades. In 1946, there were 41 NGOs listed with the United Nations; in 2005, there were 2,613. To be eligible for Consultative Status, NGOs can range from local to international in scope, but they must be non-governmental, be at least two years old, have established headquarters, and fulfill certain criteria of transparency and representative decision-making.

While the regulations governing UN-listed NGOs have not changed dramatically since their inception, they have grown more complex and prominent. The term "major groups," for example, came into official being in 1992, at the Agenda 21 conference, better known as the "Earth Summit" in Brazil. While the term "major groups" remains largely confined to academic and policy-making circles, its significance lies in the 1996 changes to the UN Consultative Statute that accompanied its development. Specifically, some NGOs have been able to achieve fast-track Consultative Status, apply for such status en masse rather than separately, and hold panels in addition to traditional NGO activities. This parallels a rise in prominence of established NGOs, as well as the growing formal adoption of participatory governance and development programs.

Far from being a definitive document on NGOs, the Earth Summit protocols nevertheless highlight the priorities with which contemporary NGOs are preoccupied, especially those concerning environmental justice and equity. The nine “major groups” of NGOs focus on:

- Global action for women towards sustainable and equitable development.
- Children and youth in sustainable development.
- Recognizing and strengthening the role of indigenous people and their communities.
- Strengthening the role of non-governmental organizations.
- Local authorities’ initiatives in support of Agenda 21.
- Strengthening the role of workers and their trade unions.
- Strengthening the role of business and industry.
- Scientific and technological community.
- Strengthening the role of farmers.

These “major groups” are not mutually exclusive or exhaustive; for example, NGOs are certainly not avoiding all national or regional governments for the sake of local ones. Nor does the fourth “major group” of “non-governmental organizations” mean that the other eight groups consist of non-NGOs; rather, this catch-all group reflects the desire of some Earth Summit participants to dissociate themselves from the term “NGO.” Nevertheless, the sustained focus on women, children, and ethnic and indigenous persons is notable.

Despite its clear origin in the United Nations, the term “NGO” now refers to a range of non-government organizations, regardless of whether they have official UN Consultative Status. Although NGOs are also registered with other intergovernmental organizations, such as the European Union and the WORLD BANK, any organization not established by a government can be called an NGO. Individual nations also have numerous laws governing NGOs; these are discussed in a subsequent section about NGOs’ relationship with business and government.

Indeed, the contemporary importance of NGOs can also be traced via the exponential proliferation of related acronyms. For example, the term ENGOS, for environmental NGOS, is also commonly used. Furthermore, some people appear to assume that most NGOs are local, calling some “international NGOs” to note exceptions, while other people assume vice versa.

The addition of other terms, such as social movement organizations (SMOs), civil society organizations (CSOs), community-based organizations (CBOs), private voluntary organizations (PVOs), and grassroots organizations (which thankfully come without an acronym), adds to the confusion. While the larger concepts to which these acronyms refer, such as “social movements” and “civil society,” are meaningful and will be discussed in further detail later in this entry, all of these organizations can also be thought of as types of NGOs. CBOs and PVOs tend to focus on individual members and local district, whereas NGOs can be local, regional, national, or international. The term NGO, then, is thought of as more neutral and general than these other terms. It also superficially rises above the other acronyms here simply because it is used more widely and officially recognized by intergovernmental and governmental funding agencies like the World Bank, the European Commission, and the United States Agency for International Development.

NGOs, Civil Society, and Social Movements

What is the relationship between NGOs and civil society? Like non-government organizations, civil society is as often defined by what it is not, namely business and government, as what it is. Civil society is a debated term and concept in its own right. While it sometimes includes seemingly apolitical, often informal, private voluntary groups like sports clubs, the point here is simply that NGOs are considered an important component of civil society at large. Unlike civil society organizations, all NGOs are assumed to engage in some activity relating to politics or public policy, so that they interact with governments or intergovernmental organizations. Still, some have suggested that NGOs be called civil society organizations (CSOs) outside of United Nations circles (Krut 1997).

While NGOs are thought to be different than interest groups and lobbying groups, the differences are more imagined than real. The term 'interest group,' for example, often evokes trade unions but any association or organization lobbying or advocating for its 'interests' can be an interest group. Likewise, business coalitions could advocate for safer streets in the interest of the success of its own members, and human rights NGOs can advocate for a better economy in order to garner safer working conditions for everyone. Therefore, the line between 'self-interest' and 'public interest' is often arbitrary. This is highlighted by the tendency of American politicians, for example, to label NGO campaigns they like to be 'in the public interest,' and to label NGO campaigns they dislike 'special interests.'

Two similar tensions transpire when NGOs engage in controversial activities, or are religiously based. First, militias and violent groups are not considered NGOs. Some groups in the Middle East, for example, are considered NGOs by some and terrorist groups by others. Second, until recently, church-based groups, Sufi brotherhoods, and other associations were considered voluntary associations and therefore NGOs by Africanists, but not traditionally studied as such by Arabists (Carapico 2000). While criteria regarding non-violence and religion appear to be clear-cut, in reality there remain controversial and possibly violent groups, and religious NGOs are generally more controversial than secular ones.

Because of their focus on policy or social change, NGOs are also compared to social movements. Both are assumed to work towards some form of social change via extra-institutional means, or outside of official political parties. Because UN-accredited NGOs must have official headquarters and be somewhat established, they are often assumed to be more hierarchical and part of the policy-making establishment than social movements. Real tensions arise when participants of social movements feel that their cause has been commandeered or distorted by large NGOs. However, NGOs are not antithetical but related to social movements, which may be structured as formal organizations or as informal, amorphous groups of individuals subscribed to specific lifestyles or working towards specific agenda. While social movements capture the popular imagination in demonstrations and marches, the speeches, preparation, and agenda are often outlined by relatively formalized collectives or NGOs.

For example, the environmental movement is certainly greater than the NGO Greenpeace International, and it has come to include people who are not Greenpeace subscribers. It includes protesters who rally against genetic food engineering for environmental reasons. To the extent that the movement has influenced popular culture, it may even include people who fastidiously recycle everything they can, but do not consider themselves activists. Still, NGOs such as Greenpeace hold important positions in and among social movements. One prominent example lies in Greenpeace's Rainbow Warrior episode. In 1985, the Greenpeace ship Rainbow Warrior traveled to New Zealand to protest French nuclear testing in the South Pacific. It was bombed, a Dutch crew member died, and it was discovered that the two bombs had been placed by the French Secret Service (Davidson 1991). In the aftermath, Greenpeace membership tripled, and the ship became a symbol for the environmental movement (Cleaver 2005). NGOs, then, often supply the public with the key images and messages representing social movements.

As with social movements, NGOs are also often assumed to be primarily progressive or leftist. This image is perpetuated by the fact that NGOs often exist because they wish to change some government policy, and governments are often assumed to be more conservative than the smaller organizations that attempt to counter them. In reality, NGOs and social movements are borne out of every space on the political spectrum. There are NGOs that advocate for greater restrictions on immigration flows, just as there those that lobby for greater refugee and asylum rights around the world. The great diversity and complexity of NGOs can render a succinct definition almost meaningless, but NGOs are also important because of their reputation as active organizations in humanitarian aid as well as law reform and social change advocacy. This particular role of NGOs is discussed further in the 'NGO Activities' section of this entry.

NGOs, Business, and Government

Unfortunately, it is deceptively simplistic to define NGOs as organizations outside of government or business. The line between NGOs and businesses is generally clearer than that between NGOs and governments. Even then, although single companies and transnational corporations are not considered NGOs, coalitions of companies are. This is because the activities of business groups and coalitions are not to make profits in and of themselves, but to conduct educational and other activities, like other NGOs, in the interests of and on behalf of member businesses. Business NGOs like the California Raisin Marketing Board in the United States, then, are controversially considered to be part of civil society.

Some NGOs and social movements, such as the People's Health Assembly and the Women's Environment and Development Organization, make a strong distinction between so-called BINGOs, or NGOs that focus on business interests, and PINGOs, NGOs that may be partly sponsored or funded by transnational corporations but nevertheless are focused on the public interest (Rowson 2002; WEDO 1995). Although the term 'public interest' can also be contested, health NGOs participating in the 1995 Fourth World Conference for Women specifically objected to the presence of tobacco, pesticides, and other industries' representatives in their meetings, passing a resolution asking that these industry representatives meet in a separate caucus (Krut 1997). Overall questions about business influence on civil society are unlikely to be resolved. Therefore, it may be more helpful to further differentiate NGOs within the BINGOs category, in order to take action first on those perceived to have the most undue influence and lobbying power, specifically larger transnational corporations (Krut 1997).

As with business, just what renders an NGO independent from government is debatable. At the very least, NGOs must prove to be non-profit in order to avoid private sector taxation. Still, in some countries, NGOs may undergo such stringent evaluations that NGO activities are greatly censored, and only those that support governmental policies are accredited. For example, "Egypt's notoriously restrictive Law Number 153 of 1999…strangles Egypt's huge but tightly controlled voluntary sector" (Carapico 2000). NGOs thrive with government-protected civil liberties and free speech, even as they appear most essential when such liberties are threatened.

While some define NGOs to be those organizations not established by governments, others define NGOs to be those not under the direct influence of governments. Some claim that in countries with more restrictive NGO accreditation laws, most NGOs are actually government- or donor-organized (Carapico 2000). Thus, there exists the acronym GONGO, for the rather counterintuitive term "government-organized-NGO." Even in less restrictive countries, some NGOs, especially those that provide services to the poor, receive some funding from governments. Government-NGO relations are especially contentious when NGOs receive some funding from government international development agencies. Recently, then, NGOs such as Mercy Corps have begun to refuse money from governments if they feel that contracts come with clauses limiting their public relations or activities. NGOs that focus on human rights issues or review of government actions, such as Human Rights Watch, tend to have policies prohibiting financial aid from any government.

A significant problem occurs when governments adopt 'front' NGOs in order to subvert the efforts of legitimate NGOs, most commonly human rights organizations. For example, the passports of two human rights NGO representatives, who were planning to attend an international human rights conference to speak on torture in Tunisia, were revoked when representatives of Jeunes Medecins sans Frontiers (Young Doctors without Borders), requested to take their place (Pitner 2000). After the French NGO Medicins San Frontiers sent a protest letter stating that the Tunisian NGO was not affiliated with them, it was discovered that the Jeunes Medecins Sans Frontiers was in fact a 'front' NGO for the Tunisian government (ibid.).

NGO Governance and Structure

NGOs are partly governed by governments, since most countries have some regulation regarding financial accountability and lawfulness of NGO activities. For example, official NGOs cannot be associated with organised crime. To be registered at intergovernmental bodies such as the United Nations, NGOs also need to show that they are governed democratically by their members. NGOs are rarely directly governed by individual participants or elected representatives, however. Rather, internal governance in most NGOs takes place via Boards of Directors and membership councils. The actual forms of participatory governance among NGOs vary greatly. To state that an NGO is governed democratically, then, is to infer that individual members, staff, and potential constituencies have formalized lines of participation in decision-making, even if they do not always have official titles or say in every decision made.

Further, NGOs are indirectly governed by whoever makes financial or in-kind contributions to them. Because they are primarily voluntary associations without large endowments or steady streams of funding, individual members must be convinced to provide resources or participate on a continual basis, or to renew memberships. Greenpeace is one example of an NGO that attempts to convince members to fund its campaigns each year. As mentioned above, corporations, foundations, and government agencies who provide financial support often have some sway over NGO activities; it is then up to the NGOs to decide whether their activities and agenda are compromised by accepting certain financial contributions. For example, some NGOs objected to American supervision or security forces accompanying their staff as they carried out NGO activities in Iraq (Beattie 2003).

An NGO's agenda and activities can be organized according to a specific geographical area, a specific constituency such as HIV-positive mothers or textile factory workers, an ideology, or a specific set of issues or policy goals, like the wider use of contraception, a ban on abortion, or a ban on nuclear testing. Official rules in the United Nations no longer ban NGOs focused on issues pertaining to a specific nationality or people, from a single country, from attaining Consultative Status. Still, NGOs focused on the issues of ethnic minorities, such as Shan organizations from Burma-Myanmar or Sikh organizations from India, have more difficulty attaining official recognition than other NGOs than similar organizations based in more than one country.

In one structural model of NGOs, individual members participate in activities and decision-making at an NGO serving the local community. The local NGO staff then report to state-wide staff, who coordinate with other staff around the country in macro-scale activities such as lobbying or advocacy at the federal or national government bodies. NGO staff and volunteers from different countries may also coordinate activities in order to promote their goals and activities internationally. An NGO focusing on women's rights, then, may operate support groups and health services in a neighborhood or village, lobby for family planning legislation at the national level, and participate in the promotion for multilateral funding or resolutions at United Nations Conferences and other venues. Therefore, in such hierarchical structures, NGO participants at the international level may not always be aware of activities at the local level, and vice versa.

Some NGOs choose to remain small because they find large-scale coordination difficult, choosing instead to participate in larger-scale or macro-level activities through coalitions or caucuses with other NGOs. This trend is especially significant among PEACE organizations. The International Campaign to Ban Landmines (ICBL) is a prominent example of a coalition that helped to outline parts of and promote the International Mine Ban Treaty of 1997. In another example, the Samoa Umbrella Group for NGOs (SUNGO) allows smaller Samoan NGOs to gain support from other NGOs and access to donors and government bodies, just as SUNGO is one avenue via which government bodies and donors attempt to reach out to NGOs. One question for umbrella groups overall, then, lies in whether certain umbrella groups dominate policy arenas, and whether excluded NGOs can present counterarguments or make an impact on their own. Greenpeace International forwarded such arguments in its objections to the creation of an Environmental Advisory Council of NGOs to the Organization for Economic Co-operation and Development (OECD), arguing that such a Council would be exclusionary (Krut 1997). Yet, smaller NGOs might argue that without formal institutions for NGO participation, only large NGOs such as Greenpeace will have the resources necessary to gain policymakers' attention.

Informal coordination can also take place outside of official coalitions. For NGOs that primarily work in advocacy, activities at different levels may be better coordinated; local offices may all be working towards the same goal of a worldwide treaty to ban nuclear weapons, for example. Caucuses are short-term alliances among NGOs for the purpose of joint participation and lobbying at a conference, summit, or forum. Various NGOs concerned with the environment, for example, may come together at a development or business conference to argue for a specific treaty or agreement to be approved. NGOs that disagree on other issues may even join a caucus to achieve together only the specific goals put forth at the conference. NGOs belonging to caucuses may or may not keep in touch once the conference is over.

Since many NGOs remain small and local, multi-level coordination is not always an issue. Nevertheless, even at the local level, governance and structure vary. Habitat for Humanity is one example of a large NGO in which most members participate in a way other than financial. Still, even then, participants are unlikely to have chosen sites for new housing construction or made budget decisions. In many medium- to large-sized NGOs, individual members are more likely to act as subscribers, people who make annual contributions to the organizations or participate in specific, short-term campaigns, than full-time participants in decision-making.

Criteria for individual membership in NGOs also vary. NGO membership can be open to everyone, most common when the NGO engages in charitable services or humanitarian activities. Membership can also be limited to people with certain skills or engaged in certain professions, as in trade unions, or to people engaged and concerned with a specific lifestyle or policy issue.

NGO Activities

Actual NGO activities can be generally categorized into (a) internal organizing or services, (b) lobbying or advocacy, and (c) fundraising. Internal organizing includes leadership development, education, documentation, speech-writing, research, and outreach for the NGO. An NGO working for safety standards in textile factories, for example, may work on teaching factory workers about their rights, documenting violations of such rights, coaching and encouraging workers to speak out on their own and on behalf of the organization, compiling and publishing materials supporting their agenda, and coordinating demonstrations or meetings about their policy goals. Service activities include health, nutrition, education, legal, or other assistance. For instance, the International Rescue Committee is an NGO that helps to set up emergency schools, psychological counseling, and health services for regugees and asylum seekers.

Lobbying or advocacy activities include networking, participation and presentations in conferences, protest, and dissemination of case histories, policy goals, and work via media. The latter takes place through traditional media, such as editorials and periodical articles, but also through independent television channels, radio stations, newsletters, and community-run media. The internet has received great attention as a means for geographically disparate individuals and NGOs to communicate and organize forums and activities. Through simple features such as directories, databases, web diaries, e-mail, and websites, NGOs can find large audiences more easily, but the process of verifying information disseminated by NGOs becomes more difficult.

While use of media is often crucial in obtaining popular support, executing outreach, publicizing and threatening protest, and fundraising, participation in conferences helps NGOs to gain institutional legitimacy and entrée in the academic, foundation, and policymaking worlds.

As the above paragraphs suggest, fundraising is not always a discrete activity, but one enmeshed in advocacy and organizing overall. Nevertheless, most NGOs have at least one staff member solely dedicated to fundraising, primarily through foundation grants or public relations and individual contributions. The optimal percentage of a non-government organization's budget spent on fundraising is often subject to debate. As non-profits devoted to social issues, NGOs are often perceived as less credible if they pursue large public relations campaigns. On the other hand, sustained funds for an NGO's primary activities and advocacy work often rely on and benefit from additional resources for fundraising.

Common Benefits and Criticisms of NGOs

Given the diversity of NGOs, it is quite difficult to draw general conclusions about shared benefits and weaknesses. Nevertheless, a review of common points of praise and criticism highlight the theme of grassroots relevance, legitimacy, and scalability as key points of debate.

NGOs are most beneficial when they fill service, advocacy, or assistance gaps left by governmental and intergovernmental bodies. In the context of political prisoners and Amnesty International, for example, Amnesty has succeeded in placing popular pressure on governments to release, or at least treat humanely, political prisoners. Because NGOs are voluntary and often rely upon everyday citizens for their agenda-setting and work, they are presumed to have popular, grassroots legitimacy. Because they also focus on specific campaigns or projects and must constantly raise funds for their work, they are also assumed to adapt well to local contexts, and to be relatively cost-effective. In the example of Amnesty International, the NGO attempts to prove this via member letters and petitions customized according to the conditions of specific political prisoners.

Sweeping criticisms of NGOs tend to focus on either the accuracy of points of praise, such as the substance of participatory decision-making processes in NGOs, or the flipside of points of praise, such as the potential absence of large-scale, contextual analyses of the smaller-scale actions and effects of NGOs. Because NGOs are often focused on short-term and medium-term survival, even those that report great success in their work must be concerned with long-term financial and administrative sustainability.

The wide diversity and continued growth of NGOs has also led to criticisms of their apparent lack of coordination; this critique also applies to large projects of intergovernmental entities such as the United Nations. Specifically, critics assert that NGOs and funded development projects sometimes duplicate work rather than reach those who are most in need of help (Gugerty & Kremer 2000). The problem here lies in the difficulty in establishing an accurate "counterfactual," or the exact situation that would have transpired without the existence of this NGO or project. Would the work have transpired or received funding from another source? Would it have been executed as well? Is there a way for NGOs to coordinate their activities and reach more people, beyond joining forces in caucuses or coalitions on specific campaigns, in a sustainable way? Is this always desirable?

Others argue that NGOs should not become so coordinated as to lose their flexibility, ability to adapt to difference contexts, and grassroots credibility. Those who focus on the relationship between NGOs and social movements, especially, fear that as NGOs become more established, they develop bureaucratic structures and reinforce, rather than challenge or complement, business and government.

The integrity and origins of NGOs are especially questioned in cases of funding from developed countries for NGOs operating in the 'global South.' In the context of postcolonialism and protests against intergovernmental bodies like the World

Bank, some fear that NGOs, too, set agenda according to what funders in industrialized nations believe is need in developing nations, rather than what people in developing nations themselves say they need. Ideally, NGOs build upon existing SOCIAL CAPITAL rather than shaping constituencies via their activities (Brown and Ashman 1996). Even when NGOs do find similar-minded partners, these partners are often universities or research agencies with coincidentally coinciding agenda (Delisle et al 2005). That is, the knowledge and lessons generated by NGOs do not systematically reach funding and research institutions.

In a 1995 survey at the NGO Forum at the World Summit for Social Development, at least 70 percent of respondents asserted that the NGO world was dominated by larger NGOs, English-speaking NGOs, and so-called Northern NGOs (Krut 1996). While Northern NGOs are not in themselves problematic, critics specifically have two key complaints. First, they assert that sometimes, Northern funders and NGOs simply look for malleable partners to further their own policy agenda; second, there often lie dicontinuity between funding and implementation schedules, and between expected and real-life support (Pitner 2000).

In one evocative example, World Vision sent bibles worth $1.5 million to Mozambique, when the government had asked for food aid (Motsisi 1995). Even NGOs focusing on basic humanitarian and charitable services, then, are often accused of deviating from principles of stakeholder-driven, participatory development. As compared to NGOs who focus on "humanitarian assistance," NGOs who focus on human rights violations are often caught in tricky situations where the local governments disapprove of their activities, and, in multi-government contexts like Jerusalem, foreign funders pressure NGOs to focus on the human rights violations of one government more than the other's (Carapico 2000).

While the risk of Northern agenda-setting in the Global South is quite real, some NGOs base headquarters in industrialized nations out of necessity, such as greater independence from specific governments. Many NGOs dealing with issues faced by Burma/ Myanmar, for instance, were founded by dissidents in Europe or North America. Therefore, to found or base an NGO in an industrialized nation does not necessarily render it pejoratively 'Northern.'

Finally, a sometimes overlooked but significant aspect of NGOs is the fact that, they represent their own large, powerful political economy. It is especially important that NGOs be transparent, and that they do not simply reflect the agenda of intergovernmental agencies or corrupt local governments, because of the sheer amount of money they bring. Especially in smaller and poorer countries, NGOs are a significant component of what is called the 'Third Sector' aside from public and private sectors, as well as the nation's economy as a whole. This applies both ways. According to the 2001 Human Development Report from the United Nations, 11 percent of Norway's 1999 Gross National Product went towards NGO funds for developing countries; at the other end of the spectrum, 29.8 percent of Nicaragua's 1999 Gross Domestic Product took the form of received "official development assistance" (UNDP 2001). In addition to questions regarding the adequacy and sustainability of such infusions of money, there are questions regarding the cultural effects of NGOs in developing countries.

Conclusion

With all of the caveats delineated in this article's definition and discussion of non-government organizations (NGOs), it might almost sound as if the NGO community is an enormous, amorphous globule. While far from true, the perception of such an image remains one of the key obstacles of the NGO community.

Even a brief overview of NGOs suggests that their role in international policymaking has grown in size, complexity, and importance. Despite the very institutionalized, chartered beginning of official NGOs in the United Nations in 1946, non-government organizations, for the most part, are still considered essential, dynamic actors of civil society.

The landscape of NGOs continues to change with greater communications technology, changing sociopolitical contexts within countries, and the creation of new intergovernmental bodies around the world. As NGOs assert and use their power, they must maintain both grassroots and official policymaking legitimacy, achieve scalability, and maintain their own sustainability. These factors, too, should not be viewed as mutually exclusive but interactive and mutually enforcing.

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North Atlantic Treaty Organisation

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What is NATO?

The North Atlantic Treaty Organization (NATO) is not just a military organization conceived as a collective defense entity for fighting wars; NATO is a political organization for the propagation of democracy and market economics. It symbolizes a new Europe in enlargement eastward of Western-style liberal democracy. It offers the global projection of military and political power against terrorism and states rogue to the norms and values of the international society in arms control and disarmament of weapons of mass destruction.
It has its origins in The North Atlantic Alliance after World War II, founded on the basis of a Treaty between member states entered into freely by each of them after public debate and due parliamentary process. The Treaty upholds the individual rights of citizens of the member states as well as their international obligations in accordance with the Charter of the United Nations. There is no obligation for conscription of citizens to soldiers nor is there any minimum obligation to commit any specific quantity of soldiers or equipment to the alliance. NATO, however, commits each member country to sharing the risks and responsibilities as well as the benefits of collective security and requires of each of them the undertaking not to enter into any other international commitment, which might conflict with the Treaty. When decisions have to be made, action is agreed upon on the basis of unanimity and common accord. There is no voting or decision by majority.

NATO throughout the Cold War (1948-1989) was an alliance committed to the collective defense of its member countries as the basis for preserving peace and ensuring future security only in the North Atlantic region. At the core of the Alliance are its member countries. The governments of these countries, meeting together, represent the highest political authorities of the Alliance. The continued basis of legitimacy of NATO remains *The North Atlantic Treaty* that conforms to the spirit of the *United Nations Charter* and derives its legitimacy from Article 5—the right to collective self defence. This states that an armed attack on one or more members will be deemed an attack against them all. There is a framework for consultation between the member countries, whenever one of them feels that its security is at risk. The admission of new members to the Alliance is in line with Article 10 stating that other European states in a position to further the principles of the Treaty and contribute to the security of the North Atlantic area may be invited to accede.

In other articles of the Treaty, each member country undertakes to contribute to the development of peaceful and friendly international relations in a number of ways, including by strengthening their free institutions and promoting conditions of stability. The Treaty also provides for efforts to eliminate conflict in the international economic policies of member countries and to encourage cooperation between them.

The Origins of NATO

Between 1947 and 1949 a series of dramatic political global events brought matters to a head necessitating a formal Treaty including direct threats to the sovereignty of Norway, Greece and Turkey, the June 1948 coup in Czechoslovakia, and the blockade of Berlin by the USSR. The causes and adversaries differed in each case though it was clear that the USSR was becoming the singular major threat to the continuance of multi-party open election capitalist democratic states by proposing alternative single party socialist communist style states. The signature of the Brussels Treaty of March 1948 marked the determination of five Western European countries—Belgium, France, Luxembourg, the Netherlands and the United Kingdom—to develop a common defense system and to strengthen the ties between them in a manner which would enable them to resist ideological, political and military threats to their security. Negotiations with the United States and Canada ensued for the creation of a single North Atlantic Alliance based on security guarantees and mutual commitments between Europe and North America. Denmark, Iceland, Italy, Norway and Portugal were invited by the Brussels Treaty powers to become participants in this process. This culminated in the signature of the Treaty of Washington in April 1949, bringing into being a common security system based on a partnership among these 12 countries.

In 1952, Greece and Turkey acceded to the Treaty. The Federal Republic of Germany joined the Alliance in 1955 following the failure of a proposed European Defense Community. In 1982, Spain also became a member of NATO, after the demise of the Franco regime. Throughout this period NATO was never required to use armed force to defend any of its member states. A bi-polar international system of the USA and USSR saw the doctrine of nuclear deterrence (the fear of mutually assured destruction if either side used such nuclear weapons) generating peace between and amongst European states. The status quo ensued until the fall of the Berlin wall and collapse of the USSR in 1989/1990 resulting in a roll back. NATO's summit meeting in London on 5/6 July 1990 was, in many ways, a unique event in Alliance history. The ensuing declaration (a new conceptual approach to a Europe whole and free, and a new concept of defence) issued by the summit leaders gave an unprecedented external impact with new overall policy.

The allies committed themselves to adopt a new NATO strategy making nuclear weapons truly weapons of last resort. The Declaration described the reordering and reorganization of a Europe as one geographical and cultural entity, with Canada and the United States, NATO's vital transatlantic connection, on the one side, but also the Soviet Union on the other, included as genuine participants. Following this was a breath-taking sequence of events that led to the Kohl-Gorbachev declaration at their Caucasus meeting and its settlement of long-standing issues concerning a unified Germany's future status in NATO. Ironically the demise of the USSR and the roll back of NATO standing forces led to a resurgence of nationalism in the Balkans. This saw NATO forces being deployed for the first time in armed activity in Kosovo (1999).

The crisis was the subject of the Washington Summit that marked NATO's 50th anniversary which was also an occasion for the accession of former Warsaw Pact countries Czech Republic, Hungary and Poland. At the Prague Summit, November 2002, a further seven states were invited to join the Alliance: Bulgaria, Estonia, Lithuania, Latvia, Romania, Slovakia and Slovenia. They joined the Alliance following domestic ratification processes and accession talks through 2004-2007. Two Balkan candidates for NATO membership, Albania and Croatia, signed the accession protocols on 9 July 2008 and became member states on 1 April 2009 at the time of NATO's 60th Anniversary. The Republic of Macedonia has been participating in the Membership Action Plan and was invited to become a member at the Bucharest Summit in April 2008 whilst at the same summit NATO Heads of State invited Bosnia and Herzegovina and Montenegro to start Intensified Dialogues;

and agreed that Georgia and Ukraine would become members in future.

NATO in Policy Practice

The lesson of the Alliance's involvement in South-Eastern Europe, including deployment of armed forces to Kosovo, is that crisis management and diplomacy have succeeded in curtailing or resolving conflict when backed by the credible threat of the use of force. The Prague 2002 summit noted that such credibility required a different structure to that of NATO's Cold War structure developed against the USSR. The new military structure will have two sections: Allied Command Transformation (ACT) based in Norfolk Virginian which was formerly Allied Command Atlantic (SACLANT) and Allied Command Operations (ACO) based in Mons, Belgium which was formerly Allied Command Europe (SACEUR).

Fundamental to this restructuring is the acknowledgement that there is no threat to shipping in the Atlantic Ocean nor to continental Europe by massed land armies. ACT will thus focus on new doctrines and integrating advanced technologies. Fundamental is the need for closer American-European co-operation for humanitarian and peacekeeping operations. For this purpose there will be two combined and joint task forces (CJTF) that will comprise the real military strength of the future ACO, deployable on a global basis. Initially this will consist of the NATO Response Force (NRF). The NRF and the European Union's Headline Goal of creating a deployable, corps-sized force are to be mutually reinforcing.

The new civil structure after enlargement has reduced the number of committees from 467 to 325. These Committees are responsible for planning ahead in such areas as political consultations, defense operations, and armaments cooperation. The committees recommend action to the North Atlantic Council—NATO's highest decision-making body—or to NATO's Defense Planning Committee, which deals primarily with questions relating to NATO's integrated military structure. Consultations also take place on economic questions related to security, including issues such as defense spending and the conversion of defense industries to civilian purposes. NATO also provides a forum for active cooperation among its member states and its partner countries in areas such as civil emergency planning, disaster relief and scientific and environmental programs. Although each nation bears the principal responsibility for its own planning to deal with civil emergencies, NATO works to ensure that the civil resources of the Alliance can be used in the most effective way, when the moment requires. NATO's role here is often a coordinating one.

As part of this transformation, NATO forges a practical partnership with many non-NATO countries with the aim of creating a more transparent Europe. Central to this idea is the “Partnership for Peace” (PfP) program, which promotes cooperation among the 28 NATO Allies and 22 Partner countries in a vast array of security-related activities. The Euro-Atlantic Partnership Council (EAPC), involving 50 countries, including the 28 NATO member countries, provides the political framework for PfP and a forum for discussion on security-related issues. Russia and Ukraine have developed special independent relationships with NATO being members of the Euro-Atlantic Partnership Council. Successful cooperation efforts include the Implementation Force (IFOR) and the Stabilisation Force (SFOR) in Bosnia and Herzegovina. In the NATO-Russia Council, NATO member states and Russia work together as equal partners making progress in areas such as peacekeeping, defence reform, proliferation of weapons of mass destruction, search and rescue at sea, civil-emergency planning, theatre missile defence and the struggle against terrorism.

Governance of NATO

Within NATO itself, committees are responsible for planning ahead in such areas as political consultations, defense planning and operations, armaments cooperation and others. The committees recommend action to the North Atlantic Council—NATO's highest decision-making body—or to NATO's Defense Planning Committee, which deals primarily with questions relating to NATO's integrated military structure. Consultations also take place on economic questions related to security, including issues such as defense spending and the conversion of defense industries to civilian purposes. NATO also provides a forum for active cooperation among its member states and its Partner countries in areas such as civil emergency planning, disaster relief and scientific and environmental programs. Although each nation bears the principal responsibility for its own planning to deal with civil emergencies, NATO works to ensure that the civil resources of the Alliance can be used in the most effective way, when the moment requires. NATO's role here is often a coordinating one. NATO also runs a number of international exchange programs relating to scientific and environmental problems of concern to NATO and Partner countries.

These programs provide support for high-level scientific research, encourage development of national scientific and technological resources, and enable cost savings to be achieved through international collaboration. A number of these activities are designed to tackle defense-related environmental problems, affecting neighboring nations. The NATO structure is complex. The top level civil structure, for example, consists of: Permanent Representatives and National Delegations; The Office of the Secretary General; NATO Integrated Data Service; The Division of Political Affairs; The Division of Defence Planning and Operations and The Division of Defence Support. Components of the top level military structure include: Explosive Ordnance Disposal and Ammunition Storage Training Team; The Group of National Directors on Codification; The NATO NAVAL Armaments Group; NATO Headquarters Consultation, Command and Control Staff; Strategic NATO Commanders; International Military Staff; Intelligence Division; NATO Training Group; Allied Command Europe Supreme Headquarters Allied Power Europe; Headquarters Allied Naval Forces North; and NATO Airborne Early Warning Force

Global Significance of NATO

NATO saw its first test as an alliance after the September 2001 attacks in New York and Washington. For the first time NATO invoked the Washington Treaty declaring that at attack on one required the assistance of all. Such assistance was to provide inter alia airlift, air-to-air refueling, secure communications, precision-guided weapons, ground surveillance and electronic warfare, as well as protection against weapons of mass destruction. Further assistance was provided to the USA in the removal of the Taliban regime in Afghanistan, in the same year with continued contributions to the ISAF force in that country, being the Alliance's first direct involvement in peace-support missions beyond Europe. Subsequently the onset of diplomatic activities against the rogue states seeking weapons of mass destruction, NATO leaders also agreed a new military concept for defence against terrorism as part of a package of measures to strengthen the Alliance's capabilities in this area, including improved intelligence sharing and crisis-response arrangements.

Part of the package was to implement a Civil Emergency Planning Action Plan to improve civil preparedness against possible chemicals-biological or radiological attacks against civilian populations and help national authorities deal with the effects of such attacks. Alliance leaders also endorsed the activation of five nuclear, biological and chemical (NBC) weapons defence initiatives, to enhance the Alliance's capabilities against weapons of mass destruction while strengthening its capabilities to counter cyber attack. It also initiated a new NATO Missile Defence feasibility study to examine options for protecting Alliance territory, forces and population against the full range of missile threats.

These initiatives have taken NATO into a wider and more diverse consensus organization than ever before. Furthermore NATO was no longer constrained to a specific geographical region of the world. Its future success as an organization in the governance of international security clearly needed successful co-operation between Europe and North America, where NATO alone appeared to be the sole guarantee of the transatlantic link in such defense matters. Thus NATO moved from being a defensive alliance rooted in the North Atlantic theatre to an organization which would go anywhere to take on new threats. NATO's leaders have shown, as a matter of international policy, their commitment to maintain the Alliance as their central institution for collective defense, security consultation and multinational military actions.

Despite this, the global security challenges of the 21st Century are too multi-faceted to be handled by one single institution, no matter how capable. NATO works together with a variety of institutions, organisations and countries to build a web of mutually reinforcing, interlocking, security arrangements. In this way, the Alliance is strengthening its institutional relationships with organisations such as the European Union, the Organisation for Security and Co-operation in Europe, the Africa Union and the United Nations and deepening and broadening existing relations with Partner countries throughout the Euro-Atlantic area, Russia, the Ukraine and the wider Mediterranean region. Historically, during the Cold War, NATO's enemy was eastward in the USSR led Warsaw Pact.

In the 21st Century NATO has taken a new global geopolitical role where a program of special cooperation is also being pursued, for example in the context of NATO's Mediterranean Dialogue, with seven non-NATO Mediterranean countries (Algeria, Egypt, Israel, Jordan, Mauritania, Morocco and Tunisia). NATO has also become involved in bi-lateral trans-regional support of the Africa Union (AU) by providing logistic support and training in general and in specific to the AU's Mission in Darfur (April 2005-December 2007). NATO continues to play an important role in Iraq and Afghanistan. There is no doubt that NATO will persist in such activities consistent with the original goal of its creation to forge a trans-Atlantic regional security alliance as well as in progressing to meet and act upon threats in a global environment. Above all, NATO needs to ensure that its equipment is inter-operable so groups of nations can undertake joint operations with NATO as a clearing house, rather than a sponsor. It is clear that the dominant player in NATO, remains the USA.

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OPEC

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Introduction

The Organisation of the Petroleum Exporting Countries (OPEC) was created at a Conference in Baghdad in September 1960 by Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela. The immediate cause why it was founded were two unilateral reductions in crude oil prices of nearly 14 percent by the big oil companies. A policy response against these losses, OPEC's aim was to co-ordinate oil policies and to form a unified front *vis-à-vis* the big oil companies in a highly oligopsonistic market dominated by seven companies, the so-called Seven Sisters. Eight more members joined later on: Qatar (1961), Indonesia and Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Ecuador (1973), and Gabon (1974). Ecuador and Gabon left OPEC again in 1992, and 1994 respectively. OPEC's headquarter, initially in Geneva, was moved to Vienna in 1965. Its supreme authority is the Conference of Ministers responsible for formulating general policies and routinely meeting twice a year. OPEC has a Board of Governors and a Secretariat (for further organs cf. OPEC 2004a). The OPEC Fund for International Development was created by OPEC members as a legally independent aid organisation, a clear sign of solidarity with other Developing Countries. Sharing increased oil revenues, aid was an important pillar of OPEC's overall strategy during the 1970s. OPEC (2004a:7) continues to emphasise that it "was part of the calls for the creation of a new international economic order" and still is a special partner of recipient countries. It was seen as a successful pioneer of the Third World's thrust for remunerative commodity prices, one of the main pillars of the New International Economic Order. During the 1970s attempts were made to "follow the OPEC example", none of them with remotely comparable results.

Founded by developing country producers OPEC can be interpreted as Galbraith's (1952) concept of counterveiling power put into practice. However, OPEC's activities were generally of a low profile during its first decade of existence. Odell (1983:21) sees OPEC's first success in the 1960s when they prevented further reductions in producer government revenues per barrel, and when its members negotiated technical changes in calculation methods for payments, resulting in small regular increases "by a few cents". Nevertheless, real oil prices were at their absolute minimum since the 1930s before the price hike of 1973. In 1994-dollars the so-called "marker crude" (Saudi Arabian Light, then the basis for all oil price calculations) cost $12.61 in 1947, and $6.87 in 1970.

Oil Price Increases of 1973-4 and 1979

Meeting in Caracas OPEC established minimum tax rates and demanded changes in posted prices to reflect foreign exchange rate movements—an event that might be seen as a turning point. Posted prices were imputed prices from which actual payments to producer governments were calculated as a "tax". During a dispute over payments between Saudi Arabia and ARAMCO in 1949 the US government offered to recognise payments for crude oil to Saudi Arabia as "taxes" that could be offset against US tax obligations. This system securing zero tax obligation in the US was maintained well into the 1980s (Odell 1983:35).

The world's largest oil companies had been organised in the London Oil Policy Group since 1968. In 1971 the Teheran-Tripoli agreements took place between OPEC members and oil companies declaring that they had come to sign, not to fight increased government takes. To help negotiations

OPEC mandated a "total embargo" against companies rejecting the minimum tax rate (EIA 2004). OPEC members started to nationalise their oil industries in the 1970s. In September 1972 OPEC directed members to negotiate price increases to offset the dollar's declining value. Small increases during 1972 were supported by OPEC threats of "appropriate sanctions" against companies failing to comply with actions undertaken by OPEC members in accordance with OPEC decisions (*ibid*.). Real export incomes declined significantly due to the dollar's depreciating value. Dollar prices of manufactures increased by over 30 percent between 1971 and 1973.

The stage was prepared for the famous price hike of 1973-4, often called the "first oil crisis". In 1973 OPEC supply was more important than ever, amounting to 58.4 percent of world, 64.7 percent of Western production, and 86.6 percent of crude exports. However, OPEC countries controlled only some 8 percent of Western refining capacity (excluding communist countries), and 5.7 percent of the world's tanker fleet capacity in 1982. Although refining capacity has increased somewhat (10.8 percent in 2004), these shares have not fundamentally changed. None of the so-called "refining centres"—countries importing large quantities of crude for processing and re-export—are OPEC members. Distribution has always firmly remained in the hands of oil companies.

The first increase in 1973 to compensate for the fall in the dollar's value was modest—posted prices were increased by 5.7 percent on 1 April. It was followed by an increase of 11.9 percent in June. In October 1973 negotiations with oil companies to revise the Teheran Agreement failed. A few days later Gulf states increased the posted price of Saudi Arabian Light by 17 percent, also announcing production cuts. The Arab-Israeli war led to the famous oil-boycott, which was not the first boycott. During the Suez War (1956) and the Six Day War (1967) Arab states tried to use their control over oil production as a weapon (Odell 1983:187). While the first boycott had some impact, the second embargo was soon lifted. In December 1973 the Gulf states announced their decision to raise the posted price of the marker crude from $5.12 to $11.65—the "first oil crisis" erupted although Saudi Arabia immediately promised to increase OPEC production by 10 percent (EIA 2004). The effect of the first oil crisis on OECD economies is often exaggerated. It was some 2-3 percent of national income for all OECD countries, much less than what Developing Countries exporting raw materials experience frequently.

The two price hikes in 1973-4 and 1979-80 commonly referred to as the two "oil crises" were brought about by a coincidence of interests. The interest of oil producing countries is obvious. The political climate was favourable around 1973, as the South demanded a New International Economic Order with "remunerative" prices for commodities. The Arab-Israeli war provided a political trigger. Oil companies had turned into energy corporations during the 1960s by acquiring alternative sources of energy cheaply. Low oil prices made possible by concentrating on the Middle East with its particularly low production costs increased oil's market share but reduced substantially the profitability of other energy sources. Comparing the evolution of prices of various oil products one notes that heating oil—a direct substitute for coal—was particularly cheap during this period. Meanwhile, as their large investments in other energy sources suffered from low oil prices, oil companies had an interest in higher prices. Relatively low price elasticities of final demand suggested substantial profits if prices went up. Higher prices increase the value of oil stocks (bought at cheaper prices in the past) overnight. Rendering other deposits, such as the North Sea, economically viable, higher prices also help reducing dependence on one group of suppliers, such as OPEC. Domestic US producers hard squeezed by low crude prices benefitted from prices increases. The specific tax privilege of oil companies was certainly another factor.

Many authors argue that the US government was interested in price increases (cf. Raffer 1987:158ff). According to Oppenheim (1975) the US wanted to use OPEC as a tool to change the price relation between oil produced within the US and cheaper foreign oil, in order to give the US competitive advantages *vis-à-vis* Europe and Japan, regions heavily dependent on oil imports. "Project Independence", a plan of the Nixon Administration to make the US energy independent, would benefit from higher world market prices. Growth of US oil imports would be curbed in favour of domestic production and non-traditional reserves, already assessed in 1964. Parts of them had been reserved, for example for the Navy (Galbraith 1979:6). The price hike changed the situation where the rest of the world enjoyed access to cheaper energy, while the US protected expensive domestic production. Odell (1983:219) sees a "deliberately initiated diplomatic effort" of the US having "its representatives talk incessantly to the oil-producing countries about their low oil prices and ... showing them the favourable impact of much higher prices." The idea to increase prices of oil from foreign wells was the core of an internal administration document already published in the US by the *National Journal* on 7 July 1973. It showed that the US, relatively little dependent on imports, would gain in comparison to its more import dependent allies in Europe and Japan. In 1973 the administration made it clear that no force against oil exporters would be used, even in the case of an oil embargo.

A coincidence of interests did thus exist in 1973. Oil company profits increased strongly. Net profits of the "majors" nearly doubled in 1973, rising to some $11.6 billion in 1974. Exxon and Royal Dutch/Shell became the world's biggest transnational companies. Higher oil prices triggered a boom in the nuclear industry, increasing uranium prices by 300 to 400 percent.

Inflation after 1973 and the depreciation of the US dollar eroded real oil prices steadily, as well as OPEC's balance of payments surpluses. In June 1978 some OPEC countries attempted to fix OPEC prices in a stabler currency than the dollar, a move blocked by Iran and Saudi Arabia. Although real prices differ according to the deflator used, it is agreed that the second hike could do no more than preserve the real price of 1974. Like in 1973-4 there were no shortages of oil. During the last quarter of 1979 production was up to 2 million barrels/day above daily consumption. Experts considered price reductions by the spring of 1980 very likely. In 1973, too, production had been increased over the last months of the year. Political turmoil—this time the Iraq-Iran war—provided again the trigger.

The second "crisis" produced again high oil company profits. Shell netted nearly $6.5 billion in 1979 and, like Exxon, more than $5 billion in 1980. Coal exports increased so drastically that port capacity bottlenecks occurred. The Carter administration, though, was not interested in another price increase. When President Carter openly attacked the oil companies, petrol happened to become unavailable to US consumers, even though stocks were full and it was sometimes difficult to find storage place. Oil companies prevailed.

The evolution of global consumption is useful to understand the events of 1979. World oil consumption fell in 1974 and 1975, but recovered quickly. In 1976 it again surpassed the quantity of 1973, continuously raising until 1979. The first crisis had not produced a long-lasting reduction of demand, only a short hiatus. One might thus have expected the same after 1979. Between 1979 and 1983, however, global consumption fell by roughly 10 percent. This might partly have resulted from lagged reactions to 1973-4. The reduction in Market Economies was significantly more pronounced as communist countries increased consumption slightly. The 1979 peak of world consumption of refined products was not surpassed again until 1992, in spite of low oil prices, and then only by a very slight margin.

"Reverse Oil Crisis"

After 1981 nominal and real prices dropped, falling roughly by half during 1985-6. In 1998 the real price adjusted for inflation in main consumer countries was $ 3.13, slightly more than $3.05 before the first famous hike (Raffer and Singer 2001:126). UNCTAD (1999, p.34) compares the 1974 price ($10.4) with the OPEC average 1998, "an estimated $4.0 a barrel" in 1974 prices, one fifth of the price of 1980. In the 1980s OPEC's global production and exports shares decreased substantially. OPEC exports fell from 67 percent of world exports (1979) to 42.4 percent in 1985, when OPEC's world production share was below 29 percent. OPEC was substituted by other sources, as the modern theory of Unequal Exchange (Raffer 1987) would suppose. Britain, Norway, or Mexico became large producers. The high concentration on the Middle East of 1973 vanished. During 1982-3 stock operations undermined OPEC's attempts to stabilise crude prices through quotas. Technical progress spurred by efforts to save energy depressed demand further. In 2000 the oil intensity of output in the North was about 40 percent lower than 1973-4.

When OPEC could not stop the gradual erosion of its market share it abandoned supply restrictions, mainly based on Saudi Arabia's willingness to be a "swing producer", the country reducing its production substantially if necessary. Prices collapsed in 1986. Between 1980 and 1985 Saudi production declined to less than one third. It fell so low that associated gas production could no longer meet domestic needs. Maintaining idle capacities in a state of readiness caused considerable costs. During the early 1980s spot prices started to dominate official OPEC prices. The new pricing system linked transaction prices closely to prices established in the organised trading markets, breaking the direct link between changes in supply and prices. Saudi Arabian Light ceased to be the "marker crude", one visible sign of changed market power.

Heavily dependent on oil exports OPEC members experienced a shock when revenues plummeted in the 1980s. Volumes and unit prices declined, with negative effects on output, budgets, and the balance of payments. The quantity of non-performing loans increased. The whole banking sector in the Gulf States looked at times on the verge of collapse during 1982-8. As a result of the crisis OPEC countries started again to invite investments by oil companies.

After the price collapse of 1986 world oil demand picked up, particularly in the South. OPEC's share started to rise again. Low demand in crisis-ridden Asia, an unusually warm winter in the North, and excess supply led to a large build-up of stocks, depressing prices in 1998. UNCTAD (1999, pp.38f) estimates the cost of the one-third drop in 1998 as $54 billion, an export revenue shortfall of 6.4 percent for all OPEC countries (excluding Iraq). Heavily indebted member countries (Nigeria:12.2, Venezuela: 8 percent) were significantly worse off.

Attempts to cut production had little effect, although key non-OPEC exporters joined in March 1998. In 1999 oil prices took off again, remaining in mid-2000 below half the historical highs of 1981 in real terms. First, production increases failed to bring down prices, a fact which OPEC blamed on speculators and the determination of prices on commodity exchanges breaking the traditional connection between prices and produced quantities. After three agreements by OPEC members to raise output in 2000, prices finally reacted and fell. OPEC actions, even when co-ordinated with non-OPEC exporters have definitely failed to control the market since then. By contrast upheavals in Nigeria (a relatively small producer) or even the Russian government's actions against the oil company Yukos have left traces in the price chart. When Saudi Arabia announced that it could increase production by as much as 14 percent on 11 August 2004 prices continued to rise as they did after OPEC had agreed to increase production quotas on 21 June 2000. The "price band" mechanism designed to defend an upper average price of $28 by automatic increases in production fell apart in November 2000. Early on many analysts had doubted whether OPEC would be able to increase production sufficiently.

The Present New Boom Period

Sharp improvements of all oil exporting economies have occurred in the recent past. Compared with the 1970s, economic policy reactions have changed fundamentally. Lessons of the years of catastrophe were obviously learned:

a) Oil Revenues Have Increasingly Been Sterilised or Used to Repay Public Debt. In 2005 state-controlled reserve funds were estimated locally to be worth some US$ 225—275 billion, a sharp contrast with the 1970s booms, when surpluses usually evaporated quickly. Oil revenues are spent carefully. Budget income derived from oil is routinely based on below market oil prices, in Algeria, e.g., only $19 per barrel were paid into the budget in 2004. Remaining oil export revenues flow into reserve funds. Conservatively low assumptions on future price paths are used.

b) Supply has Reacted Less Elastically. Drawing from past experience (the capacity overhang in the 1980s), OPEC-producers have become more cautious regarding increased upstream investment. In 2004 OPEC’s capacity was below 1978 levels. They took care, though, not to hurt the global economy.

c) Increased Diversification Efforts. Diversification is a long-term enterprise, but encouraging signs of diversification can be discerned. Dutch disease reactions could be avoided. Some economies have already diversified into services such as financial services, but increasingly also tourism. Regional integration is taking off. Finally, Arab economies have taken courageous steps towards opening their economies, signalling a will for change.

These radically different policies justify optimism. The present awareness of the volatility problem, reflected in the establishment of oil funds will allow oil exporters to absorb or at least cushion future external shocks. Higher oil income has been more cautiously used. Fiscal vulnerability to negative oil price shocks declined. Initially praised, this prudent policy has already come under attack. The IMF encourages oil exporters to resume the ways of the 1970s, once strongly and rightly criticised. Since oil prices “add” to global imbalances the IMF (2005a:113f) called for a "5 percent of GDP permanently higher investment rate" of oil producers, which “would reduce the U.S. current account deficit by about 3/4 percent of GDP after three years“. To “contribute to the adjustment of global imbalances” (IMF-code for financing the large US current account imbalance) the IMF (2005b:10) suggests that “these countries may need to increase spending on imported goods”. An IMF-employee demands higher government spending by oil exporters to contribute to reducing global imbalances by increasing imports (Nsouli 2006:11). The fact that oil exporters import relatively little from the US, having "turned into large buyers of goods from Asia” is of particular concern to the author, even though that could simply be a clear sign of Asia’s revealed comparative advantage and consumer choice, in other words, an indication that the global market functions well. Countries with low absorption capacity should "recycle their petrodollars through capital outflows to the rest of the world, contributing to dampening interest rates in the oil-importing world". Briefly, in order to help the US cover their enormous twin deficit, the IMF now recommends the very behaviour of the 1970s that created the catastrophe of the 1980s in OPEC countries, and exposed OPEC to the unjustified accusation of being the reason for the debt crisis. This attitude towards deficit countries differs radically from the usual IMF-recipe which does not request surplus/creditor countries to increase imports from deficit countries as the means to adjust. OPEC-countries should consider very carefully whether present successful policies should be changed as advised in spite of the painful experience between the booms.

Consumer Prices and Producer Receipts

As with all primary commodities, prices received by producing countries are only a fraction of final consumer prices. Oil products in particular are heavily taxed by OECD governments, especially in Europe. In 1998 EU-members collected over $250 billion in oil taxes, while world oil exports were $192 billion. French, German, and Italy's tax revenue exceeded the value of OPEC oil exports. Rising crude prices increase taxes levied as percentages (such as VAT) automatically. In contrast to crude prices this automaticity had not received much attention until 2000. The idea of reducing petrol consumption by special energy taxation within OECD countries did not raise similar concerns as OPEC's oil price policies, although both have the same effect on consumers. Nearly 50 percent of the final price expressed as shares of the so-called composite barrel (the weighted average of consumer prices of the main groups of refined products) have been taxes in OECD countries. In 1998 producers received 17.19 percent. Since prices are cif, real producer shares (fob producing country) were smaller. The US is the exception: taxes, the industry margin, and the cif-price of crude all accounted for roughly one third, even though the crude price had the smallest share in 1998. In the UK taxes accounted for over 68 percent (OPEC 1999:125). In 2003 this tax share sank to 62.7 percent due to higher crude prices, close to the EU average of 62.6. In the US taxes accounted for 25.6 percent (OPEC 2004b:120). Price differences between countries are mainly explained by taxation.

Until very recently, the whole debate on oil prices focused on the smallest layer of the final price. To put the effects of OPEC prices into perspective: doubling the OECD's average cif price in 1998 would have produced a price increase of the composite barrel of less than 17.19, as insurance and freight costs would not double as well. In 2003 this effect would have been below 28.1 percent for the EU or 21.6 percent for the UK. The impact of such price increases could be absorbed by the average EU country by tax reductions, compensating any inflationary effect.

OPEC Aid

OPEC countries were important donors before and after 1973. It is little known that OPEC aid was 1.18 percent of OPEC-GSP in 1970, well before the first price hike (OECD 1983, p.14) when the corresponding DAC average was 0.34. Three countries, Saudi Arabia (5.6 percent), Kuwait (6.21 percent), and Libya (2.01 percent), pushed the average up. For 1971 the OECD (1983:21) reported 1.1 percent, downgrading the figure to 0.78 for 1970-71 two years later, a pre-oil-boom figure less embarrassing to rich OECD donors. By steeply increasing aid after 1973-4 OPEC wanted to combine price increases with solidarity. As all commodity price increases to more remunerative levels have the same impact on developing net-importing countries, this problem is not unique to oil. Unlike OPEC, though, other primary commodity producers were unable to achieve similar price changes.

In 1973 and 1974 OPEC aid increased to 2.25 and 2.53 percent of GSP respectively. For the Gulf states (Kuwait, Qatar, Saudi Arabia, UAE) 12.76 and 7.78 percent were recorded by the OECD (1983:21) for these two years. Qatar surpassed 15, Saudi Arabia and the UAE 10 percent of GNP according to the OECD's—not their own—recording. OPEC donors set aid records. OPEC aid was by no means only Arab aid, although Arab countries were by far the most important donors. Iran, Venezuela, and Nigeria accounted for slightly less than one sixth in 1976. One should mention that aid by Nigeria and Venezuela consisted exclusively of grants in most years. OPEC aid—with the main exception of loans and grants for the supply of oil—was untied. The First Gulf War between Iraq and Iran led to the virtual disappearance of these two countries' aid programmes. The sharp fall in oil prices during the 1980s resulted in sharp cuts of financial flows from all OPEC members. Some, such as Nigeria, nearly ceased to be donors. At the moment aid from OPEC is again basically aid from (some) Arab countries. Saudi aid was 1.30 (2002), 1.12 (2003), and 0.70 (2004) percent of GNI respectively. Net disbursements of aid by "Arab countries" (Kuwait, Saudi Arabia, UAE) increased nearly 6.5-fold between 1999 and 2003, when it amounted to $2.72 billion according to the OECD. Although not aid according to the OECD's definition, grants occasionally made to OECD countries should be mentioned. Thus Barbara Bush's campaign against illiteracy in the US received $1 million from the Saudi king in 1989.

The OECD (1983:12) mentions the problem of GNP-comparisons between industrialised countries and oil-exporters. The latter swap non-renewable resources, wealth in the ground, for money, which is misleadingly recorded as growth. If a depletion factor were applied to correct this reduction in wealth, aid percentages of oil exporters would be even higher. Stauffer & Lennox (1984) presented a viable method of adjusting GNP worth discussing.

OPEC's net effect (increases in oil import bills minus inflows from OPEC) on net-importing Developing Countries has usually been exaggerated, as an estimate by Raffer (1992) for 1973-87 shows. Among the net importers of oil except refining centres three Newly Industrialising Countries (Brazil, Taiwan, South Korea) usually accounted for well over 40 percent of the total impact of higher oil prices on this group. The absolute gross effect on Least Developed Countries was surprisingly small, which does not exclude relatively heavy additional burdens on some countries' balances of payments. Although the estimate used the least favourable figures published by the OECD (which has repeatedly published inexplicably different figures for the same years) the group, as defined by the UN, had net inflows from OPEC during 1973-9, a situation which turned around after the "second oil crisis".

However, OPEC aid was by no means distributed according to oil price effects, but determined by other criteria, such as ethnical proximity, political calculus, and whether Islam was a country's official religion (cf. Neumayer 2003). The small group of half a dozen "Least Developed Arab Countries" received particularly large inflows, deriving clear net benefits from increased oil prices, not least due to increased demand for immigrant labour at the Gulf. Estimates put the number of Somalis employed abroad (mostly in oil countries) at 100,000. Immigrant labour was attracted from far off places such as Pakistan, India, and the Philippines, though not always treated well at the Gulf. Their remittances were considerable. The conservative Arab Republic of Yemen was by far the largest recipient of inflows. On the other hand Tanzania, a non-Arab, non-Muslim country with a socialist President received very little, and was consequently hard hit by increased oil prices.

To cushion the effect of higher crude prices on fellow Developing Countries, OPEC members also financed the IMF's Oil Facility, which was established in 1974**.** Ironically, Britain and Italy were among the first countries benefitting from it, ranking amongst the largest purchasers.

Comparing the effects of the two "oil crises" on non-oil Developing Countries the GATT (1980:8f) found that the "largest part" of the increase of the overall trade deficit between 1973-5 "resulted from an increased deficit in manufactures, essentially in trade with industrial countries; the rise of the deficit in fuels, while substantial, was relatively less important." In 1979 the overall trade deficit increased again, "reflecting a sharp rise in the deficit on trade in both manufactures (to $ 71 billion) and fuels (to $21 billion)."

The interest rate hikes in the 1980s impacted much more strongly on non-oil Developing Countries. According to the IMF's Gotur (1983) the total increase of their current account deficit 1978-81 ($66 billion) was caused by oil ($18 billion), net interest payments ($24 billion), and terms of trade changes ($21 billion). In spite of the "second oil crisis" the impact of interest rates was 1.33 times the impact of oil. Apparently, OPEC and oil price increases are used as convenient scapegoats in order to deflect attention from economic policy decisions of OECD member countries.

A short remark on the indirect effect of OPEC-money via the Euromarket seems necessary, as the Southern debt problem has so often been presented simply as the result of "recycling" OPEC surpluses. According to data published by the Bank of England $130 billion of the petrodollar surpluses accumulated between 1974 and the end of 1983 were channelled to private banks, and thus available for credits internationally (cf. Raffer & Singer 2001:136f). Developing Countries, however, were not the only borrowers. One cannot argue that this money was exclusively lent to them, while others, for example Northern governments, did not borrow petrofunds. Direct loans from OPEC countries to net importers in the South were US$ 55 billion during this period. Quantitative evidence apart, the recycling argument is theoretically wrong. If doubtful loans would not have been urged upon Developing Countries excess supply would have driven interest rates down towards an equilibrium allowing investments unprofitable under actual interest rates. The assumption that sovereign debtors can at most get illiquid, but not insolvent, and the knowledge that their claims would be protected against the market by Northern governments, on which commercial banks disobeying the most elementary rules of banking operated during the 1970s led to massive misallocations of resources.

Market Power, Governance Options, and Lessons for the Future

In spite of evidence to the contrary it is widely believed that OPEC alone, acting as a cartel, could force its pricing decisions on the market during the 1970s. No one would assert this for the present situation. OPEC has doubtlessly lost much of its market and pricing power, presently producing about 40 percent of the world's crude and 15 percent of its natural gas (OPEC 2004a). 55 percent of oil exports come from OPEC members. Forecasts quoted by OPEC (*ibid*., p.10) see its share in global production "grow to more than 50 per cent in the next quarter of a century". Quantitatively, this would come close to OPEC's share in 1974. However, it remains to be seen how energy conservation efforts and alternatives to crude develop until 2030. As diversification strategies have not yet been able to reduce dependence on oil, OPEC members, especially the major exporters, will continue to depend on selling crude. Indonesia that was able to diversify its economy seems one exception. Kuwait successfully transformed large parts of its oil deposits into financial assets before the Iraqi invasion, which might be seen as one form of diversification.

Since the early 1980s several large mergers have strengthened oil companies. The $81.8 billion merger of Exxon and Mobil, two of the "Seven Sisters" and both once part of Rockefeller’s Standard Oil before it was dissolved by anti-trust action, is just the most prominent example. The upstream sector, once nationalised in OPEC member countries, has been opened to oil companies again. Bigger oil majors are more powerful market players than in the 1970s.

Politically, the situation differs from the 1970s as well. The International Energy Agency was formed in 1974 to cope with oil supply disruptions. It is linked to the OECD. Its 26 members (including producers such as Norway or the UK) are committed to taking joint measures to meet oil supply emergencies. In 2002 the EU released a plan to co-ordinate its members' oil policies, including raising the minimum level of stocks from 90 to 120 days. This new system is supposed to be in place in 2007. The Commission would have the power to release oil from stockpiles if market prices reached a level that, if sustained for a year, would raise the EU's external oil bill by 0.5 percent of its GDP. Previewing the administration's energy plan the US Vice-President called for increased domestic production in 2001. This goal is more easily achieved when crude prices are high. Finally, it is widely believed that Iraq's oil deposits were at least one main reason for the US invasion. Be that as it may, Iraq's oil production is likely to remain under US influence for the foreseeable future. Few people would categorically exclude the possibility of military interventions in order to secure oil supplies should a hegemonic power think this necessary.

While future oil price increases—also highly profitable to oil companies and ministers of finance in consumer countries—should not be excluded, it seems unlikely that OPEC might become able to control the market or even to influence it strongly against the wishes of other big stakeholders. Owning large reserves OPEC members are likely to remain an important market actor able to exert some influence on crude prices under favourable conditions. OPEC may remain the most successful organisation of commodity producers from the South. But commodity power of the type wrongly ascribed to it during the 1970s is definitely not to be expected.

* For useful comments on the first draft I am indebted to Abdelkader Benamara, Phil O'Hara, and two anonymous referees.

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Political and Economic Integration in East Asia

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Introduction

One of the most remarkable and surprising developments in the second half of the twentieth century was the economic transformation that occurred in parts of Asia. In Northeast Asia in particular, a process of industrialisation and rapid economic expansion took hold that gradually spread to other parts of the continent, leading some observers to describe the end result as nothing short of 'miraculous' (World Bank 1993). At the outset, however, it is important to emphasise that 'Asia' is a strikingly diverse place, and that some parts—the central and Southern parts, for example—have not generally enjoyed the sort of economic growth rates that have attracted so much attention from the scholarly and policy-making communities. This essay, therefore, will focus on *East* Asia, which includes Japan, China, South Korea, Taiwan, Hong Kong and the countries of the Association of Southeast Asian Nations (ASEAN); for it was here that the conventional wisdom about the possibility of, and the preconditions for, economic development outside the 'core' industrialised economies of Western Europe and North America was fundamentally challenged.

Economic development anywhere is constrained or encouraged by specific historical factors. Consequently, the first part of this essay briefly looks back at the circumstances in which the 'East Asian miracle' occurred. Although there were some potentially propitious circumstances in which development could take off, much depended on the efforts of East Asians themselves and the particular political relationships and economic structures they developed to accelerate the industrialisation process. No country played a bigger part in this than Japan, and I pay particular attention to both its emergence as the first industrialised nation in Asia, and to the role the 'developmental state' played in overseeing this economic transformation. Following this I detail how other countries have attempted to emulate the Japanese experience and the impact this more generalised process of industrialisation has had in integrating the region economically. Significantly, however, this growing economic integration has not been matched to the same extent at the political level: political integration in East Asia has—until recently, at least—been limited and not region-wide. The emergence of China as a major economic and political force in the region may accelerate regional integration at a number of levels. Yet even if it does, 'East Asia' is likely to be characterised by continuing variations in the levels of economic development and political influence enjoyed by the very different countries of the region, differences that may make political and economic integration more difficult than it has been in other parts of the world.

Historical Context of East Asian Development

Given East Asia's generally difficult initial integration into the emergent global political economy, its recent rapid growth is all the more remarkable. Two critical developments that had their origins in Western Europe—the emergence of capitalism and the consolidation of the nation-state—profoundly affected the course of development across the non-core countries, especially in the nineteenth century. The economic, political, social and strategic innovations that occurred in Europe gave Europeans a decisive edge over other centres of power, and allowed them to colonize much of the rest of the world as a consequence. In East Asia, the hierarchical regional order that had been centred on China, and which had existed in one form or another for hundreds, if not thousands of years, was suddenly overturned, and much of the region was incorporated into the emergent global economy on highly unfavourable terms. European observers like Karl Marx and Max Weber thought that the comparative underdevelopment and exploitation of East Asia was a consequence of moribund Asian cultural values. Paradoxically enough, however, 'Asian values' were recently considered to be integral to East Asia's success (Ingleson 1996), which reminds us of how academic and political fashions can change.

Recent 'cultural' explanations of East Asia's rise—especially those developed by prominent regional politicians like Singapore's Lee Kuan Yew and Malaysia's Mahathir—have generally been relativistic, self-serving and not terribly convincing (Rodan 1996). What we can say, however, is that prior to the often traumatic interaction with Europe, East Asia had already established itself as a major centre of economic activity. Indeed, it has been persuasively argued that Europe's own economic development owed much to the earlier Asian success (Frank 1998). It is testimony to the generally negative impact of the colonial period that much of this early Asian developmental lead was decisively lost.

During the first half of the twentieth century there were few signs of the widespread economic renaissance to come. Only in Japan, was major industrialisation occurring. Unfortunately, much of this was driven by Japan's emulation of European imperialism and militarism (see (Beasley 1987). As is well known, Japan's imperial ambitions culminated in its defeat at the hands of the United States during World War II, and a preoccupation with economic development and pacifism in the war's aftermath. What is less well understood is that Japan's quite remarkable economic development, in which it was transformed from war-time devastation to the second largest economy in the world in little more than three decades, could not have happened without a favourable geopolitical environment and the influence of US hegemony. Indeed, for those East Asian countries fortunate enough to be on the 'right' side of the Cold War, American interventions in Korea and Vietnam proved to be important spurs to the course of economic expansion (Stubbs 1999).

The US had emerged from World War II as the most powerful country in the world, but one that found itself locked in a Manichean struggle with the Soviet Union—then a formidable adversary. In such circumstances, the US cultivated Japan as a key ally and potential bulwark against Soviet expansion in Asia (Schaller 1982). Not only did Japan receive aid and investment from the US as a consequence—something that facilitated reconstruction and development—but the Americans were prepared to tolerate Japan's mercantilist trade and industry policies if they ensured its survival as a successful capitalist state. Consequently, the 'developmental state' that had emerged before the war was largely left in place to oversee post-war reconstruction and development (Johnson 1982). The central component of the developmental state, which has been widely emulated with varying degrees of success across East Asia, was a competent bureaucracy with close ties to domestic business; a bureaucracy which had the desire and the capacity to *plan* the course of economic development.

So important has the Japanese developmental example, and latterly Japanese trade and investment links across the region, been that it is worth highlighting a number of key features of the Japanese experience. It is important to stress that the Japanese model was—and to a lesser extent, still is—fundamentally at odds with many of the ideas now associated with neoliberalism and the Washington Consensus. The sort of industry policies and trade protectionism practised by Japan were reminiscent of the sorts of policies employed, but now largely forgotten, by Britain and the US during their own industrialisation phases (Chang 2002). Not only was the Japanese developmental state highly successful for many years, but it institutionalised a distinctive set of relationships between state and market that have become characteristic of much of East Asia (Wade 1990). Even when Japanese companies began to move offshore from the 1960s and ’70s as the cost of Japanese labour and the value of the yen rose, their expansion was overseen and facilitated by the state (Hatch & Yamamura 1996). Ironically enough, Japan has come to exercise a sort of ‘hegemonic’ influence, albeit an understated one (Beeson 2001b), that the former imperial powers who colonised most of Southeast Asia did in the nineteenth century. To see why, we need to differentiate more clearly between South and Northeast Asia.

There are a number of important and broadly generalisable differences between the countries of Northeast and Southeast Asia. Some of the most important of these are historical. First, Northeast Asia was not as deeply affected by European colonisation as the South. Not only did Japan escape colonisation, but Korea and Taiwan were actually colonised by the Japanese, something that helped to integrate the Northeast Asian nations economically, and which provided a direct lesson in Japanese-style state-led development (Cumings 1984). Northeast Asia generally was able to exploit the advantages of ‘late’ development, emulating economic strategies and ‘borrowing’ the technologies that had proved successful elsewhere (Gerschenkron 1966). The second key point to make about Northeast Asia is that it industrialised early—at least within a regional context. This meant that Japan and its acolytes in Korea, Taiwan and to a lesser extent Singapore, were able to integrate themselves into the global economy at a favourable moment, and establish advantageous positions within the emerging regional economy. In Southeast Asia, by contrast, not only were the general global conditions less auspicious by the 1970s and ’80s when these later developers were taking off, but they also had to compete with their established Northeast Asian neighbours (Beeson 2002).

A third distinction between North and Southeast Asia is in their respective ‘state capacities’ (Polidano 2000). Japan, South Korea, Taiwan and the Southeast Asian anomaly, Singapore, had relatively competent and honest bureaucracies. In such circumstances, the state generally enjoyed an ability to devise and implement policies designed to further the ‘national interest’ generally and accelerate economic development in particular. In Southeast Asia, by contrast, the state has generally not enjoyed the same sort of capacity to implement policy in the sort of relatively autonomous manner that Peter Evans (1995) suggests is an essential element of successful state-led development. On the contrary, the state has frequently been ‘captured’ by vested interests, as in the Philippines (Hutchcroft 1998), or become the centre of elaborate networks of patronage and influence, as in Indonesia (Winter 1996). Even in Malaysia the state is dominated by political interests that have close ties to business or political parties that are major shareholders in key industries (Gomez & Jomo 1997). In such circumstances, the line between the political and economic spheres has become blurred at best, meaningless at worst.

This is not to suggest that relatively successful economic development has not occurred in Southeast Asia, or that Southeast Asian states have not successfully employed the sorts of industry policies that were deployed so effectively in the North. On the contrary, they have (Jomo 2001). What we do need to emphasise though, is that political and economic processes are deeply integrated, and the legitimacy of the state is highly dependent on its ability to deliver continuing economic development. Yet a number of factors that are frequently well beyond the ability of the less powerful Southeast Asian countries to manage, threaten to fundamentally undermine state capacity and legitimacy.

Regional Political Economy

One important consequence that flows from the timing of the industrialisation process has been the development of a regional production hierarchy. Because Japan went first, and was followed initially by Taiwan, Korea, Singapore and Hong Kong, and then later by the countries of Southeast Asia, a multi-tier division of labour has emerged across the region. The most positive interpretation of this evolving production hierarchy has been the 'flying geese theory', an idea assiduously promoted by a number of Japanese economists and public officials. In essence, the flying geese model suggests that Japan, as the 'lead goose' industrialised first, providing a crucial stimulus for region-wide economic development in which the Japanese model and its expanding economy would pull along other economies in its wake, allowing them to replicate Japanese success (Gangopadhyay 1998).

Unfortunately, the reality has frequently been rather different. One problem has been that historically, the Japanese multinationals- which have played a key role in establishing region-wide production structures have often been reluctant to transfer technology and the more valuable parts of the production process to other countries and potential competitors (Bernard & Ravenhill 1995). As a consequence, a distinctive triangular relationship has developed between Japan, Southeast Asia and major consumer goods markets in the US in particular. Baldly put, Japan has supplied the money, the capital goods and the expertise, while Southeast Asia has supplied cheap labour, natural resources and an export platform from which to penetrate potentially protected markets. It is important to note that 'East Asia' generally and Japan in particular have been victims of their own success in this regard: one major consequence of the rapid development of competitive manufacturing industries across the region has been the growth of politically sensitive trade surpluses, especially with the US. Throughout the 1980s in particular US-Japan relations were strained by interminable, frequently acrimonious trade negotiations as the US sought to use its political power to achieve economic goals (Schoppa 1997). Export platforms in Southeast Asia offered Japanese multinationals a way of reducing costs and circumventing protectionist pressures. Ironically, the so-called 'Plaza Accord' in which America pressured Japan to revalue its currency actually helped accelerate this process and did little to rectify the trade deficit (Brenner 1998).

Recent events and the nature of the production process itself have begun to undermine this rather crudely drawn picture of the East Asian region. On the one hand, the very nature of sophisticated manufacturing processes in hi-tech electronics is forcing Japanese multinationals to open up their production networks and encouraging technology and skill transfer. On the other hand, American firms have responded to international competitive pressures to improve productivity and re-establish themselves as rivals to the Japanese in Southeast Asia (Borrus 2000; Hsiao, Hsiao, & Yamashita 2003). Nevertheless, the idea of a regional hierarchy with Japan at its apex, the second tier countries of Korea and Taiwan not far behind, and with most of Southeast Asia bringing up the rear remains broadly true. Even if we allow for significant differences between say Malaysia and Vietnam in terms of living standards and industrial sophistication, there is an even larger gap between them and Japan or even Korea.

There is however, one factor that threatens to overturn all of the above: China. The sheer scale of China's population and economic potential has generated a good deal of hyperbole and fevered speculation. Although some of the claims about the inevitability of China's rise may be overstated (Segal 1999), it is clear that—especially in a regional context—China is going to have a profound impact on its neighbours. Already China has become the largest recipient of inward foreign investment, something that may not only deprive its smaller neighbours in Southeast Asia of valuable capital inflows, but which will add to China's already formidable industrial capacity (*Economist* 2002). In such circumstances, Southeast Asia risks being adversely affected by the competitive pressures emanating from China as it competes in the same low-end manufacturing niches. Even Japan—still by far the largest economy in the region—is becoming increasingly reliant on China as a production site and as an export market.

So rapid has China's rise been since it embarked upon a process of economic liberalisation and 'opening' toward the global economy that it is hard to gauge what its ultimate significance is likely to be, for the region or the wider world. It is difficult to make sense of basic empirical data about China's share of foreign investment, for example, as so much is re-cycled through Hong Kong (Ravenhill forthcoming). A number of points are worth noting, however. First, China's transformation has occurred under terms and conditions that were largely determined by the dominant capitalist powers led by the US. China's accession to the World Trade Organization is emblematic of this reality (Fewsmith 2001), as China has been forced to embark on far-reaching constitutional and legal reforms to comply with the existent forms of global governance. The second point to make is that China has rapidly become as dependent on access to American markets as the other industrialising economies of East Asia were before it; in China's case, however, its sheer size means that it has displaced Japan as the principal cause of American trade deficits. Predictably enough, pressure is mounting on China to fix the problem by liberalising its currency and allowing it to appreciate.

The merits of capital account liberalisation are somewhat 'technical' and—given the earlier Japanese experience—look unlikely to resolve the 'problem'. Again, however, China's situation highlights issues with more widespread ramifications.

The Asian Crisis and Its Aftermath

In 1997 what began as a localised currency crisis in Thailand, rapidly spread across the much of Southeast Asia and Korea. The 'Asian crisis' raised major questions about the status and durability of the former 'miracle' economies. In the short term this was manifest in the massive outflows of capital that played such a large part in triggering and intensifying the crisis. In the longer term, the crisis has prompted a major re-think about the region and inspired an ideologically motivated discursive deconstruction of the Asian development model (Hall 2003).

The crisis itself has been the subject of extensive commentary (Haggard 2000; Robison, Beeson, Jayasuriya, & Kim 2000), and there is no intention of repeating that here. However, the crisis was such a watershed in the region's political economy that it is important to emphasise a number of key points. Perhaps the most obvious fact that the crisis highlighted was about the evolving nature of the region's relationship with the rest of the world. At one level this was manifest in the extent to which those countries that were most badly affected by the crisis had become dependent on the rest of the world for continuing inflows of capital. Where this was in the form of foreign direct investment, it was generally a welcome catalyst for further industrialisation. But Indonesia, Thailand and South Korea had all become increasingly addicted to hot capital flows, which were generally used to fund consumer spending and speculative activities like property development. Once the idea of the 'Asian miracle' began unravel, and once doubts about the ability of governments to maintain the value of their currencies become widespread, then the preconditions for rapid capital flight were in place. Significantly, the close relationships between political and economic elites in the region that had formerly been seen as a sign of predictability and stability, were now widely blamed for all that was wrong with the region.

While there may have been much about 'crony capitalism'—as East Asia's distinctive political-economies came to be caricatured—that was corrupt and inefficient, it begs an obvious question: if crony capitalism was such a problem, why did the large institutional investors appear unconcerned about it prior to 1997, and why did institutions like the International Monrtary Fund and the World Bank lavish praise on the countries of the region as models of development success? Plainly, this was partly a consequence of perceptions which flowed from the self-sustaining and misplaced euphoria that built up around a region associated with rapid development (and rapid returns for holders of mobile financial assets). While there may have been grounds for concern about the basis and sustainability of 'miraculous' growth rates (Krugman 1994), we should also not lose sight of the fact that very real, unparalleled increases in living standards were—*and still are*—being achieved accross much of the region. True, Indonesia has struggled to regain its former position, but China's development alone is transforming global development indicators.

If the rest of the world's reaction to East Asian development prospects both before and after the crisis was frequently overdone, this only highlighted a more enduring point: as East Asian economies integrated more closely with the global political economy they were increasingly exposed to both its benefits and dangers. True, East Asian economies could tap the enormous pools of investment capital controlled by major mutual funds in places like the US, but the price for this was exposing themselves to the judgement and power of highly mobile international capital. Capital flight and violent, destabilising exchange rate movements, were the risk regional governments faced, especially in the still small economies of Southeast Asia, which are dwarfed by *daily* financial capital movements. Even more importantly in the longer term, perhaps, powerful external actors like the IMF and the US immediately recognised the crisis offered a possibly once-in-a-lifetime opportunity to compel Asian states to adopt reforms associated with neoliberalism and the Washington consensus, reforms which had been studiously resisted in most of East Asia (Bello 1998).

The attempt by external agencies to impose a new regional order that was at odds with the political practices and economic structures which had distinguished the region and underpinned its economic development was widely resented (Higgott 1998). In the longer-term, such actions had the effect of making East Asians aware of their exposure to extra-regional political and economic forces over which they had little control. Consequently, American intervention and the role of the international financial institutions has actually had the paradoxical and unintended consequence of encouraging greater regional cooperation and a push for greater independence of action—especially from the US (Beeson 2003a; Bowles 2002). Whether greater regional cooperation and institutionalisation, especially along the lines of European Union (EU) can be achieved is, however, a moot point.

Institutional Integration in East Asia

While economic integration may have been proceeding apace in East Asia, and is largely driven by the activities of the private sector, a similar degree of political integration has been much harder to achieve. The only indigenous long-standing regional institution is the Association of Southeast Asian Nations (ASEAN), which—as the name suggests is confined to Southeast Asia. Even here, ASEAN is not comparable with the EU, either in terms of political integration, or in the extent and sophistication of the region-wide institutions that have developed to manage transnational relations (Beeson 2001a). On the contrary, part of ASEAN's underlying rationale has been to provide a mechanism to *protect*, rather pool sovereignty as the EU does. Consequently, ASEAN has a comparatively tiny secretariat with little power to ensure member compliance with regional agreements. Indeed, non-'interference' in the affairs of other member states has been a fundamental part of the 'ASEAN way' of doing things—a modus operandi that stresses consensus and informality, rather than the sort of legalism that characterises similar regional agreements in Western Europe and North America (Kahler 2000). When seen in the context of Southeast Asia's unique and frequently troubled history, however, this is not surprising: the impact of the decolonisation process, the divisive and destabilising impact of the Cold War, and the need to manufacture a sense of national identity within the frequently arbitrary boundaries of formerly colonial political spaces, have all made nation-building, let alone regional cooperation, a somewhat uncertain and incomplete process (Acharya 2001).

The preoccupation with maintaining independence and freedom of action has been a particular concern of Southeast Asian states, which are often comparatively new, insecure, authoritarian and keen to protect the sorts of close relations between political and economic elites that are so distinctive of the region as a whole. In such circumstances, it is unsurprising that they have had difficulties in establishing effective regional economic agreements. The ASEAN Free Trade Area (AFTA), for example, is designed to encourage greater economic integration in Southeast Asia, a region that has conspicuously low levels of intra-regional trade. But the competitive nature of regional economies and the sensitivity of key domestic industries has made agreement and implementation difficult. There are, however, signs that the integration of the region into the wider global political economy is exerting long-term changes in the domestic balance of political forces across the region (Stubbs 2000), and helping to overcome the institutionalised patterns of political-economic relations that grew up around protected economies (Jayasuriya 2003). Continuing liberalisation of the 'real' economy in the region may be inevitable in such circumstances. Whether there will be similar enthusiasm for continuing liberalisation in the financial sector is less clear. What we can say, is that reform initiatives in the financial sector cooperation are at the centre of efforts to expand regional cooperation to include the major economies of Northeast Asia.

Cooperation in the financial sector is not as surprising as it may seem. After all, the crisis demonstrated how vulnerable the region was to rapid flows of capital, and the region has some of the largest foreign exchange reserves in the world. East Asia has generally been associated with high domestic savings rates and the capacity of countries like Japan to fund its own development gave it significant economic autonomy. The formidable foreign exchange holdings of Japan and China have been further boosted of late as both countries effectively fund America's trade and budget deficits by buying America dollars and debt (*Economist* 2004). In short, the countries of East Asia have the collective economic wherewithal to make the region generally more economically independent and to impose a more tightly regulated financial structure if they choose to do so (Dieter & Higgott 2003). Formidable technical problems, the limited capacity a number of the region's less developed economies to implement regulatory reform, and an uneasiness on the part of China and Japan about providing an open-ended commitment to some of their impecunious neighbours have placed limits on the degree of cooperation achieved thus far, however (Ravenhill 2002). Moreover, the capacity of American based financial sector interests in 'Wall Street' to influence the international policy-making and regulatory environment through their links to the US government, and the financial sector's ability to continue promoting greater liberalisation across the rest of the world despite major concerns about the stability of global financial structures as a whole, means that establishing a different or more regulated East Asian system remains a major challenge (Beeson 2003b).

But there is nothing inevitable about the course of institutional development or the dominance of 'Western' policy ideas. In this regard, it is instructive to examine the fate of what was until recently seen as the most likely institutional vehicle for promoting a reform agenda associated with neoliberalism generally and trade liberalisation in particular. The Asia Pacific Economic Cooperation forum (APEC) was initially promoted by Australia with discrete but active Japanese backing. Both countries were concerned about the emergence of trade blocs elsewhere in the world and keen to ensure that they were not locked out of important markets. Indeed, it is significant that Australia's initial proposal—which did not include the US—was coolly received in the region; access to North America's lucrative markets and a desire to keep the US 'engaged' in the region were key concerns for many East Asians (Funabashi 1995).

More fundamentally, perhaps, APEC was unable to overcome the very different perceptions about the content and implementation of its reformist agenda. The 'Anglo-Americans'—especially the US, but also Australia, New Zealand and Canada—were generally far more enthusiastic about formal agreements and binding commitments. East Asians, by contrast, insisted on making the 'ASEAN way' of consensus and voluntarism APEC's modus operandi. Consequently, only limited progress was made in realising APEC's ambitious liberalisation timetable. For those with some feeling for the region's history and the nexus between political power and economic interests that exists in much of the region, this was a fairly predictable outcome. For the economists and Western policymakers that enthusiastically championed APEC as the key to unlocking Asian markets, it came as a surprise and a disappointment (Ravenhill 2001).

At a time when APEC's voluntary trade liberalisation agenda is more effectively pursued via the World Trade Organization and even NAFTA, and following APEC's impotence and invisibility during the Asian crisis, there is an attempt to reinvent it as a security forum where heads of government from the Asia-Pacific can meet. While APEC is a potentially unique and useful forum in this context, questions remain about whether it will simply duplicate the existent ASEAN Regional Forum which already addresses regional security issues (Simon 1998), and whether it will satisfy the desire for a more authentically regional organisation in East Asia.

Yet despite the inherent obstacles that potentially face any would-be regional institution, the move toward greater regional cooperation across the wider East Asian region continues to gather momentum. The most important manifestation of this trend has been the development of 'ASEAN + 3' which, in addition to the original members of ASEAN from Southeast Asia, also includes the significantly larger economies of South Korea, China and Japan. Significantly, the first informal ASEAN + 3 summit occurred in late 1997—shortly after the financial crisis hit the region. The grouping has quickly become a prominent part of regional relations and has become increasingly institutionalised in the process (Thomas 2002). Given the East Asian region's frequently bloody history, the major differences that exist in levels of economic and political development, and ASEAN's modest record of achievement, there is understandably a good deal of scepticism about its prospects (Hund 2003). However, some of those very historical experiences that critics cite may actually provide some sense of nascent regional identity and common outlook (Stubbs 2002). At the very least we need to remember that the prospect of cooperation between France and Germany looked fairly remote in the late 1940s, but they rapidly became the central pillars of the EU—a similar rapprochement between Japan and China is hardly such an outlandish idea. Indeed, despite lingering suspicions that stem from their bloody war-time confrontation, the competition for regional leadership between Japan and China may actually be accelerating the process of regional integration as both counties attempt to shore up their positions by establishing closer ties with ASEAN in particular (Beeson 2004).

Like other regions of the world, therefore, East Asia is attempting to manage and encourage greater regional integration, while simultaneously trying to cope with more general global pressures. Indeed, in this regard regional and global processes are deeply interlinked, and the former are frequently a response to the latter (Hurrell 1995). Consequently, the quality and ends of regional cooperation are critical determinants of regional development and the place regions occupy in the wider global political economy. East Asian regional integration has thus far has been as extensive as it has in Western Europe, either in terms of economic integration or in the degree of institutionalisation that has emerged to manage intra-regional relations. While it is unlikely to do so soon, the trend line seems unstoppable: not only is their a functional requirement for some sort of regional regulatory capacity or structures of governance, but East Asians are increasingly interested in developing mechanisms with which to manage their own affairs and promote their own visions of economic and political organisation. In short, East Asia provides a powerful reminder that 'governance' is not simply a technical exercise measured by a calculus of administrative or economic efficiency, but a deeply political project that is central to the creation of regional identities (Higgott 1994).

Prospects for East Asian Integration

And yet, one of the most important influences over the course of East Asia's future integration—especially at the political level—will come from outside the region: American foreign policy will continue to play a major role in constraining or facilitating regional outcomes. In some ways this echoes the earlier European experience, but it is important to recognise that strategic issues are not as critical—the current 'war on terror' notwithstanding—as they were at the height of the Cold War. Trying to predict just how US foreign policy might develop and what impact this may have on the region is clearly a foolhardy undertaking. However, it is revealing that American opposition to East Asian regionalism has diminished and this may prove especially significant. When Malaysian Prime Minister Mahathir proposed a similar East Asian grouping in the early 1990s—the East Asian Economic Caucus (EAEC)—his initiative was effectively vetoed by the US: American opposition was enough to ensure that Japan would have no part in it. In the intervening period, however, not only has Japanese foreign policy become a little more independent and imaginative, but there is a growing regional consensus about the need for some sort of institutionalised mechanism to manage specifically East Asian concerns (Terada 2003).

As far as America's influence on regional integration is concerned, therefore, its impact is ambivalent: on the one hand, the re-emergence of security concerns in the region may create a more tolerant climate within which East Asian regional integration can continue. The US may even be less doctrinaire in its approach to economic issues and more tolerant of Asia's distinctive forms of capitalism—as it was during the Cold War when strategic issues were pre-eminent. On the other hand, the US has displayed an increased willingness to explicitly link security and economic issues in an effort to secure compliance with its long-term geopolitical agenda and the 'war on terror': those nations that accede to the US's security policy hope for, and generally receive, more favourable trade agreements than those that don't (Higgott 2003).

If the US continues to pursue its present bilateral rather than multilateral approach to international relationships and agreements this will make life difficult for regional institutions that are designed to promote greater regional cooperation. It is likely to prove particularly difficult for those regional institutions like the APEC, which are designed to promote trade liberalisation through multilateral auspices. Not only have such issues slid down the regional agenda, but inter-, as opposed to intra-regional relations seem to be less important. Indeed, the very idea of an wider 'Asia-Pacific' region, which tied both sides of the Pacific together through increased political cooperation, looks a less likely prospect in the current environment. In such circumstances, a more tightly focused East Asian grouping like ASEAN + 3 may come to seem like an increasingly attractive and —in the absence of other alternatives—functionally necessary institution for an increasingly inter-linked region.

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Refugees and Asyllum Seekers

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Introduction

The 1951 UN Convention on the Status of Refugees and Article 1(2) of the amended 1967 Protocol Relating to the Status of Refugees provide the universally recognized legal definition of a refugee as any person who: "Owing to a well founded fear of being persecuted for reasons of race, religion, nationality, membership of a particular social group or political opinion, is outside the country of his nationality and is unable or, owing to such fear, is unwilling to avail himself of the protection of that country, or who, not having a nationality and being outside the country of his former habitual residence as a result of such events, is unable, or, owing to such fear, is unwilling to return to it"

This definition emphasizes the crossing national borders and the individualized nature of persecutory threats by a state agent (which vests upon the asylum claimant the burden of proving that the fear of persecution is well founded). Although the Convention specifies the eligibility criteria for legal protection and sets minimum standards for the treatment of refugees, states are not obligated to grant asylum. The right to exit is not matched with a corresponding right to entry in a chosen country of refuge, since "it remains the prerogative of national authorities to determine if the fear of persecution is 'well founded'" (Desbratas 1992:283). This presents states with the space for negotiating around the regime to suit their interests. In practice, persons become refugees legally after being so recognized rather than being recognized because they are in fact refugees. Thus, granting asylum is frequently contingent upon domestic political exigencies in the receiving country, pertinent financial implications as well as ideological and geopolitical motivations. Politically motivated interpretation and determination of the persecution requirement by receiving governments has in some cases resulted in blanket extensions of refugee status without individual assessment of asylum claims, especially during the Cold War. For example, prior to the Refugee Act of 1980, the US granted asylum to all persons fleeing communist countries. Merely being a citizen of a communist country was deemed persecution enough (Keely and Elwell 1981: 7). Crossing of frontiers (read defection) was therefore ideologically underlined as an indictment of source country policies.

The terms refugees and asylum seekers, though often used interchangeably to designate persons fleeing from their countries, have different legal and political implications. According to Turton (2003:14), the category of asylum seekers "has emerged in response to the difficulty of making clear distinctions between people who are moving for political as opposed to economic reasons, since political upheavals usually go hand in hand with violent conflict, economic distress and human rights abuses". They are recognized in humanitarian practice as persons crossing national frontiers who share with refugees the criteria of "well-founded fear of persecution". However, they are distinguished by their location at the time of application for asylum: refugees are seeking permission to enter the asylum country from a place of temporary refuge in the country of first asylum, while asylum seekers are either already in the country in which they hope to be recognized as refugees or at its port of entry (Weiner and Teitelbaum 2001:98).

According to Keely and Elwell (1981:6) "depending on definition, estimates of the number of world refugees fluctuate dramatically on the order of millions of people, and radically alter the estimated cost and proposed methods of meeting their needs".

The Convention and the 1967 Protocol, (so far ratified by 145 states), constitutes an international refugee regime that establishes a set of principles, norms and rules of decision-making binding on parties to the Convention. Article 33(1) of the Convention articulates the fundamental refugee protection norm underpinning the international refugee protection regime, which prohibits expulsion or return of refugees to the country of nationality if doing so would expose them to agents of persecution (formally referred to as *refoulement)*. Kratochwil and Ruggie (1986:759) define a regime as "governing arrangements constructed by states to coordinate their expectations and organize aspects of international behaviour in various issue areas". Essentially, these are normative premises that serve to guide, control or regulate proper and acceptable behaviour among actors with specific- issue based convergent expectations (Weiner 1998:434).

Corresponding international norm-propagating institutions are therefore established to promote actors' compliance with the regime. This role is played by the UN High Commission for Refugees (UNHCR). The UN General Assembly established the office of the UNHCR in 1951 following the adoption of the statute of the UNHCR in December 1950.It was founded with a mandate to provide international protection to refugees by putting together international treaties and supervising their application, in cooperation with national governments, NGOs and other international organizations. Since the 1951 Convention was not directed at relations among states but at how states should treat individuals fleeing persecution, the UNHCR undertakes to exhort, persuade, cajole and even shame states in order to promote compliance with the norms of refugee protection (Weiner 1998:435).Thus, its only weapons are diplomatic pressure and moral suasion. Nevertheless, because states retain the sovereign prerogative to decide on asylum policy and practices within their borders, it is "limited in the available means to change the course of action of a government that is determined to violate international standards" (Loescher 1993:30).

Ironically it is from the same states that it must solicit for funds for its relief operations and secure acquiescence to operate from within their territories. Although the UNHCR statute adopted by the General Assembly in 1950 describes the organization as one "of an entirely non-political character" its lack of financial autonomy has increased the leverage of powerful donor governments in the allocation and use of funds through explicitly earmarking funds or exerting political pressure in fulfilling their foreign policy objectives. Accordingly, not all refugee populations receive equivalent treatment from the UNHCR thus engendering variegated practices that denude its credibility in providing disinterested protection. Tensions thus emerge between its dual roles of protection and relief which are often resolved through compromising either (Loescher 1993).

The collapse of colonial occupation in African and Latin American countries and the later changes in the post-Cold War global order, characterized by the eruption of complex humanitarian emergencies in Central and West Africa, the Balkans and the Caucasus, contributed to the expansion of the scale and complexity of the refugee problem beyond its previous European radius (UNHCR 1995:30). Correspondingly, regional bodies expanded their definition of refugees to cope with these emergent challenges (Barnett 2002:8). Members of the Organization of African Unity (OAU) and Latin American countries that are parties to the 1984 Cartagena Declaration on refugees expanded their definition of refugees to include those individuals fleeing generalized violence (UNDESA 2001:196).Over time, the Convention definition of refugees has proved inadequate for responding to the scale and nature of contemporary refugee flows. Although this definition still only applies to those who cross national borders, the UNHCR has occasionally interpreted it pragmatically to adapt it to the changing international context. In an international system that is currently experiencing disintegrating borders and significant internal displacement a strictly territorial view of refugees is limiting. While the number of uprooted people has increased, the number of those who meet the refugee definition of the 1951 Convention and its 1967 Protocol has decreased since the end of the Cold War.

The population of internally displaced persons (IDPs) has almost doubled that of Convention refugees (about 20 million compared to about 11 million by 2000) as the incidence of refugees from protracted civil war, civil disorder and ethnic conflicts multiplied and, reflecting pressures to contain forced migrants in their locations of origin, as western countries tightened immigration (IFRCRC 1996:10). This has resulted in the extension of the practice of UNHCR assistance beyond its statutory mandate to include categories such as IDPs, returnees and asylum seekers (UNHCR 1995:34). While its statute is restrictive, the mandate is in practice more dynamic. However, even as the UNHCR tries to widen the scope of the refugee regime, states narrow it again by increasing domestic restrictions. Some analysts have nevertheless argued that broadening the refugee definition to encompass 'other people of concern' to the UNHCR such as the IDPs and returnees would devalue the protective integrity of the refugee regime (Barnett: 2002 18).

Asylum Policies and Practices in Europe

The industrialized countries of Europe have had a history of liberal asylum policies and practices dating back to the post world war II period. These were embedded in the economic and foreign policy imperatives facing them then, including labor needs, ties with former colonies and the Cold War (Boswell 2002:9). From the early 1970s there has been a shift to more restrictive asylum policies largely explained by the onset of economic recession following the oil crisis of the 1970s and the collapse of the Soviet Union and the subsequent opening up of borders to the East at the end of the Cold War. Political liberation wars in the South and the outbreak of conflict in Bosnia-Herzegovina, Kosovo and the former republic of Yugoslavia also precipitated a problematic surge in the numbers of asylum seekers, which induced reactive restrictions in response (Gibney & Hansen 2002:3).

Approaches to governance with respect to asylum and migration policies in most European states are subsumed within the broader restrictive immigration policies, generally anchored on the perception of refugee movements as threats to societal, national and international security. Gibney and Hansen (2002:5) attribute this to widespread fears that asylum seekers undermine states' control over mobility through their territorial frontiers owing to their unpredictable albeit irregular arrival, which contrast with the strictly controlled entry of 'quota' asylum seekers. Liberal political cultures and social policy entitlements safeguarded in different national contexts through constitutional and legislative provisions tend to extend social and political rights to long-term residents in many European states which hinders their removal. Low rates of removal in a context of high asylum application rates and low asylum recognition rates, compounded with legislative prohibitions on asylum seekers' direct participation in labour markets, have led to the perception of asylum seekers as a burden on the welfare state and the subsequent politicization of asylum. Accordingly, the ascendancy of migration and asylum issues to the top of the political agenda after the 1970s especially in the UK, France and Germany correlates with the rise in the political currency of welfare protectionist and ethno-nationalist ideologies. Consequently, policies in these and other European countries have converged in efforts to restrict access to their territories.

Preventive measures to contain migration flows within the regions and countries of origin include strengthening controls at points of entry, imposition of visa requirements, carrier sanctions, recognition of safe third countries (Geddes 2001:33; Hassan 2000:185), use of accommodation centres to facilitate speedy deportation, introduction of financial bonds for travelers suspected to be intending to overstay, pre-departure inspections of documents, the promotion of safe havens to contain refugee flows and interdiction at sea (Schuster 2000:121-1). Since some of these measures are usually implemented on arrival in destination countries before the assessment of claims, they "fall indiscriminately and with equal weight on illegal aliens and bona fide refugees alike" (Loescher 1993:99). Such blanket restrictions in effect "undermine the entire international refugee regime and has serious repercussions for the maintenance of asylum principles and practices in the west" (ibid).

There is also convergence with regard to deterrent measures that indirectly minimize access by reducing the entitlements and privileges of asylum seekers on arrival in a European country. These include denying or limiting access to welfare benefits; appeals procedures and employment; and the tendency to substitute temporary protection for permanent 'solutions'. By this means, asylum seekers are taken out of the normal asylum channels to reduce the responsibilities of destination countries to offer the full protection and assistance required of refugee status. These measures are expected to make these countries less attractive to prospective applicants (economic migrants).

The unintended consequence of restrictive asylum policies has been "the significant expansion in human trafficking and smuggling networks" (Boswell & Crisp 2004:1). Large proportions of asylum seekers are being funneled into the illegal channel in order to overcome barriers to entry into the industrialized countries. Koser (2000:106) observes that "asylum policies encourage trafficking, and trafficking overcomes asylum policies" thus engendering a self-defeating vicious cycle. The result is that "the distinction made between the deserving refugee and the … economic migrant has ended by prejudicing the position of all potential migrants, including the most needy political refugees" (Sutcliffe 1998:331), thereby further jeopardizing the integrity of the refugee protection regime. According to Gibney and Hansen (2002:17), when successful, current policies aimed at deterrence discourage cooperation by states to deal with the long-term economic and political causes of refugees and asylum seekers, since "those states that manage to escape large refugee flows are sapped of any motivation to ameliorate the factors that give rise to refugees". Loescher (1993:99) writes that restrictive measures taken unilaterally by western states do not solve the problem but "merely pass it on to some other country to resolve, thus contributing to interstate tensions, protectionism, and a breakdown in the international refugee regime". Moreover, the contagion effect of deterrence among neighbouring states leads towards the lowest common denominator in asylum practice (Geddes 2001:33).

The ‘externalization’ of EU asylum and immigration policy involving the use of incentives and pressures to influence the policies of neighbouring transit countries. This is institutionalized through the use of readmission agreements making transit countries bear the burden of accepting back asylum seekers or illegal migrants who have passed through their territory. Affected countries, mostly those at the periphery of Western receiving states, or those with stops en route, such as Poland, Hungary and Turkey, in turn conclude similar agreements with their neighbors to the East thereby shifting the burden of responsibility further eastward to the source countries (Boswell & Crisp 2004:24).This undermines coordinated burden sharing initiatives.

Despite convergences in policies introduced to control and manage immigration, the gap between them and actual outcomes continues to widen (Cornelius Martin and Hollifield 1994). According to Geddes (2001:34) “the point remains…that EU member states can restrict, but cannot control international migration”. The success of restrictive measures is impeded by a number of factors. Constitutional guarantees of political and civil rights for both citizens and non-citizens, safeguarded by independent judicial systems, have assisted asylum seekers and asylum advocates to challenge restrictive policies introduced by the legislative and executive arms of governments in Europe (Joppke 1998). Migrant networks operating within transnational spaces and largely closed to influence by sending and receiving countries, also generate self perpetuating dynamics of continued migrant flows which escape restrictive measures (Boswell and Crisp 2004:17) and thus produce persistent flows by generating chain migration (Gurak and Caces 1992:164).

Faced with mounting public pressure to control immigration, but with the root causes of international migration lying largely beyond their reach, and with formal restrictive policies under growing moral and judicial challenge, politicians turn to symbolic policy instruments to create an appearance of control. Repressive measures against asylum seekers are therefore sustained to serve political purposes due to their concreteness, high visibility and popularity with the electorate (Massey 1999:314).

Asylum Policies and Practices in the USA Canada and Australia

The USA, Canada and Australia are the three main refugee resettlement countries in the West. US immigration policy has traditionally been aimed at admitting legal immigrants and refugees, while attempting to reduce the entry of illegal immigrants .The concerns of immigration law from the earliest days of the republic have primarily been the protection of the health, safety and welfare of the citizenry by regulating or preventing the immigration of those who carry disease, those who bring crime, or poverty with them (Nedzel 1997:129).Nevertheless, foreign policy interests have been a principal influence on refugee policy in the US. Prior to the enactment of the Refugee Act of 1980, US law selectively defined refugees in favour of those fleeing from communist or communist dominated or Middle Eastern governments. Thus, reflecting the Cold War politics prevailing at the time, the US maintained a double standard in its refugee admission criteria accepting those from unfriendly regimes while rejecting those from US allies (Hassan 2000:190).

The overall policy approach in Australia from the 1970s largely conflated refugees and voluntary migrants with regard to intake.

Refugee selection and reception was conducted under the immigration umbrella and both groups were regarded as resettlers, as reflected in the historical designations like "refugee immigrants" and "refugee resettlers" (Nicholls 1998:72). Resettlement of refugees was linked to the immigration-related criteria of prior family or other links with Australia expected to facilitate resettlement, local integration and speedy acquisition of citizenship. From the 1990s asylum policy emphasized administrative control over the arrival and stay of asylum seekers, principally facilitated by the enforcement of a universal visa system for screening those arriving in Australia. Australia's immigration policy has two major components, the Migration Programme and the Humanitarian Programme. The latter has three parts designed to meet Australia's obligations towards refugees and to respond to global humanitarian and special needs. persecution.

All three countries have made provisions for special categories of people at risk not formally recognized in the Convention definition of refugees. The US began recognizing non-political causes of flight and the need to protect the most vulnerable when in1992 it provided for the admission of 1000 'high risk cases'. Included in this category is the recognition of female genital mutilation (FGM) as a valid reason for seeking asylum. Australia's Special Humanitarian Category (SHC) caters for victims of human rights abuse falling outside the international refugee definition either because they are internally displaced or suffer gross discrimination rather than persecution; and the Special Assistance Category (SAC) for similar groups of people otherwise overlooked in the intake, but which was later phased out in 2000-2001. Canada, which has been a pioneer in granting protection to women claiming gender-based persecution, established a "women-at-risk" programme in 1988 to help women refugees who would not ordinarily be admitted under the usual Convention criteria because they required more assistance than was available to government sponsored refugees.

Significant reforms of immigration law in the three countries in the 1990s and early 21st century have been instituted in response to emergent changes in international security concerns and the domestic political, economic and social challenges of refugee protection through resettlement. The US Congress in 1996 passed the Immigration Reform Act (IRA), formally known as the Illegal Immigration Reform and Immigrant Responsibility Act (IIRIRA) that effectively restricted access to the asylum procedure and authorized detentions and accelerated removals of unsuccessful asylum claims. It also reiterated the delegation to the states (as opposed to the federal government) discretionary authority to distinguish between citizens, legal immigrants and refugees, as spelt out in the Welfare Reform Act (WRA) of 1996 which envisaged a massive overhaul of the US welfare policy by reducing federal spending on welfare (Eppenshade et al 1997:771).

With respect to restricting illegal entry, the IIRIRA significantly increases resources to prevent entry across the US- Mexico border including strengthening the Attorney General's ability to request resources from other federal agencies, including helicopters, night-vision equipments, steel fences and four–wheel drive vehicles. Hiring of more border patrol agents to provide a uniform and visible deterrence to illegal entry on a continuing basis and the development of preinspection programs at foreign airports are also envisaged to enhance control over borders (Eppenshade et al 1997:776; Castles & Loughna 2003:7; Nedzel 1997:134).

A significant reform to the refugee and asylum process introduced by IIRIRA is the limitations it imposes on the ability of aliens to challenge immigration and naturalization service (INS) decisions and deportation rulings in a Federal Court (Eppenshade et al 1997:776).

In order to minimize the public charge of immigration, Congress passed legislation in the Personal Responsibility and Work Opportunity Reconciliation Act which further restricts non citizens' eligibility for a number of public benefit programs and discourages illegal entry of "poverty stricken aliens" by emphasizing that "aliens within the nation's borders not depend on public resources to meet their needs, but rather rely on their own capabilities and the resources of their families, their sponsors and private organizations" (Nedzel 1997:134) .

In Canada, the implementation of the new Immigration and Refugee Protection Act (IRPA) June 2002, underscored the centrality of security concerns in Canada's immigration and asylum policy. The securitized texture of asylum discourse has engendered the erection of barriers to immigrants and refugees in the same manner as in Europe and the USA. Ibrahim (2005:183) observes that "the broadening of criminality and inadmissibility alongside the tightening of the appeal process led to a new IRPA which emphasizes deterrence rather than humanitarian concern". The thrust of the new legislation is to strike a balance between selectively attracting skilled migrants and investors beneficial to Canadian society and filtering out those who pose a threat to Canadian security while ensuring that those in need of protection obtain sanctuary in consonance with Canada's humanitarian tradition. Securitization of migration discourse is premised on the widespread equation of undocumented asylum seekers' illicit modes of arrival in Canada (particularly Chinese boat people) with criminality. It has therefore provided a mould in which is cast a raft of new enforcement mechanisms and tools to govern the movement of migrants, both within and outside Canada. These include the issuance of visas to foreigners entering Canada and restrictive admission rules. The IRPA provides for refusal of admission on security grounds if one is associated with terrorism. Without a definition of what constitutes terrorism, migrants and refugees are equally susceptible to arbitrary decision making.

The conjoining of refugee and security concerns is underscored by budgetary provisions to achieve speedy and enhanced refugee and immigrant screening as well as allocations for detention and expedited removals (Adelman 2002:23). The IRPA, buttressed by the judicial system, has upheld the right of the government to deport persons deemed inadmissible on grounds that they are associated with a terrorist organization. Adelman (ibid) notes that the suspicion of being a terrorist offers substantial ground for deportation even at the risk of refoulement.

They have also signed bilateral agreements, including "readmission agreements" in order to redistribute asylum seekers among neighbouring states as well as to tackle human trafficking. A bilateral agreement signed in 1981 between the US and Haiti authorized the US coast guard to intercept vessels transporting irregular arrivals (Landgren 1998: 426). Similarly, the US and Canada signed a joint statement of cooperation on border security and regional migration issues that included a commitment to work towards a safe third country agreement that would limit or bar the access of asylum seekers passing through either of the two countries (Adelman 2002:27). In addition, following the September 11 terrorist attacks on the US, the two countries intensified cooperation in order to secure their hitherto unguarded borders against potential terrorists.

Australia also has established bilateral agreements with Indonesia, by which

Indonesian authorities, mostly the police intercept and detain irregular migrants bound for Australia while it shares the cost of caring for such detainees, until they can be resettled in or repatriated to a safe country (Tazreiter 2003:9) . Human rights violations occurring during such indefinite detentions have caused concern among domestic and international human rights groups.

In response to the growing numbers of refugees originating from US sponsored civil wars in Central America the immigration and naturalization service (INS) reinvigorated the use of detention from the 1980s to deter refugee arrivals especially those from Haiti. Collateral deterrence measures introduced over time include on-the-spot interviewing at ports of entry, expedited review processes, expanded asylum processing personnel, augmentation of detention space, tightened border controls, tracking of undocumented aliens and swift deportation (Hassan 2000:191). In particular, Guantanamo bay has been used to detain asylum seekers from Cuba and Haiti while their claims are under review "to obviate the need to grant them the constitutional protections foreigners on US sovereign territory hold" (Gibney and Hansen 2002:8). Limitations on welfare have also been imposed through the Personal Responsibility and Work Opportunity Reconciliation Act. The US has also pursued refugee containment measures. Driven largely by concerns about mass refugee flows it intercepted at sea and forcibly returned Haitian refugees who were fleeing the crisis in their country following the military overthrow of President Jean Aristide's elected government, in September 1991 (Roberts 1998:387-388). Hassan (2000:192) observes that as in the UK, the goals of deterrence in US is to reduce the number of asylum applicants "regardless of whether they are 'bogus' or 'genuine' refugees" thereby reducing the costs of claims processing and social welfare benefits as well as discouraging permanent settlement through indefinite detention.

In Australia, the strong managerial control (quota based) over immigration started facing serious challenges. This was due to the rising and unpredictable caseload of asylum seekers from the late 1990s, and also because of the quota system (within the Humanitarian Programme) which set an artificial ceiling on the number of asylum seekers to be accommodated under the programme in any given year, leading to a reduction in entry places for refugees offshore. Although prior to the 1970s boat people in Australia were received as refugees and integrated, arrivals from 1989-1992 of Cambodian boat people were the first "unauthorized" arrivals subjected to detention, marking the tightening of preventive measures against similar kinds of asylum seekers in order to safeguard immigration controls. Their mode of arrival was perceived as deliberately circumventing immigration controls at the expense of genuine refugees.

Detention is used as a strategic and administrative policy to ensure that asylum seekers do not access asylum procedures and so cannot claim legal protection. According to Nicholls (1998:66-67), harsher measures were introduced when boat arrivals persisted even after the implementation of regional 'root causes' policy initiatives such as the Peace Plan for Cambodia and the Comprehensive Plan for Action. Further, "in addition to challenging foreign and strategic policy, the new boat people directly defied the central tenets of Australia's immigration programme" (ibid).

Other deterrent measures have been introduced. These include the Temporary Protection Visa (TPV) introduced in the law in October 1999 (Tazreiter 2003:16); increased asylum application fees and huge monetary fines leveled against unsuccessful claims. Others include a reduction of Asylum Seekers Assistance Schemes' budgetary allocations; reduced access to asylum determination information and a curtailment of asylum seekers' access to the judicial system (Nicholls 1998:74). Stigmatization of asylum seekers as fraudulent and criminal queue jumpers, mainly by the media and politicians, effectively undermines their protection claims. This is so since portraying them as "riding roughshod over needy refugees by jumping the resettlement queue …[means that] official measures can be taken against asylum seekers in the moral cause of protecting the rights of genuinely needy refugees" (Nicholls 1998:77).

The effectiveness of US restrictive policies is however hampered by its geographical contiguity to several poor island nations and its long land stretch of thousands of miles of land borders, which has particularly been difficult to control. These barriers are often penetrated by asylum seekers despite control measures, especially along its border with Mexico. In Canada, high refugee recognition rates have failed to result in a major reduction in numbers of asylum seekers.

Asylum Approaches in Asia

Severe and protracted conflicts account for most refugee populations in the Asian region. During the 1980s the region hosted the largest refugee concentration in the world, of about 45% on average, of the total documented global and refugee population. These refugee populations comprised mainly Palestinian, Afghani, Iraqi and Indo-Chinese nationals.

The Asian approach to the problem of asylum and third country resettlement is to offer short-term asylum based on group assessments rather individualized determinations, on the basis of the 1951 Convention's definition of a refugee. In many Asian countries, concerns about overpopulation, and security threats to the local population balance precluded the granting of asylum and eventual integration into the host society. In eastern and southeastern Asia, short-term asylum for refugees originating from indo-China (Laos, Cambodia and Vietnam) was a practical approach because western countries, especially the US, Canada and Australia had assured resettlement of the refugees. When the exodus of indo-Chinese boat people began, no country within the region had acceded to the 1951 Convention and its Protocol. Before the refugees received offers of resettlement in the west, Asian countries of first asylum housed them in camps and restricted their freedom of movement. The indo-Chinese refugee crisis marked a watershed in international response as the flight of huge populations nearly overwhelmed the asylum system. The huge cost of refugee resettlement strained its use as a durable solution as countries closed their borders to refugees whose resettlement was not guaranteed. Diplomatic initiatives by UNHCR to pre-empt rather than react to the aftermath of a refugee crisis culminated in the establishment of the "orderly departure program." This facilitated the official emigration of Vietnamese citizens who were accepted for resettlement in a third country (UNCHR 2000: 16).

Vietnamese asylum seekers fleeing by boat to neighboring countries rose again in the late 1980s, with increased arrivals of boat people into Australia, Hong Kong, Indonesia, Malaysia and Thailand. An international conference was convened in 1989 to address the refugee problem in the region. The conference attended by 56 refugee producing, first asylum and resettlement countries and donors signed the Comprehensive Plan of Action (CPA). CPA-committed regional countries (of first asylum) grant temporary refuge, with the proviso they would be quickly resettled or returned if rejected as bona fide refugees. Hence the replacement of previous blanket admission and automatic resettlement by new procedures for individual determination of refugee status through a screening process (UNCHR 2000: 16; UNDESA 1998:188). CPA also advocated the expansion of orderly departure programs to stem the tide of irregular boat arrivals (Zlotnik 1998: 455).

Asylum Policies and Practices in Africa

Until the early 1980s, liberation wars accounted for a large proportion of refugees in sub-Saharan Africa. In the late 1990s, forced migration has generally been triggered by conflicts, droughts, famine and economic decline. State formation and nation-building projects intended to consolidate national polities out of a heterogeneous mix of social formations accounts for the ubiquity of conflict-induced refugee flows in the region during the post colonial period. However, the causes of refugees in Africa cannot be divorced from the forces and contradictions unleashed by the global economy (marginalization, debt and structural adjustment) promoting conditions for conflict and economic adversary (Akokpari 1998:223).

The great lakes region comprises countries clustered around Lake Victoria and the Horn of Africa, including Somalia, Kenya, Uganda, Tanzania, the Democratic Republic of Congo (formerly Zaire), Ethiopia, Rwanda and Burundi. This region has been one of two major refugee producing and refugee harboring sub-regions south of the Sahara, being the epicenter of violent conflicts in the region. In the 1970s and 1990s the refugee problem expanded continent-wide as West Africa started becoming a refugee producing area, notably from Guinea, Guinea-Bissau, Ivory Coast, Liberia and Sierra Leone (Bascom 1995:198).

Countries in Africa have always assumed responsibility for their own refugees to a much greater extent than other regions of the world. Local integration in other African countries was the most common solution for the majority of African refugees, many of whom found refuge across the border. Some settled indefinitely or permanently. The majority have settled spontaneously without assistance, facilitated by ethnic ties straddling national borders (UNDESA 1998:184).

The main determinants of refugee policy and practice in Africa include the size of refugee populations, institutional and resource capacities of receiving countries as well as the implications of hosting refugees for regional political stability and security.

African countries have in the past generally offered unrestricted access to asylum seekers, in accordance with the spirit of the OAU charter which encouraged member states to use their best endeavors consistent with their respective legislations to receive and resettle refugees. However, with the recent escalation of the refugee crisis in the region, there has been a shift towards refusal of entry to asylum seekers and towards the normalization of refoulement. For example, Tanzania currently hosts the largest refugee population in Africa of about 602,300 (USCR 2005) and has shown a radical shift in its previously welcoming approach to refugees. From the 1990s, it has resorted to “warehousing” refugees in camps where restrictions are imposed on their freedom of movement, use of land, and the right to work as well as on local integration (USCR 2005). Like in most African countries, camps used to accommodate refugees in the early phases of emergencies and to offer protection while delivering relief supplies end up becoming a permanent feature of their situation.

In addition to frequent refoulement in the post-1980 period, African states routinely reject refugees at their frontiers or in other cases prefer granting them protection in safe zones or containing them in similar areas within their countries of origin through closing borders (Amnesty International 1997). Where asylum is granted, it has often been buttressed by international aid. Across much of the continent, admission of refugees is conditional upon the assurance of donor support in maintaining refugee populations. Given the large scale of refugee movements, international aid plays a critical role in enabling receiving countries to cope with the social, economic and environmental impacts of refugee emergencies (Crisp 2000: 5).

In most of Africa, countries that generate huge refugee flows also harbor those from neighboring countries. Most refugees originate and settle in countries designated as least developed, invariably plagued by droughts, famines and political turmoil. Hostility to refugees is partly explained by the fact that asylum economies can hardly support such huge refugee populations (Adepoju 1995:102). Without effective protection and unable to return to their countries refugees often are on the move. The salience of chronic human insecurity in producing the complex, diffuse and unpredictable patterns of refugee movements in Africa is underscored by UNHCR's observation that "movements of refugees, returnees and internally displaced persons now often criss-cross each other, collecting and discarding people on the way", thereby undermining administrative solutions. Furthermore, there are "a growing number of situations in which people are repeatedly uprooted, expelled or relocated within and across state borders, forcing them to live a desperately insecure and nomadic existence".

Inadequate institutional apparatuses for implementing the responsibilities incumbent upon countries harboring refugee populations also undermines effective refugee protection. For example, while Kenya has no refugee-specific legislation at all, Tanzania and Uganda have legislative instruments "geared much more towards controlling refugees than protecting their rights" (Rutinwa 1998:12).

Refugee policy in the region is also influenced by the sometimes highly politicized inclinations of refugees fleeing civil wars. Refugees communities often include those who have participated directly in political action deemed threatening by their home countries and are as such perceived as a security risk to their host countries. In an increasingly globalized world, those fleeing persecution often cultivate a collective political consciousness, mobilize resources and consolidate movements to challenge their home governments. The active involvement of refugees in creating the complex political landscape in the Great Lakes region is a case in point. These experiences suggest that once consolidated, militarized refugees become autonomous transnational actors who "pursue their own independent foreign policies that prove difficult to contain or control" (Loescher 1993:27), with serious implications for regional security.

Governance Issues and Challenges in the 21st century

Widespread derogation of the refugee Convention through restrictive asylum practices underlines the limitations of international conventions in effectively achieving global governance. Even though they provide a legal basis for international action, there is no guarantee that action will be taken. Concomitant with the fight against terrorism is increasing subordination of certain principles of international refugee and human rights laws to national security interests. In the absence of a supranational authority to oversee uniform administration of refugee law, the discretion of domestic judicial systems in interpreting international refugee law has produced varying repercussions in refugee protection practice, particularly in Western countries. The intermeshing of immigration with foreign policy and national security concerns has resulted in the subservience of the judiciary to the legislative arm of government such that in the US, for example, “if the legislature considered the presence of foreigners of a different race to be dangerous to peace and security, it has the power to exclude them” (Nedzel 1997:147). Ansley (2005:201) notes that the US Supreme Court remains deferential toward legislative action by the US Congress concerning immigration. The Court holds that “Congress has the plenary power over immigration and naturalization questions, and its exercise should not be subjected to the same standards of judicial review that the court would apply in almost any other context”

Since the *sine qua non* for refugee definition remains the crossing of national borders, international response is only activated once individuals cross national borders under conditions specified in the Convention. Based on the presupposition of an existing exiled population, this exile-oriented approach is premised on a vision of the world as monopolized by territorially bounded nation states in which citizenship is the universal form of identity. Asylum seekers and refugees are thus viewed as an aberration to be corrected when citizenship is restored (Soguk 1999). In a global age, this theoretical framework is anachronistic and constrains the forging of effective governance approaches to address emergent transnational challenges. Many boundaries hitherto separating human interactions are being eroded owing to the increasing interconnectedness between societies which simultaneously weakens the putative nexus between the territorial states and national identity. The ensuing dynamics of de- and re-territorialization tend to make the world a single space and to change the meaning and importance of national identity in world affairs (İçduygu & Keyman 2000:388).

Nevertheless, within the broad contours of discourse on citizenship is a nested ethno-nationalist ideology which politicizes differences between nationalities and propagates the securitization of asylum. Faist (2002:12) argues that securitization of asylum is also politically instrumental insofar as it elevates migration to a meta-issue to which a host of other largely unrelated issues can be conveniently connected as a basis for symbolic politics. In this way, it is pressed into service by politicians in “explaining [away] many social, economic and security problems without having to give concrete evidence” (Faist 2002). Without the premise of empirical evidence, policies end up being ineffective and merely symbolic. Legitimizing the securitization of asylum is the bolder salience of the UN Security Council and regional security organizations such as NATO as key forums for governing refugee protection. Couched in the language of security, deliberations in these forums reinforce the perception of refugees as threats to states’ security and legitimize refugee containment at source.

Thus, refoulement and border closing are justified on grounds of threatened national and regional security (Chimni 2000:252). Ultimately, restrictive asylum policies undermine burden sharing among states and a common commitment to the institution of asylum globally which could exacerbate the endemic nature of refugee problems, particularly in developing countries. Furthermore, the objectification of refugees and asylum seekers as security threats dissolves their individuality by decontextualizing their diverse biographies thus rendering them a dehumanized and bureaucratized mass thereby obviating the need for individualized asylum adjudication.

Encountered through the prism of criminality, they are effectively depoliticized and their voice in public debates often muted thereby exacerbating the marginalization of their agency in the governance processes in the international asylum system.

The prominence of civil conflicts, crises of state legitimacy, internal displacements and state sponsored human rights abuses in the post Cold War era has engendered new opportunities for challenging the state both from ‘below’ and from ‘above’. Accordingly, emphasis is now shifting from focusing on the responsibility of receiving countries for solving refugee problems to the circumstances which brought them into existence in the country of origin, i.e the root cause approach. Central to the root cause approach to asylum is the concept of human security which approaches security from a comprehensive, people-centered vantage point that transcends the territorially oriented notions of state security. Fostering human security invariably means questioning the inviolability of state sovereignty and normatively redefining it as ‘responsibility to protect’ the human rights of citizens within the jurisdiction of a state.

Beck (2003:264) points out that concomitant with globalization, the interface of domestic and foreign policy is fundamentally transforming old notions of state sovereignty viz. “out of national interest, states must be denationalized and transnationalized-that is, part of their autonomy must be given up in order to muster national problems in the globalized world”. Accordingly, the issue of asylum is significantly shaping bilateral and multilateral relations among states, owing to its overlap with other transnational and regional issues such as conflict, political instability, pervasive poverty and people smuggling. Regional consultative processes and cooperative approaches to managing international refugee movements are emerging in response to the inadequacy of unilateral or bilateral policies in addressing the dynamic and transnational processes of asylum seeking.

Ghosh (2002:239) argues that such initiatives “could be valuable building blocks towards the establishment of a new international regime for better management of migration”. New inter-regional governance frameworks are also evolving to comprehensively tackle these issues. For example the Cotonou Partnership Agreement between the EU and African, Caribbean and Pacific (ACP) countries provides a legal and institutional framework to promote conflict prevention, management and resolution in crisis affected countries. It provides a framework for structured cooperation between the EU and ACP countries in addressing the root causes of refugee flows through linking EU development instruments and its common foreign and security policy (CFSP) (Gomes et al 2001).

Nevertheless, the focus of the root causes rhetoric on the countries of refugee origin presumptively locates refugee causes at source, thereby excluding from critical scrutiny the agency of external actors, including the western states themselves and their policies in the dynamic chains of causation. Shifting the blame in this way eclipses the global resonance of the refugee problem, thus undermining the construction of global governance structures.

Furthermore, the politicization of humanitarian issues has resulted in the substitution of humanitarian action for political action to address the root causes of refugee crises. In the post cold war era instances are increasing in which “humanitarian action is essentially an act of political abstention” (Chimni 2000). This imposes upon UNHCR and humanitarian NGOs new ethical dilemmas in refugee protection whereby "choices must be made among equally unsatisfactory alternatives and for which there appear to be no satisfactory solution" (Weiner 1998:440). Thus "only least worst choices can be made in many situations" (ibid: 442).

Moreover, the heightened prominence of the international media in focusing world attention on humanitarian emergencies has earned them leverage in either making or breaking humanitarian relief operations. Flows of donor contributions are guaranteed when they sustain the international public's attention on particular crises. Conversely, their departure leads to the opposite effect. Selective interventions precipitated by media pressure produce ad hoc responses that do not address the substantive issues that need resolution. As Menkhaus (1998:56) argues, "When humanitarian policy is driven only by media images and public pressure, there is a strong tendency on the part of administrators to measure success by how effectively they *appear* to be addressing the problem, rather than by how effectively they *actually* resolve it. If the stakes are political, not strategic, the policy choices will also be political, not strategic"

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Refugees. www.refugees.org

UN High Commission for Refugees. www.unhcr.ch

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Sovereign Debt

Kunibert Raffer

Introduction

The term describes debt incurred by countries, debt of or guaranteed by the (central) government, debt of some state owned institutions, and parastatals. Although virtually all countries have sovereign debt—the US has by far the highest government debt burden in absolute terms—international discussion usually has focused on debt by Developing Countries (DCs) since 1982.

Seen from an international governance perspective this may be justified. The crash of the globalised, unregulated Euromarket provided leverage for further globalisation and for enforcing policies public creditors wanted Southern debtors to implement. The discussion on "ownership" highlights this pressure: it is officially doubted whether the policies implemented are really those debtor countries would freely embrace. Some thirty years of debt management by public creditors have not solved the problem, but have changed North-South relations fundamentally.

Sovereign Debt before 1982

Before 1945 this was largely a phenomenon of Latin America and those few countries, such as the Ottoman Empire, that were not colonies. Financing their wars of independence with British loans most Latin American nations came into existence with huge debt. Debt servicing problems surfaced soon. In 1846 creditors financed an unsuccessful Spanish invasion, hoping that Spain would repay those loans that had helped its colonies gain independence.

Characterised by high effective interest rates and frequent defaults Southern debt was roughly comparable to modern junk bonds. Only a fraction of face values would actually be disbursed, the rest going into front-end fees and pre-paid interest. Typically, around one third of an English loan would actually reach Latin America during 1822-26. In 1825 Greece received 13.75% of a loan's face value, carrying a front-end discount of 43.5%. Like nowadays, bonds were the preferred instrument. Creditor committees negotiated with debtors. In 1876 the representatives of private bondholders decided to use Egyptian insolvency law as the yardstick to solve Egypt's debt crisis. Rather than applying the "lemon squeezer" approach of the Bretton Woods Institutions (BWIs), the administrator appointed to protect creditor interest lowered, e.g., taxes, postal fees, financed expenditures in public health and education, encouraged improvements in irrigation. Wages and pensions were paid out in full. After surprisingly few years this was economically successful for creditors and the debtor. This economic success must, of course, be seen with the political background of British interests in mind.

After Mexico's default 1914 creditors refused to follow Egypt's example. After years of debt management debt service was geared to Mexico's capacity to pay. Eventually, creditors received less than 10% of face values. The Egyptian solution would most probably have delivered a better result more quickly and cheaply for anyone involved. The final outcome of Latin America's debt crisis in the 1930s may be called *de facto* insolvency. After negotiations Brazil's debt was reduced by over 75 percent in 1943. "Debt default eased" Chile's "payments constraints" (Maddison 1985:28). Colombian local governments (municipalities, possibly) pioneered debt default, central authorities followed. Some big European debtors were themselves delinquent regarding their debt after World War I. The US has still not received full repayment from many European countries for loans during this War. The British and French governments defaulted in the 1930s. So did several US States in the 1940s. US states have a long history of defaulting since the 19th century. The term repudiation was coined by Mississippi when it simply refused to honour its debt.

After 1945 the debt problem surfaced again. The Pearson Report (Pearson *et al*. 1969:153ff) prepared on request of the IBRD's president, identified structural origins of the debt problem. Apparently, inequalities in the global economy exist, putting DCs at a disadvantage, such as the structural resource gaps to which the Prebisch-Singer-Thesis had drawn attention. The Report called for debt reduction, even proposing that DCs be allowed to waive or cancel interest payments unilaterally contingent on certain conditions.

Incurring debt is perfectly in line with development theory that had identified two gaps as impediments to development: the "savings gap" (insufficient savings to finance necessary investments) and the "foreign exchange gap" (insufficient resources to import needed capital goods). Thus capital from the capital abundant North had to flow to capital scarce DCs where theory assumed it to earn higher returns. The "growth-cum-debt" concept or the model of the "debt cycle" (cf. Mikesell 1968:105ff; IBRD 1985:47f) express a DC's trajectory. After increasing first, net borrowing eventually declines, turns negative, and finally the now no longer underdeveloped country becomes a net capital exporter. Apparently, this approach does not work as smoothly as assumed.

At the end of the 1960s an oversupply of US dollars increased international liquidity offering another way to deal with the debt overhang. The Report's warning was met by Southern indebtedness taking off. New lending from private sources covered up the problem. A Ponzi scheme started in the 1960s. Lending exploded during the 1970s fuelled by a nearly universal convergence of interests of borrowers, lenders, and OECD governments. A period of negative real interest rates and relatively high commodity prices encouraged DCs to borrow. Spreads fell dramatically, reducing differences between North and South, supposedly reflecting differences in risk, perceptibly. DCs saw commercial loans as an opportunity to diversify sources of finance, to improve their position *vis-à-vis* official, especially multilateral, lenders thus reducing creditor power to impose conditions. Declining aid, the practice of tying, the frequent use of aid for political purposes or to obtain economic advantages, must have made commercial loans attractive. Apart from very few exceptions confirming the rule, commercial banks have not tried to dictate their clients' policies. During the first few years, this source of finance made DCs somewhat less dependent on donor countries.

The view that commercial banks would be bailed out was nurtured, for instance by Indonesia's Pertamina crisis, which occurred a few years after Indonesia had received a generous debt reduction similar to the reduction granted to Germany in 1953, also by DCs. This did not preclude Germany from becoming one of the toughest creditors later, opposing debt reduction most fiercely.

Although contradicted by history, W. Wriston's dictum was believed in the 1970s that sovereigns would always repay. Commercial banks lent aggressively, disregarding the most elementary rules of prudent banking. OECD governments and multilateral institutions encouraged and applauded the "successful recycling of Petrodollars". After 1982 OPEC has been used as a convenient scapegoat, in spite of evidence. Historically unique, syndicated lending not bonds, characterised Euromarket loans.

Problematic facts, such as the first “adjustment measures” after 1973, debt alleviation for Low Income Countries necessary under the Retroactive Terms Adjustment in 1978, or warning voices raised throughout the 1970s were simply ignored (cf. Raffer & Singer 2001:163ff). Even after August 1982 the BWIs thought for a while that there was no crisis, stating that the money market functioned well, seeing no signs of liquidity bottlenecks, nor of restrictions regarding the capital base of private banks limiting lending to DCs, which was supposed to continue on a large scale (*ibid*.). After eventually recognising it, both IMF and IBRD skilfully used this crisis to increase their importance dramatically, assuming the role of debt administrators. The BWIs did not arrive to solve the problem but had been part of creating it. During 1979-81 the IMF approved 88 arrangements to support adjustment policies, particularly measures to reach sustainable balance of payments positions. All countries negotiating reschedulings with their creditors in 1981 had adopted an IMF adjustment programme before.

Debt Crisis of 1982 and Early Responses

Steep increases in interest rates and plummeting raw material prices around 1980 triggered the open crisis. Restrictive monetary policy by the Fed to fight inflation combined with huge US budget deficits the Reagan administration caused by financing armament (”Star Wars”). Negative real interest rates quickly turned positive, shooting beyond 20%. The price of money increased drastically while revenues plummeted. New loan contracts stipulating variable interest rates (typically LIBOR plus spread, the London Inter-Bank Offer Rate plus an individual surcharge) transferred risks and costs of lending quickly onto debtors. In August 1982 Mexico declared itself unable to honour its obligations. Although not the first case, this was declared the outbreak of the debt crisis.

Debt management after 1982 was based on the so-called illiquidity theory asserting that no fundamental crisis existed, only temporary payment problems. After eventually realising that there was indeed a crisis, the BWIs became the most ardent advocates of this "theory". Countries would “grow out of debt”. Debt reduction would not be needed. Public funds poured in, allowing commercial banks to receive higher (re)payments than otherwise possible, and producing a remarkable change in debt structures. The IBRD (1988:xxix) complained that concerted lending by banks since 1982 had just been sufficient to refinance around a quarter of interest payments by Highly Indebted Countries (HICs), “making the IBRD the principal net lender to HICs”. A substantial bail-out of private banks by public multilateral institutions and a major shift of risk to these public entities occurred. After the first wave of public (aid) loans, whose effects the Pearson Report had noted, and the second wave of private Euromarket lending, the third wave of lending was again characterised by public creditors (cf. Raffer 2004a).

HICs, also called “Baker countries”, were addressed by the "Baker Plan" (officially: “Programme for Sustained Growth”). The list was not immediately clear, but US interests were clearly visible. As countries would "grow out of debt" the US Secretary of the Treasury, James Baker, insisted on full repayment plus interest, proposing additional net lending of $29 billion over three years, $20 billion from commercial banks, $9 billion from International Financial Institutions (IFIs). To put this into perspective: Mexico's interest service was $9.4 billion in 1985, its annual debt service $14.5 billion, Brazil's

$10.3 billion. Baker demanded a continued central role of the BWIs, calling on them to support comprehensive macroeconomic and structural policies.

The policies supposed to help countries solve their temporary debt problems were called “Structural Adjustment". This means cutting public budgets (especially social expenditures), liberalising trade, liberalising capital accounts, reducing state activities, repressing wages, increasing exports, and devaluation, which increases the debt burden in domestic currency. Once lending occurred in debtor-currencies in the 1990s, however, the BWIs insisted on defending fixed exchange rates, which buys speculators time to leave without losses.

The BWIs insisted that "Structural Adjustment" would solve the problem. Cheaper exports were hoped to increase export volumes and thus foreign currency revenues. The BWIs advised all debtors to increase their market shares, flooding markets. Excess supply drove prices further down, a problem called "fallacy of composition": while one exporter can gain shares by selling more cheaply, this strategy cannot work for all exporters simultaneously. Devaluation increased the debt burden and import prices in domestic currency. Imports and gross investment fell so perceptibly that doubts were raised whether export capacity could be preserved in the long run. The burden was further exacerbated because debtor governments were frequently forced to "guarantee retroactively" private debt incurred without any government involvement that had gone bad. Private creditors were bailed-out by socialising debt. The BWIs raised no objections. Countries had to "honour" this debt as well—a typical feature of debt management since Chile's crash in 1982. Overoptimistic BWI-forecasts of debtors' export volumes and prices, or growth in OECD countries, were continuously published to "support" the illiquidity theory first, and insufficient debt reductions later on. Meanwhile, the IMF and IDA (2004:13) officially admitted a "bias in projecting GDP growth in U.S. dollar terms ... [of] almost 5 percentage points a year."

By squeezing domestic consumption more resources became available for debt service. The BWIs declared special measures to protect the poor as superfluous if not outright harmful. Just carrying on with austerity policies would be in the very interest of the poor. Emphasising human needs would obstruct needed reforms. "IMF-riots" by the impoverished population frequently ensued. Cornia *et al.* (1987) documented the effects of "Structural Adjustment" on the poor, a book influencing debt management strongly.

Attempts by IFIs to prove success of "Structural Adjustment" were short-lived. At best, empirical evidence remained “inconclusive”. Usually there was no statistically significant difference between "adjusters" and "non-adjusters". Statistical methods, such as country groupings, were repeatedly attacked as purpose serving. One of the extremely few statistically significant results was published by Khan (1990), an IMF-econometrician: a predicted reduction in growth rates of at least 0.7% of GDP each year countries had an IMF programme. Mosley *et al*. (1991) found adverse effects of "Structural Adjustment" on growth, particularly in countries with low slippage on conditionality, and declining shares of investment in GDP. Eventually, the IBRD (1990) itself acknowledged that "Structural Adjustment" lending had achieved some success regarding the improvement of the balance of payments (largely due to import compression, critics rightly pointed out) but did not encourage investments nor enable debtors to grow out of debt. No “adjusting” debtor recovered sustainably.

However, if one follows Rodrik's (1996) interpretation that the debt crisis was an opportunity seized by orthodox economists "to wipe the slate clean and mount a frontal attack on the entire range of policies in use" one may speak of absolute success. A crisis brought about by overlending in globalised credit markets and the sudden change of Northern economic policy was simply declared to stem from too little globalisation, import substitution and "inward looking" policies. In contrast to the period before 1945, where debtors and creditors eventually reached a solution, negotiating as equals, debtors are now firmly under BWI-control.

Reschedulings (at substantial fees) were initially done annually. Multi-Year Rescheduling Agreements (MYRAs) eventually followed. Mexico first obtained one in 1984. Private banks organised in the London Club used a "menu of options" to manage their debt problem. The most popular instrument was the debt-equity swap. A bank would sell a nominal claim (100) for its secondary market value (50) to a company C about to invest in the debtor country. C would exchange 100 into domestic currency to finance investments. Debtors barred from the secondary market were eventually able to charge fees. Variations such as debt for nature (e.g. rain forest bought to be preserved) or debt for charity swaps (the buyer/recipient is a charity) occurred, but remained much less important. Unlike European banks US banks had virtually no loan loss reserves due to specificities of inappropriate US legislation. Briefly after 1982 a British banker, David Suratgar, proposed applying corporate insolvency (in the US: Chapter 11) to sovereign debtors, which was fiercely opposed, especially by the BWIs. Among the many proposals during the 1980s, there was an International Debt Management Authority to buy debt below nominal values, passing on part of the reduction to debtors. Krugman (1988) defined a debt overhang as expected present values of future transfers less than debt. Economic efforts cannot change the debtor's situation but benefit creditors exclusively, a strong disincentive for debtors.

Admitting the Necessity of Debt Reductions

While stretching maturities, the Paris Club, the informal group of bilateral creditors, still insisted on full repayment in 1987 (Venice Terms). In 1988 it recognised the need for debt reduction. On Britain's initiative the so-called Toronto Terms were agreed. Debt of poor (IDA-only) countries was to be reduced by one third, either of the stock of eligible debt or by equivalent interest reductions. On US insistence a third option was considered equal: stretched maturities and grace periods. Regarding private creditors, the US supported a relatively small and unsuccessful Mexican restructuring deal including debt reduction. In 1989 the new US Treasury Secretary, Nicholas Brady, presented the "Brady Plan" after violent IMF-riots in Venezuela. Only commercial banks were called on to reduce claims voluntarily. Official creditors remained exempt. In spite of the name, this proposal originated in a debtor country. It was first made by the Brazilian Finance Minister, Bresser Pereira, and immediately turned down by the US Treasury. Later, Japan's Finance Minister, Miyazawa Kiichi, supported it before it became the "Brady Plan". "Brady reductions" were implemented under BWI-guidance, a new task for the BWIs which made them discard the illiquidity theory immediately.

Mexico negotiated the first "Brady deal". With some prodding of commercial banks by the US new bonds were exchanged for old syndicated debt at a discount of 35%. Three options existed: capital stock reduction, equivalent reduction in interest rates ("par bonds"), and new money (chosen by 13%).

As official money poured in to "finance debt relief", Mexico's total debt changed little. The effect was negligible. Further Brady deals (called Debt and Debt Service Reduction schemes after Brady had left the Treasury) followed, such as Argentina, Costa Rica, Brazil, Venezuela. Ecuador officially defaulted on its Brady bonds in 1999. Although private creditors had granted 45% reduction, Ecuador's debt time series only shows a small blip downwards. If all creditors had reduced by only 30%, Ecuador would in all probability have been economically afloat again.

In 1991 Britain proposed reducing eligible debt of poor countries by two thirds. The Paris Club considered these Trinidad Terms so radical that it took three years until the Naples Terms foresaw 50-67% reductions. Meanwhile 100% has been reached, which proves that granting necessary relief in time would have avoided many economic and social problems. The Paris Club's high percentages of debt reduction are misleading, though. On principle only so-called pre-cut-off debt has been eligible (meanwhile exceptions have become possible). This date is when debtors first asked the Paris Club for relief, which can be soon after 1980. An early cut-off date could combine 100% "debt forgiveness" with an actual reduction of less than 1% of total debt. Recently the Paris Club considered "adjusting" cut-off dates.

After the "Lost Decade" of the 1980s, the 1990s began with officially heralded hope and recovery, at least for debtors with "prudent" economic policies, meaning those implementing BWI advice. This optimism was based on huge capital inflows, especially to Latin America, and conventional debt indicators, such as the Debt Service Ratio, at pre-1982 levels. However, as the BWIs' indicators measure payments made not payments due, the "improvement" was largely explained by increasing arrears, as the BWIs' own statistics documented. Countries without debt have the same indicators as overindebted countries paying nothing. A new indicator dividing payments actually made by payments contractually due (Raffer 1996) showed that Latin America honoured about half its obligations. Argentina and Brazil, two of the main countries able to place bonds, paid roughly one fourth and one third according to the latest data before the "Tequila Crisis" in 1994-5. Mexico had an exploding current account deficit. Furthermore, new money came again from bonds, the public at large, not from old creditors. Commercial banks reduced their exposure further, which hardly characterises regained confidence. Paving the way for bonds, regulators in OECD countries relaxed guidelines for bond issues and lowered minimum credit ratings. These regulatory changes, the IMF's insistence on liberalising capital accounts, and official euphoria made the crises of the 1990s possible. Inflows of hot short term money were encouraged by Basle I, privileging these with lower capital weights, thus positively fuelling the Asian crash of 1997.

Regarding the quality of BWI-data caveats seem justified. There often are substantial and unexplained differences and "improvements" in official BWI time series for the distant past that do justify questions (Raffer 1996; Raffer & Singer 2001:180ff). An extreme example is Chile. First lauded for avoiding capital flight when this was a sign of good policies, it became again the model once repatriation became the touchstone of sound economic policies. Both the absence of fleeing capital and its return are "duly" reflected in official BWI-statistics.

Soon after the "Tequila Crisis" the old cycle of euphoria and doom repeated itself. East Asian countries were hailed as model economies right into the crash. Asians were said to be successful because they had embraced globalisation and the teachings of economic orthodoxy so fully—like Mexico, the model pupil before 1994-5. Later, the IBRD (1999:2) acknowledged having known "the relevant institutional lessons" for years. A report by its Operations Evaluation Department on Chile's structural adjustment loans "highlighted the lack of prudential supervision of financial institutions in increasing the economy's vulnerability to the point of collapse" (*ibid*.). The "key lesson" that "prudential rules and surveillance are necessary safeguards ... rather than unnecessary restrictions" (*ibid*.) did not keep the BWIs from encouraging the very policies leading to Chile's crash to Mexico and Asian countries. The problem was recognised years before. The unfolding of the Asian Crisis could be watched like a movie whose script is known. Argentina's crisis 1995 goes unmentioned, although it was of a similar variety. The Asian crash and the crises in Brazil and Russia following suit stimulated the search for new solutions (cf. Eichengreen 1999, Rogoff 1999).

James Wolfensohn broke the last taboo, reducing multilateral debt, pushing the Highly Indebted Poor Countries (HIPC) Initiative through against strong resistance by the IMF and within his own IBRD. Its declared aim was to enable a HIPC "to meet its current and future external debt-service obligations in full without recourse to debt relief, rescheduling of debts, or the accumulation of arrears, and without unduly compromising growth." (Boote & Thugge 1997:109). HIPC I classified debt as sustainable if net present values were expected to fall below 200% of exports, and debt service ratios below 20% within five years. For values of 200-250% and 20-25% sustainability was to be determined in each case, anything higher was unsustainable. As HIPC I did not work, the G7-Summit of 1999 introduced HIPC II. The important indicators were reduced, but remained a multiple of what was considered sustainable when Germany's debt was roughly halved in 1953. For the first time HIPC II incorporates poverty alleviation and civil society participation, proposals rabidly fought by the BWIs when made as part of a sovereign insolvency model copying the US Chapter 9 in 1987 (Raffer 1990; Raffer & Singer 2001:192ff). Both HIPC-Initiatives preserve a preferred status of multilaterals, relying on higher reductions by other creditors bailing out IFIs. HIPC II did not deliver. Soon, HIPC III was suggested. Sceptics may call "topping-up" (routine additional relief at Completion Point) HIPC III, and the MDRI HIPC IV. The results of the HIPC-Initiatives based on rules established by creditors prove what is known: creditors must not decide in their own cause.

The IMF recognised the failure of BWI debt management for Middle Income Countries by proposing its Sovereign Debt Resolution Mechanism (SDRM) in 2001 (cf. Krueger 2002). It was a highly self-serving proposal. The IMF's Executive Board would determine sustainability, and the "adequacy" of debtors' economic policies. Determining sustainability the IMF would automatically determine the amount of debt reduction. Multilateral debt, especially the IMF's own claims, remain exempt. The present *de facto* preferential status is to be legalised. The whole procedure, down to details, should be enshrined into the IMF's Articles of Agreement. The IMF argued this to be necessary because vulture funds would otherwise disturb or block the mechanism. Creditor majorities and the debtor, officially presented as controlling the process, would have little to decide. Basically, not much would change, except that the IBRD would have lost the turf war which BWI is managing debt. Although the IMF churned out many variants, these features never changed. The Fund remained vague on whether Paris Club members (its important shareholders) should grant debt reductions. Private creditors would bear the brunt. Considering that private creditors have granted more reductions than the Fund so far, the IMF's declared goal of "bailing-in the private sector" sounds astonishing. The SDRM triggered strong opposition from Wall Street, the US, emerging markets (for which it was proposed), NGOs, and academia. It was downvoted at the Spring Meeting 2003. Not even mentioning any protective measures for the poor, participation by the population, or multilateral reductions, the SDRM fell far behind the standards of HIPC II (Raffer 2006). In 2003, Uruguay successfully reprofiled her debt obligations. This was interpreted as the proof that the private sector could deliver solutions without the SDRM.

Although the IMF presented the SDRM as a "new approach", the idea of adapting insolvency procedures is not new (cf. Rogoff & Zettelmeyer 2002). Adam Smith was the first to suggest it. When emulating corporate insolvency was proposed after 1982, the IMF was among the fiercest opponents, claiming that what it would propose itself in 2001 was impossible because of sovereignty. Countering this argument, Raffer (1990) proposed in 1987 to emulate the basic principles of the US Chapter 9, municipal insolvency. This model preserves the debtor's governmental sphere (sovereignty), and gives the affected population a right to be heard. This participatory element was strongly opposed by the BWIs and declared impossible to implement—before their own HIPC II introduced this feature in principle years later. Unlike under the SDRM, where the IMF would establish the panel of arbitrators presiding negotiations, creditors and the debtor would nominate an equal number of panel members, who would elect one further member. In contrast to present debt management a neutral entity, not creditors themselves, would thus chair the process. Sustainability would not be determined by the IMF, but emerge from negotiations. Many NGOs, especially the Jubilee movement have taken up this proposal and campaigned for it. Unfortunately, creditors are still not prepared to believe Adam Smith.

Recent Debt Reduction Strategies

In the absence of viable general solutions, different strategies of debt reduction have emerged, all based on highly specific circumstances. Massive retiring of Brady bonds brought their outstanding (dollar-denominated) volume down to below $50 billion in 2006. Mexico re-bought all “Bradies” as early as 2002, giving important savings in debt service as the reason.

Iraq’s highly unusual debt reduction proved how easily the most controversial element of the SDRM (shelved just weeks before) can be implemented. A stay on lawsuits was implemented at the stroke of a pen, without discussion or resistance by “vultures”, and without amending the IMF’s statues, which the IMF had alleged to be necessary. Iraq’s prime assets were put outside creditors’ reach. The US had revived their odious debt doctrine to argue in favour of generous debt reduction, an idea eagerly taken up by NGOs. Once the administration realised that it had given new credibility to the odious debt doctrine, it back-pedalled vigorously. The word “odious” was shunned.

As no formal framework existed and the situation was desperate, Argentina had no other chance but to demand debt reduction unilaterally. Argentina’s first offer to creditors was 75% off nominal values. This was flatly rejected, although some observers argued that the Argentine government’s position was not unreasonable. In 2004, Argentina modified the initial offer somewhat. Finally, the haircut was roughly

70% according to Helleiner (2005:959). Sceptics calculated an overall reduction of roughly 14.2%, predicting that this haircut—once again suffered by only one class of creditors—would prove insufficient. Nevertheless, this precedent may encourage other sovereigns to become bolder, to return to pre-BWIs debtor-creditor relations.

Many bondholders did not accept, organising themselves into bondholders' associations, without recovering anything so far. Now, the neoliberal privatisation drive protects Argentina: there is practically nothing left to attach. After Iraq, the IMF's essential argument for a statutory solution was again disproved. There was no problem connected with keeping creditors from enforcing their rights, also because the US government supported Argentina's request for a stay to all enforcement.

It is finally important to note that Argentina openly opposed the IMF, even threatening not to pay the Fund as due. On several occasions she prevailed against the IMF. Argentina and Brazil triggered a wave of early repayments by DC-debtors to the IMF, which starts to create problems for the Fund.

After Nigeria's legislators had threatened to repudiate Nigeria's debt on the grounds that these were odious and illegitimate, Nigeria received (to quote the Paris Club) an "exceptional treatment", a debt reduction of US$18 billion. Nigeria had chosen not to have an IMF-programme but to implement her own economic reforms instead, which led to the invention of a totally new IMF-instrument, called Policy Support Instrument (PSI), allowing Nigeria ample policy space. Considering that even Iraq had to sign an IMF programme, this is path-breaking. Again, the IMF's rule over debtors was challenged.

Increasing debt reductions, the G8 decision at Gleneagles recognised once again that creditor determined debt reduction schemes have remained insufficient, meanwhile called Multilateral Debt Reduction Initiative (MDRI), it proves that further multilateral debt reduction is possible, a fact IFIs themselves had vigorously denied until then. Unfortunately, IFIs remain largely able to shift risk onto others. The arbitrary choice of countries and institutions (debt *vis-à-vis* IDA and the African Development Fund but not *vis-à-vis* their Inter-American equivalent) once again highlights creditor arbitrariness.

The new Norwegian Government (2005) explicitly expressed its intention to "adopt an even more offensive position in the international work to reduce the debt burden of poor countries", firmly opposing undue conditionality regarding privatisation. Norway "will support the work to set up an international debt settlement court that will hear matters concerning illegitimate debt". The UN was called upon to establish criteria for what can be characterised as illegitimate debt to be cancelled.

On 2 October 2006 Norway declared that she will cancel claims of 520 million crowns to five countries, deriving from her Ship Export Campaign (1976-80), which the government classified as a "development policy failure". Cancellation is unilateral and unconditional, recognising a shared responsibility of creditors for this debt. Unlike other OECD-"donors", Norway will not record this money as ODA. It is additional to normal aid.

Strongly increasing debt and current account deficits of the US (IMF-code: "global imbalances") have triggered an IMF-reaction unheard of so far. The IMF exhorts DCs, such as oil exporters with balance of payments surpluses, to import more from the US. They should re-direct their demand from Asian exporters to the US. The prudent use of large current account surpluses by Arab countries after 2000, first lauded as an improvement over the 1970s, came under attack. Surplus-countries with low absorption capacity are requested to recycle their petrodollars through capital outflows to the rest of the world—the very policy is now requested from OPEC, which has been used so far to blame the debt crisis on OPEC.

Such demands on surplus countries differ markedly from the usual IMF strategy to adjust balance of payments deficits. One may wonder, whether this is the first sign of a fundamental re-orientation of the Fund's "adjustment" policies, whether one should expect the IMF soon to request higher imports of Argentine beef or African cotton by OECD-countries in order to correct imbalances, right in the way Keynes had wanted it.

Debt and Governance in the 21st Century

In spite of decades of disastrous "debt management" official creditors and the BWIs refuse to adapt the well-established insolvency mechanism, applying its principles including the protection of debtors and their human rights to DCs. This supports Rodrik's (1996) perception of the debt crisis used to gain control over debtor countries. It strongly recalls List's recommendation on North-South relations. Better known for his opposition to the "English philosophy" of free trade as harmful to Germany in its early stages of development, List (1841:211) advocated joint exploitation of the South as "promising much richer and more certain fruits than the mutual enmity of war and trade regulations". In contrast to debt crises before 1945, institutions to administer debtor countries in this neo-Listian manner (Raffer 1987; Raffer & Singer 2001:54) exist nowadays: the BWIs. While their debt management has been absolutely unable to solve the problem, it has been highly efficient in administering debtor economies. Assuming this to be the real purpose would easily explain why their role has been increased over decades, an increase in importance that cannot be justified by overwhelming success. A strong institutional self-interest of the BWIs seems to exist as well. The self-serving SDRM-proposal is a case in point. At present BWIs even gain financially from their own errors and negligence. If projects fail due to their lack of due diligence, they can extend new loans to repair damages done (Raffer 2004b), thus earning twice instead of indemnifying their clients. This is a perverted incentive system, absolutely at odds with Western market economies, reinforcing, however, their position as debt managers.

The future of debtor countries, their role in international politics and thus global governance will depend on whether this present form of indenture can be abolished or whether creditors will continue being judge and jury in their own cause. If the Rule of Law and respect for human rights could eventually be introduced in creditor-debtor relations—as my Chapter 9 insolvency model would—DCs would become re-enabled to influence international issues, defend their interests, and exert some countervailing power against the North.

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Terms of Trade and Development

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Introduction

The Terms of Trade (ToT) measure the relative purchasing power of countries; what they get in exchange for their exports. The expression refers most frequently to the relation of the price indices of exports (P_x) and imports (P_m), also called commodity or net-barter ToT:

$$(1) \quad P_x/P_m$$

Double Factoral (also "Factorial") ToT are net-barter ToT weighted by productivity indices. They compare the rewards of homogeneous factor units

$$(2) \quad P_xN_x/P_mN_m$$

Meaningful productivity indices are empirically difficult to estimate. Unequal Exchange is defined as Double Factoral ToT different from 1, or homogeneous factors rewarded unequally, which violates one basic condition of functioning markets.

Academic discussion has largely focussed on these two types. Further types of ToT exist:

- Income ToT (P_xQ_x/P_m, where Q_x is the exported quantity), the real export income (deflated by import prices),
- Gross barter ToT (Q_x/Qm), the relation of quantities exported and imported,
- Single Factoral ToT (only exports weighted with N_x),
- Employment Corrected Double Factoral ToT (P_xN_x multiplied by an index of employment in the developing country, cf. Spraos 1983; Singer 1989).

ToT are the terms at which countries have to engage in international trade: prices per export-unit or real export income. They determine how much money countries can earn, and to what extent they can finance development without relying on external sources. Insufficient export revenues can be substituted by ODA or loans. Both sources, however, make 'developing countries' dependent on donors or capital markets, respectively. ODA-flows have decreased perceptibly, especially after the Cold War. Furthermore, aid has increasingly been diverted to financing other things than development, such as global public goods. The debt crisis proved that borrowing is a costly and may be a problematic alternative. These facts highlight how important the capacity to earn and accumulate resources is that enables countries to finance development strategies without external help. ToT reflect this capacity. Short-term shocks triggered by ToT volatility produce unstable export revenues and cause severe problems. Finally, the long run evolution of ToT indicates how international trade really works. One can compare real ToT-movements with how they should move if neoclassical theory and free-tradism were right.

Volatility and Short-Term Shocks

Strong price fluctuations have always been characteristic for raw materials. Since this sector contributes substantially to exports and GDP in most developing countries, such shocks are detrimental to investments and growth. They tend to cause import volume instability affecting the capacity to import capital goods. Maizels (1992) summarises theoretical arguments and empirical evidence in support of the view that volatility affects economies negatively, which strongly prevailed until the 1980s.

Behrman (1987) represents the opposite view. Conceding problems with empirical estimates he doubts deleterious effects of commodity price instabilities on Developing Countries. He concludes price fluctuations not to have very large effects. If they existed he thinks them at least as likely to be positive as negative.

It was discussed whether to stabilise prices or revenues (=income ToT if deflated by P_m). Obviously, stabilising prices need not stabilise income, especially so if supply is fairly inelastic. Politically, Developing Countries preferred price, Industrialised Countries income stabilisation. The Compensatory Financing Facility established by the IMF in 1963 stabilised income. Compensating short-term shortfalls largely beyond the exporter's control, it was initially not subject to any conditionality. Signing the first Lomé Agreement with ACP-countries, the EU offered STABEX, a scheme stabilising income. Initially a right of developing members to compensation, it became eventually subject to strong conditionality, as did the IMF's Facility. Why remedies against shocks beyond the country's control should be made conditional on policy changes remains logically inexplicable unless power politics are brought into the picture.

Reducing price volatility was one of the main demands of the New International Economic Order in the 1970s. Pressure by the South led to the adoption of UNCTAD's Integrated Programme for Commodities in 1979. Its main element was the Common Fund with separate buffer stock agreements which stabilise commodity prices by buying when prices threaten to fall below a floor and selling when prices reach the upper limit of the stabilising band. Its "second window" was to finance activities such as research and development or diversification. Although OPEC bank rolled the contributions of poor countries the process of ratification was slow. The Common Fund came into existence in 1989, obsolete as an instrument of commodity policy because of insufficient resources and the breakdown of Commodity Agreements that were supposed to deposit resources at the Fund (on these agreements cf. Gilbert 1987) The collapse of the Tin Agreement in 1985 apparently marked the end of the era of international commodity agreements.

Meanwhile the opposite view prevails politically: commodity policies are unnecessary if not outright harmful. Exporters should be sufficiently flexible, embrace neoliberal policies, and rely on the market. Under the Cotonou Treaty the EU has dismantled STABEX.

Considering the potential effects of volatility this view seems doubtful. Comparing the shocks farmers in the South might have to absorb with US recessions Newbery & Stiglitz (1985:2) argue that price volatility of some commodities reduced farmers' income many times as much. While the largest annual decline was 15 percent of US national income during the Great Depression, farmers producing cash crops for export in Developing Countries might have to absorb gross income reductions of 25 to 67 percent and an even greater fall in net income.

One might also compare volatility caused shocks with the "first oil crisis". It amounted to some 2-3 percent of GNP in OECD countries. If prices of raw materials that account for 30 percent of export revenues drop by 25 percent and exports equal 30 percent of GNP, the exporting country has to cope with an external shock of 2.25 percent of GNP. These are not unrealistic percentages. Compared with some historical cases they might be called conservative. Especially very poor countries are more highly dependent on raw materials and often characterised by a very high concentration on one or very few commodities. Shocks occur repeatedly. However, while economic problems in the North are sometimes still ascribed to the 1973-4 oil price hike, Developing Countries have been expected to be able to absorb high volatility without great problems, although their economic structures are by definition less developed.

Lending or insurance schemes were sometimes proposed instead of government interventions. Loans are costly and small farmers may not necessarily have access at all or at reasonable cost. Insuring revenues via better futures markets is subject to important limitations. Newbery and Stiglitz (1985:42) point out that "this approach ignores the reason for the absence of adequate futures markets". They show that such markets, "may either fail to exist, or if they exist, will not possess the optimality properties usually attributed to competitive markets." It should be noted that OECD countries themselves do not rely on market forces or market mechanism when it comes to their own agrarian producers.

Short term volatility is often price volatility because supply elasticities are usually not large enough to allow rapid changes of output. Bumper crops and natural catastrophes are examples to the contrary. Beyond the short run, however, price fluctuations usually produce the quantity reactions known from cobweb theory. After 1982 the Bretton Woods Institutions have advised all debtors to increase commodity exports and reduce export prices. This policy might work if one (small) supplier embraces it. If many or all exporters do so market prices fall dramatically. This is known as the "fallacy of composition".

Prebisch-Singer Thesis or ToT-Debate

Productivity growth was universally assumed to be higher in Industrialised Countries (or Centre) than in Developing Countries (or Periphery). Standard micoeconomic concepts, economies of scale, learning by doing in manufacturing, and increasing marginal costs of expanding raw material production supported this view. Historical data for British ToT during the first half of the 19th century show in fact a deterioration against this dominating exporter of manufactures (Singer 1989:323). They reflect falling prices of manufactures and increasing primary commodity prices, as textbooks predict. Net-barter ToT of Developing Countries were assumed to improve, distributing productivity gains globally. For actual trade to be as beneficial as the textbook model this is necessary. Prices have to equal marginal costs in the long run perfect market equilibrium. It was taken for granted that the world market functioned like the textbook model.

The Prebisch-Singer Thesis rocked the boat of professional complacency (Toye & Toye 2003, describe its genesis in detail), exposing an apparent contradiction between theoretical expectations and practical outcome. This was a shock. The US even attempted to close the Economic Commission for Latin America, where Prebisch worked (*ibid.*:463). Secularly deteriorating net-barter ToT of Developing Countries as documented by the seminal work of Singer (1950) and Prebisch (1950) destroy the whole established orthodox logic of beneficial world markets. If international markets and trade behaved according to academic predictions and models net-barter ToT would have to improve for Developing Countries. Empirical analysis showed they did not. Real trade was not as beneficial as theory predicted. This conclusion also holds with constant ToT if the Centre's rate of technical progress is higher than the Periphery's. Prices would not be aligned to marginal costs, the Periphery's double factoral ToT deteriorate. Prebisch talked of "syphoning off productivity gains". Singer's (1950) title emphasised the distribution of gains. Singer's interest derived from the problem of worldwide unequalising growth and whether world markets would replicate the division of labour militarily enforced by colonialism (Toye & Toye 2003:448)

Some Industrial Countries have been quantitatively important primary commodity exporters, also during the period the Prebisch-Singer Thesis analysed. But until 1950—well before the rise of industrial production in some Developing Countries—the South exported virtually only raw materials. With few exceptions, Developing Countries have remained relatively dependent on them. Singer (1989) presents quantitative evidence for the period 1954-72 that primary commodity prices of Industrial Countries (in constant export unit values) fell by 0.73 percent annually, prices of those exported by Developing Countries, however, by 1.82 percent (both coefficients significant at 1 percent). Thirlwall and Bergevin's (1985) evidence supports this. Primary commodities (excluding oil) exported by Developing Countries experienced a pronounced and significant negative trend, while those exported by Industrial Countries had no significant trend.

Singer and Prebisch presented the following reasons for this inequalising drive of real world markets, sometimes wrongly believed to be different versions:

♦ *Marketpower of factors of production*: workers (trade unions) and entrepreneurs in Industrial Countries have sufficient market power to keep prices in Industrial Countries from falling along with technical progress. Its fruits are distributed via higher factor incomes within the Centre. The lack of such power forces export prices of Developing Countries down. This "para-market" assumption was strongly criticised (cf. Spraos 1983:23f). Considering that orthodox economists had blamed the Great Depression of the 1930s on union power and stickiness of wages in Industrial Countries this is certainly surprising.

♦ *Trade cycles* are cushioned in the Centre better able to preserve its incomes. Price volatility of raw materials is bigger. Prices fall steeply during recessions, adding momentum to the declining trend.

♦ *Low income elasticities of primary commodity exports* limit growth prospects of exports of Developing Countries containing virtually no manufactures around 1950. This view was hotly attacked initially but is generally accepted meanwhile, as the phrase "de-coupling growth from raw material consumption" documents.

♦ *Low demand elasticities*: lower prices of primary commodity exports do not trigger strong increases in demand. Strong expansion of raw material exports thus tends to create excess supply.

♦ *The necessity of importing products* such as machinery, which cannot be produced locally. The control of sophisticated technology embodied in these exports remains concentrated in the Centre (Singer 1989:326). Low income elasticities of imports by the Centre and high income elasticities of Developing Countries needing imports to develop produce disequilibria. Peripheral exporters are unable to earn the resources needed for development because the Periphery is unable to produce the investment goods needed. Balance of payments deficits and foreign exchange gaps result. Indebtedness usually follows. Protectionism by the Centre increases these disequilibria by restricting the Periphery's export revenues further, while protectionism by the Periphery reduces disequilibria. Diversification is needed to close the gap between earning capacity and developmental import needs.

♦ *Oversupply of labour* in Developing Countries keeping wages down.

Cultural dependence, resulting in the waste of scarce resources for luxury consumption or imports of little or no developmental importance, increasing the gap between revenues and developmental import needs, and debt pressure forcing countries to sell were added later.

Retained productivity gains are the central problem. In a closed economy real income can increase in two ways. Either nominal incomes increase at constant prices, or prices fall at constant nominal incomes in line with productivity. Internationally, however, only prices can transmit productivity gains. Competitive markets would make export prices fall in line with marginal costs. Export prices of countries experiencing stronger productivity gains would fall more, thus improving net-barter ToT for importers with slower productivity growth. The factor market argument of the Prebisch-Singer Thesis simply means: the Centre's productivity gains are largely absorbed by higher incomes, while the Periphery's tend to be transmitted via lower prices. Bloch & Sapsford (2000) show that differences in the growth of wages and the trend increase in mark-ups in manufacturing impact negatively on net-barter ToT. Particularly strong manufacturing growth may result in intervals of net improvements of net-barter ToT, as one would expect on the basis of the Prebisch-Singer Thesis. For the period analysed by Bloch and Spasford strong growth in manufacturing production offsets almost exactly this negative effect. Progress in input saving technologies and the shift towards less raw material intensive growth must be expected to reduce this positive effect of manufacturing growth in the future.

The Statistical Debate

The debate soon focussed on technical and statistical questions, such as the quality of historical data, whether product quality improvements of manufactures were appropriately reflected in prices, changes in transport costs possibly affecting prices, resting the case on British ToT, and eventually on the interesting technical question whether a negative trend can be proved statistically. Both Singer (1950) and Prebisch (1950) drew attention to quality problems of their historical data. Many of the problems presented as though they had just been discovered "were already acknowledged at some length in the United Nations paper [authored by Singer, KR] ... which Prebisch had indicated as the source of British data" (Spraos 1983:45).

Over decades many new econometric methods used the Prebisch-Singer Thesis for test runs. Sapsford & Chen (1998:28f) compiled an overview on the statistical evidence of the Prebisch-Singer Thesis between 1950 and 1998, concluding that—with "Ten out of the top twelve studies listed" supporting it—the Prebisch-Singer Thesis stood the test of time extremely well. Naturally, annual rates of deterioration differ among publications. Oil is usually omitted as a special case after 1973. What is even more important, none of the econometric studies found increasing net-barter ToT of Developing Countries, nor was this ever claimed to have happened. Grilli and Young (1988) published an alternative data set widely used by more recent papers, which also showed a negative trend. Criticising shortcomings of time series analysis, Chen and Stocker (1988) use a partial equilibrium model for related goods and principal component analysis to re-examine the Prebisch-Singer Thesis. Their results for 1900-86 clearly support the Prebisch-Singer Thesis.

Obviously, econometric results may be influenced by the time period chosen. Connected with this is the question whether structural breaks occurred. Spraos (1983:68) concluded with some reservation as to their quality that regarding data up to the publication of the Prebisch-Singer Thesis "evidence points to a deteriorating trend", but with a rate of deterioration smaller than initially believed. Extending the series into the 1970s, however, he had concluded that no significant trend can be found, a conclusion he qualified later in view of plummeting of raw material prices in the 1980s. Sapsford (1985) extended Spraos's analysis into the early eighties. Analysing the time series from 1900 and accounting for the war time break of the Second World War, he found the Prebisch-Singer Thesis strongly borne out by both the pre-war and post war periods, and the whole series since 1900. There is a clear downward trend before the War, and a strong upward shift brought about by it. The NBToT start from a much higher level after this discontinuity, but immediately begin to deteriorate again perceptibly.

The only serious challenge to the Prebisch-Singer Thesis was made by Cuddington and Urzua (1989), who criticised the method of trend estimation, rejecting the Second World War break in favour of one structural break after 1920 presumably reflecting the end of the prolonged expansion following the First World War. Thus there was a one-time structural shift, and no evidence of an "ongoing, continual downtrend" (*ibid*.:441). Sapsford et al (1992) challenged this conclusion on technical grounds, and showed that the extreme drop 1920-21 of the more recently constructed Grilli-Yang series on which it rests, is absent in earlier material. They find an annual trend decline of 0.6 percent for 1900-85. A statistical debate whether prices fall continuously or one of several trendless series follows the other after structural price drops is theoretically interesting, but of little practical relevance to development policy. In both cases diversifying away from primary commodities is indicated.

In 1994 several IMF-publications corroborated the negative trend. Reinhard and Wickham (1994:175) conclude "the recent weakness in commodity prices is mostly secular, stressing the need ... to concentrate on export diversification and other structural policies", even seeing scope for stabilisation funds. Borensztein *et al* (1994:7) found "some evidence that the downward trend has steepened in the recent past". The large decline of real commodity prices during the previous decade should be regarded as largely permanent. Also, price volatility had increased steadily and considerably since the 1960s. The growth of supply (an effect of the IMF's "Structural Adjustment" policies forced on debtor nations) is seen as one price-depressing factor. These findings by IMF staff, an institution highly critical of the Prebisch-Singer Thesis over decades, seem to have contributed to closing the debate on whether a falling trend exists. Nearly half a century after publication the Prebisch-Singer Thesis stands vindicated.

Policy Advice Derived from the Prebisch-Singer Thesis

To close the gap between necessary imports and limited capacities to earn foreign exchange Prebisch and Singer advocated diversification. Early proponents of the Prebisch-Singer Thesis, including Singer and Prebisch, were often accused of advocating Import-Substituting-Industrialisation (ISI) in opposition to export drives. This erroneous belief produced protracted and fierce debates. Sir Hans clarified: “But the whole debate which the critics of Prebisch now conduct in terms of outward versus inward orientation, or of export promotion versus import substitution is an absurd and silly discussion. Obviously we want both, as Raúl Prebisch pointed out so clearly...we want a combination of import substitution and export promotion. ... In other words what is needed is an interplay between inward-oriented or import substitution efforts (where regional co-operation also has a great role to play) and export promotion" (Singer 1986:4f). Prebisch (e.g. 1984) repeatedly advocated export subsides to iron out the disadvantages of infant exporters, thinking, however, that they might meet stronger opposition from Industrial Countries than infant industry protection. ISI would thus be a second best solution. Protection should make up for cost disadvantages of Developing Countries, and be reduced in line with productivity improvements of domestic industries to be eventually phased out. Singer (1986:6) points out that Prebisch's ideas were realised in South Korea, which was able to implement Prebisch's preferred option of supporting exporters—and that many Korean economists were well aware of this.

Prebisch (1976:66) clearly stated that there is no inherent or irreversible intrinsic quality of raw materials dooming them to deteriorating net-barter ToT. Deterioration occurs when increases in production outstrip the growth of demand—i.e. the Periphery wants to sell more than the Centre wants to buy. This, of course, could equally well happen in the case of manufactures (cf. Prebisch, 1959:258f), but Prebisch never included manufactures fully into his analysis. Singer extended empirical research to manufactures (Sarkar & Singer 1991). As it turned out, shifting away from commodities to manufactures did not necessarily solve the problem. In comparison with manufactured exports of Industrial Countries the type of manufactures exported by Developing Countries "shared some of the disadvantages pointed out by Prebisch-Singer for primary commodities in relation to manufactures" (Singer 1989:327). ToT of manufactures improved less for Developing than for Industrial Countries. Singer therefore concluded that both commodity and country effects existed, reinforcing each other. He attributed the deterioration of ToT during 1954-72 to three distinct factors: falling ToT of primary products compared with manufactures, a fall in prices of manufactures exported by Developing Countries relative to manufactures exported by Industrial Countries, and a higher proportion of primary commodities in the Periphery's exports.

It is sometimes argued that income ToT are much more important than net-barter ToT. If additional exports (over)compensate the effect of falling net-barter ToT—which is not necessarily so due to demand elasticities—the same or more resources are available to finance development. This is quantitatively true, but may hide another problem. If falling net-barter ToT are not caused by increased productivity but simply reflect falling export prices, double factoral ToT deteriorate. More must be produced and exported to earn the same revenues (=constant Income ToT), similar to people having to work longer hours after wage cuts. Even with constant income, they might not be totally indifferent to lower hourly wages.

While net-barter ToT cannot fall below the Ricardian limbo's lower border under textbook comparative advantages assumptions, replacing the unrealistic assumption of constant returns *ceteris paribus* by increasing and decreasing returns to scale, as Graham (1923) did, widens the limbo. NBToT can deteriorate beyond the initial lower limbo border. Graham's raw material exporter loses by specialising according to comparative advantage, experiencing a development of underdevelopment. Graham's Paradox gives further theoretical weight to the policy conclusions of the Prebisch-Singer Thesis.

Unequal Exchange—Double Factoral ToT

A less empirical approach focussing directly on double factoral ToT are the theories of Unequal Exchange. Like Singer (1989) they all see the basis of disadvantages in specific characteristics of countries. Emmanuel (1972) was the first influential theory. He qualified the trade aspects of Lewis's dualism model and the Prebisch-Singer Thesis as "on the fringe" of Unequal Exchange. Based on Marxist analysis and the concept of transfers of value, Emmanuel sees global differences in wages as the unique cause of Unequal Exchange. Inequality is measured in comparison with what prices of production would be if wages were equal. Wages determine prices and the level of development. High wages create huge effective demand and induce (labour saving) technical progress, while low wages perpetuate underdevelopment. Transfers of value due to different organic composition of capital (=capital intensity), equalising the rate of profit in Marx's analysis are normal under capitalism and therefore of no interest to Emmanuel. Exogenously given real wages reflecting subsistence needs, Emmanuel's cornerstone, are also the great problem of his approach. If all real wages are exogenous variables, price variations within the model cannot affect them, especially so if standardised labour hours are the numéraire. Thus higher wages in the Centre resulting in higher export prices cannot reduce wages in the Periphery. Emmanuel switches from Marx's prices of production to a Sraffa model to make his point clearer, but this basic contradiction can, of course, not be solved (Raffer 1987 surveys the discussion on Emmanuel).

Published when the South demanded a New International Economic Order and remunerative prices, Emmanuel (1972) had a wide impact. As wages cannot be simply raised to Northern wage levels Emmanuel proposed increasing taxes on production in order to overcome Unequal Exchange. OPEC's price increases of 1973-4 were precisely such a measure. Emmanuel thus interpreted OPEC as a successful policy example.

Braun (1977) inverted Emmanuel's causality: prices determine wages. Increases in wages decrease the rate of profit. Using a simple Sraffa model he argued that low prices of Periphery exports are determined by the Centre able to select the closure. To preserve its independence the Centre subsidises minimum levels of production of potentially important products, such as food. Developing Countries might be forced into inverse supply reactions, offering more when prices fall to prevent revenues from falling below a minimum level, or minimum income ToT. Amin (1976) estimated losses from Unequal Exchange to amount to around 15 percent of the Periphery's GDP. He argued that exploiting the informal sector ("non-capitalist modes of production") in the Periphery allows a higher global rate of profit. Selling cheap food and other products to workers in the "modern sector" the informal economy makes relatively lower wages in world market integrated sectors possible. Thus profits are higher than otherwise possible.

The most recent theory of Unequal Exchange comes closest to the Prebisch-Singer Thesis (Raffer 1987, 1994). Using neoclassical tools it is based on the perception of different specific importances of products, which result in differences in pricing power. Exports of any country- be they raw materials or manufactures—have different specific importance, depending on how urgently they are needed and how easily buyers can refrain from buying them. Exporters having specialised on more important products or services can change both net-barter and double factoral ToT in their favour. It therefore matters on what one specialises. Exports of Developing Countries are either easily substituted—at least for a longer period than any Developing Country could afford not to sell—or amenities on which the smooth running of industrialised economies does not depend (for instance, tropical fruits).

Individual problems, such as urgent need of foreign exchange to service debts, may further reduce the exporter's bargaining power.

The individual elasticity of demand each supplier is facing measures this specific importance. It is

$$(3) \quad - |\eta_i| = [—|\eta_{wi}|—\Sigma\, e_{rij}\, s_{rj}]\, s_i^{-1}$$

or verbally: the specific elasticity of demand of a product exported by country i equals the cross elasticity of global demand for this product(η_{wi}) plus the sum of all cross elasticities of supply from all other sources (e_{rij}) times their respective shares (s_{rj}) divided by the share of the exporter (s_i). If i is a group of exporters, not one small country, s_i will be higher and η_i lower. The subscript j indicates other sources from where i's product could be substituted. These may be other exporting countries (country substitution), product substitution (copper by fibreglass, jute by plastics), technical change granting access to new, so far economically unviable sources (e.g. recycling capacities, ocean floor mining), supplies from stockpiles (government or private), and domestic production. Like with Braun, agrarian protectionism is partly explained: domestic food production capacities are important. Stockpiles are the most important short run instrument against attempts to raise prices.

Unlike normal estimates (3) uses arc-elasticities, because buyers' reactions—in international trade usually intermediaries—depend on the size of price changes. These reactions are inferred from estimates of potential substitution at higher prices, not based on observations of past "business as usual" as in traditional econometrics. Price changes are understood to be sustainable increases to higher levels, as attempted by Developing Countries in the 1970s, not the usual short run fluctuations. The high elasticity values obtained by this method explain why those attempts remained unsuccessful although traditional estimates render extremely low demand elasticities for raw materials. If they were correct one-sided price increases would simply solve any ToT-problems. As with the Prebisch-Singer Thesis, shifting to more diversified and modern economic structures is the policy conclusion.

Policy and Governance Conclusions

To solve the problems of commodity export dependence diversifying developing economies is mandatory. This is a difficult and thorny task as the whole economy must be restructured. As the economic history of Developed Countries shows this needs government intervention and protective measures (cf. Chang 2002). The framework of international trade must allow interventions that are necessary to foster development.

In more concrete terms this means changing the WTO framework in favour of meaningful differentiated and preferential treatment of developing members. Raffer & Singer (2001:251ff) propose to integrate the right of Developing Countries to obtain a given number of waivers for industries the country specifies, and for a specified time, depending on the country's stage of development (differentiated for instance by GDP/head). As proposed by Prebisch, protection should be precisely high enough to equalise productivity differences between the country and global markets. To avoid petrification protection would be reduced over a reasonable period of time, irrespective of whether productivity gaps were closed or not. The authors also propose compensatory and stabilisation schemes for commodities and the abolition of the discrimination of Developing Countries presently inherent in the trade policy of Developed Countries. Such changes would enable Developing Countries to transform their economies, to achieve balanced economic structures with appropriate shares of manufacturing and modern services that are no longer dominated by raw materials. However, while these policies are necessary, they are not sufficient conditions for development.

* *For his most helpful comments I am very grateful to Sir Hans (H.W.) Singer, who died on 26 February 2006. He will always be remembered. I am also indebted to the anonymous referees.*

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Terrorism

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Introduction

Terrorism became a major concern for many governments and their populations, especially in the aftermath of 11 September 2001 and the attacks on the tourist facilities in Bali, the bombs on the commuter trains in Madrid, suicide bombings in Israel, the London bombings, and the attack on the school in Breslan in Russia. While many countries have experienced terrorist incidents long before these events, the attacks on the United States on 11 September, demonstrated very clearly that anyone was vulnerable and that any country could suffer devastating losses. As a consequence, more governments have had to think about the appropriate policies to prevent terrorism and the actions that they may have to undertake to deal with possible terrorists. They have also had to initiate counterterrorist policies in advance of potential terrorist attacks.

Definition of Terrorism

There have been many definitions of terrorism proposed. Some of the definitions are subtle variations on each other while additional definitions attempt to make major distinctions that would in effect define terrorism in substantially different ways. A basic, and reasonably straightforward, definition of terrorism includes six basic points. Terrorism involves the use of violence or the threat of violence to achieve political objectives; the terrorists are part of an organization; there is an audience beyond the immediate victims; the action involves a non-state actor as the perpetrator, the victims, or both; and terrorism is a weapon of the weak that is used to attempt to redress an imbalance of power (Claridge 1996; Hoffman 2006:Ch 1; Lutz & Lutz 2008:9-14). Of the above points, it is not necessary for the terrorist to be involved in a strict hierarchical structure or closely integrated in a clandestine organization. In some cases the organization may consist of loosely connected individuals in a network. Target audiences are particularly important since the terrorists hope to induce the elite or the public to make appropriate changes in the current situation or to give up power entirely. Some definitions also specify that the targets be civilians or anyone but the military, security forces, or police actually on duty (Schmid 2004:204). Most terrorist attacks do involve civilians. Attacks on police or military troops are more likely to be undertaken by guerrilla units. Attacks on civilians or government employees heightens the threat that the terrorists are seeking to project and increases the effect on potential audiences, which can include government leaders and their supporters, the general public, or other groups. Terrorism ultimately is a form of psychological warfare that intimidates through the fear it creates (Chalk 1996:13; Wilkinson 1977:81). Since the definition specifies that at least the attacker or the target not be a state, it excludes covert violence between states during hot wars and cold wars. There are many horrible and reprehensible actions that can occur in wartime and even in peacetime as a consequence of strained relationships among countries. These actions often are designed to instill terror in populations as has been the case with terror bombings from the air or when conquering armies put cities to the sword in order to attain the quick surrender of other cities and garrisons. While some would consider these actions to be state terrorism (Cf., among others, Chang 1997; Chomsky 2003; George 1991), many others regard these actions as atrocities or war crimes and place them in a different category. Genocide is probably the most horrendous action that can involve states, but it also does not constitute terrorism since annihilation rather than instilling terror in a target audience is the goal. States can and have supported terrorist groups in other countries, but the groups already existed. The external support makes them more dangerous in many cases. In cold war between states, support for violent dissidents on the other side may become quite common. This definition also excludes more government repression, no matter how oppressive, since individuals in such a state can avoid punishment by following the rules, even the onerous ones (Chalk 1996:20; Sproat 1991:24). The definition does include those situations in which governments support groups that attempt to instill terror against fellow citizen by encouraging paramilitary organizations or death squads to move against enemies of those in power. In extreme circumstances that can exist in totalitarian regimes such as Nazi Germany, the Soviet Union under Stalin, or Iraq under Saddam Hussein, the terror involved in repression may be so great that the practices constitute state terrorism, especially when individuals cannot avoid arrest or death by following the rules of the regime (Lutz & Lutz 2004:Ch 10).

Terrorism as Technique and Practitioners

It is important to realize in addition that terrorism is a technique that has been and can be used by a variety of groups with limited options for obtaining their goals for attempting to bring about change. As a consequence, it is available for use by many kinds of dissident organizations seeking a multitude of objectives. The terrorists may have goals based in religious beliefs or concerns, as was the case with the Sikhs in India in 1980s; Aum Shinrikyo in Japan; and Islamic groups today in many different countries—including Israel/Palestine, or extremist Jews who see the West Bank as part of a biblical heritage. In other cases, national or ethnic concerns can lie behind the willingness to use violence, as has often occurred in the world. National liberation struggles in Cyprus and Algeria in the 1950s, the continuing guerrilla and terrorist efforts of Tamils in Sri Lanka, the struggles of the PLO and other Palestinian groups, and the battles of the Kurds in Turkey all provide examples of terrorism rooted in ethnic differences.

Ideologies have been the driving force behind many terrorist groups. Left-wing groups were prominent in the 1970s and 1980s, especially in West Europe and Latin America, although leftist terrorist groups go back at least as far as the Anarchists in the late nineteenth century. The Montoneros and others in Argentina, the Tupameros in Uruguay, the Red Brigades in Italy, the Red Army Faction (Baader-Meinhoff Gang) in West Germany, and many other groups operated in this period attempting to undo the inequities and unfairness of both capitalism in individual states and the global system of capitalism. The leftist terrorism was not restricted to Europe and Latin America. The Untied States saw the appearance of groups such as the Weathermen, but they were never as important as their major European counterparts. The Japanese Red Army was important for a few years in Japan. When it was first established, the Islamic Republic of Iran faced 18 months of terrorist attacks from middle class and leftist groups that were trying to oust the clerical leaders from power and establish a more secular (for the middle classes) or different style of revolutionary (for the leftists) state.

Right-wing groups have also resorted to terrorist violence as a technique. Fascist parties in Europe after World War I, including the Fascist Party in Italy, the Nazi Party in Germany, and the Iron Guard in Rumania, all used this type of tactical violence in their efforts to come to power. The Ku Klux Klan in the United States in the past, neo-Nazis and skinheads in Europe in the years after World War II, and the violent patriot organizations in the United States that spawned Timothy McVeigh and Terry Nichols are additional examples of right-wing terrorist organizations.

In addition, there have been important groups with more complex motivations that have included mixtures of ethnicity, religion, ideology, and other elements as part of their reason for being and in their objectives. The IRA, although a nationalist group, combines elements of ethnicity and religion. The continuing terrorist violence in Colombia is based in a combination of leftist ideology and the more pragmatic goals of the drug cartels to make money. Shining Path (*Sendero Luminoso*) in Peru involved leftist ideology and drew upon the ethnic discontent of Indian communities with the Europeanized elite of the country, and the movement involved important interactions with drug producers as well. Religion and ethnicity have fueled the attacks of the Chechen dissidents in Russia, and there has been a similar mixture of motives behind the continuing unrest in Kashmir.

The terrorist and insurgent attacks against the military forces of the United States and its allies in Iraq as well as attacks on the new Iraqi government (including politicians, officials, police, and members of the military) spring from a number of different groups. These groups have dissimilar motivations. For some their attacks are rooted in religious opposition to the west while others are supporters of the former Baathist Party and its ideology. Others have been simply Iraqi nationalist fighting against what they see as a foreign occupier.

Governments can be involved in terrorist violence that is directed against its own citizens or subjects. Governments willing to use such techniques are usually too weak to use direct repression (Campbell 2000:7-11). The state may lack the necessary security structure and forces. Domestic public opinion may oppose massive repression or the government may have to appease foreign supporters by an appearance of governing within the rule of law. Under these circumstances, the political leaders may create and directly support groups that seek to launch terrorist attacks against those who are identified as being domestic dissidents or enemies of the state. In other cases, local paramilitary or militia groups that side with those in power may be formed to help protect the states. These groups may then attack the presumed dissidents on their own and use terror tactics in an effort to disrupt the dissident groups and to eliminate their political activities. In some cases, the government may choose to supply tacit support to these groups by ignoring their activities, while in others the government may be too weak to be able to do much to control the groups in question. These groups may receive funding, arms, and training from government sources in some circumstances. One of the key advantages these groups will have in all circumstances is that they can operate without fear of being arrested or prosecuted for their activities. Unlike dissident groups, they do not have to divert resources to protecting the identity of members or otherwise worrying about government harassment or investigations (Arnson 2000: 89). Even when governments support these groups it benefits with domestic and foreign opinion from its ability to have plausible, or even implausible, deniability in regard to the activities of the groups.

Governments may have a variety of religious, national, or ideological reasons that lead them to support or tolerate terrorism against their own citizens. In the late 1800s and early 1900s the Tsarist government in Russia permitted the Black Hundred to target liberals and democrats and engage in pogroms against Jewish subjects. Death squads in Argentina in the mid-1970s targeted suspected leftists in large numbers ("The Disappeared Ones"). In fact, leftist groups and their supporters throughout Latin America have often been victimized by death squads, although generally not on anything approaching the scale of what took place in Argentina. Similar groups in India have been used against Sikh religious dissidents in the Punjab, Muslim and ethnic dissidents in Kashmir, and leftists elsewhere in the country (Gossman 2000:262-63, 272-75; Mahmood 2000). In Bosnia ethnic cleansing was practiced by Serbs, Croats, and Muslims—but most frequently by Serb militias and paramilitaries, and the local governments or quasi-governmental bodies at the local levels supported these efforts to drive out the potentially disloyal groups of different ethnicities or religion. In East Timor the Indonesian government used death squads and militias, as well as more direct military repression, to destroy the popular support for an independent state. East Timor eventually did gain its independence, but not before hundreds of thousands had died in the violence. More recently the government of the Sudan has practiced ethnic cleansing in Darfur against a population suspected of disloyalty to the regime in power. In the past the government also tolerated or encouraged pro-government militias to attack groups in the southern part of the country that generally supported the guerrillas in that area on an ethnic or religious basis. In Zimbabwe militants in the ruling party of President Robert Mugabe have been permitted to attack political opponents of the regime with virtual impunity.

Terrorism against citizens supported or tolerated by governments has been the most deadly form of terrorism on average. When state resources, even from relatively weak states, are added to those of groups, the casualties from the terrorist attacks can mount very quickly. Among the dissident terrorist groups there have been indications that religious groups (from a variety of the major religions) have been less concerned about causing casualties (Cronin 2002/03:41-2; Dolnik & Gunaratna 2006:80). It should be noted, however, that religious groups have not always aimed to kill or wound large numbers of people and not all the attacks causing mass casualties have been launched by religious groups (Parachini 2001:399; Quillen 2002). More casualties with religious dissidents remain possible, however, since these groups may be less interested in winning over the population of others in the society to their view or they may believe that conversion is unlikely (Hoffman 1995:272-73). Religious groups may see their struggle as one between good and evil, and potential opponents can be demonized as a consequence. This view was apparent for many members of Aum Shinrikyo when they attempted to use sarin gas in the Tokyo subway in 1995.

Among ideological groups, most of the leftist groups generally tried to limit casualties in their attacks. One of the objectives of these organizations was winning over the population to their cause; consequently, the infliction of mass casualties was not usually considered a viable strategy. Groups on the ideological right, however, have been more willing in some circumstances to inflict more casualties than their left-wing counterparts (Lutz & Lutz 2008:187). Many of these groups, moreover, have not been attempting to win over the population but rather to force the government to adopt more authoritarian policies. High casualty incidents can fit in with this strategy. In some cases where the right-wing attitudes include elements of anti-immigrant or racist attitudes, more deaths are logically possible. The target populations are de-humanized, and increased deaths or injuries may become a very effective means of convincing the foreign elements to leave.

Ethnic or nationalist groups may seek casualties in some cases and not in others, but even the more selective groups may inflict significant casualties if they persist over a long period of time. Ethnic cleansing efforts, whether by governments or dissidents, can result in heavy tools among members of target audiences. In these cases the attacks must be deadly in order to force the audience to depart as quickly as possible. Casualties may be at their highest in those cases where ethnic and religious differences reinforce each other to separate the dissidents from the majority and make it virtually impossible for members of the groups to collaborate or convert (Gurr & Cole 2000:31; Quillen 2002:290).

Among the dissident terrorist groups, those that have roots at least in part in ethnic communities seem to persist the longest (Tan 2000:268). The Irish nationalist groups have been around for over a century, even if not active in all those years. Basque nationalists continue to target the Spanish government in their quest for independence after more than 30 years of violence. The Kurds in Turkey, Tamils in Sri Lanka, Palestinians in the Occupied Territories, and others have also continued to operate for decades. Further, those groups that represent complex mixtures of objectives and motivations for the dissidents also appear to survive longer, perhaps because of their complexity. The mix of objectives makes it unlikely than any government reforms can meet all the demands of the dissident organization. The diversity of objectives is also likely to mean that there is more than one potential pool of recruits for the organization so that it is easier for the group to renew itself. The links between the leftists and the drug cartels in Colombia have given the dissidents greater staying power. In Peru, Shining Path survived for as long as it did because it was able to combine leftist ideology with ethnicity and drug groups.

Causes

Although there have been hundreds of thousands of words written about terrorism, there is no compelling cause to explain the appearance of this form of violence. At one level, terrorism results from the ethnic, religious, or ideological disagreements of the dissidents with their political system or groups within it. Another important reason for the lack of any one underlying cause is because terrorism is a technique open to many different groups. Governments are insecure or dissidents have ideological, ethnic, or religious concerns (or mixtures of concerns) with governments that are in power. The causes of terrorism in some senses are in essence the causes of dissent or insecurity in general, and terrorism is only one possible response. Economic problems, government failures, repression, and similar events can stimulate the increase in discontent. The dissidents are reacting to situations that they deem to be unacceptable. The groups are suffering from oppression or discrimination, or they at least see themselves as victims of government policies. The problems or perceived problems may also be related to feelings of relative deprivation rather than situations of acute poverty or disadvantage. When discontent rises, dissidents may first attempt to use peaceful techniques to change government policies, and then move on to violent ones if the peaceful methods fail to bring about acceptable results. Violence is not limited to terrorism.

Terrorism will only be chosen if the dissidents lack allies in the military to stage a coup. They may also lack sufficient popular support or arms for an insurrection or popular uprising. Under these circumstances, terrorism becomes an important option. The same economic, political, and social conditions that lead to coups, rebellions, political assassinations, and guerrilla wars also contribute to terrorism. Terrorism and guerrilla warfare are adopted by groups lacking the capacity to undertake more forceful types of violence (Beckett 2001:vii-viii). Terrorism can also be chosen by weaker dissident groups because it is a low-cost method of violent opposition with at least the potential to generate major benefits (Wilkinson 2000:13). Thus, terrorism as a technique, and particularly as a technique of weaker dissident groups or governments, can arise from multiple causes rather than any one identifiable source.

While there are potentially many causes that can lead to the use of terrorism, there are some contributing factors that have been more generally associated with occurrences of terrorist violence. While weak states may resort to supporting or tolerating terrorist actions against dissidents as a means of control, a weak state structure may contribute to dissident terrorism by permitting opponents to organize and attack (Crenshaw 2003:94; Gross 1972:90). By way of contrast totalitarian and strong authoritarian regimes can deal with dissidents and terrorists more quickly and definitively. The presence of capable security forces, options to torture suspects for information, and the possibility of swift retaliation makes it difficult for violent dissident groups to operate, and even if the dissidents attempt to attack their governments by launching efforts abroad, the regime can threaten group or family members at home or send out assassination teams (Chalk 1998:386).

Democracies, however, provide greater opportunities for terrorists to operate since there is greater freedom of movement and much lower levels of surveillance by security agencies. Even when suspected terrorists are arrested or questioned, they cannot be tortured, and they have to be convicted in trials according to the rule of law (even if juries or magistrates might be very quick to convict persons charged with terrorism). The strength of democracies, of course, lies in their regard for individual rights, but there are also greater opportunities for terrorists. There have been indications that weaker state systems do face greater likelihood of terrorism.

The Soviet Union faced very few such attacks when the communist regime was firmly in power. The collapse of communism and the breakup of the USSR had led to outbreaks of terrorism in a number of the successor states, including Russia. There have been indications that democracies have indeed suffered more from terrorist activities than other kinds of systems (Mousseau 2001; Weinberg & Eubank 1998). One other type of political system has also seemed to be vulnerable. States in transition from one form of government to another may be more susceptible, even if the transition is from one form of authoritarianism to another (Weinberg & Eubank 1998:114). The government run by the religious leaders in Iran faced a wave of terrorism when it was first created; once the government became more firmly established and the security forces were created, the terrorists were defeated.

One additional variable has been associated with political violence, including terrorism. Increasing globalization has triggered violent responses. Globalization usually leads to the intrusion of outside ideas and values into societies, and it disrupts the economic, social, and political systems. Social, cultural, and religious values can be challenged by greater interaction with the outside world. Those challenged by globalization or negatively affected by the changes may resort to terrorism to protect what they consider to be important. Much of the terrorism that does occur can be seen as these kinds of reactions. Religious groups react negatively to the secularism that has often come with globalization (Juergensmeyer 2003:185, 191). Right-wing anti-immigrant groups in Europe and the United States oppose foreign migration and the intrusion of foreign cultures into their homelands. Ethnic groups see the demise of their cultures and languages with the exposure to the outside world. For terrorists involved with leftist groups globalization has brought with it the evils of international capitalism with its exploitation and oppression. Thus, many different groups have found that integration into the global community has disrupted and changed societies and threatened important values, and the reaction to this threat has often been violent.

Some Key Concerns

While terrorism is not a new phenomenon, it has become more threatening to many people. Even if the newer threats that come from Al Qaeda, skinheads, cults like Aum Shinriyko, and Chechen dissidents were to disappear, terrorism would still continue to occur in many parts of the world. A number of key concerns that are central to terrorism in the present time deserve special mention—the presence of a multitude of potential targets, the international linkages or networks among different groups, the increased interaction of terrorist groups with criminal organizations, and the threat of the use of weapons of mass destruction.

One of the biggest advantages that any terrorist group has is that they operate in a "target rich environment" (to use a current jargonistic euphemism). There are far too many targets for any government to protect. There are thousands of government officials or teachers who can be killed as part of an effort to weaken the ability of government agencies to deliver services. If a dissident group wants to increase insecurity but limit casualties, there are a myriad of buildings or monuments to select from. They can destroy power transmission lines to create blackouts. In other cases, if the dissidents are targeting an ethnic or religious majority or some particular minority group, any congregation of people in the group will suffice as a potential choice for bombs or bullets. In an anti-colonial struggle virtually the entire population and infrastructure of the colonial power can become targets. In other circumstances the dissidents may launch attacks against foreign targets in their own country to embarrass the domestic government or in an effort to drive away foreign support for the regime in power. If security in the home country becomes so great that it is difficult to launch attacks, the terrorists may go abroad to attack diplomatic missions or economic activities of their country. Since terrorists have many choices, the resources of the organization and the security measures of the target will influence the decisions (Drake 1989:54). For example, Al Qaeda chose the US embassies in Kenya and Tanzania for attacks for a number of reasons. The operatives could blend in with the local populations; the embassies were approachable and vulnerable; and the security and counterintelligence agencies in Kenya and Tanzania were relatively small and not equipped to deal with sophisticated attacks. Similarly, after security was improved in the industrialized countries after 9/11, terrorists began to focus more attention on targets in developing countries (Enders and Sandler 2006:2). In the final analysis "terrorists always have the advantage. They can attack anything, anywhere, at any time. We cannot possibly protect everything all the time" (Jenkins 2001:323).

International connections have been important in a number of ways. During the Cold War, the CIA and KGB were often willing to help dissidents that were threatening an ally of the opposition superpower. The USSR and its Eastern European allies aided many of the radical leftist groups in West Europe in the 1970s and 1980s. The CIA in turn aided the Contras in Nicaragua. Other countries engaged in disputes, such as India and Pakistan, South Africa under apartheid and its neighbors, and Iran and Iraq channeled assistance to dissident groups in each other in efforts to weaken an enemy. The end of the Cold War led to a decline in such external support, but not to its disappearance, since not all conflicts among states were related to the international politics of the Cold War. Other international connections have been important. A variety of groups have received important financial assistance from their countrymen abroad. The IRA, the Sikhs in India during their struggle, the Palestinians over the last half century, and the Tamils in Sri Lanka have all benefited from fundraising abroad (Fair 2005; Laqueur 1999:194). Al Qaeda has received contributions from many individuals who sympathize with it. Al Qaeda and other groups have also taken advantage of modern technology and the ability to channel and transfer funds around the world with limited interference (Basile 2004; Hoffman 2001:418). While funds from abroad and/or assistance from foreign governments have not usually been essential for the presence of terrorist groups or their survival, it has made them more dangerous. The international links like those forged by Al Qaeda also make it much more difficult for security agencies to disrupt the dissident organizations except by taking on one section at a time.

Another form of linkage has been the increasing involvement of terrorist groups with criminal organizations. Both groups seek to weaken national governments, albeit for different ends. For the dissidents a weaker government may create the opportunity for gaining policy changes or even changes in the political system. At the very least, a weaker government makes survival of the terrorist group easier. The criminal groups are more likely to thrive and benefit financially if the government is too weak to control criminal activity effectively. Colombia has been the worse example of the effects that an alliance between dissidents and drug cartels can bring. The government has lost control over significant portions of its own territory. Collaboration between criminal elements and dissidents has also been prominent in Chechnya. Such alliances have become increasingly common as many groups use money from drug trafficking to help finance their operations (Lutz & Lutz 2008:190-2). These connections are likely to continue and to exacerbate the problems that terrorist groups (and criminal organizations) pose for the state.

A final area of concern focuses on the treat that terrorists will acquire and use weapons of mass destruction—chemical, biological, or nuclear (including dirty bombs—regular explosives designed to spread radiological material in the blast area). There was always some fear that terrorists might use such weapons, but it increased when Aum Shinriyko released sarin gas in the Tokyo subways in the failed effort to kill thousands or even tens of thousands of people. The fear increases further with the anthrax attacks in the United States in the wake of September 11th, even though anthrax is not contagious and only a handful of people died. The fact that a biological agent killed them increased the level of terror associated with the attack. As a consequence of these events, time and money have been spent preparing for the possibility of such attacks, even though they are not very likely to occur. Most of the attempts to develop such weapons and the even fewer attempts to use them have failed (Tucker 2000). Further, most terrorist groups prefer to use conventional weapons that are familiar to them and that they know will work (Wilkinson 2003:134). A number of attacks have demonstrated that such conventional attacks can be quite deadly. Still, there are some terrorist groups, such as Al Qaeda, that would be likely to use such weapons if they had them and if the circumstances were right (from their perspective).

Counter-Terrorism Policies

Most governments have to determine which policies they will adopt to deal with terrorist threats. A variety of countermeasures are available to government policy makers, including repression, intelligence gathering, or even concessions and reform. All of these responses can be supplemented by diplomatic efforts designed to coordinate activities with other states to isolate terrorist organizations. One additional important concern that has to be considered by democratic governments is the potential effect that policies can have on civil liberties and the rule of law. To some extent options will vary depending upon the location of the threat. If the terrorists are part of a domestic group, increased efforts at detection and arrest are the obvious choices. If the dissidents are more likely to strike at national targets in other countries, the policy choices become more complicated. The attacks abroad, whether launched by domestic groups or foreign groups trying to undercut external support of their governments, can strike at particularly vulnerable targets.

Tourists can become prime targets as witnessed by the bombing in Bali, kidnappings in the Philippines and Kashmir, attacks against Israeli tourists in Kenya, and attacks on tourists in Egypt. Protecting tourists, foreign office and operations of national companies (or firms seen as national companies), and diplomatic buildings and personnel requires coordination and cooperation with foreign security and police forces. These local forces may have limited resources (Kenya or Tanzania) or may operate in states where the government may not control parts of its own territory (Colombia or Lebanon for many years). The difficulties are compounded, as noted, because terrorists have a multitude of targeting possibilities.

Repression–including in-context normal police activities to capture terrorists who have invariably broken the law–is normally the first response to attacks. Police and security forces frequently do capture violent dissidents, and they are convicted and either imprisoned or executed. If the government feels that certain segments of society are supporting the terrorists it may increase surveillance of group members. In more authoritarian societies, the repression may be more severe and involve curfews, detention, and frequent searches, especially of members of suspect segments of the society. Eventually some governments may resort to group reprisals in efforts to defeat the terrorists, including support for paramilitary or militia groups that attack the suspect population or even the use of death squads. Such repression could also include the use of assassination teams to target dissidents abroad. Repression (including the more extreme forms) always runs the risk of alienating larger groups of citizens and leading them to support the dissidents in self-defense. Repression can be either effective or counterproductive, depending upon the circumstances.

Reforms or concessions constitute a diametrically different response to terrorism. The reforms will often be directed at the population to which the terrorists are appealing (ethnic, religious, class). If the reforms are successful, the dissidents will never generate much popular appeal or attract recruits and eventually disappear or be dealt with by the police. Concessions involve more direct response to terrorist demands. They may have elements of reform as well, such as the replacement of corrupt officials or changing discriminatory laws. The Basque region in Spain has been given greater local autonomy by the central government as part of efforts to undercut support for the violent nationalists. The PLO eventually became a negotiating partner for the future of the West Bank and the Gaza Strip as a consequence of the Oslo Accords. The agitation of right-wing groups in Europe has led to a number of governments adopting more restrictive immigration and asylum policies in an effort to forestall violence (Leiken 2005). These policy changes are, however, a concession to the extremists who had launched the violence. Of course, sometimes the appropriate concessions or reforms are not possible. The government cannot make a minority religion the state religion or mandate religious law as state law contrary to the wishes of the majority. The United States cannot grant independence to Puerto Rico as radical nationalists demand, given the preference of a huge majority of Puerto Ricans for either statehood or the continuation of the current status. An ethnic, religious, or ideological minority should not be driven into exile by a democratic government. In some cases, concessions to one violent group might trigger violence by some other groups in society. The Oslo Accords led to the assassination of Prime Minister Yitzak Rabin in Israel and other attacks by Jewish and Palestinian extremists opposed to the prospect of peace.

Essential to repression is effective intelligence operations so that the terrorists can be arrested and their organizations disrupted. If the intent is to assassinate key members of the dissident group, they must be located before they are killed. Israeli intelligence services, for example, were quite effective in pinpointing key members of Hamas. If the intent is to use reform to undercut the appeal of the dissidents, the government needs to know what efforts are likely to work. Intelligence may also be relevant for negotiations and offering concessions—or even for knowing whether negotiations or concessions are even worth pursing. Intelligence services are essential for preventing the acquisition or use of weapons of mass destruction. The effective use of intelligence gathering agencies will normally be easier in the domestic arena where officials will have familiarity and knowledge. Efforts to prevent attacks on foreign soil or to catch dissidents will be more difficult. Diplomatic efforts can become important for arranging the necessary cooperation with local security groups. Diplomatic initiatives might also be necessary to arrange for the extradition of suspects and for joint operations.

In democracies, counter-terrorism policies have to balance the need to combat terrorism with the need to continue to honor the rights of citizens and residents. There is always the danger that overzealous police or security forces will arrest and detain innocent people. Terrorism can lead to other limitations on individual rights. Because of IRA intimidation of jurors in Northern Ireland, the British created special courts where the judge determined guilt or innocence. Convictions, some of which were clearly justified, became easier in these circumstances, but the rights of the accused did suffer. The British also used preventative detention in Northern Ireland, and the United States has effectively done so with many suspected terrorist since 9/11 (but has avoided using the term). Other countries also regularly use such practices. In some countries special courts or military tribunals may be established for terrorist cases. Closed trials and limitations on evidence also become a possibility in dealing with terrorists. Such practices lead to a diminishing of civil liberties in the countries that use them. Authoritarian states often do not have to deal with these issues, but in democracies a balance between preserving the rights of individuals and providing adequate protection against attack is a very fine line indeed.

Ultimately, fighting terrorism effectively is contingent on circumstances. The large number of potential targets means that even with good intelligence, prevention and detection will not always be possible. In other cases reforms may eliminate the terrorist threat by removing public support. Concessions might be effective with some groups but not others. Diplomatic efforts may improve the chances of dealing with some groups of terrorists but not others. Some governments might find it difficult to extradite dissidents to an authoritarian regime (Iraq under Saddam Hussein) even if the individuals were guilty of terrorist attacks against the regime in power. In some cases the underlying cause for the terrorist outbreak might lie in the disruptions that have occurred due to globalization and modernization. The government might understand the cause, but the insight provides very little practical guidelines on how to deal with the violent responses. In the final analysis, since groups with different motivations and different goals use terrorist techniques, what works as counter-terrorism policy in one country or in one circumstance will not work in another. Terrorism is a complex phenomenon rising from various causes and mixtures of causes, and responses to terrorism often will have to be complex as well.

Conclusion

Terrorism has become a major concern in today's world, and it will continue to threaten because it has worked in at least some situations in terms of achieving political objective or getting the modification of government policies. While the terrorists frequently fail, it has succeeded—or at least appeared to succeed—often enough to encourage other groups to adopt the technique. Terrorism also appeals to weak groups because there is at least a chance of success with the expenditure of minimal resources. Since so many different groups adopt terrorism to achieve different goals, there is no one set of policies that governments can adopt to prevent outbreak or deal with the threat once it is present. Most outbreaks will have to be dealt with differently. The German political system had to respond to the actions of the Baader-Meinhoff Gang differently than it did to the activities of the neo-Nazis and skinheads. While some of the government initiatives were the same, others had to be different give the source of the threat. In the final analysis, since terrorism requires few resources and can be adopted by many different groups, terrorism will not disappear in the immediate future. At best, increasing levels of terrorism can be contained and many groups attempting to use the technique will be broken up and the members arrested before they can do significant damage.

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Tobin-Type Taxes and Capital Controls

John Lodewijks

Introduction

Over the last decade or so there have been significant financial crises, often associated with severe economic, social and political distress. Some of the more significant crises occurred in 1992-3 in Europe, in 1994-5 in Mexico, in 1997-1998 in East and South-East Asia, in 1998 in Russia, in 1999 in Brazil and in 2002 in Argentina. The crises involve various combinations of banking, currency and debt problems. Of 181 countries surveyed in 1996, 133 had experienced significant banking sector problems at some stage during the past fifteen years. The cumulative output losses have been considerable. Covering the four years after the start of the Asian crisis, these amounted to 24% of the annual GDP of Korea, 26% for Malaysia, 54% for Thailand and 83% for Indonesia (Gruen & Gower 1999; Stiglitz 2002). Losses of this magnitude are enormous and in some cases exceed those experienced during the Great Depression. The frequency—one major international financial crisis every two years—and intensity of financial crises has led many observers to question how efficiently global financial markets function in an environment of volatile short-term capital flows and exchange rate instability.

The foreign exchange market is the largest financial market in the world with average daily turnover in excess of US $1 trillion. Foreign exchange markets may suffer from asymmetric information, destabilising speculation and herd behaviour that give rise to sudden surges in capital inflows followed by dramatic capital outflows as euphoria turns to panic. The consequences include persistent misalignments and unstable exchange rates that can result in banking and financial crisis with painful consequences for the real economy. This raises the issue of how can we then reconstruct the global financial architecture so as to reduce the likelihood of financial crises occurring and reduce their severity when they do occur?

The most obvious way to stop speculation in foreign exchange markets is to abolish separate currencies, as with the European Union. Introduction of the euro has already reduced the volume of foreign exchange trading. The abolition of national currencies and dollarisation (Salvatore et al 2003) is a fairly drastic step to take but a number of countries are considering just that alternative, particularly in Latin America. There has also been discussion of an Asian currency union. In the meantime, monetary authorities in East Asia are building up their stockpiles of foreign exchange reserves in case of another assault on their currencies. Short of regional or even a world currency, various ‘second best’ alternatives exist: direct controls on the movement of foreign capital and currency conversion, special deposit requirements on overseas borrowing, and transaction taxes.

The Tobin Tax

More than thirty years ago Nobel laureate James Tobin (1918-2002) proposed a uniform international tax payable on foreign exchange transactions to discourage speculation by making currency trading more costly. A tax of a tenth to a quarter of one percent on foreign currency transactions might be too low to upset long-term investors, while discouraging destabilising short-term capital flows, leading to greater exchange rate stability. The Tobin Tax is aimed at reducing very short-term speculative foreign exchange transactions. The burden of the tax varies inversely to the maturity of the foreign exchange transaction so that it particularly penalises short-term transactions. A 0.2 per cent tax on each round trip currency transaction ends up costing 48 per cent annually if transactions are conducted every day, 10 per cent if weekly and 2.4 per cent if monthly.

Given the relatively small size of the non-financial market for foreign exchange (no more than 20 per cent) in support of real trade and direct foreign investment activity, and that 80 per cent of foreign exchange transactions involve round trips of a week or less, a transaction tax would hurt the speculators disproportionately more because they tend to trade much more frequently. The implicit assumptions are that speculative trading is on average destabilising, which causes prices to be more volatile, and that short-term capital flows ("hot" money) are motivated by speculative gains while longer-term direct investment is based on underlying economic fundamentals.

How feasible would a Tobin Tax be? Ideally the geographical coverage of the tax should be universal and so requires international agreement. Otherwise the tax could be avoided via moving to untaxed jurisdictions. Another concern is that new financial instruments might be invented to circumvent the tax. Hopefully a low tax rate would minimize incentives to evade the tax. The Tax could be administered by the International Monetary Fund or the Bank of International Settlements or simply collected by individual countries. Perhaps certain trades could be exempted from the tax, such as central bank intervention in foreign exchange markets, and higher rates could be imposed during currency crises or periods of speculative attacks.

What is clear is that with foreign exchange trading amounting to a 100 times total world trade in goods and services, even a small tax rate imposed on such a large tax base would yield sizeable revenues. Even a low tax rate of 0.1 per cent may raise a minimum of US $50 billion annually which dwarfs the budget of the United Nations and the total official development aid contributions provided by the world's 20 richest countries. The funds could be used to finance global public goods like the environment, poverty reductions, international diseases and public health programs, disaster relief and humanitarian aid, peace-keeping operations and removing land-mines. There is no shortage of worthy causes to fund and any inefficiencies associated with the tax (for example, it may penalize legitimate trade credit transactions) would need to be offset against the benefits to humanity involved with these spending programs.

Turbulence in world financial markets has solicited greater interest in Tobin Taxes to discourage speculative currency trading and to make exchange rates reflect long-run fundamentals relative to short-term expectations and bubbles (see Haq et al 1996). Whether the Tobin Tax is the perfect solution is unclear. Paul Davidson (1997) argues that a Tobin tax would not avert very large speculative attacks and there is a need for outright prohibition of such capital flows via an International Money Clearing Unit. Nevertheless, it would lead to a decline in the volume of foreign exchange transactions by throwing some sand in the wheels of international currency speculators.

Capital Account Liberalization

Countries can try to directly control or tax capital movements but emerging market economies in recent decades have been strongly encouraged by international institutions like the International Monetary Fund to open their markets to international capital flows (this is often called capital account liberalization). Proponents of liberalization suggest that it will lead to a more efficient global allocation of investment, improve opportunities for risk diversification and impose greater discipline on domestic policymakers. However, empirically, there is little evidence that growth or investment is higher in more financially open economies. Bhagwati (2002) believes that many of the perceived benefits of liberalized international capital flows are derived from influential free market ideology, in an environment where financial sector institutions and prudential supervision are inadequate. It may be the case that a more open capital account positively effects growth only after a country has achieved a certain degree of economic development. There is some evidence of a 'threshold effect' in the relationship between financial globalization and economic growth (Edwards 1999). Sound macroeconomic policies and improved institutions and governance, including robust legal and supervisory frameworks, is important in attracting less volatile capital flows and in reducing a country's vulnerability to crisis.

Since the late 1980s many Asian developing economies had experienced surges in capital inflows. The composition of capital inflows does appear to have a significant effect on a country's vulnerability to financial crises. Capital flows take the form of commercial bank lending, foreign direct investment, or equity portfolio investment. Foreign direct investment is the most stable source of capital inflow while bank loans are the most volatile. During the Asian crisis, the most significant fall in foreign borrowing was in foreign bank lending to domestic banks and the majority of the short-term bank funds were linked to derivative contracts. As the Asian economies approached the period of crisis, the ratio of foreign direct investment to short term and portfolio investment declined. Financial liberalization in Asia promoted dramatic shifts toward speculative financing as local banks became heavily involved in risky domestic lending and as local firms were free to borrow abroad. The ensuing credit boom was directed towards the property sector and the rise in asset prices induced further capital inflows. When the bubble burst, the foreign capital departed as quickly as it had come in, leaving plunging currencies and unsustainable debt to equity ratios as asset prices collapsed.

The response of international institutions like the International Monetary Fund has been to argue that the principal cause of the crisis was domestic financial sector weakness which permitted overinvestment in the property sector of these Asian economies through excessive foreign borrowing at short maturities. They strongly resisted dealing with the problem via capital controls. Instead they argue that because it was neglect of financial sector reform that got these countries into trouble, such reform has to be the centre-piece of the recovery package. It is then argued that banks and finance companies either need to be closed down or recapitalized to meet international capital standards. Foreign-ownership limits, they suggest, should be liberalized in the financial sector and supervision and regulation strengthened.

Others, however, point to internationally mobile capital and the development of derivatives and other highly levered financial intermediaries, such as hedge funds and bank proprietary trading departments, which are programmed to move large pools of capital quickly between different financial markets. It is interesting to note that the countries that escaped the crisis either had enormous international reserves like Singapore and Hong Kong or capital controls. Singapore had both, with a set of rules on capital transactions, for example, so that non-residents cannot borrow in Singapore dollars. Vietnam has stringent controls over both the capital and the current accounts. These control mechanisms reflect the feeling that the net benefit of short-term capital is small or even negative. What is clearly apparent is the extraordinary surge in capital inflows following financial liberalization of crisis countries. Stiglitz (2002:99) has stated that: "I believe that capital account liberalization was *the single most important factor leading to the* [Asian] *crisis*".

Hedge Funds

The activities of the large macro hedge funds are being increasingly scrutinized as they often appear the strategic players in international currency speculation and hence a major reason for countries to contemplate capital controls. Paul Krugman (2000) provides a detailed account of the Quantum Hedge Fund in Britain in 1990-92 and similar episodes are recorded for Hong Kong, South Africa and Russia in 1998. Franklin Edwards (1999) provides an illuminating account of one of these funds, Long Term Capital Management. He states with alarm that the 'misadventure of a single wayward hedge fund with only $US4.8 billion in equity at the start of 1998 could take the United States or even the world economy so close to the precipice of financial disaster' (p.189). Hedge funds are left mostly unregulated as speculative vehicles for high net-worth individuals and institutional investors. Hedge funds typically have high minimum investment requirements (the Tiger Fund has a $US5 million minimum, LTCM $US10 million). LTCM had a more than 20 to 1 leverage ratio so that in 1998 it borrowed $US125 billion on an asset base of $US5 billion. The returns can be impressive; LTCM earned in excess of 40% returns in 1995 and 1996, as are the risks taken in speculating in foreign currencies. The examples of George Soros and LTCM show that in this high-risk gambling casino of foreign exchange markets the major speculators can come undone but the effects on small developing countries can be catastrophic.

Paul Volcker (in Gruen & Gower 1999) is particularly concerned about the vulnerability of small banking and financial systems to such speculative behaviour. The aggregate size of banks in Argentina or Thailand or Indonesia falls in the range of a small regional U.S. bank so only marginal shifts of funds in massive international financial markets can overwhelm the absorptive capacities of these countries banks. However, even in the U.S. financial supervision did not prevent the Savings and Loan debacle in the 1980s and the collective failure of some of the largest commercial banks. Respectable major U.S. banks were lending to small, incredibly risky hedge funds in the LTCM saga. Improving financial supervision and regulation 'may be inadequate to deal with the truly systemic problems before us', says Volcker, and he suggests stronger regulations to control foreign exposures of banks and that taxes on short-term capital inflows by means of special reserve requirements might be an option.

Capital Controls: Comparative Analysis

Capital controls refer to measures that manage the volume, allocation, or composition of international private capital flows. They were integral to the operation of the old Bretton Woods system. The controls can be tax-based (like the proposed Tobin taxes) or quantitative restrictions. These controls are still used in many emerging market economies such as Brazil, Chile and Colombia in Latin America and Korea, China, India, Vietnam and Malaysia in Asia. These controls are another weapon to be used to stem massive temporary inflows or outflows of debt and they can be adjusted depending on circumstances and in response to detected evasion strategies. The purpose of these controls is to quarantine economies from excessive 'hot' money inflows and outflows that disrupt economic stability and lead to exchange rate misalignments. We now discuss the recent experiences with capital controls in a number of countries using the excellent information provided by Epstein, Grabel and Jomo (2003).

The 'Chilean' model of capital controls is often presented as an exemplar for other developing countries. In Chile foreign loans were taxed. Capital inflows were subject to a one-year residence requirement and a non-interest bearing reserve requirement was placed on all types of external credits and all foreign financial investments in the country. The required reserves were held by the Central bank for one year. The reserve requirement was in effect a tax to discourage short-term flows by raising the costs of these investments. It may be interpreted as a sort of Tobin tax but one imposed unilaterally not multilaterally. Chilean-style controls on capital inflow have been successful in lengthening the maturity of foreign debt without reducing the quantity of capital inflow. The only costs of these controls appear to be some rising in the capital costs to small-sized enterprises. The benefits were that the controls reduced the risk of financial crisis, allowed policy makers some degree of autonomy in its macroeconomic management, and thereby avoided the intrusions of the International Monetary Fund.

Taiwan also uses an extensive set of capital controls. There is no convertibility of the New Taiwan dollar and authorities maintain restriction on the ability of banks to engage in speculative activities and on foreign borrowing. In 1995 the Taiwan foreign exchange market was closed for a year when it was discovered that foreign inflows that had been approved for equity investment were actually used to speculate against the currency. In Singapore there is long-standing policy of not encouraging the internationalization of the Singapore dollar. This has helped the Singapore authorities to maintain a managed exchange rate. In the academic literature it is often noted that one can not simultaneously achieve the three goals of exchange rate stability, monetary policy autonomy and free capital flows. By restricting capital flows the other objectives can be reconciled.

Malaysian-type controls on capital flows are alleged to have allowed that country to recover quickly from the Asian crisis. Compared to countries that did not impose controls, Malaysian policies produced faster economic growth, smaller declines in employment and real wages, and a more rapid turnaround in the stock market. The controls were implemented transparently and with remarkable efficiency and the authorities were careful to target short-term speculative capital flows, insulating long-term direct foreign investment. The Malaysian experience is interesting because they had a history of open capital accounts and during the Asian crisis they refused to accept International Monetary Fund 'rescue' packages. Instead they infuriated the IMF and the international financial community by imposing capital controls on outflows. This allowed the authorities to use expansionary macroeconomic policies while protecting its exchange rate and international reserves. A system of graduated exit levies based on the duration of stay was later introduced. The main cost of these capital controls was the political favouritism associated with their implementation.

China and India have achieved high growth rates despite limited and selective capital account liberalization. India has had controls on inflows and outflows and strictly regulated the financial system to control foreign currency transactions. They have attempted to shift the composition of capital inflows from debt to equity. China has the most extensive foreign exchange and capital controls yet attracts very high levels of foreign direct investment. There are strict controls on foreign debt accumulation.

Edwards (1999) provides a detailed discussion of capital controls although he is a fierce opponent of such controls in most cases. Following the Asian Crisis of the late 1990's, there has been a renewed interest in the role of capital controls in developing countries. While numerous economists remain quite skeptical about the viability and desirability of controls, even strong proponents of capital account liberalization have acknowledged that many countries that avoided the worst effects of recent financial crises were also those that used capital controls. Indeed, a number of highly respected economists—such as Jagdish Bhagwati, Paul Krugman, Dani Rodrik and Joseph Stiglitz—have actively argued in favour of capital controls. Yet there remains much debate about whether the controls should be on inflows, outflows or both; the duration of the controls; the type of controls (the Chilean implicit taxes on foreign capital are often singled out for praise) and the relationship between the controls and the underlying macroeconomic fundamentals of a country. Recently even the International Monetary Fund appears to have softened their line on capital controls. They express cautious support for market-based capital inflow controls, Chilean style.

Conclusions

The proliferation of financial crises is often viewed as one of the defining aspects of the intensification of financial globalization over the last few decades. Good fundamentals alone do not appear to insulate a country from the effects of financial contagion. The October 1997 crash on the Hong Kong Exchange demonstrated that. Similarly, floating exchange rates are not immune to speculative attacks. This demonstrates that speculative attacks may succeed in the absence of underlying macroeconomic imbalances. In the light of these experiences, a fundamental reappraisal of theoretical models of international capital flows is now proceeding. New approaches to private speculative behaviour are being developed that are significant departures from rational expectations or efficient market models. One such model is the theory of rational speculative bubbles where prices continue to rise and depart more and more from economic fundamentals. Investors base their actions on what they see others doing—herd behaviour and informational cascades—and mimic the action of others. 'Irrational exuberance' is another term that has been used to describe this situation (Shiller 2000).

These developments have led to a search for better 'financial architecture' for the world economy. Rogoff (1999) presents an excellent survey of the options available for dealing with financial crises. One suggestion is the need for international regulation. Eatwell and Taylor (2001) have proposed a World Financial Authority. There is clearly a need for international coordination to reduce destabilising effects of highly leveraged institutions. Improvements in the quality of domestic financial and regulatory institutions are also necessary.

Turbulence in world financial markets has solicited greater interest in Tobin Taxes to discourage speculative currency trading and to make exchange rates reflect long-run fundamentals relative to short-term expectations and bubbles. Whether the Tobin Tax is the solution or even feasible to implement multilaterally is unclear. Several countries are taxing selective foreign exchange transactions themselves without waiting for a global solution.

Certainly many countries are closely monitoring a number of vulnerability indicators. Vulnerability indicators include at the macroeconomic level the ratio of short-term foreign-currency-denominated debt to foreign exchange reserves, the extent of real exchange rate appreciation and the current account deficit. At more disaggregated levels, there is a need to monitor the balance sheets of individual sectors of the financial and corporate sectors. In particular, maturity mismatches between short-term liabilities and longer-term liquid assets, borrower foreign currency denominated liabilities compared to domestic currency assets, and debt-equity financing ratios, need to be watched. Generally, there is a necessity to monitor foreign currency exposure of corporate and financial sectors and to implement an enhanced regulatory oversight of highly leveraged institutions. The inherent instability and volatility which characterizes real world international capital markets can not be dismissed. Capital controls, in various forms, can contribute to economic welfare by dampening such instability. This is particularly pertinent to developing countries that are more vulnerable to capital flight.

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Transition Economies

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Introduction

The collapse of centrally administered socialism in the Soviet Union, Central and Eastern Europe and Asia resulted in the adoption of the market process as a means of allocating scarce resources. The transformation from a centrally administered economy to an economy based on market relations which involved macroeconomic stabilization, price and trade liberalization, institutional reform, restructuring and privatization, and has been conceptualised by the word transition and thus the economies of Central and Eastern Europe, former Soviet Union, and Asia that have adopted this transformation process are named transition economies.

During the transition process, elements of centrally administered socialism and embryonic market relations co-existed. This made traditional economic theory problematic; thus, the transition process "had to be conceived and implemented largely in the dark" (Sestanovich 1992:vii). While the collapse of centrally administered economies did not surprise social scientists, the transition process did. The transition process was one of the most dramatic non-marginal adjustments in economic systems ever experienced. The complexities involved did not have any historical parallels and the general desire for quick results caught social scientists unprepared. Consequently, the transition process turned out to be far more complex than initially hoped and created new challenges for everyone, since transition economies "travelled into uncharted waters".

The transition process in Central and Eastern Europe, former Soviet Union and Asia was associated with an explicit or implicit end-state. The international financial institutions (IMF and World Bank), mature market economies and the elite in transition economies associated this end-state with the establishment of a capitalist economic system. In a capitalist economic system, the explicit or implicit goal of transition economies, market relations are dominant as the result of abolishing centrally administered commands; the majority of property is private as a result of privatisation of state enterprises; and effective property rights are respected and enforced as a result of economic actors adjusting their economic behaviour in accordance to the rules of market exchange.

The transition process was dominated in Central and Eastern Europe, former Soviet Union and Mongolia by the orthodox theory (neoclassical economics) in either the shock therapy or gradualist form complemented by a democratic process of decision-making. Whereas in the remaining Asian economies (China and Vietnam) the process is dominated by an authoritarian political structure irrespective of the pace of transition.

Shock Therapy Transition Process

The shock therapy model of transition involved: immediate price liberalisation, immediate privatisation, immediate establishment of an independent central bank, immediate achievement of a balanced budget, immediate introduction of free trade and immediate establishment of a fully convertible flexible currency. Jeffrey Sachs—an adviser to the Polish and Russian governments who guided the shock therapy process in these countries—stated that: 'Poland's goal is to establish the economic, legal, institutional basis for a private-sector market economy in just one year' (Sachs 1990:19). In essence, the shock therapy model was an orthodox macroeconomic stabilisation program, emphasising price liberalisation and strict budgetary policy and advocating the implementation of the necessary reforms in one shot to establish a free market democratic capitalist economy.

The aim of the shock therapy model was to remove social obstacles driven by anti-social self-interest. The result would have been a free market, which, as the supporters of the model argued, in the long run guaranteed full employment, stability and growth. With regard to the associated costs of the reform process, the shock therapy supporters argued that gradualists exaggerated these costs (Lipton & Sachs 1992:216; Woo 1994:290; Aslund 1997:186). Shock therapy supporters argued that the radical reforms did not increase unemployment, halt the development of the private sector or hinder the evolution of institutional structures. These countries performed better, even though they suffered a decline in output in the beginning of transition. Poland, Estonia were the first ones to achieve positive economic growth (Aslund et al 1996:226). The policies recommended by shock therapy model are presented in Table 1, below:

Table 1. Shock Therapy Processes and Policies

TRANSITION POLICIES	SHOCK THERAPY METHODS
Price Policies & Stabilization	Immediate price liberalisation No state intervention
Privatization and Property Relations	Restitution, auctions and free distribution of vouchers. Minimum state
Institutions	Formal and informal institutions, product of market forces
Monetary and Financial Policy	Independent central bank and privately owned banks
Fiscal Policy	Neutral tax system and balanced budget
Trade & Foreign Aid	Free trade, fully convertible currency Conditional foreign aid
Social Policy	Immediate Safety Net
Examples	Poland, Estonia

The Gradualist Transition Process.

The fundamental basis of the gradualist approach to transition was the need to establish the economic, institutional, political and ideological structures before any attempt at liberalisation was undertaken. Without this minimum foundation, radical reforms would have inhibited the development of a competitive market capitalist system. This was because “privatisation, marketisation, and the introduction of competition cannot be contemplated in an economy reduced to barter” (Carrington 1992:24). Moreover, the implementation of the reform program required minimum standards of living to foster a social consensus and, also, the transition process had to be guided by the principles of voluntariness and free choice.

The introduction of market relations to the centrally administered economies was not a simple task, based on the gradualist propositions. In the transition economies, the market was underdeveloped, the private sector was immature and democratic institutions were weak. Institutions were changing rapidly and the behaviour of individuals was constantly adjusting. As a result, “a special kind of dynamic analysis is needed” (Kornai 1994:2). Given the nature of the gradualist transition process it was impossible to solve the associated problems independently of the political and social aspects of the reform.

According to the gradualist approach it was desirable to maintain a semi-centralised system, coupled with a combination of centralised markets. The distinguishing feature in the gradual transition process was that the ultimate goal of an approximation to competitive capitalism should be achieved by the gradual elimination of centralisation. The objective was to create a large class of people with interests in the former state sector that developed genuine Schumpeterian entrepreneurs through a process of ‘embourgeoisment’.

Gradualist transition supporters argued that the process clearly outperformed the shock therapy approach, rather than merely avoiding some of the obvious flaws (Csaba 1995:191). Hungary and Romania are examples of a gradualist approach. This was because it was naïve and premature to free prices, float the exchange rate, and privatise and decentralise decision-making before proper fiscal and monetary control over the economy had been established. The policies recommended by gradualists are presented also in Table 2, below:

Table 2 . Gradualist Processes and Policies

TRANSITION POLICIES	GRADUALIST METHODS
Price Policies & Stabilization	Gradual price liberalisation Gradual removal of state intervention
Privatization and Property Relations	Restitution, auctions and free distribution of vouchers Minimum state
Institutions	Formal and informal institutions, product of market forces
Monetary and Financial Policy	Gradual establishment of independent central bank and privately owned banks
Fiscal Policy	Gradual neutral tax system and balanced budget
Trade & Foreign Aid	Gradual free trade and fully convertible currency Conditional foreign aid
Social Policy	Gradual Safety Net
Examples	Hungary and Romania

Authoritarian Transition Process.

A democratic process of decision-making complemented both the implementation of shock therapy and gradualism in the Central and Eastern Europe, some countries of the former Soviet Union and Mongolia. In China and Vietnam the transition process was initiated and kept under control by the authoritarian rule of the Communist Party. Most importantly, the Communist Party is still in power in China and Vietnam—unlike Eastern Europe, the republics of the former Soviet Union and Mongolia—and the development of a socialist society is still the state's official goal.

A quarter of century ago, the Communist leadership, under Deng Xiaoping, initiated a marketisation process in China's centrally administered socialist economic system. The start of these reforms is usually identified with the Communist Party Plenum in December 1978 (Nolan 1995:1). Thus the period of reform has been at least double than in Central and Eastern Europe and the former Soviet Union. China's reforms differed markedly from those implemented in the transition economies.

The reforms have consisted of small step-by-step changes. The ultimate goal was not announced, nor was any timetable for the transition mentioned. Some of the changes were initiated spontaneously, at the ground level, and only after they were successful were they ratified by government and implemented as official policy. The reforms proceeded by trial and error, with frequent mid-course corrections and reversals of policy. The goal was modest: avoiding disaster and achieving some improvements through cautious changes; attempting to 'perfect' the existing public ownership-based planned economy via improving efficiency and incentives and correcting for structural imbalances. Therefore, China tried whatever measures would propel economic growth and transform a command economy into a market economy.

It has been widely accepted that the Chinese reforms have been successful. In sum, the economic growth rate is among the highest on record and fairly stable, it has been achieved without sacrificing external equilibrium, and inflation has been kept under control. However, whether China's reforms and successes could have been replicated in other transition economies was hotly debated. McKinnon (1993), McMillan and Naughton (1992) and Blackburn (1991) argued that China's success demonstrated the superiority of an evolutionary, experimental and bottom-up reform over the comprehensive and top-down shock therapy approach.

In fact, the aforementioned neoclassical gradualist approach was highly influenced by the Chinese process of transition (Popov

2000:2). Woo (1994), Sachs and Woo (1994) argued that the success of the Chinese reforms was due to neither gradualism nor to experimentation but rather to China's unique initial conditions. It was argued that the model did not have any implications for other transition economies that faced different initial conditions. Hence, "the recommendation that Russia should take the same path as China amounts to telling apples to be pears" (Aslund 1993:99). Nevertheless, the economic problems in pre-reform China were common to all centrally administered economies and so the Chinese model of transition could have held some interest to Central and Eastern Europe and the republics of the former Soviet Union.

As was to be expected, Vietnam's transition was greatly influenced by China's successful experience. The start of market reforms dates back to the Sixth plenum of the Fourth Party Congress, in September 1979 (Riedel and Comer 1997:191). After a long period of unsuccessful partial and gradual reforms in 1989 the course of transition in Vietnam broke away from the Chinese model and a shock therapy approach was adopted. The pace of reform in Vietnam from 1989 to 1991 was anything but gradual, and the stabilisation program adopted in 1989 was certainly as ambitious as the shock therapy approach in other transition economies. The radical stabilisation program 'was pure IMF orthodoxy, albeit without IMF behind it' (Riedel and Comer 1997:196). The program involved: liberalisation of prices; the elimination of the system of state procurement; raising interest rates; devaluing and unifying the exchange rate and reducing the budget deficit.

Between 1989 and 1991 government expenditure was reduced by six percentage points of GDP. Subsidies to state enterprises were largely eliminated, the investment program was severely cut, uniform tax treatment of state and non-state enterprises was implemented, wage increase for civil servants were restrained below the inflation rate, spending on education, health and other welfare services was cut, and about one-half million soldiers were demobilised. The outcome of the radical program was, nevertheless, very different from the one experienced in Central and Eastern Europe and Russia, where shock therapy is associated with a sudden collapse in output. In Vietnam shock therapy was able to stimulate economic growth and reduce inflation. The policies recommended by the authoritarian transition process are presented also in Table 3, below:

Table 3. Authoritarian Processes and Policies

TRANSITION POLICIES	AUTHORITARIAN METHODS
Price Policies & Stabilization	Gradual price liberalisation Market planning and directives
Privatization and Property Relations	Development of TVEs and private firms in special economic zones. Leasing of land. Majority social with some private property
Institutions	Informal institutions, product of market forces
Monetary and Financial Policy	State-controlled central bank and state-owned banks
Fiscal Policy	Discretionary tax system and fiscal policy
Trade & Foreign Aid	Tariffs and non-tariffs barriers, discretionary exchange rate policy. Non-conditional foreign aid
Social Policy	Enterprise funded Welfare Services
Examples	China and Vietnam

Macroeconomic Performance

The macroeconomic performance for a sample of transition economies of Central and Eastern Europe and the former Soviet Union is revealed in Table 4. All countries experienced a reduction in output. The cumulative output decline was the largest was Georgia. By 2005 from the 11 countries in the sample, eight still had yet to achieve the 1989 real GDP level. Comparing Table 4 with Table 5 reveals that on average China, Mongolia and Vietnam performed much better than their Eastern European and former Soviet Union counterparts. However, this was not before Mongolia's real GDP was reduced and inflation increased while Vietnam's inflation increased.

Table 4: GDP, Selected Transitional Economies 1989-2005

Countries	Lowest 1990s GDP % 1989 GDP	Year of lowest 1990s GDP	Projected 2005 GDP 1989 =100	Av. Ann. GDP Growth 1989-2005	% Δ GDP PC US$ 1989-2005
Albania	60	1992	144	2.31	30.64
Armenia	43	1993	106	0.36	5.60
Azerbaijan	37	1995	92	-0.52	-8.64
Croatia	60	1993	98	-0.15	-2.36
Estonia	62	1994	114	0.83	12.41
Georgia	25	1994	48	-4.38	-104.93
Latvia	52	1995	96	-0.27	-4.36
Lithuania	53	1994	95	-0.32	-5.26
Moldova	33	1999	46	-4.84	-121.27
Russian Federation	59	1996	89	-0.95	-16.47
Ukraine	38	1998	61	-3.08	-64.91

Source: Adapted from European Bank of Reconstruction and Development (2005)

Table 5 Transitional Asian Economies, Average Annual Growth of GDP Per Capita 1981-2005

Country	1981-91	1991-01	2000	2001	2004	2005
China	8.4	8.6	7.1	6.6	9.4	9.2
Mongolia	2.1	0.9	0.3	0.4	9.2	4.6
Vietnam	2.5	6.1	5.4	5.4	6.6	7.4

Source: Adapted from World Bank "Country at a Glance Report" (http://www.worldbank.org)

Critical Analysis of the Transition Process

There was an internal contradiction in the shock therapy reform program: the shock therapy process, while rapid, required some unspecified time to be operative, depending on fragile coalition governments based on a democratic process of decision-making. Under these circumstances it was impossible for a reform program of this magnitude with such high social costs to survive a democratic decision-making process; economic reforms result in severe social costs immediately, but produce benefits only gradually. Balcerowicz, (1994:75) argued that "this 'visibility effect', absent in classical democratisations, was likely to encourage unfavourable assessments of the whole transition and, consequently, to influence electoral outcomes and the subsequent direction or pace of the economic transition".

Support for shock therapy was very high initially but started to deteriorate when the social cost increased. The result was governments implementing shock therapy lost power after only one term in office, leaving the reform process in disgrace. The new governments that followed, dominated usually by ex-communists, reversed the course of reform and proceeded with a gradualist transition approach. Hence, as a political strategy, shock therapy turned out to be suicidal for the governments that launched it. There is also the argument that the transition governments that pursued shock therapy did not have a mandate from the people to introduce the radical reforms, as in the Polish and Russian cases. Table 6 demonstrates the duration of shock therapy in transition economies.

Table 6. Duration of the Shock Therapy Process

Country	Transition Type	Reforms Commenced	Gradual Shift
Poland	Shock therapy	1 Jan 1990	19 Sep 1993
Czechoslovakia	Shock therapy	1 Jan 1991	Slovakia: 1 Jan 1993. Czech Rep: 1 Jun 1996.
Bulgaria	Shock therapy concept slow implementation	1 Feb 1991	18 Dec 1994
Russia	Shock therapy	2 Feb 1992	12 Dec 1993
Albania	Initially gradual then shock therapy	June 91—gradual July 92—shock therapy	19 June 1997
Estonia	Shock therapy	Sept 1992	5 Mar 1995
Latvia	Shock therapy	5 June 1993	25 July 1997

Source: Adapted from Economic Survey of Europe 1993–1994, Economic Commission for Europe 1994 pp.138–139; Keesing's Record of World Events Volume 40, Number 7, July 1994, Longman, UK; EIU Country Report, Slovakia, 2nd Quarter 1995, Economic Intelligence Unit, UK. p.29

The gradualist process of transition combined a democratic political structure with a market economy. In contrast to the shock therapy supporters, the policies of the gradualist economists had to be approved by the democratic political process in order to facilitate transition. Meanwhile, a neoclassical gradualist approach entailed the maintenance of short-term inefficiencies. However, these priorities presented an unfortunate policy dilemma for the neoclassical gradualist economists. In order to secure macroeconomic stabilisation in the short run, important pricing, enterprise, banking, interest rate and international trade policies had to move counter to the ultimate goal of long-run liberalisation. Transition governments were encouraged by the neoclassical gradualist economists to seize the financial assets of enterprises, command outputs through state orders, and reinstitute price controls and other such devices. Consequently, the recommendations were for the re-regulation of the financial system, international trade and state enterprises.

If competitive capitalism was the ultimate goal of neoclassical gradualist economists, there was an apparent contradiction with the recommended strategy of transition. A competitive capitalist system requires a government with no discretion. However, re-regulation and re-nationalisation occurred during the transition period. The government's discretionary power was increased in the name of gaining control of economic affairs. However, there was a direct link between increased government power and the interests of the bureaucracy and other lobby groups. The crucial question was: how could the economy, from a system of increasing government power during the transition period, be transformed into a free market system? The neoclassical gradualist economists failed to reveal how this would have been achieved. Strangely enough, the state was expected to 'wither away' (Csaba 1995:89). Stalin had advanced a similar argument: for the state to 'wither away', its power firstly had to be maximised (Nove 1989:63). However, the state would never have 'withered away', as it was linked to the interests and privileges of the bureaucracy, and to other lobby groups and sectoral interests. These groups resisted their own dissolution, and state power and intervention continued. This argument was maintained by neoclassical economists to explain the lack of reform in the Stalinist system. Paradoxically, the same argument finds validity in the neoclassical gradualist process of transition.

The long-term commitment to the socialist market concept in China and Vietnam appears doubtful. Thus despite the continued claim by the government that its system is socialist, it is possible to argue that China and Vietnam are already under a system of state capitalism in which, even with a high degree of public ownership, the workers and peasants are exploited for the benefit of the political and economic elite. "It does not matter if a regime calls itself red or white, as long as it exploits the working classes for profit" (Weil 1996:26). The future reform challenges in China and Vietnam will almost surely be political. It would be naïve to assume that the commercialisation of economic relationships and the invigoration of the private sector would not affect the country's political relations. People increasingly desire democracy partly as a result of their better economic position and partly due to the influence of foreign investment. A more professionally run economy would eventually undermine China's and Vietnam's authoritarian politics. Decentralisation has reached a point where its advantages with respect to reform are close to being outweighed by hurdles it puts in the way of policy-making and consensus building. The political rules and their constitutional underpinnings need to be reappraised in the light of changed economic circumstances. Without a new political contract that brings clarity to the rules of the centre and provinces, no amount of tinkering with monetary and fiscal instruments would enhance effectiveness. China and Vietnam seem to ignore that within the current model there is still an unresolved tension between the dynamic economic change and political centralization. China and Vietnam will not doubt discover that an open market economy is basically incompatible with closed, repressive polity.

The first major clash in China resulting from the growing resistance to the effects of marketisation and especially the rampant corruption was the uprising of 1989 in Tiananmen Square, led by students and intellectuals, though joined by many workers as it proceeded. Their challenge to the Communist Party authority was repressed brutally and the continued dominance of the Communist Party was signalled by the crackdown as non-negotiable. The response of the government in the aftermath of Tiananmen seems to have been to accelerate the reforms, in order to present the Chinese masses with a fait accompli, to ‘complete’ marketisation, while Deng Xiaoping was still alive to guide the process.

Nevertheless a puzzle in the outcomes of the transition process requires clarification: Why did shock therapy in Eastern Europe and Russia result in a large decline in output, while in Vietnam it resulted in an increase in output? Why did gradualism in parts of Eastern Europe, the republics of the former USSR and Mongolia, result in a large decline in output—albeit less than shock therapy—while China, which effectively implemented the same strategy, registered a large increase in output? It appears that it is not the speed of the transition process that determines the variation in output between transition strategies. Instead, it seems that the maintenance of authoritarian political control by the Communist Party in both in China and Vietnam ensured, independently of the speed of transition, increases in economic growth and the reduction in inflation.

The reforms in China and Vietnam seem to suggest that economic reform should precede political reform. It appears that in countries like China and Vietnam, that were very unevenly developed, democratisation should be the result of economic reform, by firstly ensuring development of the productive forces and increases in income. Initially people are more likely to value improvements in their living standard more highly than democratic rights. Moreover, their rankings of the relative importance of these goals tend to alter sharply as their income level and security changes (Nolan 1995:73). The nature of the transition process necessitated a hard, strong, efficient and flexible authoritarian state to precisely allow a more controlled and flexible transition process. Sufficient state enforcement power was required to carry out a reform. In such a process, the strong state was able to use its power to prevent a rapid growth of asset inequality and protect the weaker members of society who might otherwise suffer more during the transition process. The political stability maintained in China and Vietnam has been an important factor encouraging foreign investment that was required to finance economic growth. The question though arises of how to change the authoritarian state after a successful reform process.

Global Significance.

On the one hand, the repercussions of their transforming efforts extend far beyond the borders of transition economies, as the assessment of reforms by the international community affects their participation in the international political economy, especially international trade and capital flows. On the other hand, it is important to determine how transition economies managed and planned to conduct themselves to deal with the surmounting number of issues facing the entire international community. There existed a need for participation of transition economies in some kind of “global governance” due to the similarity of problems facing many countries.

Governance does not relate only with government; it relates to the institutions associated with governability and accounts for state capacity and institutional variety in conducting policy reform (Ahrens & Mengeringhaus 2006:77). As a process, “global governance” is a normative assignment of places, values and options. It is based on “control mechanisms” that are meant to steer the world in a certain direction. Through these mechanisms and assignments of values, global governance attempts today to mitigate and regulate the effects of globalization. Transition economies adopted and continue to take on these “control mechanisms” under the assumption that they will stimulate further economic and social development. The adoption of the international norms and guidelines by transition economies lead to new strategies and belief systems, not without resistance, for dealing with specific issues. Chaos, conflict and instability are more likely to be avoided, it was argued, if transition economies were willing to meet the challenges of the day and effectively address the problems that transcend borders by accepting the international norms. However, the ability to produce operative domestic policies under the acceptance of international norms largely depend on if these new policies were able to emulate the institutional foundation of the past. In spite of this, the priorities set were the establishment of property rights and the introduction of minimum laws, both the foundation of laissez-fair capitalism, and in the mean time wait and persevere for the evolutionary development of institutions. However, the failure of corporate and public governance, especially in Russia, demonstrates the need for democratically established legal rules (Nivet 2004:3).

Transition economies, it can be argued, might have a very utopian view for the future of governance in the world. Transition economies advocated for a vision that higher levels of cooperation in areas of common concern can be accomplished by simple adopting and participating in the current global system. While they highlighted the importance of taking diversity into account in decision making procedures, for issues such as domestic security and development, transition economies uncritically believed that these issues can be accomplished within the framework of the current global system.

Meanwhile, the current global system is driven primarily by the institutions of the World Bank and IMF. They seek to protect the advantages in the world market possessed by mature market economies over the developing economies that have become globalized through the use of coercion and persuasion by these international agencies (Haque 2002:108).

The goal of the international financial organisations (IMF and World Bank), mature market economies and the elite of the ‘transition’ economies was the integration of the formerly centrally administered economies in the global political economic structure to provide cheap inputs, new product markets and international financial markets for mature market economies. They contributed to the development of comprador and financial capitalism, while mature and sustainable institutions have largely failed to materialise.

Privatisation was an obsession in transition economies, imposed by international organisations and mature market economies. But simply privatising state property cannot create a market. In such an environment “it is not the state which is privatising the soviet enterprise, but the soviet enterprise which is privatising the state" (Clarke 1992:5). In conditions of general uncertainty, it was impossible to carry out privatisation without weakening economic links and undermining managerial confidence and efficiency; destroying productive forces, increasing unemployment and prolonging the crisis of transition and adjustment. Privatisation has enriched managers with few benefits to the workers or long-term social wealth generation. Transition economies that implemented buyouts and 'give away' privatizations established networks that are more defensive and reinforced the former non-commercial patterns of working that inhibit much crucial learning and thus restructuring (Filatotchev et.al 2003:343). Enterprises dominated by insiders have an unsound system of corporate governance and generally the performance of many enterprises decreased or did not improved after being privatized (D'Orio & Tsenova 2006:66).

The collapse of central administration passed power from the central authority to the managers, who took the opportunity to appropriate the enterprise's assets through spontaneous privatisation—stolen would be a more accurate description—and to transform themselves into a new bourgeoisie. In Russia, due to the sluggish institutional structure the former Russian nomenclature often in collaboration with Mafia-like groups which are rumoured to be composed of former KGB officers, was more successful than in Central Europe in turning public property into private wealth. Eyal, Szelenyi and Townsley (1997:62) characterised post-Stalinist Central Europe as "capitalism without capitalists" while the emerging Russian structure as "capitalists without capitalism".

The transition economies lacked private capitalists with the necessary financial capital to purchase enterprises. Thus ultimately the only legal alternative left was foreign ownership. It was not by coincidence that foreign capital came to the rescue of transition economies. This was an act of purposeful action by the mature market economies and international financial institutions, ensuring that foreign ownership was the only permissible medium of privatisation. The aim of the orthodox approach was a rapid transition to capitalism, disregarding any consideration of the political, social and cultural impacts which were seen as constraints. A process like this implicitly had the goal of initiating the destruction of institutional barriers inhibiting the penetration, influence and power of foreign capital.

The effects of the new ideology in transition economies has been that major policy decisions within countries are no longer based on equality, fairness, representation of public welfare, but instead they are now only acceptable if they can produce efficiency, consumer satisfaction and competition (Haque 2002:112). But markets need pro-market social norms to be effective, and these norms do not appear all of a sudden, especially in societies where markets have been repressed for decades (Nivet 2004:3). In concurrence with this view of the function of global governance which transition economies struggled to be part of Halabi (2002:22) states that "global governance is an attempt by the developed countries to regulate relations among states and bind developing state to global rules". What the transition economies did not realize was that at the end these global rules are much more beneficial to the more developed countries. As both the International Monetary Fund and the World Bank bear responsibility for creating the depression in transition economies through the collapse of domestic markets and Council for Mutual Economic Cooperation (COMECON), the development of the hard budget constraint and the provision of foreign aid on the condition of satisfying specific targets based on the shock therapy. In an environment like this you can be sure that the only interested buyers will come from abroad at a price of "next to nothing" (Gowan 1995:45). There was "a brutal struggle to steal everything they could get their hands on" (Holmstrom and Smith 2000:7).

Equally important was pressure exerted on governments of transition economies to sell state assets and public utilities to multinational companies (the only possible buyers) so they can reduce fiscal deficits, inflation and discipline the labour market by inducing high unemployment. Effectively, multinationals practice "cherry-picking" in the name of global integration and national disintegration (Radice 1993:10). Incentives and legal regulations were often negotiated on a case-by-case basis, making the process appear arbitrary and even corrupt (Smyth 1998:366). As Bucknall (1997:8) put it "it must be great fun at remaking nations, a chance few ever get, and it must be even better when it is personally profitable".

Foreign investment was oriented simply to control the domestic market. After firms were privatised foreign investors shut them down or their production was significantly reduced to allow the importation of foreign goods. By purchasing state monopolies foreign owners created new monopolistic situations. Multinationals viewed transition economies as potential markets for their products, cheap labour and as intellectual reserves. Management sold their firms at advantageous prices to their foreign business connections and at the same time they made sure that in exchange for their services they will retain their position as managers. In this way they could increase their incomes and modernise their firms without risk. By the mid-1990s, Russia's red bourgeoisie had stashed more than 150 billion dollars in foreign bank accounts, investments and properties (Holmstrom & Smith 2000:7). Russia's external debt was $196 billion in 1997 and the annual flight was four times larger than the cost of servicing the debt (Howard & King 1999:30).

Many believe in transition economies that globalized laws are trying to push the world towards a point of convergence in norms, but "here, power is the authority to legitimate certain visions of the social order, to determine relations between persons and groups, and to manipulate cultural understanding and discourses" (Halliday and Osinsky 2006:456). It follows then that transition economies did not have a problem with American led "global governance" model, and in fact would claim that it is necessary in order to maintain some semblance of stability and order in the world. However, Glasman (1994:79) argued that "the Western contribution can be summarised as follows: all we can give you is a model, which has had no success in any developed industrial nation, but whose implementation is the precondition of receiving any hope of recognition as even a subordinate partner in the 'free Europe' you have struggled for so long to join". In summary, the big winners of the market penetration in the capitalist form were the managers, the black marketeers and the multinationals. While the big losers, as with every capitalist development were the people with no economic or political power, the workers and the poor. Those empowered by privatization that is individuals, politicians and bureaucrats, tend to resist reforms improving legal institutions. The law should protect citizens, especially those without property, against property owners, criminals and politicians because they tend to collude and often merge. Protection of shareholders is urgent in transition countries, because enterprises which would typically be owned and controlled often by dispersed and unskilled stockholders (Nivet 2004:11).

However, a uniform corporate governance model will not be appropriate for all economies as suggested by the laissez-fair model, neither for all transitional countries (Pucko 2005:17). A recent perception of corporate governance incorporates the views of other stakeholders also participating in governance and that they should make major strategic decisions together with owners as well as supervise managerial decisions and participate in decisions on profit sharing (Pucko 2005:2). The stakeholders' governance model does not deny the central role of owners' interest in corporate governance. Nevertheless, based on the stakeholders' model the owners' interests should not be the only interests determining the corporate governance process.

Nowadays, the emphasis is on effective governments in formulating, implementing and enforcing reforms. Improvements in the quality of public governance and accountability provided by the state and its bureaucracy which are connected to a successful political transformation facilitate positive changes in transition economies (Frensch 2004:389). However, in many transition economies, states are weak, in Myrdal's (1989) sense, as the state lacks the capacity to implement and enforce policies and to protect property rights. In addition, it is not capable of preventing public officials from corruptive behaviour and influential pressure groups from rent-seeking and distorting economic policies (Ahrens and Mengeringhaus 2006:77). Basic principles such as credibility, predictability and transparency, absent in transition economies, undermine the effectiveness is governance structure and policy-markers cannot gain legitimacy and enhance their credibility (Ahrens & Mengeringhaus 2006:96). But most institutions, including social norms and trust, customs, standards of conduct, beliefs, ethics, are of an informal nature. They usually evolve historically and evolutionary dependent on a variety of factors factors (Nivet 2004:16).

In total, due to the faults of the privatization methods and practices, underdeveloped equity markets, lack of legal institutions guaranteeing the protection of creditors and shareholders' rights and an underdeveloped banking system there is a tendency towards enterprises in transition economies being controlled by insiders (D'Orio & Tsenova 2006:66).

Meanwhile, governance quality is dynamic process because different stages of economic development, varying international environments and changing political conditions may make governance obsolete. There would be a need for new institutional arrangements which are appropriate to the new challenges of reform relying on the coordination of diverse actors in the public as well as the private sector (Ahrens & Mengeringhaus 2006:77,97).

At the end, transition economies followed differentiated national trajectories, influenced by initial conditions, social and political contexts, resulting in path-dependent mixed economies with an uncertain and open future. There is no doubt that the Central and Eastern European (CEE) economies have achieved a stupendous breakthrough in allocative efficiency as a result of market reforms. The introduction of market forces underpinned by administrative, political and legal changes, has allowed these economies to become full-fledged market economies in a relative short period of time, achieving the preconditions for joining the EU. Thus, a degree of variability is noticeable in the transition economies as we have different groupings of these economies: the advance CEE economies already members of the EU and fully integrated in the international political economy, the "towards" South-East European economies potential members of the EU

(Bulgaria and Romania joined the EU in 2007), the lagging countries of the Commonwealth of Independent States mostly under authoritarian rule with GDP levels less than the GDP in 1989 and the Asian economies of China and Vietnam achieving record growth rates under authoritarianism.

Conclusion.

The transition strategies adopted in Central and Eastern Europe, the former Soviet Union and Mongolia resulted in large decreases in output, inflation or even hyperinflation, unemployment, collapse of trade, corruption and crime and the destruction of the state apparatus. In China and post-1989 Vietnam the transition strategies implemented resulted in positive economic growth, low inflation, underemployment, corruption and crime and the maintenance of the authoritarian Communist Party state apparatus. Independent of the pace of transition and the accompanied political structure the common element of the transition process is the large increase in corruption and crime. As there has been a systemic disregard for the necessary institutional structure that complements the workings of the market.

The destruction of the state apparatus in Central and Eastern Europe, the former Soviet Union and Mongolia and the maintenance of the authoritarian Chinese state and post-1989 Vietnam, created an environment in which the supporting the role of the state in the unfolding market process has been handicapped. Polanyi (1944:140) revealed the oxymoron: "the road to the free market was opened and kept open by an enormous increase in continuous, centrally organised, and controlled interventionism". As such, the implementation of the transition strategies in the centrally administered economies of Eastern Europe, the former Soviet Union and Asia resulted in 'maximal dislocation' of the existing institutional fabric of transition economies, which resulted in regressive institutional changes associated with corruption and crime.

As most of the countries of Central and Eastern Europe have joined or are in the process of joining the European Union, many commentators argue that the transition process is over. As research and interest into transition has been diminished, at the same time the republics of the former Soviet Union struggle to grow under corruption and authoritarianism. Russia and most of the republics of the former Soviet Union have barely achieved their 1989 real GDP level and the scars of the transition process are still present in Central and Eastern Europe, taking more time than expected to heal. As the South East European the transition economies struggle to achieve the institutional prerequisites accession for the EU and the CIS to stimulate growth, the differentiated outcomes of the transition process have increased. The transition experience demonstrates that institutions and governance matter, although a best-practice approach that fits all countries does not exist (Ahrens and Mengeringhaus 2006:96).

Internet Sites

Centre for the Study of Transition and Development www.iss.nl/cestrad/index.htm

Transition Newsletter: www.worldbank.org/html/prddr/trans/recent.htm

Transition Online www.tol.cz/

World Bank Research-transition Economies: econ.worldbank.org/topic.php?topic=24

Stockholm Institute of Transition Economies: web.hhs.se/site/

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Tourism

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Introduction and Key Terms

This entry focuses on four main areas, namely key terms, definitions and concepts within tourism (this section), the role of government within tourism, The Role of multinational enterprises in tourism-dependent economies, and sustainable tourism, eco-tourism and environmental issues for tourism. It must be emphasised that tourism is a multi-disciplinary topic encompassing diverse areas such as culture, architecture, psychology, sociology, the environment, moral and ethical issues outside the scope of this entry that focuses primarily upon the role of tourism in the context of political economy and ensuing major issues.

The tourism industry is one of the world's most important economic sectors, currently ranked around third and forecast to rise to number one position in the next decade or so. Whilst there has been debate on the use and meaning of terms such as 'tourism', 'travel', 'leisure', and 'hospitality', the term *travel and tourism* is widely accepted as the all-bracing form describing those businesses that satisfy tourism demand. For simplicity many scholars and those in the industry use the shorter term tourism in preference to that a longer term.

The *tourism industry* is generally a rapidly growing sector, having demonstrated high growth rates since the advent of what is called 'mass tourism' since around the 1960s. However, it is not new: tourism has existed in one form or another for many centuries, probably since the Babylonian and Egyptian Empires, in the 6^{th} Century BC. Business tourism developed with the many traders and explorers throughout the world that were the forerunners of various world empires such as the Greek, Roman, Ottaman, Prussian, Mongolian, Spanish and British Empires.

The importance of reliable transport and political control is shown by the development of travel throughout the Roman Empire, with no foreign borders between England and Syria, a common currency, and seas safe from piracy. Roads first built by the Romans continue to provide important links between the important older cities and places in the UK. The word *holidays* originates from the 'holy days' common in the European Middle Ages, although at that time travel was very restricted for the vast majority of the population.

A *tourist* may be simply defined as a person who visits another place other than his/her normal place of residence for a period of more than 24 hours and less than one year. The reason is of no consequence in terms of the definition. Some definitions state 'one night away' rather than 24 hours away from home. Some research studies and authors give longer, more sophisticated definitions as to what constitutes a tourist, and such definitions are particularly important for Government tourist statisticians and ensuing tourism data. For example, some definitions include the purpose, and specify leisure (recreation, health, sport, holiday, study or religion), or business, family, mission or meeting. Other definitions may introduce a distance element, stating that the tourist must travel at least a minimum distance from home eg 40km from home as used by the Australian Domestic Tourism Monitor. Difficulties may arise with longer stay visitors such as students and retired persons.

Another term used in the literature is that of an *excursionist*, who is classed as a temporary visitor staying less than 24 hours, including a cruise traveller but excluding a traveller in transit. A transit passenger is generally defined as someone who stays for a very short period at an airport or seaport and who does not pass through Customs (passport control), although a few countries may relax this definition and allow travellers some access to the country whilst 'in transit'.

The key terms are presented in Table 1.

Table 1. Defining a Tourist

Tourists (stay longer than 24 hours but less than one year)	**Purpose of visit** Holidays Business Health Study Mission/Meeting/Congress Family (Visiting Friends or Relatives) Religion Sports Others
Excursionists (stay less than 24 hours)	Day Visitors Cruise Passengers
Travellers not included in tourism statistics in most countries	Permanent immigrants Temporary immigrants Diplomats Representation of consulates Members of armed forces Refugees Nomads Border workers Transit passengers

Notes: 1 Crews not included. 2 Inclusion of long-stay students as tourists is debateable.
Source: Pope (2004), adapted from Holloway (1994, p3)/World Tourism Organisation.

The *tourism product* is an important yet complex term used in the industry. Pope (2004) identifies the essential characteristics of a tourism product as:

- it is primarily a service rather than a physical product, although tourists do of course buy souvenirs and make other retail purchases, as well as purchasing food and beverages.
- it is 'experiential' – it cannot be inspected prior to purchase (unlike, say, a TV) and it cannot be stored for later sale (once a room or airline seat is unsold for one time period then its output is lost forever, unlike manufactured products).
- it normally necessitates travel and movement to another place (although an exception may be virtual tours that create an illusion of travel).
- the tourism product is normally dependent upon 'seamless operation', in so far as consistent high quality service is required from a number of usually separately owned enterprises. The overall tourist experience can easily be marred and perceived as poor because of just one unexpected problem or difficulty.
- the tourism product and experience is often dependent upon the facilities and services of both the private and public sectors to a much greater degree than other businesses within the economy.
- satisfaction in consumption of the tourism product involves psychological factors, including memories, 'stories' and reminiscences, to a much greater degree than other services and particularly in comparison with the satisfaction derived from buying physical products.

The tourism product may be distinguished further in terms of whether the tourist is an *independent* traveller or is on a *packaged or organised tour*, known in the industry as an *inclusive tour*. The latter is where transport and accommodation is purchased at an all-inclusive price. The tour operator, or wholesaler, normally buys the transport, accommodation and any other parts of the package eg visits, entertainment, in advance, usually at a lower price because the product is being purchased in bulk. The package is then sold either directly to tourists eg through media advertisements or the internet, or through the more traditional travel agents. Essentially, tour operators exist because they are able to 'add value' to the various parts of the package, and sell at a cheaper price and in a way that is less time-consuming for the consumer, than the consumer would be able to obtain buying each product separately him/herself. Nowadays, leisure tourism is often said to be driven by the four S's, namely sun, sea, sand and sex.

Tourists may be either *international tourists* or *domestic tourists*. The industry and Governments tend to focus upon international tourists as they tend to spend more per head than their domestic counterparts. However, from a global perspective, it must be remembered that domestic tourists account for around 75% of all tourists, and may be considered the 'bread and butter' of the industry. It is the international tourists who provide the 'jam', a fact that the tourism industry worldwide tended to become rather blasé about until the Severe Acute Respiratory Syndrome (SARS) health epidemic brought them a 'wake-up' call in March-June 2003 with dramatic falls in international travellers, particularly within and through the Asia-Pacific region.

One of the main difficulties in analysing travel and tourism from an economic viewpoint is that significant parts of the tourism product may also be consumed by non-tourists ie the local population eg taxis, theme parks, casinos and even short-haul day return air travel. It applies less in poorer tourism-dependent countries where the local population would generally not have the 'spending power' of richer overseas tourists, but the principle still applies. The difficulty of non-tourists consuming the product is less of a problem for long-distance transport carriers ie air, rail, ship, where a day trip is either not possible or unlikely.

The composition of the *tourism industry* is another important yet difficult issue. The background is that historical government statistical classifications never recognised the tourism industry as a separate part of the economy. Rather, tourism was subsumed under, or was a part of, other more traditional industries in the economy such as transport, accommodation, restaurants, and so on. This led to very approximate estimations of the importance of tourism in the overall economy being made for many years, and invariably conflicts between the optimistic, rather high, industry estimates and the lower, more conservative government estimates. In the past few years, in various countries around the world including Australia, this has been overcome by *satellite accounting*, a computerised system that extracts the tourism component from each of the traditional sectors of the economy in order to produce an overall accurate estimate of the tourism within the whole economy.

The core industries that comprise the travel and tourism industry are classified by Pope (2004) as:

- travel agents and wholesalers
- transport carriers
- accommodation
- hospitality
- retail
- man-made attractions and entertainment
- other private sector services
- public sector infrastructure
- public sector services

Other important terms used within travel and tourism are:

- the *generator* or *generating area*, namely the country, region or city from where tourists come from
- the *destination*, the area to which tourists travel to as either their main objective or the first point of their visit
- *stopover*, a place that tourists may stay en-route for a short while
- *in-transit*, an airport or seaport that tourists stop at in order to change flights or ships respectively, but do not normally pass through Customs or passport control in order

to visit the country where they are transiting through.

There are many other technical terms used within the travel and tourism industry by airlines, shipping companies, travel agents and other businesses that are not considered here (refer specialist texts).

To sum up this section, tourists may be simply defined as persons who visit another place other than their normal residence for a period of 24 hours or more. The tourism product is complex and varies from situation to situation, although there are six key characteristics. The tourism industry consists of, and depends upon, a number of industries many of which depend upon the local market as well as upon tourists.

Role of Government

Key roles

The government of any country has a multitude of roles and responsibilities, most of which apply to the whole economy rather than travel and tourism specifically. On the other hand, the nature of tourism means that governments usually play a significant role, perhaps more so than for many other industries. The term *government* essentially means the public sector. It includes the government of the country, government departments and the civil service, and government and public sector agencies. In many countries it includes companies and holding companies owned or controlled by the government, generally using company structures and share-holding arrangements as found in the private sector. Government involvement also includes expenditure, subsidies, tax incentives, regulation and controls, licensing, planning and international treaties and agreements.

From a travel and tourism perspective, Pope (2004) has identified five main roles of government:

- taxation
- expenditure
- as a supplier
- regulation
- safety and security

The security role is emphasised here following the 11 September 2001 terrorist attack upon the USA, and heightened awareness of security issues throughout the world. This category also includes security or protection against health epidemics such as SARS, and situations affecting tourism such as foot and mouth disease (as in the UK in 2001). Earlier literature has made a somewhat different classification eg Bull (1995:212), who includes redistribution as a policy in the sense of tax and welfare, price controls or levies including training. Pope includes these policies, in countries where they exist, under the main headings of taxation or expenditure. Note that both regulation and security involves government expenditure on administration and, particularly for security, other goods and services, but it is clearer to distinguish these separately.

Taxation

The major types of taxation upon tourism are: Goods and Services Tax (GST) [also called Value Added Tax (VAT)] or a Retail Sales Tax; excise taxes (or similar) levied upon goods such as petrol and diesel, alcohol, cigarettes, gambling; company and any other taxes eg social security, payroll, that may be levied upon businesses across all sectors of the economy; specific taxes upon tourists; taxes hidden in the form of user pays charges on goods or services consumed mostly or partly by tourists.

Data from the World Travel and Tourism Council (2003) suggests that a level of tourism taxation within a country of around 16% is about average; rates of 20% or more may be considered high and rates of 10% or less low. Canada, Australia, Singapore, Malaysia and Thailand have relatively low rates of taxation upon tourism, with the UK slightly below the world average.

Expenditure

Most government expenditure on tourism can be categorised into six main areas: infrastructure (new investment and maintenance); tourism development and assistance; tourism marketing; redistribution; training and tertiary education; government as a 'consumer' of tourism products; government as a 'supplier' of tourism products.

Infrastructure expenditure is normally undertaken by the government and its agencies primarily because: of its monopoly or monopolistic nature arising from large economies of scale; it is capital-intensive; it is long term; of its wide benefits; of the economic, social and other benefits accruing to non-users ie external benefits (through economic growth, higher employment, income, wealth, and so on).

Government and Tourism Products

The major sectors of government ownership in tourism vary from country to country and time to time but include or have included:

- airlines and airports
- railways
- long distance coach services and/or terminals
- local public transport eg buses, light railways
- ferry services
- seaports
- hotels (often linked with railways or airlines)
- tourism resorts (particularly in tourism-dependent countries or regions)
- attractions such as national parks, parks, zoos, museums, art galleries

The role of government as a supplier of tourism products depends upon the political views of the government as well as the political, social and cultural history of the country concerned.

Regulation

Governments may impose regulations and controls on both suppliers and consumers within an economy for various reasons in order to achieve 'orderly markets' in line with the government's philosophy and objectives, including: consumer protection; equity and social reasons; political reasons; religious reasons; macro-economic policies eg minimising unemployment, economic development.

The ways in which a government regulates an economy include: (legal) suppliers of a good or service; controls on prices; controls on quantity traded; market conditions and rules. Important areas of regulation affecting travel and tourism within a country may include: opening hours; licensing hours; gambling licensing and controls; smoking and non-smoking regulations; price controls; bonds, particularly for travel agents; licensing eg taxis, tour guides; accommodation classification systems; control of congested airport slots; environmental and labour controls; business and land ownership laws restricting the establishment of foreign-owned businesses.

A governments regulates international tourism through the: issuing of passports for their own citizens (generating country policy); issuing of visas or entry permits for foreign tourists visiting the country (destination country policy).

Safety and Security

The issue of safety and security is a major role for many governments these days. The government and its agencies must protect its own citizens and foreign tourists for which it is responsible against: terrorist acts, both at home and overseas; war, or acts arising from war; life-threatening health epidemics; significant animal and agricultural diseases and ensuing health, economic, social and environmental issues; any other unforeseen situations of a dangerous or untoward nature.

The economic impact of terrorism upon travel and tourism is significant, but generally less so than that of SARS from a world or regional perspective. Nonetheless, particular destinations may suffer severe reductions in tourist arrivals after a terrorist event. Arguably since 11 September 2001, from a policy perspective, many governments throughout the world have moved away from privatisation and sub-contracting policies for certain 'security sensitive' parts of the economy, such as airports or, at least, security services at such places (Pope, 2004).

Role of MNEs

Background

A *Multi-National Enterprise* (MNE) is a business that trades in two or more countries rather than just one (home) country. Generally MNEs are multi-million or multi-billion dollar businesses trading in many countries with large operating and marketing networks. The so-called globalisation of the economic environment since the 1980s has increased the role and significance of MNEs. However, increasing business access and use of the internet and world wide web since around the mid 1990s, and particularly its low entry costs, has meant that small businesses, typically confined to domestic markets, are now able to attract customers from overseas and even participate in overseas markets. Such information technology developments are particularly beneficial to small travel and tourism businesses that now have much improved opportunities to access markets previously out of their reach.

An MNE has its headquarters in its parent or home country and extends its operations into one or more host countries. Many of the leading travel and tourism MNEs throughout the world have their headquarters in the USA, UK, France, Germany, Japan and Hong Kong. All international airlines are by definition MNEs and provide good examples in most countries throughout the world.

Having recognised that an MNE may be of any size, the common perception is that an MNE is a large international conglomerate with powerful vested interests, often equal to or exceeding some small nations. These businesses are the primary focus of this section, although it must be remembered that many of the economic arguments discussed apply to MNEs irrespective of their size.

Overall tourists from generating countries who use MNEs to book their travel, accommodation and/or other services benefit in the following major ways:

- lower prices (arising through economies of scale)
- higher quality of service
- reliable service (standards can be depended upon)
- 'seamless travel', dealing with one company and information source across a range of services
- usually home country, own language representatives and/or employees
- bookings with groups of 'like-minded' tourists

The importance and growth of MNEs in travel and tourism located in various countries, usually major generating countries, throughout the world ultimately reflects consumer satisfaction and preference in dealing with such companies compared with alternatives, such as booking directly with the airline, hotel, local taxi company and so on. Indeed, some hotels in tourism-dependent countries eg Mauritius, do not accept bookings from individuals but refer all enquiries to the main MNE wholesalers or tour companies.

Although MNEs undoubtedly bring many benefits to tourists in generating countries, their presence in the host country offers a range of both benefits and costs to that economy. Whilst these benefits and costs exist in all host countries, their effect is minimal in well established economies such as the UK and Australia where tourism typically accounts for less than 10% of GDP. By contrast, the presence of MNEs can have significant economic and other effects on small tourism-dependent economies. Typically 20% or more of their GDP may be directly dependent upon international tourism (WTTC 2003).

An important socio-economic and developmental issue is thus the role of MNEs in tourism-dependent economies. These are often small island nations typically found in the Atlantic, Pacific and Indian Oceans. Many of the Caribbean countries provide good examples of the tensions and trade-offs that exist between economic development (driven by tourism) and over-dependence upon MNEs. (Note that the tourism literature may take a different perspective to that of economic development issues more generally.)

Benefits to the Host Country

The major economic and other benefits of MNEs to the host country may include:

- extra investment
- extra foreign exchange earnings (international tourism represents an ‘export’ in economic terms)
- extra employment
- additional revenue and profits for local suppliers of goods and services
- technology and skills transfer
- improved marketing of the host country and its facilities in major generating countries
- improved infrastructure, such as airports and roads
- cultural, educational, training and similar opportunities and benefits to some of the local population
- often but not always, *ex gratia* payments or other benefits to local politicians and officials (bribery)

Most of these are self-explanatory, but it is worth commenting on three:

Extra investment means new investment over and above what the host country would otherwise invest out of its own resources. Usually capital is scarce in tourism-dependent economies and their governments generally welcome, not to say actively chase, MNE investment in their country. Indeed, competition for MNE investment in similar countries eg in the Caribbean, is often fierce. MNEs take advantage of this by ‘playing one economy against another’, and attempt to extract the most concessions they can from each competing government (refer later). This extra investment generates primary effects (arising from construction of the facilities and related start-up) and secondary effects (arising from operating the facilities, once opened). In economic terms any tourism investment (ie MNE spending on construction and start-up) and income (ie tourists’ spending) generates additional income and employment within the local economy, known as the indirect or the economy effects, through the multiplier effect.

Technology and skills transfer improves the productivity of the local economy through local businesses copying MNE work practices, known in economic terms as the *demonstration effect*.

Ex gratia payments or other benefits to local politicians and officials (bribery) is a two-edged sword, depending upon one’s viewpoint (refer below). It is undoubtedly a benefit to politicians and officials who receive it, and for that reason has been included here. To the extent that this is spent in the host economy it is an economic benefit to the host economy. More likely than not it may remain in an overseas bank account or be spent overseas in which case the host economy would receive no benefit at all.

Costs to Host Country

The major economic and other costs of MNEs to the host country, or some possible problems, may include:

- leakages from the economy
- lower prices to local suppliers
- unfair competition, especially between MNEs and local businesses
- lower tax revenues
- inappropriate infrastructure development
- loss of government control
- political corruption
- resource grabbing
- enclave development
- environmental pollution and degradation
- adverse cultural effects
- higher rates of crime, drug use, alcoholism, gambling addiction, prostitution and health issues
- power to pull out

Leakages from the economy occur for a number of reasons. A major loss arises from the consumer tastes and preferences of international tourists in so far as they prefer what products that they are familiar with eg American tourists drinking imported Budweiser beer. Further losses arise from MNE profits and any interest payments on loans which would be remitted to the parent company. Senior management staff are invariably from overseas rather than being locals, and are generally paid in line with parent country salary levels rather than at local levels. Most of their salaries are spent in the parent country rather than the local country – and are thus a leakage. In formal economic terms leakages fall into two main categories: payments for imported goods and services; and payments to overseas factors of production.

Lower prices to local suppliers arise from the bargaining power of MNEs. For example British and German tour operators are well known for negotiating extremely low prices with Spanish and Greek hotel and tourism attraction owners (Bull 1995:204).

Unfair competition between MNEs and local businesses arises primarily from the concessions that MNEs are able to obtain from the host government. It is often argued that large businesses have a competitive edge over smaller businesses arising from their bargaining power but this is an additional argument that is not relevant in the context of 'unfair competition' between MNEs and local businesses.

A more serious anti-competitive situation arises where one MNE signs an exclusive contract that restricts competition from other MNEs and also dictates to the host economy the style of development. Examples include Club Med and some United States hotel chains (Bull 1995:203).

Lower tax revenues may occur if it can be argued that MNEs would locate in the country even without any tax concessions because of, for example, the desirability of the destination to tourists from generating-countries. This is problematical and, in most cases, unlikely. Of course if MNEs do not locate in a particular host country and go elsewhere tax revenues would be lower still!

Inappropriate infrastructure development may occur where an MNE, or group of MNEs, lobby the government for facilities (financed from taxation revenue) that may be under-utilised and of little benefit to the majority of the population eg high-quality roads to particular hotels, or where expenditure may be viewed as excessive eg 'luxury' airport terminals or unnecessary from a local viewpoint eg street lighting. Spanish infrastructure expenditure in the1980s provides an example (Bull 1995:204).

Loss of government control essentially means that it is the MNEs that wield political power in the host country rather than the government. This may arise because of *political corruption* that may include bribery in the form of money, business assets or favours to local politicians, officials, businessmen and/or lobby groups. The attitude of many politicians and others is that it is they who, through decision-making and legislation, enable the MNEs to 'get rich' and who are therefore entitled to something in return. The ethical view of this practice in the host country may be completely different to that in the parent country, where, as a general rule, it would be an illegal activity. MNEs often view local bribes as a cost of doing business overseas. Needless to say such *ex gratia* payments are well hidden in the MNEs accounts! The extent to which the local media is critical of, or condones, suspected corruption, together with the degree of political opposition to the government, are important factors influencing outcomes. Overt corruption may lead to some form of social unrest and impede economic growth – the very thing MNEs are supposed to foster and generate!

More specifically, the host government may lose control over specific flows of tourists to its country. This may arise where an MNE with airline and hotel interests maximises yields on its air routes by selling the most profitable market segment with consistent load factors. That market segment may spend less in the host country than other segments, and also have more significant 'home tastes', thereby increasing leakage from the host economy – hence giving rise to a potential conflict of interests between the MNE and host government. Examples include middle class New Yorkers on vacation in the Bahamas and Japanese honeymooners visiting Thai resorts (Bull 1995:203).

Resource grabbing is an economic term referring, in this context, to MNEs obtaining large amounts of land, and possibly other resources, at low or relatively low prices by international comparison. MNEs have easy access to large amounts of capital whereas host countries are capital-scarce. Planning permission is relatively easily given to MNEs because of their political and bargaining power. 'Selling off' large amounts of land may in future years constrain the country's economic development as it would be unavailable for local uses. An example of this is a Japanese golf course development in the Philippines (Tribe 1999:352), where 150 hectares of land was bought for 150 million yen, at a fraction of the cost in Japan. It was estimated that the golf course would yield four times the initial land cost by recruiting just 300 members out of a planned 1,600 eventual total membership. MNEs generally obtain the best locations and sites for resort development because of their ability to pay and outbid any local competitors.

Enclave development occurs where a resort is built exclusively for overseas tourists and excludes the local people (other than as workers). An enclave typically has walls and/or fences, security guards and a security-guarded main entrance. Any beach is effectively private with access only through the resort. An example is the Coral Resort, Cebu, Philippines, which is Japanese owned, which has armed security guards (Tribe 1999:352). A larger example where the term enclave may also be applied is Bintan Resort, Bintan Island, Indonesia. Although there is public access through ferries, particularly from Singapore, the lack of good roads and public transport services to the island's main town, as well as other villages, renders Bintan

Resort isolated and exclusive to overseas tourists (apart from the predominantly Indonesian workers who have employer provided worker accommodation). The relatively high prices are a further deterrent to the local population whose wages are very low.

Environmental pollution and degradation is a contentious issue in tourism-dependent countries. The issue revolves around the concept of sustainability and short-term v long term development. Of course MNEs seek to maintain clean beaches and an unspoilt maritime and land environment for their guests, and the more exclusive MNE hotels adopt eco-tourism principles and policies as far as possible. Against that environmentalists in host countries often accuse MNEs of short term thinking, of making developments on or close to beaches that may be subject to erosion; of developments that may damage irreplaceable coral; of encouraging private yachts and boats to use sensitive marine areas, and so on. Local conservationists are always likely to argue that MNEs can always re-locate in future years if the environment deteriorates badly; local businesses and workers do not have the luxury of that option.

Adverse cultural effects is a term used to indicate that the presence of large numbers of overseas tourists (mainly brought in by MNEs) may lead to deterioration in the culture of the local population across a range of factors. Depending upon the country, these may include the wearing of traditional dress, the maintenance of customs, the type of music and songs that are heard, the type of food and drinks available, and so on. For example, in Antigua, Caribbean, it is argued that tourists only want to hear ‘happy, lively calypsos’ not the more traditional sad calypsos that have their roots in the slave trade on the island.

Higher rates of crime, drug use, alcoholism, gambling addiction, prostitution, and health issues, and other negative social effects, may arise because of large numbers of overseas tourists in the country due to MNE developments. Arguably, many of these social problems occur in particular destinations in larger countries that are dependent on tourism for a significant proportion of their GDP, such as Pattaya, Thailand, rather than in smaller countries, often island states, such as those in the Caribbean and Pacific Ocean. It also depends on the type of tourist attracted to the country; a higher percentage of single men are more likely to lead to heavy drinking, prostitution and other social and health problems than a destination that attracts mainly families. Generally, MNEs, local businessmen and politicians ‘play down’ such social and health issues whereas the opposition and critics of government policies would try to draw attention to these issues.

Power to pull out means that MNEs have no loyalty to a particular country or destination, and may leave that market any time they wish. Their primary responsibility is to their shareholders and the MNE group overall, as well as their customers, and not countries or governments in which they are located. Fortunately examples of a significant number of MNEs exiting a destination are rare, although of course sales of individual properties do occur from time to time as part of normal business opportunities and changing policies. Examples include Japanese tour operators pulling out of Canada in the early 1990s and British hotel chains and tour operators scaling down their operations in Malta primarily because it became much less popular for British tourists (Bull 1995:204).

In economic terms any of the above issues that can realistically be attributed to MNE development should be recognised, costed where possible and set against the overall benefits. Generally those with a vested interest in development neglect to do this, and take advantage of the fact that most of the negative effects of MNE development take a long time to materialise, whereas employment, profits and so on are more immediate and tend to be favourably viewed by the majority of the local population.

Overall, a significant presence of MNEs in a tourism-dependent country, or particular destination(s) within that country, should be viewed objectively with a careful and thorough understanding of all the longer term benefits, costs and risks involved.

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Uneven Development and Regional Economic Performance

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Introduction

Uneven development can be defined as "a systematic process of economic and social development that is uneven in space and time" (Smith 2000:867). Although this definition derives from a Marxist perspective, it encapsulates two key elements of uneven development. Development is uneven in space in the sense that it is a localised process. Since the beginning of civilisation certain regions have acted as springboards of development and as production sites of advanced forms of innovation (Scott & Storper 2003). Systematic agriculture, for instance, was initiated in Mesopotamia, industrial revolution started sporadically in some European regions, while Silicon Valley and Route 128 in the US had a prominent role in the advent of the computer and information age. Furthermore, even though development was subsequently diffused from these hotbeds to other areas, it has been still accompanied by the geographical concentration of key economic activities, military power, and political control in a small number of core regions and the formation of vast peripheries where such features are absent (Storper & Walker 1989). By the same token, development does not evolve smoothly over time, but it is characterised by periods of rapid expansion, turbulence, crisis or stagnation. Historically, several long waves of growth and development have been observed. Similarly, economic growth rates are subject to business cycles and economic fluctuations, which tend to differ greatly from one place to another.

Consequently, development in general, and economic growth in particular, neither appear everywhere simultaneously, nor do they occur at the same speed. Regional economic performances are likely to vary considerably across and within countries during any given period, leading to the emergence of spatial inequality in the distribution of income and wealth.

The causes of uneven development have been a fiercely debated topic in the literature. Various theories have been proposed, sometimes complimentary to each other, in order to explain the emergence and persistence of the deviation in regional economic performances. Although most theories accept that territorial inequalities are linked to the development process and therefore are subject to change over time, there is much controversy regarding the actual factors and mechanisms that fuel uneven development.

The evolution of regional economies at global scale during the last half century does not provide unequivocal support for a single theoretical framework against the others. Territorial disparities remain significant in many countries despite declining tendencies over short or longer periods and their alleviation continues to be a priority for public governance. This is even more so at the present age of globalization. The necessity to raise international competitiveness entails that the available funds for assistance to poorer regions from government budgets are limited. Furthermore, persistent regional inequalities threaten social and economic cohesion, and thus jeopardise the continuation of free trade and factor (capital and labour) mobility reforms.

Theories of Uneven Development and Regional Growth

The literature on the causes of uneven development and the determinants of regional economic performances is too vast to be examined in detail here. This section aims to present briefly the main aspects of some influential concepts and analytical frameworks that have been proposed in order to explain the emergence of spatial inequality.

Geographical and geophysical factors compose the first set of variables that give rise to regional disparities. Topography, climatic variation, environmental differences, and the unequal distribution of natural resources entail that some areas are more suitable than others for habitation, resource-based economic development (agriculture, mining, etc.) and trade. These areas start to develop early and depending on other factors their initial advantages can be further augmented through capital accumulation and investment in infrastructure and industrial activities. Undoubtedly, technological progress and the de-materialisation of the economy have reduced the impact of environmental parameters and natural resources endowment on economic growth. Nonetheless, as Gallup et al (1999) argue even today geographical disadvantages influence considerably regional economic performances. Landlocked regions have fewer chances to benefit from international trade than coastal regions due to higher transportation costs. Similarly, tropical regions have to bear a heavy burden of disease and mortality.

The neoclassical growth theory approaches uneven development as a side effect of economic growth that under certain conditions will disappear eventually. The key assumptions leading to this prediction are that the production function exhibits constant returns to scale - a most useful though not strictly necessary simplification (Solow, 1994) - and that technology improvements are exogenous. Labour productivity gains stemming from capital intensity increases are the main driver of growth. However, constant returns to scale entail that the relationship between the two variables is subject to diminishing returns. As regions accumulate capital labour Productivity gains are gradually reduced, until the economy reaches its steady state when they evaporate completely.

From this viewpoint, growth convergence and divergence are the two sides of the same coin. Diminishing returns ensure that regions that are well below their steady state grow faster than regions nearer to it. If both advanced and lagging regions are converging towards the same steady state then unconditional convergence is likely to occur and regional disparities will be eventually eliminated. In contrast, the emergence of convergence across economies that have different steady states depends on the distance of each economy from its own steady state. If richer regions are close to their own steady state and poor regions are well below it, then the geographical distribution of income per person will become more even. In the opposite case divergence trends will prevail.

Apart from diminishing returns, the neoclassical theory highlights another three convergence mechanisms. The mobility of economic agents (i.e. the IMMIGRATION of workers in areas offering higher wages and the relocation of capital in poorer regions where returns are supposedly better) allows the elimination of regional differences in factor prices in the long run and the establishment of a spatial equilibrium. The transfer of technology has arguably similar effects. By not having to bear the research and development costs, lagging states and regions have a chance, at least theoretically, to benefit more from the efforts of the technological leaders. In practice, the impact of this mechanism is subject to the ability of backward economies to absorb and adapt new technologies to their specific needs, as well as, the costs associated with innovative activity (De la Fuente 2000). Finally, structural change is another cause of convergence. The industrial structure of developing economies is usually dominated by low productivity sectors, such as, agriculture. As these economies expand, capital and labour are shifted from agriculture to higher productivity industries, boosting in this way further aggregate productivity.

The endogenous growth theory departs from the neoclassical models by incorporating technology (stock of ideas) in the aggregate production function. Technical change far from being exogenous is assumed to be driven by the growth process itself, as inventors and companies seek to maximize their profits. The pace of technical progress depends on the number of people that are devoted to research (Romer, 1994). The inclusion of technology in the model has two implications. First, it demonstrates explicitly that invention is the engine of economic growth, and second introduces increasing returns to scale in the model, as ideas are non-rivalrous (Jones 1998). The second point is particularly important, since increasing returns to scale imply that the concentration of production in advanced regions triggers higher growth rates that can be sustainable in the long run.

Increasing returns allow the achievement of economies of scale (the reduction of the production cost per unit as output quantity increases), which favour the concentration of production in larger plants that by definition are located in fewer places. Local network externalities, usually termed as external economies, have similar spatial effects, although they derive from different sources, such as, the sharing of common infrastructures or the procurement of intermediate inputs from neighbouring firms. Moreover, Marshallian agglomeration economies offer additional advantages for the clustering of economic activity. Large labour markets are created that benefit both enterprises and workers, as the associated costs of finding new personnel or employment are lowered. Similarly, firms enjoy a greater variety of specialised inputs and services, while geographic proximity enables the rapid spread of innovations (Krugman 1991).

Agglomeration, external and scale economies set off cumulative causation processes that lead to the establishment of spatial disequilibria. Economic growth accelerates in areas enjoying initial advantages over other regions, as output expansion is accompanied by productivity gains. Regional inequalities become sharper and the position of lagging regions may deteriorate further, if backwash effects drain them from their skilled labour and capital to the benefit of advanced regions. Although the subsequent spread of growth to peripheral areas cannot be ruled out, in the short-run cumulative causation produces uneven geographies of economic development.

The realisation of economies is not the only possible effect of spatial concentration. Diseconomies can also arise, especially when the relationship between economic growth and the environment is not harmonious. The heavy concentration of industries in a single location may cause environmental degradation, which hinders future growth. In addition, traffic congestion, land use clashes, and higher real estate prices are just a few of the negative consequences of excessive spatial clustering.

The new economic geography models endeavour to shed more light on uneven development, by investigating in a formal way the interactions among the above mechanisms. Territorial concentration and dispersion are approached as outcomes of the struggle between centripetal and centrifugal forces. The first category includes agglomeration, external and scale economies that promote spatial clustering, while the second category consists of forces, such as, immobile factors, land rents and pure external diseconomies that induce spatial dispersion

(Krugman 1995, 1999). The novelty of these models rests on their assertion that the territorial impact of each set of forces is mediated by transport costs and geographic variance. By doing so, they avoid circular arguments (e.g. urban agglomerations arise simply because of agglomeration economies) and highlight the importance of location.

Export base and competitiveness models focus on the implications of interregional trade for territorial performances. The trade of goods and services sets in motion cumulative causation processes. The additional income and jobs that are created in the exporting industries induce demand for locally consumed products and services. The traded sector requires greater quantities of intermediate inputs, while the workers of the sector have more income to spend. The operation of regional multipliers enhances further these induced effects (Armstrong and Taylor 2000). Furthermore, the formation of exporting clusters leads to the emergence of agglomeration economies that raise the competitiveness of export orientated regions (Porter, 1996). The building of competitive advantages is considered to be crucial for regional economic performance, given that globalization gradually erodes the mechanisms (currency adjustment, etc.) that permit interregional trade on the basis of comparative advantages (Camagni 2002).

Social capital theory emphasises the role of networks of civic engagement in the development process (Putnam 1993). Strong civic groups, church organisations, sport clubs, labour unions and business organisations can boost regional economic performance, if they promote the building of relationships of trust and norms of reciprocity among enterprises, encouraging in this way cooperation. However, economic growth may be hampered, if these groups adopt a rent-seeking behaviour (Rupasingha et al 2002).

Last but not least, the Marxists approach uneven development as an intrinsic aspect of capitalism. The production of surplus value that fuels capitalist expansion necessitates the accumulation of capital in specific places. However, by concentrating in these locations capital also creates conditions (high wages and land rents, formation of labour unions, etc.) that inhibit future growth. In contrast, underdevelopment offers the opposite conditions that are more conducive to growth. Thus, capital tends to move back and forth from advanced to lagging areas, exploiting and producing at the same time global and regional division of labor (Smith 1990).

Regional Economic Performances

The evolution of regional economies at global scale during the past five decades does not provide unequivocal support in favour of a single theoretical framework. A brief review of the literature suggests that in many developed (the EUROPEAN UNION, the US, etc.) and developing (Brazil, Mexico, etc.) economies territorial inequalities followed a downward trend until the mid-1970s or early 1980s, in accordance to the predictions of the neoclassical theory. Nevertheless, since then the convergence processes appear to have been weakened. The elimination of trade barriers and the hypermobility of capital and labour are thought to have reinforced cumulative causation and endogenous growth processes, leading to the higher concentration of economic activity in some advanced regions. In this light, endogenous growth theory, export competitiveness and new economic geography models provide some valuable insights on these evolutions.

Elsewhere (Japan and Korea) the largest part of national economic growth has occurred within the boundaries of a few urban agglomerations. Geographical and geophysical factors, as well as industry policies of promoting export based growth have allegedly been responsible for this outcome. The experience of ex-socialist and currently transitional and emerging economies, such as, the former USSR or China, reveals that uneven development is not endemic solely to capitalism, but also to economic systems that strive to achieve a more equitable distribution of the wealth.

Although a single theory cannot account fully for the spatial and temporal variation in regional economic performances, the parallel utilisation of several frameworks is helpful in comprehending the forces that shape territorial inequality. The discussion of the empirical literature will emphasise further this point. The studies presented below approach uneven development, either as geographically unbalanced distribution of economic activity, or in terms of spatial inequality in human welfare. Despite the availability of several welfare, standard of living and quality of life measures, the vast majority of studies utilise GDP or income per capita indicators.

Developed Economies

The US offers perhaps the most prominent example of strong and enduring convergence trends in regional income per capita. The gap between the poorer southern states and their richer northern and western counterparts has been narrowing since 1880 (Barro & Sala-i-Martin 1991), albeit at different speeds. According to Carlino and Mills (1996) and Ray and Montouri (1999) the rate of convergence was higher during the period 1929-1945 than between the years 1946-1994. Nonetheless, the improvement in the position of the poorer states does not imply the eradication of spatial inequalities. The convergence speed has been reported to be around 2% for the overall period, thus the reduction in the dispersion of regional incomes has been rather slow. Similarly, convergence is conditional on structural factors that determine the level of the steady state of each regional economy (Barro and Sala-i-Martin, 1991). There is evidence that since the mid-1970s income polarisation has been increasing, as spatial economic restructuring and sectoral shifts have brought convergence to an end (Amos 1988; Fan & Casett 1994). Ray and Montouri (1999) argue further that although states are converging in relative incomes this does not happen independently. State economies tend to display movements similar to those of their neighbours. Moreover, Bhatta and Lobo (2000) demonstrate that human capital differences are an important source of interregional inequality. Human capital variation explains at least 49% of the observed difference in gross state product per capita between New York, the representative rich state, and each of the poorest states.

At lower spatial scales inequalities are by far greater. Porter (2003) reports that in 2000 average wages across the US Economic Areas were ranging between 19,228 dollars in North Plate NE-CO and 52,213 dollars in San Francisco-Oakland-San Jose CA. Export competitiveness is not unrelated to this huge variation, as local wages tend to be determined by the average wage achieved in a region’s traded industries. In the same vein, Rupasingha et al (2002) report that despite the strong convergence no less than 532 counties are listed by the US Department of Agriculture as persistently poor. Ethnic diversity and higher levels of social capital are argued to have positive effects on regional economic growth rates. In contrast, greater income inequality within a county is found to be harmful to growth.

Although substantial, regional inequalities in the US are rather moderate in comparison to the European Union. National borders have imposed restrictions not only to trade but also to the mobility of labour and capital, resulting in lower levels of social and economic cohesion across the continent. Consequently, until fairly recently there was limited scope for the neoclassic mechanisms of convergence to operate towards the reduction of territorial disparities. The North/South divide remains significant with the northern member states enjoying higher levels of income per capita and attracting all the key economic sectors. The acceleration of the process of European integration since 1992 has increased the accessibility of peripheral regions to core markets. However, there are also fears that endogenous growth and cumulative causation processes may actually aggravate disparities before the effects of the neoclassic mechanisms materialise. Several 'natural' barriers to trade, such as transportation and cultural differences, have survived, while new economic geography models suggest that economies of scale and moderate trade barriers favour the concentration of production in core locations that offer optimum, not just improved, market access (Krugman & Venables 1990; 1996).

Empirical studies at regional level (for an extensive review see Armstrong, 2002) demonstrate that the European Union's experience since the 1950s has been similar to that of other developed economies. Barro and Sala-i-Martin (1991) and Sala-i-Martin (1996) report strong convergence in per capita incomes for the period 1950-1990, at a rate (just below 2%) that is close to that of the US, Japan and Canada. While other authors agree in principle with these findings, their results reveal slower convergence speeds since the 1970s (Armstrong 1995), stagnation or divergence signs after the 1980s and the existence of North/South differences in the trends (Neven and Gouyette, 1995). Martin (1998) argues that not only the implied convergence rate between the years 1978 and 1992 has been lower (1.3%), but also that regional inequalities within countries have not diminished. Le Gallo and Ertur (2003) provide additional support to the last point by detecting spatial clusters of high and low per capita GDP throughout the period 1980-1995. The formation of such clusters underlines the persistence of spatial disparities.

Canada is a country that until the early 1950s was characterised by the presence of significant territorial inequalities. Nevertheless, since then strong convergence trends have prevailed at a speed of approximately 5% a year. Favourable changes in terms of trade, government transfers and taxation policy are thought to have played an important role in the reduction of territorial disparity (Coulombe and Lee 1995). Coulombe (2000) argues that since the mid-1980s most Canadian provinces are in the neighbourhood of their respective steady states which are mainly determined by relative levels of urbanisation. As a result, more urbanised regions tend to be wealthier, although long-run regional inequalities remain modest as the standard deviation of the provincial income per capita is around 10%. The higher concentration of human capital in more urbanised provinces enhances further the performance of these provinces (Coulombe 2003).

Landscape and demographic pressures are important sources of uneven development in Japan. Remoteness is difficult to be overcome in a country consisting of around 7000 islands that extend across a 3000 kilometre long arc. In addition, mountains, volcanic zones and uplands account for more than two thirds of the total area. The small habitable area and the large size of the population (127 million people in 2001) have given rise to high concentrations of human activity in three metropolitan regions (Tokyo, Osaka and Nagoya). In the early 1990s these three areas combined were accounting for 43% of the national population, 47% of total employment, 50% of the service sector employment and 55% of the national GDP (OECD 1996). Despite the presence of huge urban agglomerations regional disparities in income per capita are less severe than elsewhere. In 2001 the income per capita of the richest prefecture (Tokyo) was twice that of Okinawa, the poorest prefecture (Statistical Research and Training Institute 2005). Similarly, regional per capita incomes have been converging since 1955 (Sala-i-Martin 1996). However, the concentration of population and economic activities in a few cities and the parallel depopulation of rural communities (particularly in northern Honshu and Hokaido) pose significant regional problems (OECD, 1996). Urban economies suffer from extensive external diseconomies, while the provision of public services in rural communities becomes more expensive as population declines.

In accordance to Williamson's (1965) thesis about the relationship between industrialisation and territorial inequality, regional disparities in Korea increased considerably during the period of rapid national economic expansion (early 1970s to mid-1980s), only to start to diminish when income per capita levels converged to those of developed economies. The territorial variation in economic performances is linked to regional development policy, which during this period actively promoted the formation of industrial complexes—specialised in steel, petrochemicals, fertilisers and machinery products—along the southeast coast, in an attempt to minimise distribution and procurement costs. At the same time, a huge concentration of population and economic activities took place in the capital region and the surrounding provinces causing serious congestion problems (Kim & Kim 2003). During the 1980s regional policy aimed at balancing growth and improving living conditions. Despite these efforts the hydrocephalic growth of the capital region continued until the 1990s. In 1995 the capital region was accounting for more than 45% of national population and 50% of manufacturing employment (Kim & Kim 2003). After a brief period of dramatic decline in the mid-1980s, regional inequalities remained stable over the period 1987-1997 (Kim et al, 2003).

Developing economies

Apart from being staggering regional disparities have been enduring in developing economies. In Brazil the per capita income of the richest state is around seven times higher than that of the poorest. During the 1970s and 1980s territorial disparities diminished, but since then they have been stable (Azzoni 2001). After examining the evolution of regional income inequality between the years 1939 and 1998 Mossi et al (2003) argue that a low income cluster has been formed in the northeast part of Brazil, while in the southeast a high income cluster has emerged. Thus, like in the US, states with relatively rich neighbours have more chances of becoming prosperous.

In neighbouring Colombia regional incomes per capita converged at an annual rate close to 4% during the period 1950-1989, resulting in a spectacular decrease of disparities (Cárdenas & Pónton 1995). The ratio in the income per head between the richest and the poorest department declined from 10 in 1950 to 3.1 in 1989. The discovery and exploitation of natural resources played a significant role in boosting incomes in the lagging departments, while improvements in education had a positive impact to growth everywhere. Nonetheless, regional economic growth has been unstable, as frequent changes in the structural parameters cause deviations from the growth path.

Similarly, in Mexico the GDP per head of the wealthiest state (Distrito Federal) was around six times higher than that of the poorest (Chiapas) in 1999. Between the years 1970 and 1985 neoclassical mechanisms induced a convergence process across states. Although the relative position of the poorer southern and central states in the GDP per capita rankings did not improve, they grew faster than their richest counterparts (Chiquiar 2005). These trends reversed after 1985. The exposure of the national economy to international trade, through the accession to the General Agreement on Tariffs and Trade (GATT) and the subsequent integration to the North American Free Trade Agreement (NAFTA) area in 1994, are considered to be the main causes of divergence (Sánchez-Reaza & Rodriguez-Pose 2002). These events put in motion endogenous growth processes that favoured the faster growth of the richest parts of the country and the states close to the US borders. Higher levels of human and industrial capital, as well as, better communication and transport infrastructures entailed that border states had more opportunities to benefit from international trade and integration with the US and Canada (Chiquiar 2005).

Transitional and Emerging Economies

The recent experiences of post-socialist economies indicate that the transition from a centrally planned to a market economy is associated with an upsurge in regional disparities. Nonetheless, in the case of the former USSR the territorial divergence in economic performances started long before the collapse of the communist regime. As Westlund (1998) notes regional inequalities followed a declining trend up to 1960. However, the variation in national income per head among 15 republics increased steadily during the period 1960-1975, while in the 1980s the pace of divergence accelerated. Westlund (1998) attributes the early fall of regional inequalities to the extremely unbalanced industrialisation strategy of the Stalin era, which was based on an extensive exploitation of raw materials that favoured the dispersion of production. Once the economy entered into a balanced phase, growth concentrated in the developed parts of the country (Russia, the Baltic Republics, Belarus and Ukraine). The implementation of a centralised planning system and the intense efforts to create a more equitable distribution of the wealth were not sufficient to prevent the exacerbation of territorial disparities.

In China regional inequalities have deteriorated significantly since 1990. Income per capita growth has been fast in coastal provinces and urban areas, while western provinces and rural areas are staying behind. Development strategies favouring urban and coastal regions and the selective open door policy implemented after 1978 are often cited as the main causes of this territorial imbalance (Lu and Wang 2002). Démurger et al (2002) stress the role of geography and history in this outcome. Coastal provinces provide better access to international and domestic markets. Furthermore, historically the availability of infrastructure and pools of management and technical expertise has been higher in these provinces, while the linkages among enterprises have been denser. The metropolitan areas of Beijing, Tianjin and Shanghai and coastal provinces have been the main poles of economic growth even before the founding of the new China in 1949. The attempts of the communist regime in the 1950s and 1960s to reduce regional inequalities by shifting resources to landlocked provinces were futile. Despite allocating 56% to 71% of state investment to the interior provinces over the period 1953-1970 and relocating many companies there, the long-run performance of these provinces was not improved. The absence of basic infrastructure and the limited access to suppliers and customers meant that around one third of the investment for the construction of factories was wasted (Démurger et al 2002). The discriminatory policy against the coastal provinces was abandoned in the 1970s to avoid the further undermining of the national economy. Foreign direct investment has boosted growth in urban and coastal areas after 1978. Foreign manufacturers are pulled there due to agglomeration economies and easy access to markets, while investment incentives and moderate labour costs also influence their decisions (He 2003).

Public Governance

The persistence of territorial disparities raises important urban and regional policy issues. Since the end of World War II the alleviation of regional inequalities in human welfare has been a priority for all levels of public governance, as it serves two key purposes. First, it facilitates the function of the welfare state by improving the standard of living of less affluent citizens residing in deprived areas. Second, it enhances social and economic cohesion across territories, generating in this way benefits for both prosperous and lagging areas.

The advent of the latest era of globalization that coincides with the reversal of regional convergence trends across the world offers additional reasons for intensifying efforts to reduce territorial inequality. Key aspects of globalization, such as free trade agreements, are the outcome of lengthy intergovernmental deliberations among fears that the treaties may affect negatively the more vulnerable segments of the society. Such fears have already triggered considerable social upheaval in some countries. In this light, the widening of the gap between prosperous and poor regions has the potential to undermine the viability of international trade and factor mobility reforms and destabilise supranational governance structures that promote global economic integration.

Nonetheless, under the present circumstances the task of assisting lagging regions to catch up is difficult. The increased mobility of enterprises and human capital entails that low taxation policies have become indispensable in retaining competitive businesses and attracting foreign direct investment. Lower revenues compel national governments to reduce budget deficits and rationalise government spending. Thus, the available funds for regional assistance are also limited. Furthermore, the abolition of trade barriers has been accompanied by international agreements on competition policy rules that seek to end protectionism. In this context, the state aid for industrial and regional policy purposes is monitored by supranational governance structures and on several occasions is restricted (e.g. direct subsidies to enterprises). Similarly, the necessity to enhance the international competitiveness of the national economy implies that public investments are increasingly directed to developed areas, where they can be more efficient.

Supranational organisations encounter different problems when engaged on regional policy initiatives. The European Union’s regional policy, for instance, has to meet several objectives that are designed in a way that allows most member states to receive benefits from the regional policy budget (Beek & Neal 2004). Consequently, the effectiveness of the regional policy is reduced as the large number of eligible areas for assistance leads to the fragmentation of the limited resources to smaller projects. The recent enlargement of the European Union to the east has brought the system to its limits, since most of the new member states need desperately the regional assistance funds, the present recipients are reluctant to see the resources allocated to them diminishing and the net contributors are unenthusiastic about increasing their contributions to the European Union’s budget. Hence, direct measures, such as the targeting of the assistance at fewer, smaller sub-regions that need it most (Armstrong 1996), are difficult to be implemented, since they involve sacrifices for some member states. A mixed solution, involving the allocation of some limited funds to accession countries and the tolerance during the first years of their membership of practices that do not comply with the competition policy, is claimed to be more feasible (Beek & Neal 2004).

Finally, the devolution of economic development policy responsibilities to local, state or provincial governance bodies does not appear so far to have a positive impact on the elimination of spatial disparities. Rodríguez-Pose and Gill (2004) argue that this happens because decentralisation initiatives entail fiscal, political and administrative costs, which are burdensome for poorer regions with limited adjustment capabilities. Moreover, Cheshire and Gordon (1998) note that the formation of local economic policies in competition with other territories can be wasteful or generate benefits only for the initiating region.

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United Nations

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Introduction

The United Nations (U.N.) officially came into existence with the ratification of the U.N. Charter on 24 October 1945. Its founding vision was to help secure peace, prosperity, and respect for individual rights through international cooperation in the postwar world. The U.N.'s core ideas and structures evolved from the ideas and lessons learned from the League of Nations, established by Woodrow Wilson and others following WWI. The League's failure highlighted the needs to entice all major powers to become members of international institutions and to give those institutions some means of enforcement. At the same time, U.N. founders did not wish the U.N. to become either simply a tool of the great powers, or an all-powerful world government that disregarded the interests and sovereignty of its member states. Thus, on the two key issues of dividing control between great powers and other states and of giving the U.N. enforcement authority, U.N. structures were compromises to a narrow middle ground right from the start.

Over time, the U.N. has faced criticism from those on both sides of these two issues. Some observers feel U.N. structures must become more egalitarian if they are to be respected worldwide; meanwhile, superpowers occasionally feel constrained by the current system. Secondly, some feel the U.N. has become too large and overstepped its authority, while others lament the U.N.'s ineffectiveness and inactivity in addressing global issues. Although the U.N. has not achieved the lofty goals of its founders, supporters argue that it has achieved important policy goals and can be bettered through minor structural modifications. Critics, however, maintain that it has produced few achievements relative to its costs and should either be abandoned or greatly modified to better reflect international political realities.

Structures of the UN

There are four major structural components of the U.N.: the General Assembly, the Security Council, the Secretary General, and the bureaucracy consisting of the Economic and Social Council (ECOSOC) and the Secretariat (Coyle 1969; Weiss 1994). The General Assembly consists of all member countries. Each country has one vote regardless of size, population, or global power. The General Assembly originally had 51 members, with the vast majority coming from Europe or the Americas. Over time, the General Assembly grew to over 190 members with the end of colonization in Africa and Asia, and later shifts in Eastern Europe. Voting power shifted significantly to the developing countries. The General Assembly can discuss any issue within the scope of the Charter. In reality, most crucial issues of security and economics are handled by the Security Council and General Assembly Resolutions are often ignored by member states. The General Assembly, though, remains an important forum for international debate.

The Security Council has primary responsibility for maintaining international peace. Therefore, it is usually considered significantly more important than the General Assembly. It currently has 15 seats. Five of the seats are held permanently by the major powers of the 1940s: the United States, the Soviet Union (now Russia), England, France, and China. The remaining ten seats rotate in two year terms among the remaining U.N. members. The rotating seats are allocated by region to ensure that all regions will have a voice in key disputes. In Security Council votes, the permanent members have veto power: if even one of them rejects a resolution, it is defeated. If the permanent five agree or abstain, the resolution needs a total of nine votes to pass. In practice, if the five agree, it is unlikely that they will not have sufficient allied support to pass the resolution, so the permanent five determine most votes. This system was established to encourage the major world powers to join the U.N. by ensuring them the greatest voice and the ability to veto resolutions unfavorable to them or their allies.

The Secretary General is the U.N.'s chief administrative officer. He is appointed by the General Assembly, with recommendation of the Security Council, and traditionally has come from a small European or developing country. The Secretary General oversees the U.N. administration, can help shape the organization's agenda, and can be an important diplomatic figure worldwide. Recent Secretary Generals have drawn much attention—Boutros Boutros-Ghali for his efforts to expand U.N. programs in the early-1990s and Kofi Annan for efforts to reform the U.N. and diplomatic efforts that led to his winning the 2001 Nobel Peace Prize.

The Secretary General oversees both ECOSOC and the Secretariat, which run a wide variety of economic and social programs. As with any government, the bureaucrats have some autonomy and are key in information gathering and policy implementation. The U.N. maintains programs from science cooperation to refugees, from health concerns to development projects. Over time, U.N. agencies have grown in size and range of programs and at the turn of the 21st century employed about 70,000 people globally.

Early Problems and Policy Challenges

The U.N. was designed to encourage international cooperation and peace and many of its founders were convinced that they were ushering in a new era in international politics; however, even at its founding, Cold War era tensions between the United States and the Soviet Union were mounting. Conflicts between the superpowers and their allies had three major impacts on the U.N. over its first forty-five years. First, with each superpower wielding veto power in the Security Council, quick and forceful actions were rare. During the Cold War, the Security Council typically passed less than a dozen resolutions per year and there were 193 substantive vetoes (Malone 2003). Bold actions were the exception and often the result of an unusual situation. For example, U.N. action in the Korean War was made possible by the Soviets missing the Korean vote while they protested the exclusion of Communist China from the Security Council. Second, broader Cold War tensions destroyed the principle of "collective security," which holds that "all nations have an equal interest in opposing specific acts of aggression and are willing to incur identical risks in opposing them" (Eban 1995). Since the U.N. has no army, collective security is central to enforcing U.N. resolutions. The subversion of this principle during the Cold War made the U.N. a paper tiger in the eyes of many. Third, the Cold War somewhat shifted the attention of world powers and the U.N. toward security issues and away from economic and social development.

The U.N.'s division along East-West lines was then further complicated by a division along North-South lines after the end of colonialism. States in Africa and Asia quickly joined the U.N. after independence, since membership conferred a degree of legitimacy to the new states. The balance of power within the General Assembly shifted and it became a forum for the grievances of the newly independent states. Much time was spent discussing perceived inequalities in the existing global economic system and condemning controversial states such as Israel and South Africa. The United States and its allies began to lose General Assembly votes to a coalition of developing countries and communist states (Hovet, 1977). The western powers tried to downplay the importance of General Assembly actions, but this only reinforced the views of some that the powers needed to be challenged.

The early U.N. also sought to find the delicate balance between international institutional power and state sovereignty. Article 2 (VII) of the Charter states, “Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state.” Chapter VII of the Charter, though, authorizes action “to maintain or restore international peace and security” whenever there is a “threat to the peace, breach of the peace, or act of aggression.” A strict division between domestic issues and international breaches of the peace has proven problematic in reality. Also, concepts of sovereignty have modified over time to allow greater focus on individual human rights and transnational issues like environmental protection.

Early Successes

With the U.N. split along both East-West and North-South lines and constrained by state sovereignty, most observers noted, and in some cases lamented, the inactivity of the early U.N. (Stevenson 1961; Meisler 1995). U.N. supporters, though, argue that the U.N. did succeed in a number of areas (do Amaral, 1995). Through its regular meetings and periodic conferences on particular issues, the U.N. provided a global forum for discussion. Countries did not always achieve their desired ends, but at least their voices were heard. Also, the U.N. provided a less formal site for enemies and friends to engage in regular discussions and come to understandings without the intense scrutiny of summit meetings and state visits.

The U.N. was not given legislative power, but did play a role in establishing international law. Particularly in the area of human rights, the U.N. established international standards for action with the Universal Declaration of Human Rights and subsequent Conventions. Since the time of Wilson, a key hope has been that, by establishing international law, international institutions can tame the worst aspects of a Hobbesian international state of nature and make international politics more closely resemble domestic politics.

The U.N. did not succeed in bringing world peace and played little role in ending the Cold War, but it did play a more significant role in ending regional disputes. U.N. officials often led negotiations and U.N. peacekeeping troops sought to maintain key peace agreements in the Middle East, Cyprus, and several states in Africa. U.N. agencies also aided countries in rebuilding after conflicts. Furthermore, the U.N. sought to alleviate the social and economic conditions that led to poverty and conflict.

Rebirth in the 1990s

The Cold War proved a major stumbling block for the U.N. The Cold War’s end, along with concurrent changes, led to a reinvigoration of the U.N. and a return of much of the optimism of its founders. With Russia and the United States no longer competing and dueling with Security Council vetoes, the U.N. became more active. In the 1990s, only a dozen resolutions were vetoed, while there was a manifold increase in the number passed per year compared to the Cold War period (Murthy, 1995). The Cold War’s end also had an important impact on U.S. perceptions of world leadership. After decades of bearing much of the cost of fighting communism in high defense spending, global military commitments and lives lost, the United States was hoping for a peace dividend. Talk thus shifted to ideas of "burden sharing" and "assertive multilateralism." The U.N. appeared to be the ideal institution for a world shaped by U.S. influence but sharing costs.

The end of the Cold War also reinforced an existing shift in the world's agenda away from global security issues towards resolving regional and civil wars, limiting the proliferation of weapons, pursuing individual human rights, and responding to transnational issues such as environmental damage. For each of these four issue types, the U.N. was seen as a useful institution and therefore became more active during the 1990s. To address regional and civil wars, U.N. negotiators became more active in Latin America, Africa and elsewhere. U.N. peacekeeping missions were greatly expanded. By 1992, there were U.N. troops in 25 countries. The U.N. also became bolder in its actions-- it shifted away from traditional peace-keeping, done after a settlement has been reached, to peace-making and nation-building. For example, U.S. and U.N. troops entered Somalia in 1992 to quell a civil war that was disrupting food distribution, and then stayed in an attempt to build new social, economic and political institutions. The U.N. also attempted to limit the potential damage of future regional wars by addressing proliferation. Security Council resolutions authorized the Persian Gulf War and demanded that Iraq end its pursuit of weapons of mass destruction and allow extensive U.N. weapons inspections. The U.N. also promoted extension of the Nuclear Non-Proliferation Treaty (NPT) and creation of new treaties on chemical weapons.

Although the U.N. is an association of sovereign states, it has always taken an interest in individual human rights. In the 1990s, that interest was illustrated by the adoption of several new conventions on particular human rights issues, the creation of a U.N. High Commissioner for Human Rights, efforts to look critically beyond traditional targets like Israel and South Africa, and creation of International Tribunals for the former Yugoslavia and Rwanda. Sovereignty was not abandoned, but was no longer seen as a barrier to all action. Similarly, the U.N. became a forum for addressing transnational issues, even if that meant challenging the policies of particular members. An instructive example of this was the 1992 Earth Summit and subsequent Kyoto Protocol on global warming.

In addition to the impact of Cold War's end, the new agenda and actions reflected new leadership at the U.N. In 1992, Egyptian diplomat Boutros Boutros-Ghali became Secretary General. His widely read and discussed work, *An Agenda for Peace*, laid out a bold vision for the U.N.'s role in the post-Cold War world. He suggested, "The time of absolute and exclusive sovereignty. . . has passed" and "It is the task of leaders of states to understand this" (Boutros-Ghali 1992:10). Thus, he argued for expanding the U.N.'s programs for economic and social development and for creating a standing U.N. military force that would still be subject to Security Council control, but would give the U.N. the ability to intervene rapidly and forcefully. To pay for the new programs, he advocated increased funding. He also argued for reforms such as an expansion in Security Council seats and autonomy for the Secretary General. Boutros-Ghali was seen as the embodiment of the new activist U.N. He became a lightning rod that drew both praise and condemnation, depending on observers' views on the proper role of the U.N.

Critics' Responses to U.N. Growth

Given its rapid expansion of programs, the U.N. budget and staff size soared in the early-

1990s. Supporters of the U.N. argued that it was still remarkably small and cheap considering it was providing services for a global population (Holtje 1995), but critics charged that the budget, and thus the burden on the world's taxpayers, was rising out of control. These critics also charged that the budget and staff increases were being driven by the U.N.'s overexpansion into areas previously reserved for states and an attempt to transform itself into a true world government.

One of the most vocal critics of the U.N. during this period was U.S. Senator Jesse Helms (R–N.C.), who was Chair of the Senate Foreign Relations Committee. Helms argued that the U.N. staff of over 50,000 showed an overgrown bureaucracy that expanded to meet new challenges without ever reducing ineffective or outdated programs (Helms, 1996). He noted that the United States was contributing over $3.5 billion annually to the U.N. system at a time of U.S. budget deficits and higher taxes. Most crucially, he argued the U.N. had expanded "from an institution of sovereign nations into a quasi-sovereign entity in itself" without approval of the member states. This criticism showed that the conflict between state sovereignty and an empowered global institution, which dated from the League of Nations debates, had only been reinforced by the 1990s activism.

Helms and others called for replacing Boutros-Ghali with a less activist Secretary General, radically reducing U.N. staff size, overhauling peace-keeping to return it to its roots of post-conflict missions, generally scaling back U.N. authority, and reducing U.S. payments. These demands were built into U.S. legislation that authorized future U.S. contributions only after U.N. reform occurred. The United States began withholding, or delaying, its annual assessments. These tactics were resented by many U.N. officials, but also by other countries that felt great powers should not attempt to dominate or strong-arm an international institution. Ultimately, Helms was pleased by reductions in U.N. programs and by Boutros-Ghali's failure to win a second term.

Possible Budget Reforms

More friendly critics of the U.N. disagreed with Helms' solution of cutting programs, but did acknowledge that there was a growing problem of U.N. goals and programs exceeding U.N. financial resources. Focus in this camp thus turned to ways to generate new funds. The easiest solution would have been to increase the dues of member countries, but, with key countries such as the United States and Russia behind in their payments and seeking reductions in future dues, this option was closed off. The range of other financial plans proposed was quite wide (See Diehi, 2000), but the ones that appear most politically viable are incremental changes in the system or an international tax.

Incremental changes suggested include: late payment charges (Ford Foundation 1993; D'Orville & Najmam 1995), dividing payments into quarterly installments (Ford Foundation 1993; Childers 1995), modifying or more aggressively enforcing Article 19 of the Charter that states that members two years behind in their dues lose their General Assembly seat (D'Orville & Najmam 1995), or changing the assessments schedule so that less burden falls on the major economic powers (Commission of Global Governance 1995). Each of these changes could increase funds, but it is not clear whether they could generate enough revenue to be significant and whether they would address the underlying disputes that caused the budget crisis (Diehi, 2000).

A second group of funding proposals centers on international taxation. The best known of these tax proposals was advanced by Nobel laureate James Tobin, and is often referred to as the Tobin Tax (Tobin 1978). Tobin suggested a small tax on foreign exchange transactions. He argued that, given the trillions of dollars of currency exchanged daily, even a very low tax that would not alter financial flows could generate large amounts of revenue. Others have suggested taxes on those who use sea routes, outer space, travel internationally, ship goods internationally and so on (Global Commission 1995; Henderson 1995; Childers 1995). Thus, those who benefit most directly from the peace and stability brought by the U.N. would shoulder the responsibility for financing it. Any of these efforts raise practical issues of collection. They also have been criticized by some who feel that an international institution of states should not be funded by individuals. Further tough opposition has come from conservatives who feel that giving the U.N. an independent source of funds would further decrease state control of the institution and reinforce trends toward world government (Kennedy & Russett 1995).

Reforming the Security Council

The U.N.'s 1990s expansion led many observers around the world to argue that the U.N. needed to divide power more equitably among its members, so that it would be seen as a legitimate world body and not a tool of the great powers. Reform proposals have been advanced by numerous scholars, special commissions, U.N. officials, and the U.N.'s own Open-Ended Working Group on the Question of Equitable Representation and Increase in the Membership of the Security Council and Other Matters Related to the Security Council that was established in 1993 (Kennedy & Russett 1995, Berween 2002; Bourantonis 2002). The exact formulas suggested by these various reformers differ, but most include some mix of three major ideas: 1) increasing the number of seats on the Security Council, 2) changing or adding to the states with permanent seats on the Council, and 3) altering the veto rules.

When the U.N. was founded with 51 members, selecting 11 to the Security Council seemed a reasonable representative sample. As overall membership increased, the Council was expanded in 1965 to its current 15 seats. Today, many question whether 15 countries can adequately represent the diversity of world perspectives. This is exacerbated by the European bias built into the system with three European permanent seats and others allocated to rotate among European states. Proposals have been advanced that would increase the Council to 25-30 seats, with most of the new seats allocated to the developing world. Many, though, feel that increasing the Council's size will only slow deliberations and make debate unwieldy. Furthermore, there is the ongoing question of whether major military or economic powers should have more influence in deliberations since they will pay many of the costs of the resulting decisions.

A related series of reforms seeks to alter the permanent Security Council seats. Most observers assume the permanent five will not concede their seats, so in reality it is more a debate over who should be added. Over time, there has been much support for adding Germany and/or Japan with the logic that they are major economic powers and major U.N. contributors who to date are being punished for having lost WWII. These additions, though, have been actively opposed by Italy, and also many developing countries that feel that it only reinforces the European bias of the system. Other suggestions have been made to add regional powers such as India, South Africa, or Brazil. These suggestions, though, have been met with opposition from Pakistan, Nigeria, and Argentina, which ask why they are less worthy than their regional rivals.

Underlying the question of expanding permanent seats is the question of whether those seats would carry veto power. If they did, the fear is that the Council would be even more paralyzed than during the Cold War. If they did not, then they would represent a third type of Council member with moderate but not great power. Some reformers' solution to this dilemma is to call for modifications of the existing voting rules. Remembering that the veto was one of the major enticements given to ensure great power membership, it is unlikely that it will be abolished. The permanent members could, though, be encouraged to show overall restraint in their vetoes or pledge that they will use them only in cases of national security. The decline in vetoes after the Cold War somewhat muted the drive to reform this aspect, but it remains an area open to further discussion.

George W. Bush and the U.N.

By the end of the 1990s, both the activism and optimism apparent early in the decade were somewhat tempered. Critics continued to demand cutbacks and reform, while even strong U.N. supporters had to concede that U.N. operations had not been entirely successful in Somalia, Rwanda, Cambodia and Yugoslavia. The U.N.'s future then was further clouded by the continued growth of U.S. power and the election of George W. Bush, who many perceived as more of a unilateralist than his predecessors.

The U.N.'s structure was designed to acknowledge the reality that some states are more powerful than others, but it was not designed to work in a unipolar world. By the year 2000, it was clear that U.S. power had so far surpassed the power of others that it posed new challenges to the system. Discussion therefore shifted to whether the United States still needed the U.N. for any reason and whether the U.N. could either tame or learn to coexist with the United States (Nye 2002, Weiss 2003, Tharoor, 2003).

President Bush and many of his neoconservative advisers came to power with a skeptical attitude about multilateralism. In their eyes, multilateral institutions were long on talk and negotiation, but short on meaningful action and efficiently. More crucially, they believed that multilateral agreements that gave other powers de facto veto power over U.S. actions could run counter to U.S. national interests. The Bush administration therefore opposed the Kyoto Accords, the International Criminal Court, the Comprehensive Test Ban Treaty, the Landmines Treaty and the like. Early, Bush was not openly hostile to the U.N., and helped settle U.S. contribution arrears, but he was not a strong supporter.

Tensions came to a head with discussion of possible military action against Iraq. For a time, it appeared that Bush would not seek U.N. approval of any planned U.S. action, but he was pressured by Secretary of State Colin Powell and U.S. allies to go to the U.N. to show that the action was a global response to an emerging threat. Speaking there, Bush argued that the U.N. had given Saddam Hussein more than enough time to comply with weapons inspections, therefore only a tough resolution authorizing force could alter the situation and restore a strong U.N. reputation. The administration bristled under pressure from France, Germany and Russia to continue sanctions and negotiations. The resulting November 2002 compromise resolution, which gave Iraq one last chance before facing "serious consequences," was a measure of the U.N.'s world role, but only postponed a final decision. In the spring of 2003, it was clear that the Security Council still would not authorize the use of force. The debate reflected both divided world opinion and the U.N.'s difficult institutional position.

If force was authorized, the U.N. risked being perceived as a rubberstamp for U.S. actions. If force was opposed, the U.N. risked looking weak in enforcing its resolutions. Worse still for U.N. supporters, if force was opposed and the U.S. still acted, the UN risked becoming irrelevant like the League of Nations before it. Ultimately, Bush made the judgment that U.S. power made final U.N. support unnecessary and ordered an invasion of Iraq.

Many observers saw the Iraq debate as a prime example of the U.N.'s ongoing problem in working with a hegemonic United States (Glennon 2003; Luck et al 2003). Some concluded that the U.N. was too weak to constrain the United States, and needed to be strengthened. Others concluded that the U.N. was an unnecessary constraint on U.S. action. They argued that the United States should simply bypass the U.N. in the future, and take action with "coalitions of the willing" (Ponnuru 2003). The U.N. thus appeared to be on shaky ground as a meaningful institution. Subsequently, however, events in Iraq made the United States more interested in sharing the military and economic burdens of pacifying and rebuilding Iraq. Although the Bush administration never yielded major control, U.N. officials did play a significant role in establishing Iraq's interim government.

New Efforts on Reform

The crisis over Iraq policy highlighted the perennial issues of great power control and U.N. power to enforce resolutions in a sovereign country. The UN also faced other concurrent institutional challenges--corruption in implementing the oil-for-food program in Iraq, sexual misconduct by UN peacekeepers, and discreditation of its Human Rights Commission--and practical challenges in addressing security issues in an era of proliferation and terrorism. In 2003, Annan told the General Assembly, "we have come to a fork in the road. This may be a moment no less decisive than 1945 itself, when the United Nations was founded" (Annan 2003). By December 2004, a U.N.-appointed high-level panel had developed 101 recommendations. In March 2005, Annan advanced many of these recommendations, as well as some of his own, as a reform package entitled *In Larger Freedom: Towards Security, Development and Human Rights for All* (Annan 2005). Following the patterns of the past, the broad idea of reform was hailed by many, but actual changes were limited by the ongoing disputes over control and UN power, and by conflicting state interests (Luck 2005).

One central issue was reform of the Security Council. Three competing plans emerged. A coalition of Brazil, Germany, India and Japan proposed adding ten new seats--six permanent seats without veto power for themselves and two African countries and four rotating seats. A coalition of African states wanted the six new permanent seats to have veto power, and wanted a guarantee of increased African representation in the rotating seats. Several regional rivals of the coalition countries argued that all ten new seats should rotate. Whether any of these plans would make the UN truly representative of world opinion or more effective in addressing global challenges was hotly debated. Ultimately, none of the plans garnered the political support necessary for passage, so all the options were shelved without formal votes.

Many other proposed reforms to UN goals and operations also met political challenges and most were reduced in scope or abandoned. For example, the United States opposed calls for Security Council oversight of all preemptive uses of force and for firm commitments to increase development aid to particular numerical targets. The United States also complicated debate on many other issues after controversial U.S. Ambassador John R. Bolton assumed his post in August 2005 and advanced a long list of proposed modifications. Islamic countries sought changes in a proposed definition of terrorism in light of ongoing attacks in Israel. Many developing countries opposed language justifying UN interventions to protect human rights, tough membership standards for the new Human Rights Council, and plans to increase the Secretary General's budgetary and personnel flexibility, which was seen as weakening General Assembly control.

The only area of consensus is that reform is needed. Future scholars and interested parties will continue to seek formulas for reform. These formulas must incorporate not only what is preferable, but what is politically possible. Others will focus on the impact of changes that have been implemented. The UN may never meet all the objectives of its supporters, but its continued existence and evolution demand further study of its practical influence on world issues and its place in the evolution of the international system.

Internet Sites

2004 report by UN High Level Panel on Reform. www.un.org/secureworld/

Citizens Group Favoring Major Reform www.globalpolicy.org/reform

Official UN site. www.un.org

Private U.S. Group Supporting UN Activity www.unausa.org

U.S. State Department Documents on Reform www.state.gov/p/io/c15031.htm

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United States Hegemony

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Introduction

Over the last decade or so, it has become increasingly commonplace to describe the United States as an 'hegemonic power'. While there are some important differences in the way various theoretical traditions understand the notion of hegemony, which will be explored in detail below, it is generally taken to refer to the dominant power of a particular era and its capacity to shape the international system of that time. That the US has come to be described as hegemonic is indicative of just how powerful most observers consider it to be in comparison with other countries in the contemporary international system. This is somewhat surprising for two reasons: first, for much of the 1980s, and even into the 1990s, it was commonly assumed that the US was in permanent decline (Keohane 1984). According to one widely noted argument, the apparent deterioration of the US economy was considered to be causing 'imperial overstretch', and America's economy was thought to be increasingly incapable of underwriting its geo-political ambitions as a consequence (Kennedy 1988). This perception was completely overturned by the beginning of the twenty-first century—despite lingering doubts about the underlying strength of the American economy (see Brenner 2001). The second reason for surprise about the widespread discussion of American hegemony is that, as a term, hegemony was used most frequently by radical scholars concerned about what they considered to be the negative impacts of hegemonic dominance. However, when even mainstream, market-oriented publications like *The Economist* (2002) routinely describe the US as hegemonic, it is indicative of just how much perceptions of American power have shifted, and just how widely its dominance is recognised.

To understand how and why perceptions of the US and its position at the centre of the contemporary international order have changed so much of late we need to look at the basis of American power and the role the US has played in actively creating a distinctive international order over the last fifty years or so. The periodisation is not arbitrary, for it was only in the aftermath of the Second World War that it became unambiguously clear that America had become the most powerful country on the planet. Before considering the specific historical record of American hegemony, however, it is important to spell out in greater detail just how the concept of hegemony is understood in the various strands of theoretical literature that utilise the term. As we shall see, scholars working in different traditions have very different views about what hegemony is, and about whether it is desirable or inevitable. Yet all of them contain important insights which help us to understand the nature of contemporary US hegemony.

Theories of Hegemony

'Hegemony' is derived from the Greek, and originally referred to the dominance of one state over the others in the international system. This might seem like a relatively straightforward way of conceptualising the relationship between states, but it is important to stress at the outset that many observers consider hegemony to be a much more pervasive force than this sort of exclusively state-based analysis might suggest. 'Radical' scholars working in a broadly Marxist tradition, for example, draw attention to what they see as the evolution of a transnational capitalist class, which they claim has emerged in tandem with changes in an increasing integrated international economy as an integral part of structure and operation of hegemony (Cox 1987; Robinson and Harris 2000). Even liberal theorists recognise that American hegemony, particularly in an era characterised by processes of 'globalisation' embraces far more than simply the power of the US state (Nye 2002; Ikenberry 1998). Nevertheless, as the Greek origins of the term suggest, 'realist' scholarship has a venerable tradition of thinking about hegemony which continues to generate important insights.

At the centre of the realist view of hegemony are the same assumptions that inform realist thinking more generally: unitary states are the principal actors in an essentially anarchic international system, survival in which necessitates an endless struggle for supremacy and material advantage, with stability being achieved through a balance of power (Waltz 1979). What is distinctive about realist theories of hegemony, however, is that at particular historical moments one state will assume a paramount position that allows it to 'organize political, territorial, and especially economic relations in terms of their respective security and economic interests' (Gilpin 1981:144). The two key examples of this possibility are Britain in the nineteenth century and the US from the second half of the twentieth onwards. Crucially, both countries were able to assume a dominant position because of their military and economic strength, something that allowed them to either impose their will on lesser powers, or encouraged subordinate countries to follow their leadership.

Given the assumptions realists make about the competitive, zero-sum nature of the international system, hegemonic power is consequently seen as cyclical: one power will ultimately be replaced by another as uneven economic growth fundamentally transforms power relativities between states. Changes in the underlying balance of power are resolved in hegemonic wars as a new international hierarchy is established around the emergent hegemonic power (Gilpin 1989). Even though some of the most influential realist perspectives on hegemony question whether any state has the capacity to achieve global dominance, the logic of realist thinking dictates that hegemonic powers will and—in America's case at least—*ought* to try and suppress rivals in the interests of systemic stability (Mearsheimer 2001).

These assumptions about warfare and the management of potential conflict continue to figure prominently in the theory and practice of hegemony. Charles Kindleberger's (1973) highly influential analysis of the inter-war economic and financial crises was based on his claim that such turmoil resulted from the failure of any country to play an hegemonic role. Kindleberger's ideas brought the concept of hegemony back into mainstream scholarship, ultimately paving the way for the development of the hegemonic stability hypothesis, considered elsewhere in this volume. In essence, Kindleberger's argument was that the Depression of the 1930s was a consequence of the failure of any country to impose an 'open' economic order and ward off mutually destructive beggar-thy-neighbour economic policies. Such ideas influenced the construction of the post-war international order and much subsequent theorising about hegemony. Interestingly, Kindleberger's broadly realist position has been extended by liberal theorists.

In the 1980s most liberals were primarily concerned with how to encourage international cooperation 'after hegemony' (Keohane 1984), as the expectation was that American power would decline, and countries would need to find new ways to manage their interactions. However, in the aftermath of the Cold War, and with the US assuming a relatively uncontested 'unipolar' position in the international system (Wohlforth 1999), attention has turned to explaining the failure of other countries to 'balance' American power in the way realist theory predicted. Arguably, the most sophisticated and interesting contribution to recent liberal theories of hegemonic power has been developed by G John Ikenberry. A number of points are worth highlighting in Ikenberry's overall position, as they help us to understand contemporary events. First, Ikenberry (2001) argues that wars and their aftermaths present especially fluid moments in which emergent hegemonic powers can create a new international order. Significantly, however—and despite what Ikenberry recognises as the US's unparalleled power—the international order the US was instrumental in creating was one characterised by a high degree of institutionalisation. The Bretton Woods regime, considered in more detail below, not only provided a capacity to manage and guide international economic and political relations, but it provided key incentives and pay-offs for all concerned. While the overall liberal international order may have reflected and furthered the interests of the US as the dominant power of the era (Latham 1997), subordinate nations benefited from the creation of a predictable, open, rules-based economic order, and—crucially—the self-restraint of the hegemonic power which was also constrained by the very system it had created (Ikenberry 2001:1998).

Liberal theorists like Ikenberry, then, have extended Kindleberger's original formulation and created a sophisticated explanation for the persistence of American dominance. However, it is important to recognise that the liberal position contains a number of—frequently unacknowledged—normative assumptions about the supposed benefits that may flow from hegemonic power generally and from US dominance in particular. The final theoretical tradition to be considered here, which draws its inspiration from Marxism, takes a very different view about both the supposed benefits of US hegemony and the way that it is maintained.

One of the most important and influential statements of this more radical position has been developed by Robert Cox. Cox's understanding of hegemony has been heavily influenced by the Italian Marxist Antonio Gramsci (1992), and consequently places a great deal of emphasis on the historical evolution of capitalism and the ideological discourses that have emerged around it. Although the conceptual framework that informs Cox's account is very different from Ikenberry's, and reflects fundamental assumptions about the inherently conflictive nature of class-based societies characterised by inequalities of power and life-chances, his analysis of the operation of hegemony has some surprising parallels. For Cox, one of the key tasks for capitalist states is to create ideological support and legitimation for the existent (inequitable) order. Significantly, this is made possible because it offers 'some measure of support or satisfaction to the less powerful' (Cox 1987:7). Like Ikenberry, therefore, Cox recognises that—for some class allies in other parts of the world, at least—there are potentially significant pay-offs to be derived from cooperation with the hegemonic power of the day.

Perhaps the most significant contribution of this sort of Gramscian-inspired analysis of hegemony is that, although it shares realism's concern with the way power may be used to promote particular interests in a potentially self-interested manner, it does so in ways that go beyond realism's reductionist, state-based analysis (Germain and Kenny 1998). At a time when the international system is widely considered to be shaped by processes associated with globalization, the emphasis placed by neo-Gramscian scholarship on the trans-nationalisation of social relations, and the crucial role played by what Cox (1987:359) describes as a 'transnational managerial class' in managing the increasingly integrated global political economy is clearly important. What neo-Gramscians draw attention to is the multi-faceted nature of hegemony in the contemporary period and the way in which particular ideas can become the ruling orthodoxy and profoundly constrain the choices available to individuals and policymakers alike (Gill 1994). Consequently, hegemony can be far more institutionalised and pervasive than simply the policies of one state (Agnew and Corbridge 1995:17). Indeed, it is important to recognise in this context that even 'the United States' may be constrained by new patterns of power and authority that have emerged in the international system. For the US is, of course, a disparate array of centres of power and influence that encompass not just the foreign policymaking elite, but an array of historically powerful domestic interests (Trubowitz 1998), and increasingly influential transnational forces that can limit domestic policy-making autonomy of even the most powerful state (Cerny 1996). To see why, it is useful to compare the way American hegemony has evolved in the post-war period.

US Hegemony in the Bretton Woods Era

It was only in the aftermath of the Second World War that it became apparent just how powerful the US had become. Potential European rivals were either defeated like Germany, or left permanently weakened, like the former hegemon Britain. What had been unclear during the inter-war period was now unambiguous: the US was the most powerful country in the world. Its power was not unrivalled, however. The distinguishing characteristic of the first phase of American hegemony was that it occurred within the overarching context of the Cold War and the concomitant, implacable rivalry with the former Soviet Union. This overwhelming strategic imperative, and what was then the very real concern with Soviet expansion, powerfully influenced the strategic orientation of the US and gave a particular cast to both its military and economic policies. Indeed, American hegemony of this period cannot be understood unless both aspects of its overall policy position are considered.

Despite the inflammatory ideological rhetoric that issued from both sides of the 'iron curtain', the dangers inherent in direct, nuclear-armed, 'superpower' confrontation were widely recognised and accepted, as was the underlying bi-polar balance of power between the US and the Soviet Union (Hobsbawm 1994). This did not stop the US from clearly articulating its commitment to opposing Soviet expansionism, however. The 'Truman Doctrine' spelled out America's commitment to protect people everywhere from 'subjugation' and established it as the leader of the 'free world'. But the impossibility of directly confronting the Soviet Union meant that much attention was given to cultivating sympathetic allies and client states in what became an increasingly global rivalry. Despite the fact that the US's preoccupation with the fight against communism meant it frequently supported allies that were authoritarian and undemocratic, the logic of the Cold War superpower confrontation became 'the organizing framework for international relations and for the world economy' (Cronin 1996:45).

One of the most significant and enduring characteristics of American strategic policy was to establish itself at the centre of a dense web of 'hub and spokes' security relationships. This essentially bilateral architecture extended throughout the strategically pivotal theatres of Cold War confrontation. In Europe, NATO became a critical element of this pattern of US-centric alliance structures, while in East Asia, a series of bilateral relations entrenched the US's position across the region (Mastanduno 2002). Significantly, the US was prepared—until the early 1970s, at least—to back this commitment with direct military involvement in Korea and Vietnam. Equally important in the longer-term, however, was the US's commitment to aid directly the establishment of sustainable, successful capitalist economies.

It was this element of American hegemony—the preparedness to use certain types of foreign aid and investment to encourage capitalist economic development that is one of its most distinctive characteristics. Even more remarkable, perhaps, was the pivotal role the US played in creating the complex institutional architecture which has effectively managed and encouraged the development of the contemporary global political economy. By comparison, the Soviet Union, despite being considered a superpower and credible strategic and ideological rival, had nothing like the same capacity as the US to shape the post-war international order.

Although American policy during the Cold War may have been driven primarily by its antagonism with the Soviet Union, it is important to recognise that, even before the Second World War had concluded, American policymakers were already turning their minds to the shape of the international system in its aftermath. The central goal as far as the economic system was concerned was to avoid the 'mistakes' of the interwar period when the absence of an hegemonic power willing to provide critical public goods was widely considered to have contributed to the economic crises. Two aspects of American policy are worth highlighting: first, through innovative policies like the Marshall Plan, America provided the essential capital to kick start the reconstruction process in places like Western Europe and Japan (Hogan 1987). Second, the US was instrumental in designing the innovative and distinctive 'Bretton Woods' institutions that were to become such prominent parts of the emerging system of global governance.

The key elements of the Bretton Woods framework were the World Bank, the International Monetary Fund, and the General Agreement on Tariffs and Trade, which would ultimately be replaced by the World Trade Organisation (Eichengreen and Kenen 1994). Together, these institutions provided the building blocks for nascent global policy coordination, and actively promoted ideas that would come to be associated with neoliberalism and the Washington consensus. However, it is important to recognise that, in its early phases, at least, the Bretton Woods system that emerged under the auspices of American hegemony was far more multilateral than it would ultimately become in the contemporary period, and it was a system in which individual states potentially retained a noteworthy degree of autonomy. Indeed, one of the striking characteristics of the original Bretton Woods order that prevailed until the early 1970s, was what Ruggie (1982) described as 'embedded liberalism' , in which states cooperated to promote trade liberalisation, but did so within the context of a system of managed exchange rates, which allowed a good deal of domestic policy autonomy. When the US government decided in 1971 to unilaterally abandon a system of regulated exchange rates because of its own budgetary problems—which emerged partly as a consequence of the Vietnam War and partly because of growing international economic competition from the very countries it helped to revive economically—it effectively ended the old system and paved the way for the contemporary wave of financial system deregulation.

Although the US was the only country that could unilaterally transform the international economic system in this way, it was this period that seemed to reveal the apparent vulnerability and lack of competitiveness of the American economy, and which fuelled the idea that it was in irreversible decline. It was also during this period that there was a noticeable shift in US policy. Although US policy may still have been concerned with promoting the sort of open, liberal order associated with globalisation, it was increasingly prepared to unilaterally employ its political and economic leverage to achieve policy goals it considered to be in its 'national interest'. The interminable trade disputes with Japan that occurred in the 1980s and early 1990s were emblematic of this new approach (Schoppa 1997). In short, over the first four decades of American hegemony there was a discernible shift in the way that America engaged with the world, one that has been thrown into sharp relief by the policies of the current administration of George W. Bush in the aftermath of the terrorist attacks on America (Beeson 2006).

Contemporary Hegemony

There are three key factors that have come to define and underpin the contemporary style of American hegemony: the end of the Cold War; the apparent renaissance of America's economic position; the attacks of September 11th and the concomitant (re)militarisation of American foreign policy. Important as the latter has been in shaping the foreign policy of the current Bush administration, it is the end of the Cold War and the emergence of America as an unrivalled unipolar power that may prove of greatest long-term significance.

Until 1989 and the collapse of the Soviet empire, US policy was constrained by the existence of a credible rival. The very existence of an alternative centre of power meant that other states could potentially play off one side against the other. With the demise of the Soviet Union and China's increasingly enthusiastic embrace of capitalism, there is less room for manoeuvre even for relatively powerful countries, especially as far as the general direction of economic policy is concerned (Buzan and Little 1999). Significantly, if—or more realistically perhaps, when—China achieves an economic and military capacity to rival that of the US, it is likely to do so as challenger *within* the overarching international system American hegemony has helped construct, rather than as an alternative to it. In such circumstances, not only are American-based interests unlikely to be directly threatened by such a development, but China is likely to find itself constrained by, and socialised into, the very system that has underpinned its recent rise (Johnston 2003). Thus, the ideological component of American hegemony has been reinforced not just by the 'soft power' that flows from the pervasive influence of US culture and values (Nye 2002), but from the fact that there are presently no credible alternatives to market capitalism. True, there are still important and persistent varieties of capitalism (Coates 2000), but the overall dominance of the capitalist system and the pervasive influence of market principles has led some radical observers to argue that the US is at the apex of a more diffuse, unprecedented form of imperial hegemony (Hardt and Negri 2000).

America's dominant position has been reinforced by the unexpected and remarkable transformation in its own economic position. Concerns about imperial overstretch and hegemonic decline have given way to triumphalism and predictions of another 'American century' (Zuckerman 1998). Although the rise and fall of the 'DotCom' share market bubble served as a troubling and timely reminder that much of America's apparent economic renaissance was in fact based on speculation, debt, and a structurally embedded, potentially volatile dependence on foreign capital (Brenner 2000), it remained the case that in the year 2000 the US alone represented about a third of global GDP and defence spending (*The Economist* 2002). Even more remarkably, perhaps, America's overwhelming military dominance was achieved on the cheap: not only did the US spend more on defence procurements and R&D than all the other major powers combined, but it required less than 4% of GDP to do it (Brooks and Wohlforth 2002). Such dominance was unprecedented and provided a powerful spur to the third distinctive quality of American hegemony in the contemporary era: the militarisation of American foreign policy.

The terrorist attacks on America would have provoked a major re-think about the direction of policy no matter who was president. Even before September 11, however, the administration of George W. Bush had displayed a noteworthy willingness to abandon multilateral agreements it either disliked or felt to be too constraining, an approach that was powerfully reinforced by an influential coterie of neo-conservative advisors and commentators (see, for example Kagan 2003). In this context, Defence Secretary Donald Rumsfeld was quick to recognise that the events of September 11 and the subsequent 'war on terror' represented a possibly unique opportunity to apply America's undoubted pre-eminence and 'refashion the world' (cited in Bacevich 2002:227). Like their predecessors in the aftermath of World War 2, the current crop of American policymakers are imposing their vision of a possible new intentional order. By contrast with their forerunners, however, the current style of hegemony is a good deal less multilateral. In the security sphere American policy has become increasingly unilateral—a pattern articulated in the new doctrine of 'pre-emption'—whilst in the economic sphere, the trend is increasingly toward bilateralism.

There is one echo of the earlier era, however: as in the Cold War, the new 'war on terror' is seeing an explicitly linking of security and economic issues as the US uses its power to encourage compliance with its overarching strategic agenda. Unlike the Cold War period, however, disgruntled friends and foes alike have nowhere else to turn. The implications that flow from the current administration's attempt to systematically link security and trade issues can be seen in the behaviour of less powerful but strategically significant allies like Thailand, which has embarked on a vigorous crackdown on 'terrorist threats' as part of a wider campaign to gain a bilateral free trade deal with the US (see Beeson 2004). Indeed, at a time when American actions—specifically the privileging of narrow national interests on the one hand and grand strategy on the other—are effectively undermining the extant multilateral system and entrenching the move toward bilateralism, America's policy leverage may actually be enhanced in the short-term, at least.

The Future of American Hegemony

Seen in a long-term historical context, recent changes in the style of American hegemony are significant and mark an important shift from the more consensual, multilaterally-based form of hegemony that prevailed for much of the post-war period. It remains to be seen whether such a policy will be sustainable and whether other countries will seek to 'balance' American power as realist theories of international relations would lead us to expect. At this stage such an outcome looks unlikely, but this does not mean that American foreign policy-makers can act with impunity or total autonomy either: even the

US is susceptible to changes of sentiment in global financial markets and highly dependent on continuing inflows of capital to underpin its rapidly deteriorating budget position. Indeed, for all its undoubted economic might the costs of actually using its latent military advantages are significant, and it is unclear whether this will be sustainable either economically or—more importantly, perhaps—in the face of domestic opposition if foreign entanglements go badly.

Already the potential constraints on American power are becoming evident in Iraq, where the US's increasingly unilateralist impulses have been given greatest expression. The campaign to impose order and 'regime change' in Iraq has, at the time of writing, begun to bog-down in a costly, brutal and potentially long-term conflict that will test the attention span of American policy-makers and voters alike. Most significantly, perhaps, the Bush administration has been forced into a humiliating back-down: its earlier criticisms of the United Nations as irrelevant and impotent have been modified as it desperately seeks assistance in managing the Iraq conflict. The impact of the militarisation of American foreign policy is also becoming painfully apparent as the cost of the campaign in Iraq mounts; when combined with an ideological commitment to tax cuts for the core Republican constituency of affluent Americans, the budgetary position of even the US begins to look unsustainable (*The Economist* 2003).

It is always difficult and generally unwise to speculate about the future on the basis of rapidly evolving contemporary events, but it is at least possible to identify some of the key questions that emerge from the Bush administration's approach to foreign policy-making that are likely to define American hegemony. The great strength of American hegemony for much of the post-war period was that—for allies, at least—it was comparatively benign and offered real advantages for subordinate nations. The remarkable economic rise of East Asia, for example, and the failure of any East Asian power to challenge American hegemony must be understood in this context (Beeson and Berger 2003). The key question now is whether such patterns of acquiescence in Asia, Europe or even Latin America will continue if the US continues its increasingly unilateral approach to policy-making. At a time of greater international interdependence and economic integration, when new patterns of global governance are emerging that require greater cooperation and coordination between individual states, and between state and non-state actors, the US simply cannot act unilaterally without jeopardising key elements of the international system it has played such a prominent part in creating. Intentionally or unintentionally, therefore, US hegemony will continue to define the intentional order in which it remains such a critical part.

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War, Collective Violence and Conflict: Civil and Regional

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Introduction

Armed conflicts is defined by the widely-used Uppsala Conflict Data Project as a "contested incompatibility that concerns government or territory or both where the use of armed force between two parties", at least one of which is the government of a state, which results in at least 25 battle-related deaths. Such conflicts can be classified into three types according to types of protagonists: interstate armed conflict, between two or more states; extra-state armed conflict, between a state and a non-state group outside its own territory; and internal armed conflict, between the government of a state and internal oppositions groups (with or without intervention from other states). In this entry we will define civil and regional wars, collective violence and conflict as internal armed conflict, but extend it to include organized violent conflict between non-state groups, terrorist activities internal to a country, and one-sided organized killing in the form of genocide, and for brevity refer to them as civil wars.

Internal armed conflict have been by far the most common type of armed conflicts in the post World War II period. Of the total of 225 conflicts for the period 1946 to 2001, 163 were internal ones (Gleditsch et al 2002). The number of internal armed conflicts increased till after the end of the Cold War in 1989, but declined from 1992 (although there were ups and downs in both periods). These conflicts are geographically concentrated, mostly in countries with low per capita GDP. The zones of concentration are: Central America and the Caribbean, spreading into South America; from East Central Europe through the Balkans and the Middle East through India into Indonesia; and Africa, spanning almost the entire continent. Some civil wars have involved the use of conventional weapons, battle techniques and armies, and resulted in heavy military casualties. But what Kaldor (2001) calls "new" wars, often driven by exclusionary identity politics, have usually been fought with small arms, unconventional tactics such as guerilla warfare, and with unclear distinctions between the military and civilians.

This entry examines the causes of civil conflicts, then their consequences, and finally policy issues. This structure, while it is analytically convenient, is problematic in terms of the chronology of actual conflicts, in which the effects of, and policies to deal with, conflict, often mingle with causes which make them persist.

Causes

The causes of civil conflicts have been investigated in a variety of ways. One uses theoretical, including formal mathematical, methods. Collier et al (2003) analyzes rebel groups as political, military and business organizations and examines conditions under which these organizations can persist. Grossman (1991) examines a model of interaction between a ruler who collects taxes from peasants who choose between production, soldiering and insurrection activity, and where the probability of success of the insurrection depends on the number of rebels compared to the number of soldiers. Another approach uses cross-country analysis, often employing econometric methods. Using data for the period 1960-92 from 98 countries, Collier and Hoeffler (1998) and Collier (2000) examine factors which affect the probability of the occurrence (and the duration) of civil wars. By far the most popular is the case study approach which examines particular civil wars or compares a small number of them (see Ballentine & Sherman 2003, Arnson &

Zartman 2005, Collier & Sambanis 2005). General studies of these types have uncovered a number of causes of civil conflicts. Other studies have focused on specific factors, such as natural resources, environmental degradation, ethnic divisions, and globalization.

These causes of civil wars can be classified in a number of ways. One is according to levels of analysis (Levy 2001), that is, whether the causes relate to the characteristics of individuals, groups, countries as a whole, or the entire world. Another is according disciplinary focus, that is, whether they focus on psychological, social, political, geographical, environmental, economic, or other factors. Although causes related to different levels of analysis interact with each other, and disciplinary boundaries are rather blurred, we can use this two-way classification to discuss some of the main causes.

Social and Political Factors

Sociological approaches focus on groups with shared ethnic, linguistic or religious identities, and causes of civil wars have often been located in the characteristics of these groups, and the propensity of individuals to identify with them. Examples of conflicts in which group identities have been important include those arising from ethnic divisions in Rwanda, Burundi, the Darfur region of Sudan and Zimbabwe, clan divisions in Somalia and Afghanistan, religious divisions in Northern Ireland, Sri Lanka, Nigeria and in Sudan. Since 1945 the proportion of conflicts involving ethnic violence has increased steadily (Stewart & Brown 2008). However, it is often the social characteristics of countries rather than of groups which are the major determinants of conflicts. It has been found that the probability of civil wars first rises and then falls with the degree of ethnolinguistic fractionalization. Completely homogeneous and highly diverse and fractionalized countries have low risks of civil wars, with the highest risks being in countries with ethnic dominance by one group with a large minority group. International factors such as globalization can also reduce national cohesiveness as groups find closer cultural and ethnic ties with those across their boarders, thereby creating conditions for the eruption of civil wars.

Political explanations of civil wars can lie in the propensity of groups to monopolize political power. As other groups feel left out from political processes and access to government resources, they become aggrieved, and such grievances can lead to civil wars. They can also relate to characteristics of countries, that is, of “failed states” which lack legitimacy because they are unable to govern effectively and are too weak to contain opposition (Ayoob 2001). Another country characteristic refers to the form of government. It can be argued that democracies provide opportunities for more peaceful forms of dissent. However, democracies do not seem to be less prone to civil wars at low income levels than authoritarian regimes which can maintain power by force, although at higher income levels, the conjecture seems to be correct (see Collier et al 2003). The kind of democracy–whether majoritarian or proportional–can have a more decisive effect (Reynal-Querol 2002). Majoritarian democracies can give rise to civil wars by provoking aggrieved minorities especially if they are well-off (Chua 2003).

Geographical and Environmental Factors

A geographical characteristic of a country that is often argued to make it susceptible to civil wars is the existence of natural resources (see Klare 2001). Natural resources can provide funding for rebel groups, especially if they are “lootable” in the sense that they can be appropriated or cultivated by small groups of unskilled workers (such diamonds, coca and opium), and fund government efforts if they are non-lootable (such as oil, natural gas and deep-shaft mining). Resources captured by some groups aggrieve other groups, and if they are non-lootable, lead to secessionist struggles by local groups (as in Aceh, Indonesia). Econometric studies confirm that the likelihood and duration of civil wars (across countries) increases with the importance of natural resources (as measured by the share of primary product exports in GDP) although beyond a point the sign is reversed, probably by increasing the power of the government. Natural resources that have played an important role in financing civil wars include diamonds, oil, cobalt, copper, timber, coca and opium.

Environmental problems have also been argued to cause civil wars (see Homer-Dixon, 1999). Environmental scarcities reflected by land degradation, deforestation, air and water pollution, water scarcity, and a decline in animal stocks and resulting losses in production reduce the overall amount of resources available, intensifying competition over them. Powerful groups, recognizing the scarcity, use their power and influence to change laws and institutions and take extra-legal actions to capture these resources. Scarcities and resource capture leads to migration to other areas, often marginal lands with low productivity, where competition over resources and jobs intensify. A culture of selfishness often emerges as groups try to compete for their share of the diminished resources rather than try to conserve the total, exacerbating the scarcities. Depending on the conditions prevailing in the area, such competition often breaks into organized violence and civil war. Land, firewood and water scarcities in many LDCs have led to violent conflict, as in South Africa. More widespread violence and insurgencies occurred in the Chiapas region of Mexico and in Peru, due to land scarcities. In the Philippines cropland and forest degradation led to the ecological marginalization of poor farmers and landless workers, and can explain the insurgencies of the 1980s and 1990s.

Another geographical characteristic that increases the likelihood of civil wars is terrain. Military viability and survival can be helped by forest and mountainous terrain (as in Nepal), scarcely populated remote hinterlands and concentrated urban populations. Yet another is the size of the country. Countries with large areas and boundaries far from capital cities make localized civil conflict in frontier regions more likely.

Economic Factors

Given the dominance of the neoclassical individual optimizing approach, it is not surprising that individual characteristics have received much attention in economics. The neoclassical approach allows individuals to choose between violence and other activities in order to maximize utility, as in Becker's (1968) approach to the economics of crime. Optimizing individuals are less likely to participate in civil wars if they can obtain higher income from normal economic activities from, for instance, employment and more likely to do so if they can make money out of war. It has been argued that rebel leaders, their followers, and others can do well out of wars even if they do not emerge victorious, which is why they start and continue wars and do not wish to end them. Rebel leaders can profit from capturing valuable resources like diamonds and selling them. The general absence of law and order during armed conflict makes it possible for leaders and their followers to make money by, for instance, appropriating precious metals (such as diamonds in Angola and Sierra Leone), producing and selling drugs (coca in Colombia and opium in Afghanistan), smuggling activities (as in the Balkans), stealing and pillaging cattle, land and other assets, obtaining ransom money by kidnapping and extortion (as in Colombia), and by getting access to forced labor, including child labor. Others not directly involved with the rebellion can also engage in these activities, and they are also helped by the disruption of markets which result in scarcities and high prices. Profit opportunities can even exist for government officials, who can make use of these avenues and expropriate foreign aid which is often increased during civil conflicts; they can even moonlight as rebels and participate in looting and plunder. These ideas have led to the notion that civil wars are largely caused by greed. Some support for this view is also provided by the econometric finding that civil wars are more likely in low-income countries with low literacy rates (and hence fewer options for gainful employment).

However, these arguments do not necessarily imply that greed is the main cause of civil wars. Rebel organizations need to function as business organizations if they are to effectively conduct wars. Thus, raising money in a variety ways may merely reflect the need to fund rebel organizations. There are examples of individuals who leave lucrative positions to lead rebel groups, but there are also examples of leaders who have amassed large fortunes. At least for certain kinds of violence, like terrorism, the economic model does not seem to do well. Kruger and Maleckova (2003), for instance, find few links between poverty and lack of education on one hand and engagement in, or tendency to supportive of, terrorist activities among Palestinians and the Israeli underground.

The greed view actually emerged in opposition to the grievance view which explains civil wars due to actual or perceived political (as discussed earlier) and economic grievances of a group. Proponents of the greed view argued that there is no relationship between economic inequality and the likelihood of civil wars. However, the concept of inequality employed in these empirical studies is vertical inequality rather than horizontal inequality. Vertical inequality is inequality between individuals ranked according to income, Horizontal inequality is that between groups based on ethnicity, religion, region, language or class. It has been found from case studies that civil wars are likely when there is horizontal inequality, when grievances lead to group formation due to greater solidarity within groups (Stewart 2000). Such solidarity is likely to overcome free rider problems that might otherwise prevent the formation of rebel groups (because individuals can expect to gain from regime changes without incurring the costs of joining rebellions).

Economic characteristics of countries, such as low per capita income, low levels of education and high levels of (especially horizontal) inequality, as discussed earlier, have an important role to play. Since average incomes are low and levels of education are also low, they can be fertile ground for recruiting soldiers. Low levels of income are also likely to generate more real and perceived grievances. Poor countries are also likely to have poor government and other institutions, and insufficient resources to strengthen these institutions; the sense of a break in the social contract, and the inability of the government to control discontent, can result in violence. Poor countries can also have greater environmental stresses and are less able to overcome them. Finally, poor countries often tend to concentrate their productive activity and exports on natural resource-based industries, which increase the likelihood of civil wars.

Characteristics of the world economy can also affect the possibility of civil wars. The availability of imported weapons, the inflow of funds from abroad, particularly from diaspora populations (as in the case of Tamils émigrés for Sri Lanka), from transnational corporations with the promise of lucrative contracts after the civil war (as in the Congo), and from sympathetic foreign governments, and the opportunity to sell primary products, including illegal products, abroad make civil wars more likely. It is not surprising, therefore, that international factors, and more specifically, globalization – in the form of greater flows between countries of trade, capital, technology and other things – have been seen as having an important causal effect on civil wars.

As in other aspects of the economy and society, globalization has often been seen as the panacea against civil wars. Increased globalization is assumed to increase economic growth and improve the distribution of income within countries (as the demand for labor in them grows due to greater exports of labor intensive products and more direct foreign capital inflows) and this is supposed to reduce the chances of civil war. Such effects can certainly be expected in countries where globalization has had positive effects. However, in addition to the direct effects of capital and trade flows noted earlier, greater economic openness can also expose poor countries to greater macroeconomic instability due to changes in the price of natural resources and international, especially short term, capital flows, and constrain the ability governments to deal with these problems (fearing capital outflows, for instance). All this can contribute to social unrest, exacerbated by austerity measures imposed by the International Monetary Fund. A surge of imports due to trade liberalization, as pushed by the World Bank, can lead to higher unemployment. Increased globalization can also exacerbate economic inequalities as those who are already economically well placed may be able to take advantage of the opportunities in terms of trade, employment and foreign collaborations. Chua (2003) has discussed cases in which there are rich and well-placed ethnic minorities—including, for instance, the Tutsis in Rwanda, the Chinese in Indonesia and the Philippines, and Indians in East Africa—have benefited from globalization so that inequalities have intensified. Violence is likely to erupt in situations in which such trends are accompanied by democratization which has increased the political power of the poor majorities, either because the majority tries to redress their grievances or the minority tries to overthrow democracy.

Although we have classified the causes of civil conflict in terms of disciplinary boundaries, our discussion makes it clear that factors stressed within individual disciplines actually interact with factors from other disciplines in complex ways to cause conflict. For instance, it is not ethnic or religious differences as such, but horizontal inequalities caused by economic and political factors – given the existence of such divisions – that give rise to civil wars. We have noted several instances of how geographical (natural resource abundance), environmental (scarcity) and political factors (failed states) interact with economic factors to create conditions making civil wars likely.

Consequences

The economic consequences of civil armed conflict and violence depend on its duration and severity, the tactics used and whether it is localized or spread over the country. However, a number of general observations can be made. We may discuss macroeconomic effects, effects on particular sectors of the economy, effects on people and on other countries. We may also discuss effects during the conflict itself, and effects that linger afterwards, what are called legacy effects.

Macroeconomic and Sectoral Effects

During civil wars resources are diverted from normal productive activities to wartime military uses. Collier et al (2003) estimate that the average LDC (defined as a country with less that US $3,000 GDP per capita in 1995) normally spends 2.8 per cent of its GDP on the military, but this number rises to 5 per cent during civil wars. This refers to official government expenditures and does not take into account increases in military spending by rebel groups. There is a very large literature on the macroeconomic, especially growth effects, of increases in military expenditure in LDCs. While early studies found that an increase in military expenditure results in an increase in economic growth in LDCs, later studies show that the effects are more likely to be negative. Some estimates show that the average of 2.2 per cent increase in military spending noted earlier leads to a 2 per cent loss in GDP on a permanent basis, even at peacetime and without any direct war damage (Collier et al. 2003).

Positive macroeconomic effects of military expenditure can follow from an expansion in aggregate demand due to the increase in government expenditure, from technological spin-offs from defense-related production to other sectors, from greater infrastructural spending (on roads, bridges, etc.) as part of military expenditure, from health and educational expenditures on the military which can lead to increases in productivity, and from possibly greater security and stability that encourages saving, domestic investment and foreign investment. Negative effects are likely to arise from the diversion of government expenditure, because of budgetary constraints, from physical expenditure, education and social programs, which can reduce GDP and growth (Sandler and Hartley, 1995). When the economy faces supply constraints, an increase in military spending can increase inflation and interest rates, crowd out private investment and thereby reduce growth. If arms are imported, increases in military expenditures can also worsen the balance of payments situation and reduce growth by reducing machinery and intermediate good imports. The diversion of personnel from economically productive sectors to the military will also reduce production, although if there are unemployed people, there may not be a loss.

More losses occur from the damage caused by the use of the resources which are diverted to the military. Collier (1999) econometrically estimates that countries experiencing civil wars grow about 2.2 per cent more slowly during civil wars than when at peace, implying that after a seven-year civil war income would be about 15 per cent lower than what it would be if the war had not occurred (Collier et al. 2003).

The main effects are as follows. First, there is a loss of human lives. In addition to the loss of lives of soldiers, the loss in civilian lives is large, given the tactics of new wars and attempts to conduct “ethnic cleansing”. This causes economic dislocation by reducing the number of economically productive workers. Second, since people engage in violence or are forced to engage in violence, there is a further reduction in productive workers; in the case of children they leave schools and there is a resultant loss of human capital. Third, wars cause the destruction and looting of physical capital, including machinery, equipment, factories and livestock, which reduces production and causes a further loss in employment. Fourth, wars result in the destruction of infrastructure: rebel forces often target physical infrastructure like railways, airports and bridges, and rebel and government soldiers loot and destroy infrastructural facilities. The damage to the infrastructure reduces output, exports and foreign exchange earnings, as well as growth, given that infrastructure positively affects growth. Fifth, violence leads to fear of the loss of life and property, which leads to the flight of people (large migrations which reduce the labor force and migration of skilled people which results in a brain drain), capital flight (estimates suggest that capital flight increases from 9 per cent of private wealth to around 20 per cent during civil wars), reduced savings and reduced tourism (leading to losses in income and foreign exchange earnings). Sixth, civil conflicts also increase uncertainty and reduce capital inflows, which is not offset by possible increases official and NGO aid for political support and for humanitarian purposes. The resulting foreign exchange shortage, exacerbated by a reduction in exports and greater arms imports, reduces investment and production and leads to further losses in employment. Seventh, by raising uncertainty civil violence shortens time horizons, and displacement of people severs family and community links. The result is an increase in opportunistic and illegal behavior and a decline in social capital (though there may be some counteracting effect due to greater solidarity within particular groups). This has adverse effects on production and trading, and people often withdraw into subsistence activities. Eighth, the loss in production and income and increases in subsistence and illegal activity during civil conflict leads to a loss in government revenue. Governments can try to maintain their spending by borrowing domestically or abroad, but the risk of the government falling will militate against this possibility. They may also print money, but in supply-constrained economies this frequently increases the inflation rate and the price of food and other essentials, a process often exacerbated by speculative activity. But falling revenues (and increases in military spending) often imply cuts in government expenditure, especially on infrastructure and “social” sectors, having adverse effects on production, income and consumption. Finally, civil violence reduces the legitimacy of the state and its ability to perform economic functions, including law and order, and the provision of education and health services. All of these effects are likely to be stronger the poorer the country and the weaker its institutions.

These adverse macroeconomic effects often persist long into the future. Increases in military expenditure that occur during civil wars are difficult to reverse because of vested interests (of the military and other related lobbies), because of problems of conversion, and because of fears of future violence. The problems arising from high military expenditures, including cuts in social spending, can last for a long time. Capital flight (because of continued uncertainty), labor migration (because people settle abroad) and the loss of social capital (reputation or honesty) are difficult to reverse. The decay of government and other institutions creates hurdles for good policies for a long time, and arguably often results in more unstable macroeconomic policies, less inclusive social policies and poorly managed public sectors (see Collier et al, 2003).

Other problems which have a tendency to persist for a long time include those in education, health, trauma and other psychological problems. The spread of disease due to the dislocation of people, deterioration of health infrastructure and cuts in government health spending has serious long-term consequences as shown by the spread of the HIV-AIDS virus in African countries due to rape and the expansion of prostitution as soldiers are stationed away from their families. Civil conflicts also leave weapons like landmines which injure and kill people well after the wars end, as in the case of Cambodia.

Effects on Individuals

The obvious effects of civil war on people can be seen in death, injuries and dislocation, which obviously undermine their ability to live and lead “normal” lives. However, there are many indirect effects on people, which can be conveniently examined using the entitlements approach pioneered by Sen (1983). Entitlements refer to the resources from all forms of income and the direct availability of resources from work, assets and transfers, that enable people to have command over goods and services of use to them.

There are three standard types of entitlements. Firstly, there are market entitlements, which people obtain by selling or renting the resources they have. Examples include labor and assets, or what they produce and use to buy the things they need. Secondly, there are direct entitlements, which come from directly producing the things they consume, such as in subsistence farming. And thirdly, there are public entitlements, which are directly provided to them by the government, such as free health, education and other services. During civil conflict, market entitlements decline because of: the destruction of labor and other resources like livestock; a decline in the price of, and marketability of these resources due to, for instance, labor market disruptions; and higher prices and reduced availability of things such as food that people buy. Direct entitlements decline because of the destruction of private resources as well as public resources such as infrastructure. Public entitlements fall, especially for the poor. Cuts in government expenditure, the failure of the government to reach remote areas during conflict, and shifts in government entitlements away from the poor to elites who have more power to effect government policies all play a role.

Stewart and Fitzgerald (2001) add additional types of entitlements that are particularly relevant in conflict situations. These include civic entitlements, which are provided by the local community or NGOs, often in response to a decline in public entitlements; and extra-legal entitlements, which are acquired or lost by theft or the use of force. Civic entitlements can fall during conflict when communities become more divided and charity to the poor falls, but can rise because of greater NGO activity during periods of conflict (although NGOs sometimes tend to depart when violence occurs) and because of greater solidarity within different parties to the conflict. Extra-legal entitlements increase for those who engage in looting, pillage, illegal production and trading activity such as drug sales, smuggling and arms trade, but fall for the victims of theft and robbery.

The well-being of people can be examined by looking at their functionings and capabilities (Sen 1999). Functionings refer to the extent to which individuals achieve what they value doing or being, such as living healthily and securely, being nourished, and being educated. Capabilities refer to the possibility of achieving these things, whether or not people choose to voluntarity achieve them. That many of the changes in entitlements, especially losses, lead to changes in such functionings and capabilities during and well after civil wars is well documented. For instance, in a typical 5 year war, infant mortality is estimated to increase by 13 per cent during the war, and for the first five years after the war it remains 11 per cent higher than before war. Adult mortality rates behave even worse (Collier et al 2003).

Two implications of these changes may be noted. First, while most people may suffer as a consequence of conflict, some may well gain; this confirms the point discussed in the previous section that some people may do well out of war and have an incentive to continue it. Second, since the poor are more likely to depend on essential government services, because they are less able to benefit from illegal activities, because they spend a large proportion of their income on food which experiences price increases, and because of changes in entitlements due to policy changes which benefit the ruling elites, can be expected to bear the brunt of the costs. Because they often have a low standard of living, even a small fall can imply ruin for many of them.

International Effects

Civil wars not only affect the country in which they occur, but other countries as well. Neighboring countries, in particular, may be severely affected. Refugees migrate from war-torn countries to neighboring ones, often on foot, as occurred from then East Pakistan to India during the Pakistani civil war in 1971, and from Afghanistan to Pakistan in the Afghan civil war. The movement of refugees also spreads diseases such as malaria and AIDS, as has occurred in Africa. Violence in one country can spill over into neighboring countries because warring groups can infiltrate their neighbors for looting and hiding, because of the greater availability of smuggled arms, and because of the presence of similar ethnic groups, as is suggested by the spread of violence in the Balkans in the 1990s. Military build-up in a country experiencing civil violence can spur regional arms races with their neighbors. Civil wars in a country can affect their neighbors by reducing trade with them, by making international investors believe that the entire region is riskier, and by blocking transportation routes (as the war in Mozambique adversely affected Malawi).

Beyond these neighborhood effects, civil wars can also have wider global effects, by increasing flows of hard drugs, the spread of diseases such as AIDS and by contributing to the growth of terrorism (as happened with Al Qaida in Afghanistan).

Policies

If civil wars are primarily caused by age-old ethnic divisions, there may not be much that can be done to ameliorate conflict. If their adverse effects are felt primarily by those who are fighting, then it can be argued that outsiders need not interfere. However, to the extent that they are caused by potentially changeable factors, and that they adversely affect many innocent bystanders in countries experiencing civil wars (and participants sometimes gain from them) and across their borders, the need for efforts for reducing and preventing them, is obvious.

Special actions are required for countries which are experiencing civil wars and which have just come out of them. Cutting off funding for the protagonists is important. Foreign military intervention may be necessary to end conflict and to bring about and enforce peace agreements, and there is much to be said for multilateral forces to give such forces legitimacy and the appearance of neutrality, and for forces from the region so that the peacekeepers have a better understanding of local conditions. Some sort of power-sharing agreement which addresses sources of conflict between parties may help in negotiations. Rebuilding after wars requires building up infrastructure and the absorption of soldiers and physical capital into civilian use. Special programs, such a micro-finance, to reintegrate combatants into economic activities, may be necessary. Demobilization has to be done simultaneously for different protagonists for it to be done successfully and to reduce the chances of recurrence of violence. International and domestic NGOs can play an important part in helping in this, as well as in building up civil society groups and social capital. Diaspora funding can be tapped to finance small-scale development projects.

More generally for countries coming out of civil wars and others which may be prone to them economic development is of central importance. As we have seen, since civil wars are more likely to occur in poor countries, and civil wars lead to poverty, the key to reducing civil wars and their likelihood is by breaking the vicious cycle of civil war and underdevelopment by appropriate policies for economic development. Improvements in per capita income, reduction of poverty, and the reduction of economic inequality should all be major goals of economic policies. Since this raises issues that are the same as policies for economic development in general, only a few general comments will suffice. First, special care must be taken to reduce excessive dependence on natural resources in economic activity and in exports, and till that is achieved, to pursue policies that allow an equitable sharing of the benefits of their revenues. Second, the economy needs to be insulated to the extent possible from destabilizing shocks due to fluctuations in export prices and in capital flows; this may require external financing to tide over difficult times as well as domestic policies that reduce the adverse effects of such shocks especially for the poor. Third, special care has to be taken to ensure that economic growth is equitable, and does not increase inequality, including regional inequality, and does not result in sectoral shifts that bring about unemployment. If structural reforms as recommended by international institutions are adopted extreme caution should be adopted to avoid such outcomes. Fourth, policies have to address issues related to horizontal inequalities, which may include the sharing political power through proportional representation, political decentralization and affirmative action policies to improve economic conditions for poor ethnic groups.

A number of policies that require international cooperation have also been recommended. Foreign aid has sometimes been justified for humanitarian reasons for people suffering from the adverse effects of civil wars, for improving economic performance to reduce the chances of war, for reconstruction after wars, but also for negotiating peace between conflicting groups. However, some have argued that foreign aid has often been squandered and been appropriated by ruling elites with little development impact and worse, it has encouraged civil wars by making it more desirable for rebels to overthrow governments who have received such aid and by providing funds to warring groups who are able to siphon away the aid for their own ends. Given the possibly large humanitarian problems such steps would cause, and because of the need for foreign aid for reconstruction and long-run development and to reduce the effects of price and capital flow shocks, foreign aid would have to be provided in ways that minimize the chances of their misuse for funding and encouraging violence and maximizing their effectiveness. This clearly requires international coordination among donors. Economic sanctions in addition to cutting of foreign aid, such as imposing embargos on foreign trade and capital flows, have also been recommended for countries undergoing civil wars, in order to force governments and possibly rebel groups to take actions to reduce violence.

However, such sanctions may be rendered ineffective due to the actions of other countries not imposing sanctions, they may end up hurting the poor and causing humanitarian emergencies as the ruling elites are able to alter their entitlements, and they may politically strengthen the ruling elites who can blame foreigners for the problems faced by the country. To overcome these problem, the use of "smart" sanctions which target specific goods such as diamond, oil and arms, and certain people (ruling elites and their families) have been recommended, together with international coordination, such as through the United Nations.

Finally, the international governance of natural resources has been recommended and implemented, for instance, by the certification of diamonds by the Kimberly process, with laws and international cooperation to reduce money laundering from the sale of commodities, and by cooperation to reduce the consumption as well as the production of hard drugs.

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War, Collective Violence and Conflict: Nuclear and Biological

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Introduction

Society, throughout history, has had a tendency to use physical force when desiring an objective unattainable by other means. Typically the use of such physical force, especially killing, has been constrained and forbidden by the laws of society stemming from religion, legislation and the behavioral norms adopted by communities. The exception being where man acts collectively for the objective of a clan, tribe, nation or, in modern times, the nation-state. Such collective killing, known commonly as war, is considered permissible and hence provides the definition that war is the act of collective violence arising out of a conflict between two or more groups. The definition also encompasses the period of such conflict and the techniques and procedures of war (military science). War has also been used to refer to a concerted effort or campaign to combat or put an end to something considered injurious, such as the war against acid rain or the war on drugs. Historically, conflict over natural resources—such as water or oil and physical items such as cattle and territory—have been major causes of wars, although there have also been instances of spontaneous rampages or pure vindictive war.

The character of war has evolved due to two major considerations, even though the causes of conflict have remained consistent over centuries. Firstly this has been due to the societal environment in which man has resided. Groupings of people have become institutionalized collectively with the advent of city states in Greek times, empires in Roman times, feudal fiefdoms in the middle ages, and cultural and ideological nation-states in a fashion known as the Westphalian system that persist into the twenty-first century. The shape and texture of the societal collective and the nature of governance over society has altered the number of people involved in any war and the manner in which decisions have been taken by those in governance. This has been manifest in the various trends and patterns of military composition from small pure mercenary forces paid for by the leaders in society to mass conscription of the entire society. Similarly the age and gender of combatants has varied according to societal considerations.

Weapons of Mass Destruction

The second consideration in the manner in which war has changed has been due to technological developments. The larger the armed forces facing each other and the better trained the greater the inclination to seek technological innovations to overcome adversaries. Progressively with technological developments, war has become exceedingly quicker, more global and more devastating in its intensity, scope and after-effects. At the fore of such technological developments in the nineteenth and twentieth centuries have been weapons of mass destruction (WMD) and associated delivery systems. WMD typically comprise nuclear, biological and chemical components while delivery systems could be long-range artillery, land mines, submarines, aircraft and missiles. This has dramatically altered the nature of war, collective violence and conflict as the combination of WMD components and delivery systems has taken war away from hand-to-hand fighting where adversaries saw each other face-to-face in combat. Military personnel may sit in underground bunkers on opposite ends of the planet, in submarines below the world's oceans or in aircraft high above the earth without even seeing each other or even feeling the violence they inflict on each other's states and individuals. Further, the victims may not even be serving armed forces. To be sure, the area of destruction and the after-effects—such as radiation—tend to impact on large non-combatant civilian populations as well as the environment as such weapons, if and when used, cannot be contained solely to military targets.

Consequently, and associated with such technological developments, there have been innovations in tactics, strategy and doctrine on when to procure and how to use these weapons: namely the offense, the defense and the deterrent. Integral to this is the premise that these weapons, being weapons of mass destruction, have proven that there is little if anything that can be utilized to protect military targets or even the public at large. Passive defenses such as nuclear bomb shelters have limited value given that the residual radiation would still inflict injury; occupants cannot stay in them indefinitely while radiation may contaminate the environment for decades. Similarly mass inoculation of the population against many known biological weapons at the same time could have side-effects while other biological weapons are so deadly they have no known vaccination or cure. Gas masks need to have their filters changed every few hours in a safe environment. Moreover, active defense systems against missiles have yet to be developed.

This inability to defend against WMD has provoked military apprehension to use WMD in the offense for fear of retaliation and subsequent mutually assured destruction of both sides. It is for these reasons that both nuclear and biological weapons have been procured by states more as a political tool of compliance and deterrence than as a weapon of war. Moreover the public policy approach of predominately rational state leaders, spurred by public pressure in democracies, has been to adopt a two-prong approach to reduce the necessity for such weapons: namely arms control (non-proliferation) and disarmament (counter-proliferation). Despite this, it has also been recognized that no planning can prevent accidental or terrorist usage, necessitating substantial safeguard mechanisms by states that have pursued the intent to attain WMD capability.

Historical Cases of WMD

There are nevertheless different public policy approaches to nuclear and biological war, despite the commonality of deliberations and consequences. The policy approach to biological warfare has evolved over centuries given that it's existence has been recorded as long as the study of medicine. Ever since people realized that harmful viruses and bacteria could be artificially spread, man has attempted to apply this knowledge to kill fellow humans. Over the centuries such efforts have met with, at best, mixed success Historical use of such biological agents show them to be isolated and limited—not inflicting mass destruction. The use and successes are so few that they are quickly identifiable. One of the earliest recorded biological attacks was during the fall of Kaffa to the Tartars in 1346, which is generally credited to the systematic spread of plague. Another early record shows the use of smallpox in America by General Jeffrey Amherst in 1763 in the Ohio area. In response to certain native tribes in the area that had become increasingly hostile, the General wrote a letter to a subordinate outlining a plan to "extirpate this execrable race" via the dispensation of smallpox-infected blankets. The order was carried out with military efficiency. A smallpox epidemic duly took hold amongst the tribes with an ensuing high mortality thereby breaking the rebellion. Another attempted use of biological warfare occurred between 1754 and 1767 when the

British infiltrated smallpox-infested blankets to unsuspecting American Indians during the French and Indian war thereby decimating the Indians.

Modern biological warfare tending towards a weapon of mass destruction emerged during World War I. German agents attempted to spread glanders to French and Russian horses since the horse was the key form of military transport. The Germans hoped that a glanders epidemic could seriously limit the mobility of opposing forces. The success of the biological pathogens was limited for reasons unclear, while other military technologies, such as the tank, rapidly replaced the horse negating any potential success of the biological campaign against the horse. Subsequently the first real use of biological weapons that can be classified as an occurrence of mass destruction was in 1932. The Japanese Imperial armed forces began a series of horrific experiments on human beings at 'Unit 731' outside Harbin, Manchuria, China. Following this at least 11 Chinese cities were attacked with the agents of anthrax, cholera, shigellosis, salmonella, and plague, and at least 10,000 died.

By the Cold War period, after World War II, biology had become the most potent latent force in war. Theoretically, pathogenic agents could be the perfect potential weapon against massed armies in Europe and Asia: they were inexpensive, relatively easy to manufacture, and could inflict extremely high casualties on the enemy. Theoretically nothing could beat a biological weapon in pure killing power: the right weapon applied at the right time could literally annihilate an entire population. Further, biological weapons also had the tremendous side-benefit of not destroying infrastructure. The enemy's valuable buildings and capital would be left intact—it would only the enemy themselves who would be destroyed. Political planners agreed that such weapons could also deliver a potent psychological element, that of fear. Fear of disease would be fundamental to victory even without its use, particularly disease that could manifest itself in a widespread epidemic. Thus the mere presence of a weaponized disease in the ranks of an army or populace or the inference of its intended use could create a extraordinary amount of panic and chaos, far above and beyond the actual mortality of the sickness itself. The advantage of such chaos in the ranks of the enemy would in itself be militarily useful. Given such fear, the possession and threat of the use of such weapons would be politically useful as a tool of diplomacy in compliance and deterrence.

Problems of Deployment of WMD

Despite these compelling theoretical advantages, the Cold War military and political planners in the opposing super power blocs, NATO and the Warsaw Pact, recognised that there were major technical roadblocks to the actual deployment and use of such weapons. Two of the most important and relevant were the viability and dispersion associated with the living organisms that are the essential components of any biological weapon. Unlike a conventional explosive or nuclear-based weapon, a biological warhead cannot be easily mounted on a missile and fired at an adversary on the other side of the planet. Some of the organisms needed for the warhead could take months to cultivate while others would need to be kept in a viable and infectious state within the warhead in order to remain effective. Once deployed in a warhead in the most basic form environmental parameters such as temperature and pressure would have to be carefully controlled. Hence it would be difficult to ensure efficient delivery and dispersion of weaponized organisms via missiles or airborne bombs. Even if the biological component were to be deployed locally by soldiers on the ground such factors as wind, humidity and thermal patterns could easily frustrate the biological effects of such a weapon. Yet if these were to be overcome there would be more subtle problems since pathogens require very specific environments and constraints in order to infect. It would not usually be adequate to simply present the micro-organism to the enemy and then wait for them to die. The pathogen would need to be presented in the correct ecological fashion. Some organisms would be stricter than others in this regard, but it would always the case that the ecological and epidemiological nature of the disease would need to be understood before it could be utilized for war. Other drawbacks notably include the reality that living organisms have their own agenda and are thus not so easily controlled. A pathogen that could be applied to an opposing army could also easily spread to friendly forces or to a friendly civilian population. Similarly a military pathogen might be successfully used, only then to lie latent in a field. It would do little good to use a biological weapon against a city or airfield if that city or airfield was then denied to the attacker, due to the potential for further epidemics. Moreover the exact time taken to kill the adversary could not be calculated, making victory seem like the fog of war. In the calculus of these issues, professional military have found biological weapons to be unattractive to attain specific military targets for the political goal of victory.

WMD Governance

It follows, not surprisingly, that diplomats and heads of states have met on countless occasions to negotiate agreements to deny or delay the development and use of biological weapons. Notable multilateral international efforts in the 20th Century start with the Geneva Protocols (1925) signed for the main purpose of outlawing biological warfare. Despite good intentions, conflict and collective violence overcame prudence. By the late 1930's a number of countries had developed significant biological programs. Japan was one such country that subsequently used its biological weapons against China in World War II. During the Cold War both the super power blocs developed biological warfare capabilities, mainly out of paranoia that “the other side” was also developing them and hence the need to procure for deterrent purposes. Following the realisation of the irrationality of the possession of such weapons 144 countries signed a landmark treaty in 1972 during the period of detente. In sweeping terms the Biological and Toxic Weapons Convention (BWC) abolished the development, acquisition and stockpiling of all such weapons and made their use in any circumstance illegal. As in 1925, there were two main problems. First, the treaty provided no means of validation, verification and enforcement. Second, many nations resolved to cheat to gain an advantage over those who had complied. A partial list of cheaters includes the United States, France, China, Russia, Cuba, Israel, Iraq, Iran, North Korea, Libya and Syria. The Iraqis weaponized anthrax, botulinum toxin, and aflatoxin, using them in the Iran-Iraq War in the 1980s as well as on local populace such as the village of Halbja.

It was clear by 1999 that there was an essential need for a strict and reliable inspections regime for biological weapons given the demise of the bi-polar Cold War that had imposed a freeze on small state and non-state proliferates. This international reality combined with the emergence of domestic public pressure groups against the development of genetic engineering that was also being actively harnessed to the military cause, resulting in the formulation of a draft international agreement for an inspections regime. This regime bears the burden of a bleak but not a totally pessimistic future. As already noted, many countries find that the mere suggestion of the possession of incurable forms of existing pathogens—anthrax, smallpox, blood fevers as well as completely artificial organisms—functions as a deterrent against adversaries who might have aggressive intentions. It follows with no surprise that such deterrence functionality has given biological weapons the reference as the "poor man's nuclear weapon".

This proclamation is not surprising given that the main function of nuclear weapons has been as a deterrent to collective violence and war rather than as a usable military tool in conflict. Nuclear weapons, usually the use of the minerals uranium and plutonium as an explosive component placed in an artillery shell, bomb or missile warhead, were first developed for use in World War II. After initial theoretical advances the world entered the atomic age on December 2, 1942, at 3:25pm when a team of scientists led by Enrico Fermi in America were the first in history to initiate a self sustaining nuclear chain reaction and control it. This lead to a massive sustained effort known as the Manhattan Project to develop a nuclear bomb for military use. Originally the weapon was intended for use against Germany but the European theatre of war was concluded before the weapon was ready for use. Subsequently the American President Harry S Truman decided to bring a quick ending to the Pacific theatre of war. A nuclear bomb was dropped by a B-29 Super Fortress aircraft on Hiroshima, Japan August 6, 1945, and another on Nagasaki Japan August 9, 1945. Both cities were instantaneously destroyed with long term radiation illness suffered by the few survivors. The nuclear bombs had their successful military intent and war ended with the Japanese Emperor's announcement to the Japanese people on August 15, 1945. Nuclear weapons have not been used as a tool of war since then.

Many additional countries have actively pursued policies to attain nuclear capability in realizing the potential political advantage in addition to military capability of such nuclear weapons. The first was the USSR by surreptitiously pilfering nuclear technology from the American project. This led to a period from the end of WW II until 1989, known as the Cold War typified by collective security organizations such as NATO led by the USA and the Warsaw Pact led by the USSR who provided a nuclear umbrella to protect all alliance member states. It was called the Cold War as the opposing blocs never went into physical war with each other given the fear of the devastating capability brought by nuclear weapons—bringing the longest peace known to Europe in over 350 years. This devastating capability came, in part, from the military-industrial complex that was instrumental in producing progressively more powerful nuclear weapons and delivery systems. Originally nuclear weapons were bombs that could be dropped from aircraft like any other type of bomb. In addition, by the end of the Cold War delivery system included missiles launched from underground silos and submarines with multiple warheads and cruise missiles that could be launched from ships or aircraft 100s of kilometers from their targets. This arms race and technological developments ultimately made them militarily unusable given that the world was brought to the precipice of the destruction of the planet through the combined power of nuclear arsenals. This nuclear umbrella and its deterrence to war has been the lasting legacy of nuclear weapons.

In realizing the political potential of such weapons to deter war and with a desire to be a member of an elite nuclear weapons club, other states acquired weapons. This includes the five permanent members of the United

Nations Security Council—the United Kingdom, France, China, USA and Russia. These five states have tried but have not been successful in nuclear exclusivity; namely they have not been able to prevent the proliferation of nuclear technology. Nuclear tests have conducted by India and Pakistan in May 1998 and both nations have publicly declared themselves to in possession of a nuclear arsenal. Israel and North Korea are recognized as having nuclear weapons, but not having made a public display of such capability. As with biological weapons, the future is bleak but not totally pessimistic. The three smaller Soviet successor states that inherited nuclear arsenals (Ukraine, Kazakhstan, and Belarus) removed their nuclear warheads to Russia. It is also generally accepted that South Africa dismantled its nuclear weapons. Other states such as Germany and Japan have the capability to develop nuclear weapons, given the advanced nature of their nuclear energy projects, but have chosen not to do so.

As with biological weapons, states have met on countless occasions to negotiate agreements to inhibit, restrict and prevent the development, proliferation and use of nuclear weapons. This policy of arms control and disarmament has been spurred by public pressure groups such as the Campaign for Nuclear Disarmament (CND). To this end, intense and sustained diplomatic activity has given rise to a comprehensive international regime of arms control and disarmament pertaining to nuclear weapons. The first major nuclear weapons treaty to be signed was the Nuclear Non-Proliferation Treaty (NPT) adopted at the U.N. on 12 June 1968, opened for signature on 1 July 1968, and entered into force of 5 March 1970. Currently there are 187 parties to the NPT, including 185 of the 189 member nations of the U.N. (Switzerland and the Vatican have signed but are not UN members). The only holdouts are Cuba, India, Israel, and Pakistan. Other treaties restricting nuclear arms, their development, testing and proliferation include the Antarctic Treaty (1964), Nuclear Test Ban Treaty (1963), Outer Space Treaty (27 January 1967), Treaty of Tlatelolco (1967), Limited Test Ban Treaty (1968), Seabed Treaty (1971), SALT I (Strategic Arms Limitation Talks I) (1974), SALT II (Strategic Arms Limitation Talks II) (1985), Intermediate Range Nuclear Forces (INF) Treaty (1987), START I (Strategic Arms Reduction Talks I) (1991), START II (Strategic Arms Reduction Talks II) (1993), Comprehensive Test Ban Treaty (CTBT) (1996).

Inspections

Such international agreements provide for inspection and verification methods via the International Atomic Energy Agency (IAEA) and/or the European Atomic Energy Community (EURATOM). EURATOM and the IAEA are formal nuclear inspection agencies for nuclear material, were no such agencies exist for biological material.

The IAEA is a specialised agency of the United Nations formalised in the IAEA Statute unanimously approved by 81 nations in October 1956 that was created from the expectations and fears resulting from the discovery of nuclear energy. After the 1962 Cuban Missile crises it was clear that the safeguards prescribed in the Statute pertaining to individual plants and supplies of fuel were inadequate to deter proliferation giving rise to numerous USA-USSR bi-lateral agreements and multi-lateral agreements such as the Tlatelolco (1967) and NPT (1968). Thereafter its mission includes that of verifying, through its inspection system, that States comply with their commitments under the NTP Treaty and other non-proliferation agreements, to use nuclear material and facilities only for peaceful purposes. By the early 1980s the demand for new nuclear power plants had declined dramatically in the West, thereby reducing the IAEA's role. Isolated incidents such as the Three Mile Island Accident, Chernobyl, the 1991 discovery of Iraq's clandestine WMD program and the DPRK's violation of the NPT led to government's around the world calling for a strengthening of the IAEA's role in enhanced nuclear safety. Military nuclear activities are beyond the IAEA's statutory scope, though it has formed inspection teams for problems bequeathed by the end of the Cold War ie verification of the storage and peaceful use of dismantled nuclear weapons. The IAEA has also been mandated, ad hoc by the United Nations Security Council, to form inspection teams for commissions established by United Nations Resolutions such as U.N. Security Council Resolution 687 on 3 April 1991, which formed UNSCOM to monitor and verify Iraq's compliance with its undertaking not to use, develop, construct or acquire any weapons of mass destruction. The IAEA also formed and managed inspections for UNSCOM's successor—UNMOVIC.

The IAEA has no mandate over member states of the European Union nor any right to safeguard EU nuclear weapon states other than selected facilities on a voluntarily basis. All European Union states are automatically members of EURATOM, established by the founding EU Treaty of Rome (1957). EURATOM is formally the owner of all nuclear materials in all EU countries holding exclusive right to validate contracts, inside or outside EU, following the utilities concluding their own contracts. There is an exception that applies to Special Fissile Materials (plutonium and high-enriched uranium) that is left to the disposal of the producer, to be stocked and used for its own needs, or to be placed at the disposal of other connected companies. EURATOM maintains safeguards and inspections to ensure that no diversion of nuclear materials takes place "for other than intended uses" allowing this to be military use in contrast with IAEA safeguards. There are no reactors under construction in the EU. Only Britain and France are declared nuclear weapon states, while reducing their arsenals, where no other EU state is seeking military nuclear capability. Seven EU states do not have nuclear power and four more have the political objective of phasing out nuclear power programs. Fourteen of the fifteen EU states have rejected any growth in civil nuclear capacity.

EURATOM and the IAEA have found that for the main part, most states have adhered to their agreements, acknowledging the Cold War reality that nuclear weapons are more of a deterrent to war than a tool of the armed forces in actual conflict. Similar to biological weapons, there is general apprehension that unguarded nuclear weapons and technology might fall into the hands of non-state entities such as terrorists while accidents might happen.

Terrorism

Terrorists, many of whom are irrational or lack sensitivity to the ramifications of their actions, may find advantages in the disadvantages of biological and nuclear weapons for the armed forces of nation-states. Terrorists do not always wish to occupy a territory or to supplant an existing system of governance. Given this there is appeal in nuclear weapons, which physically destroy infrastructure including entire cities, and biological weapons which make similar areas unusable for years or even decades. Some terrorists perpetrate terror for the sake of terror. The good news is that there is no known possession of nuclear weapons by any terrorist entity. This is not the case with biological weapons. The worst fears were realised in 1995 when the Aum Shinrikyo cult, that released sarin nerve gas in a Japanese subway, was also found to possess rudimentary biological weapons including anthrax, botulism, and Q fever. Terrorists will find it easier to acquire, weaponize and deploy biological weapons over that of nuclear weapons given the readily available components “over the counter” which makes it the most feared weapon of any non-state entity.

Conclusion

In sum, it is clear that both nuclear and biological weapons are by far the most devastating types of weapons that could potentially be used in war, together with chemical weapons. Military planners consider them as weapons of last resort. Given this, political leaders have for the main chosen not to use these weapons as tools of combat. It follows that in practise nuclear and biological weapons are more akin to tools of diplomacy as a deterrent to war. If both opposing sides possess nuclear and biological weapons then a stalemate would ensue, as was the case between the USA and the USSR during the Cold War. Should one side not possess such weapons then the premise rests on the option of surrender or suicide; where rational leaders would prefer surrender. Should neither side possess such weapons then there exists the risk of escalation to obtain them to gain a form of leverage to compel an adversary to surrender. To be sure, nuclear and biological weapons should be placed in perspective of war that is waged by conventional weapons. The facts and figures show that nuclear and biological means are the exception rather than the rule. In the past 350 years there have more than 700 wars between states; nuclear weapons having only been used in one war by one side with biological weapons having only been used in six wars. The real risk remains that should terrorists acquire such weapons then they might be used for the sake of terror alone. Public policy efforts are aimed at preventing this.

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World Bank

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Introduction

Headquartered in Washington, DC, with a staff of approximately 9,300 people worldwide, the World Bank (or "The Bank") is the world's premier multilateral economic development institution. It was conceived in July 1944 at Bretton Woods, New Hampshire, together with the International Monetary Fund (IMF), to help rebuild Europe, following the destructions of World War II. It came into formal existence as the International Bank for Reconstruction and Development (IBRD) in December 1945, after the ratification of its Articles of Agreement by 29 governments. The Bank commenced its operations on June 25, 1946, with Eugene Meyer, an American investment manager, as its first President (Peet 2003; the World Bank 2005a). The Bank's very first loan, to the tune of US$250 million, was granted to France in 1947 for postwar reconstruction—in real terms, this remains the largest single loan issued by the Bank to date. Available records (notably, the World Bank 2005b) show that by August 1947, the budding Bank had authorized reconstruction loans to the Netherlands (US$195 million), Denmark (US$40 million), and Luxembourg (US$12 million). With the realization that the postwar reconstruction of Europe would take more than such piecemeal loans, the United States, almost single-handedly, established the European Recovery Program (or the Marshall Plan) of 1947, thereby relieving the Bank of its heavy reconstruction burden. While reconstruction, relating especially to natural disaster and post-conflict rehabilitation, remains an important part of the Bank's activities, much of its contemporary preoccupation is on poverty alleviation, with its publicly stated mission "to fight poverty and improve the living standards of people in the developing world" (World Bank 2005c). During its early years, the Bank relied mostly on the expertise of engineers, financial analysts, and economists; but today it has become far bigger and more complex, employing a wide variety of physical and social scientists, public policy experts, and sectoral analysts from about 160 different countries in pursuit of its overarching goal of poverty alleviation.

Organizational Structure and Purpose

To be precise, the World Bank is part of a big, multifaceted conglomerate called the World Bank Group, made up of five closely related development institutions, which include:

The International Bank for Reconstruction and Development (IBRC), which was established in 1945 with the original intent of helping to reconstruct postwar Europe, but now focusing mostly on poverty reduction in the developing world through the allocation of loans, grants, and technical assistance. The IBRD now has 184 members with a cumulative lending of US$394 billion, as of August 2005 (World Bank 2005d);

The International Finance Corporation (IFC), which was established in 1956 to promote private enterprise through the provision of technical assistance, loans, and equity financing to private investors, without accepting government guarantees. The IFC now has a membership of 178 countries and a cumulative committed portfolio of US$23.5 billion, as of August 2005;

The International Development Association (IDA), which was established in 1960 to provide loans to the poorest and non-creditworthy countries of the South. Its loans are generally interest-free, but carry a 0.75 *per cent* administrative fee. The IDA now has 165 members and a cumulative loan commitment of about US$150 billion by August 2005;

The International Center for Settlement of Investment Dispute (ICSID), which was established in 1966 to help settle investment disputes between governments and foreign investors. The ICSID has "full international legal personality" with the capacity "to contract; to acquire and dispose of movable and immovable property; and to institute legal proceedings" (World Bank 2005e). The ICSID has a membership of 165 and a cumulative total of 159 registered cases by August 2005 (World Bank 2005d).

The Multilateral Investment Guarantee Agency (MIGA), which was established in 1988 to provide investment insurance for noncommercial risks, such as currency inconvertibility, war, civil unrest, and breach of contract. MIGA also provides advisory and technical services to help developing countries attract foreign investment. It now has 165 members, and has issued cumulative guarantees of up to US$13.5 billion by August 2005 (World Bank 2005d).

Each of the five institutions of the World Bank Group is owned and controlled by its member governments which subscribe to its basic share capital. While all five constitute the World Bank Group, the term World Bank (or the Bank) is usually used (as in what follows) to refer specifically to the International Bank of Reconstruction and Development (IBRD) and its closely-related (albeit, legally distinct) subsidiary, the International Development Association (IDA). It bears acknowledging that, since the IBRD and IDA are legally distinct entities, bundling them here, as is often done (see Peet 2003), is a bit problematic, even though the World Bank lists both the IBRD and the IDA on its official letterhead.

The operations of both the IBRD and IDA resemble those of a regular bank in the sense that they both grant loans and credits to member countries. However, the World Bank (i.e., IBRD and the IDA) is not a bank, in the common usage of the word, but one of the many specialized agencies of the United Nations and, consequently, does not operate for profit, for one thing (Peet 2003).

The purpose of the World Bank as stated in the original Bretton Woods Articles of Agreement is fivefold:

"(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.

(ii) To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

(iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.

(iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to peacetime economy (the World Bank 2005f)."

The World Bank is owned by its member nations, or shareholders. The number of shares and votes held by members varies somewhat, but not exclusively, in accordance with the size of their respective economies. Thus, as with the IMF, the World Bank is dominated by the rich nations of the North, most notably, the United States, which now holds 16.41 *per cent* of the total votes; other influential members are Japan (7.87 *per cent*), Germany (4.49 *per cent*), United Kingdom (4.31 *per cent*), and France—4.31 *per cent* (World Bank 2005g). At the same time, to be fair, we must note that the IBRD has an allotment of 250 basic votes to each member to help reduce some of the economy-based vote disparities.

The member countries are represented at the Bank by a Board of Governors, which is the final decision-making body of the institution. These Governors meet once a year at the Bank's Annual Meetings. The day-to-day operations of the Bank are delegated to the Bank's 24 Executive Directors, five of whom are appointed by the top five shareholders—United States, United Kingdom, France, Japan, and Germany—with the remainder elected by the other members. The Executive Directors meet as often as the business of the Bank warrants. They deliberate and decide on loans, grants, and other applications to the Bank—in conjunction with several Vice Presidents—before making proposals to the President for final approval (World Bank 2005g). The Presidency of the World Bank is customarily given to the United States (which also has the largest number of shares and votes) as part of a 'gentlemen's agreement' between United States and Europe in exchange for the *de facto* right of Europeans to nominate the head of the IMF. Thus, whereas the IMF has always been headed by Europeans, all the past and present Presidents of the Bank have been American citizens; they include Eugene Meyers (June 1946-December 1946); John J. McCloy (March 1947-June 1949); Eugene R. Black (July 1949- December 1962); George D. Woods (January 1963-March 1968); Robert S. McNamara (April 1968-June 1981); Alden W. Clausen (July 1981-June 1986); Barber B. Conable (July 1986-August 1991); Lewis T. Preston (September 1991-May 1995), James D. Wolfensohn (June 1995-May 2005); and Paul Wolfowitz, from June 2005 (World Bank 2005h) to June 2007.

Financial Resources and Lending Facilities

The World Bank raises its funds primarily from the private financial market through the sale of bonds, discount notes, and other debt securities (Peet 2003). On an annual basis the Bank raises anywhere from US$12 to US$15 billion; for the 2004 fiscal year, for instance, it raised US$13 billion (the World Bank 2005i). The Bank uses its AAA-credit rating (derived mainly from the guarantees of the OECD governments) to procure funds from the international capital market, which it, in turn, lends to its middle- and low-income member countries. In addition to these debt products, the Bank derives some of its financial resources from interest on its loans, members' capital subscriptions, and regular donations from its rich members (Peet 2003). IBRD loans are for the most part given at near-market terms, but with relatively longer maturity periods, ranging from 15 to 20 years with an additional three-year grace period. The main recipients of IBRD loans are middle-income countries, such as those in Asia, Latin America, the Caribbean, and Eastern Europe. In 2004, for instance, out of the total lending of US$11 billion by the IBRD, a whopping 45 *per cent* went to Latin America and the Caribbean, with the remainder going to the regions of Europe and Central Asia (27 *per cent*); East Asia and Pacific (15 *per cent*), Middle East and North Africa (9 *per cent*), and South Asia—4 *per cent* (World Bank 2005i).

The IDA, on the other hand, concentrates on the very poor countries of the world with interest-free loans, credits and, more recently, grants; the latter is becoming all the more popular due to the Bank's increasing zeal towards poverty reduction. Unlike the IBRD, which depends mainly on the sale of bonds for much of its financial resources, the IDA is financed mostly by donor countries, which meet every third year to pull their resources together for future IDA operations. IDA loans generally have longer maturity dates: ranging from 35 to 40 years, with as much as a 10-year grace period. To qualify for IDA loans, the member nation should have no more than US$865 in *per capita* gross national income. Unsurprisingly, Africa features quite prominently in IDA loans. During the 2004 fiscal year, for instance, Africa topped the list of all regions that received IDA funding, with a share of 45 *per cent* of the nine-billion-dollar total for the year (World Bank 2005i). Other notable regions in this regard include South Asia (33 *per cent*) and East Asia and Pacific (10 *per cent*), with the remaining 12 *per cent* going to the countries of the Middle East and North Africa; Latin America and the Caribbean; and Europe and Central Asia (World Bank 2005i**).**

The World Bank has two main lending facilities, namely, *investment lending* and *development policy lending*—the latter replaced the erstwhile Structural Adjustment Lending Facility recently (World Bank 2005j). Investment lending, which constitutes about 75 to 80 *per cent* of the Bank's lending, is used to fund a wide range of physical infrastructural projects, social services, and post-conflict reconstruction. Development policy loans, which constitute about 20 to 25 *per cent* of the Bank's lending, are geared toward long-term structural reforms. They are usually granted by the Bank, working in conjunction with the IMF. Until recently, development policy loans were used primarily to support macroeconomic policy reforms and sectoral reforms in such areas as agriculture, forestry, and mining, under the Structural Adjustment Programs (SAPs), within the overarching framework of neoliberalism and the Washington Consensus. The latter refers to an unwritten consensus emanating from long-standing consultations between several Washington, DC-based institutions (e.g., the IMF, World Bank, US Congress and US Treasury Department), which emphasize macroeconomic stability, free-trade, privatization, and financial deregulation in their dealings with the countries of the South (Stiglitz 2003:16; De Rivero 2001:56). It was following intense public outcry and protest from civil society organizations, academics, policy maker, and many other concerned groups that the Bank recently replaced its adjustment lending with the development policy lending, which now covers not only structural and sectoral reforms, but also initiatives in poverty reduction, capacity building, democratic governance, tax reforms, civil service reforms, human development, and legal and regulatory reforms. Like the investment loans, the Bank's development policy loans are given to middle- and low-income countries. With the increasing realization that development programs could hardly succeed without a deep sense of control on the part of the borrowing nation and its citizenry, the Bank is now using this policy-based lending to promote national ownership of programs, by encouraging broader consultations with the public and stakeholders in the design and implementation of its development programs (World Bank 2005j).

Development Activities and Paradigm Shifts over the Years

Currently the World Bank is involved in more than 1,800 development projects in nearly all socioeconomic sectors across the developing world. These projects range from providing micro-credit in Bosnia Herzegovina, improving access to health care in Mexico, helping raise awareness about HIV/AIDS in Guinea and the Republic of South Africa, enhancing the education of girls in India and Turkey to assisting in the reconstruction of post-conflict East Timor, fighting river-borne diseases in Senegal, and assisting in rural development projects in Tanzania (World Bank 2005b,k; Mallaby 2005).

The striking feature of World Bank funding in recent years is its growing support for social services (e.g., education, health, and nutrition) and environmental sustainability (Prah 2005; Peet 2003). In fact, the Bank is now the leading external financier of education projects in the world, with some US$30 billion in loans and credits committed to more than 150 such projects in about 83 countries in 2005 (World Bank 2005c and 2005k). Similarly, the Bank leads all external funders in the fight against HIV/AIDS for which it has committed billions of dollars in the developing world, especially in Africa—home to as much as 70 *per cent* of the world's 42 million infected people (World Bank 2005k). With regards to environmental sustainability, the Bank is now involved in a host of biodiversity, water resources, and pollution control projects in conjunction with several environmentally conscientious groups and foundations such as the MacArthur Foundation, Conservation International, and the Washington, D.C.-based Global Environment Facility (World Bank 2005k).

Yet, until the 1960s the Bank's preoccupation was almost exclusively on large physical infrastructural projects, especially those dealing with hydro-electric power dams, transportation and, to a lesser extent, telecommunication. Meager support was given to the social sector, be it education, healthcare, or sanitation (Prah 2005; Peet 2003). That was hardly surprising for a number of reasons: First, the prevailing development wisdom at that time saw economic growth, as measured by macroeconomic indicators such as gross national product or growth rates, as the surest path to development. A corollary of this thinking was the belief that the best way to accomplish economic growth was through capital investments in physical infrastructure, such as roads and power plants, to help alleviate what was purportedly the main obstacles to progress: physical barriers, frictions of distance, and poor rural conditions. Secondly, from the perspective of the Bank, which was then operating primarily as a financial, rather than a development, institution, investments in such tangible, mega-projects were preferable, if not more valuable, because they were naturally readily visible, easily defined, and more amenable to quantitative measurements and direct monetary returns. We must remember too that during that time, a far greater proportion of the Bank's financial resources (at least, until the creation of the IDA in 1960) emanated from the sale of bonds to Wall Street investors whose ideas of financial prudence couldn't be informed less by the social and ethical ramifications of capital investments. Many were those investors who actually believed that investments in social provisions (e.g., education, water, healthcare, etc.) did not normally, or at least directly, increase the borrowing country's ability to repay its loans. Thirdly, from the standpoint of national politicians, such mega-projects offered, as have always been the case, good opportunities for self-serving ceremonies, monuments, and politically expedient photo-ops, not to mention avenues for corruption and favoritism. So strong was the emphasis on mega infrastructure projects that, between 1948 and 1961, power and transportation projects accounted for a whopping 87 *per cent* of the Bank's lending to less developed nations (Prah 2005)

This tilt in the Bank's funding towards physical projects continued till the late 1960s when Robert McNamara used his presidency (from 1968-1981) to move poverty reduction to the centre of the Bank's operations. This transformation—informed by the basic needs approach to development that was becoming popular among academics and policy makers at the time—questioned the veracity of the prevailing orthodoxy that gave primacy to economic growth, and the attendant emphasis on physical capital at the expense of human capital. It was becoming clear to many observers then that outcomes of investments in physical infrastructure were no where near what could be possibly ascertained through investments in human capital, with such provisions as good, affordable education, health care, nutrition, family planning and the like. And as the basic needs approach gained currency, the Bank began to see itself not so much as a financial institution as a development agency, whose aim was to help alleviate poverty and improve the human condition in the developing world. Notable example of the Bank's basic needs lending in this early period included a 1970 Fertility Planning loan to Jamaica; a 1974 education loan to Malaysia and another in the same year to Oman to construct and equip that country's very first primary teacher training institution; and the highly successful *Onchocerciasis* (river blindness) Control Program of 1974, undertaken in conjunction with WHO and UNDP in West Africa (World Bank 2005b,k).

Despite the Bank's turn towards the social sector (including population-control), loans in this sector never exceeded those approved for mega-infrastructural projects, let alone replaced them. For instance, the Bank's very first financing for family planning, which went to Jamaica in 1970, amounted to US$2 million. By the end of 1973 fiscal year, the Bank's total lending for population control worldwide had increased to US$22 million—this obviously amounted to a sizeable relative increase; yet it constituted a mere 3 *per cent* of the Bank's lending for transportation (US$682 million) and about 7 *per cent* of its funding for electric power ($322 million) during the same fiscal year (Prah 2005). What makes this disparity even more remarkable was the fact that McNamara for one saw the population problem as one of the greatest obstacles in poverty alleviation (Prah 2005).

Peet (2003) speculates that the motives behind McNamara's move towards poverty alleviation "seem to have combined genuine, compassionate generosity with the realization, intensified by the Vietnam disaster, that US national security was incompatible with a world of poverty" (p.119). One could also assert that the then US President Lyndon Johnson's war on poverty, promulgated through his *Economic Opportunity Act* of 1964; the civil right movement of the time, which culminated in the signings of the *Civil Rights Act* of 1964 and the *Voting Right Act* of 1965; and the introduction of Medicare and Medicaid in 1965 made poverty alleviation an acceptable, and perhaps even palatable, social theme in the minds of many American citizens and investors then. Equally plausible is the conjecture that some of the North's appetite for poverty alleviation in the South then emanated from the dynamic realities of the Cold War: It was not unreasonable then to argue for poverty alleviation funding on grounds that it was an investment in the fight against the spread of communism and in world peace. Not only that, by the late 1960s and the early 1970s, criticisms over the environmental devastations wrought by many of the Bank-sponsored mega dams, such as the Volta River Project and the Akosombo Dam in Ghana, the Ganges-Kobadak Irrigation Project in Bangladesh, and many others in places like India, Pakistan, Bangladesh, and Thailand were becoming highly vociferous not only in the development circle but also in the popular press (Caufield 1996). In fact, such criticisms continue to follow the Bank today, with even increasing intensity, given its enduring interest in funding such projects across the world (the World Bank 2005b).

By the early 1970s, the Bank was putting more of its basic needs funding into agricultural and rural development projects which culminated in the popular notion of "integrated rural development" during the McNamara era (World Bank 2005b). In a landmark address to the Bank's Board of Governors, held in Nairobi, Kenya, in September 1973, McNamara proposed a strategy for integrated rural development with small-scale farming at its core (the World Bank 2005b). However, much of the Bank's efforts in agriculture, in particular, and rural development, in general, were frustrated by its acute dearth of insight into the land tenure systems and the cultural values of many of the agricultural communities it sought to assist. And, as Peet (2003:120) points out, "well before the end of McNamara's presidency, the ardour had gone from the poverty initiative;…debt and balance of payment in the Third World became leading issues, with structural adjustment as the solution."

World Bank and SAPs

Joseph Stiglitz in his *Globalization and its Discontent* attributes the Bank's (and the IMF's) dramatic shift towards SAPs to the neoliberalism advocated by the Thatcher and Reagan governments in the United Kingdom and the United States, respectively, during the 1980s. As he puts it "the IMF and the World Bank became the new missionary institutions, through which these ideas were pushed on the reluctant poor countries that often badly needed their loans and grants" (Stiglitz 2003:13). A similar view is held by Harvey (2003), who observes—under the pithy sub-heading of "Accumulation by Dispossession" in his *The New Imperialism*—that:

"Together with Reagan, she (Thatcher) transformed the whole orientation of state activity away from the welfare state and towards active support for the 'supply-side' conditions of capital accumulation. The IMF and the World Bank changed their policy framework almost overnight, and within a few years neo-liberal doctrine had made a very short and victorious match through the institutions to dominate policy, first in the Anglo-American world but subsequently throughout much of the rest of Europe and the world" (p. 157-58)."

The changing of the guard from the McNamara presidency to that of William Clausen in 1981 provided an additional impetus for the rapid diffusion and acceptance of the neo-liberalism at the Bank. For one thing, whereas Hollis Chenery, the Harvard development economist who served as adviser to McNamara, was a strong believer in Keynesian economics, especially in its acknowledgement of the important role of the State in development, the Stanford University professor Anne O. Krueger, who became the Chief economist under Clausen (and now the first Deputy Managing Director of the IMF since 2001), saw the State as a key rent-seeking instrument in the developing world and, thus, a major part of the development problem that needed redress (Stiglitz 2003:13). Under the influence of Clausen, Krueger and many other "free marketeers"—to borrow Dunkley's (2004:1-2) term—privatization, liberalization, deregulation, and commodification within the framework of SAPs became the mantra of the

Bank in its dealings with developing countries. This initiated a new regime of *accumulation by dispossession*, entailing the release of "assets held by the state or in common into the market where overaccumulating capital could invest in them, upgrade them, and speculate in them" (Harvey 2003:158). This regime involves (il)legal and (un)subtle mechanisms of predation, which, in turn, boost the material resources of dominant groups, institutions, and nations, while at the same time dispossessing or bilking the subaltern and the poor in the global South.

The Bank works with the IMF in pursuance of its adjustment programs. The latter, which is generally considered the senior partner in the ensuing division of labour, takes the lead with its short-term stabilization programs aimed at resolving macroeconomic problems relating to trade deficit, inflation, monetary policy, and the like, before the Bank comes in with its long-term structural adjustment-proper, dealing with anything from government spending and taxation, privatization and divestiture, and financial liberalization and deregulation to international trade policy, labour market regulations, and civil service reforms.

Even though much of the theoretical and empirical grounding for the Washington Consensus, upon which the adjustment programs are based, came from responses to the economic problems that were somewhat specific to Latin American countries (Stiglitz 2003:16), by the late 1980s adjustment programs were being applied quite religiously to virtually all countries of the South. We thus find fairly similar SAPs conditionality across the developing world, most notably in sub-Saharan Africa, where SAPs have dominated economic policy making since the early 1980s (Noorbakhsh and Paloni 2001). SAPs conditionality generally entails privatization, trade liberalization, currency devaluation, export promotion, the removal of government subsidies and price control mechanisms, and cut-backs in government jobs, wages, and social spending (Mosley, Harrigan and Toye 1995). The immediate effects of SAPs have been economic austerity, experienced through price hikes for erstwhile subsidized essential goods and services; the proliferation of user fees in social services; rising unemployment, poverty, and many such social predicaments. No wonder SAPs-induced riots have become a common fixture of the social resistance movement in the South: From Algeria, Benin, Nigeria and Ghana through Sudan and Uganda to Zambia, in the case of Africa; from Argentina, Bolivia, and Dominican Republic through Ecuador, Jamaica, and Mexico to Venezuela, in the Latin America and Caribbean region; and from Indonesia and Jordon through Malaysia and the Philippine to Russia, in the case of Asia and Eastern Europe (Peet 2003).

At the same time, it is important to note that the intense criticisms that followed the Asian and Latin American financial crises, among many other SAPs-induced social and economic problems in the developing world, prompted the Bretton Woods institutions to move into what some now call a post-Washington Consensus—involving a shift from extreme, market-friendly neo-liberalism towards poverty reduction; egalitarianism; democratic governance; capacity building; and civil society, social capital, and diaspora mobilization initiatives.

Collaboration with IMF and other Institutions

The Bank has long-standing working relations with the IMF. Indeed, besides SAPs, the Bank works with the IMF on a number of important global fronts—by way of high-level coordination, regular meetings, exchange of information, and joint mission and programs—of which the Heavily Indebted

Poor Countries (HIPCs) initiative and the Financial Sector Assessment Program deserve special mention here (Mallaby 2005; World Bank 2005c,l).

Following years of public outcry—and intense internal advocacy by James Wolfensohn, in particular, who 'fought' against the IMF and most of his own staff at the World Bank—over the acute financial constraints wrought by the debt service obligations of 'Third World' nations, the Bank and the IMF launched the HIPCs (more precisely HIPCs I) program in 1996 to provide a framework by which creditors could provide debt relief to the poorest and most heavily indebted countries of the world. Unlike previous *ad hoc* debt relief programs, the HIPCs program is a comprehensive, multi-step initiative, which enjoys the support of nearly all multilateral creditors (the World Bank 2005l). In 1999, the program was revamped under HIPCs II, with intense pressure from *Jubilee 2000* (J2K), to provide even faster, deeper, and broader relief by lowering the threshold of eligibility and by instituting new guidelines by which countries could move from the 'decision' to 'completion' points faster. HIPCs II has one important conditionality: that all freed resources be used for poverty reduction, in pursuance of which national governments are required to provide a comprehensive Poverty Reduction Strategy Paper in consultation with the general public, key stakeholders, and civil society organizations.

Some 38 countries are currently potentially eligible for debt relief under HIPCs, of which 32 are in Sub-Saharan Africa (World Bank 2005l). The Bank's main contribution to the HIPCs involves the forgiveness annual debt service due on IDA debts and the establishment of the HIPCs Trust Fund to support and reimburse the debt relief provided not only by the IDA but also by other regional and sub-regional multilateral creditors. The IMF for its part supports the initiative with assistance provided through its Poverty Reduction and Growth Facility (IMF 2005; World Bank 2005l).

Another high-profile development initiative on which the Bank is collaborating intensively with the IMF is the Millennium Development Goals (MDGs) promulgated in September 2000 at the United Nations Millennium Summit. Essentially, this declaration aims at reducing the level of poverty by half by 2015, in addition to initiatives to promote general equality, improve maternal health, achieve universal primary education, combat HIV/AIDS, and promote environmental sustainability. The Bank and the IMF contribute to the attainment of these lofty goals with their Global Monitoring Report (GMR), which provides an annual assessment of the progress made regarding the MDGs. Another noteworthy collaboration between the Bank and IMF is done through the Financial Sector Assistance Program (FSAP), which was launched in 1999 to boost the resilience of member countries' financial sectors, by identifying the strengths and weaknesses of national financial systems and making recommendations for improvement, if needed.

Besides the IMF, the Bank collaborates with many other international institutions, such as the WTO, WHO, FAO, UNICEF, and UNDP, depending on the particular trade-, health-, poverty reduction- and development-related issues at hand. For instance, the Bank is now working with the UNDP to provide basic public goods and to create conducive environment for the restoration of functioning national government in war-ravaged Somalia. Similarly, the Bank has teamed up with WHO in the global fight against diseases such as HIV/AIDS, *Tuberculosis*, *Onchocerciasis* and, more recently, the Avian (bird) flu outbreak in Asian countries such as Cambodia, Vietnam, and China. Also, since the mid-1990s, when the Bank started hiring civil society specialists to work in its headquarters and regional offices worldwide, it has been collaborating with a wide range of civil society organizations, such as indigenous peoples' organizations, labor unions, and faith-based groups etc. (the World Bank 2005i,k).

Prevailing Critiques and Polemics

For decades now the World Bank has projected an image of a development institution geared towards improving the human condition across the globe, in general, and in the developing world, in particular. To be fair, the Bank has made significant contributions to world development over the years: In addition to providing loans and grants to middle- and low-income countries and helping in the reconstruction of war-torn nations from Angola, Burundi, Rwanda, and Somalia in Africa through the Balkans (i.e., Bosnia Herzegovina, Croatia, Yugoslavia, and Macedonia) to Sri Lanka and onto East Timor in the far east, the Bank has long been an active participant in the fight against global scourges such as HIV/AIDS, malaria, and tuberculosis. Additionally, the Bank remains a leading sponsor of a wide range of mega infrastructural projects worldwide.

At the same time, set in juxtaposition with the growing North-South economic inequality in the midst of ubiquitous World Bank (and IMF) sponsored adjustment programs, it is not unreasonable to accord the Bank some culpability or, at the very least, to question the authenticity of the Bank's claim to alleviate poverty—and this is exactly what a number of intellectuals, policy makers, development practitioners, and civil society organizations are doing with a chorus of hard-hitting criticisms and polemics. For the most part, criticisms of the Bank relate to the overwhelming control exerted by the Western industrialized nations, notably the US, over its operations; the environmental devastations caused by many of the Bank-sponsored mega-projects; the adverse social consequences of its adjustment programs; and the growing poverty and debt service burdens across the developing world (Caufield 1996; Stiglitz 2003; George 2001).

As with the IMF, many are those who see the Bank as nothing but an instrument of Western hegemony and neocolonialism, operating with a hidden agenda to siphon-off financial and material resources from the developing to the developed world. Even though some critics are hesitant to go as far as alleging any grand conspiracy; others, including Susan George of the Transnational Institute and the British development scholar Robert Biel do not mince words at all. This is how Robert Biel, for instance, cast his 'conspiracy theory' in relation to the Bank and IMF's adjustment programs:

"The liberal critique of structural adjustment programs (SAPs) often assumes they are wildly mistaken, but this is to forget that SAPs are not really there to help countries develop, but to integrate them into the system of the self-expansion of capital. If they make the people poorer, this could be a sign that they are doing a very good job (Biel 2000:231)."

Biel contends that the debt crisis in the developing world was (or is) hardly fortuitous. As he puts it: "In the colonial days, the local community was made subservient to the international capitalist one by introducing taxes; in order to pay these, families had to switch to cultivating cash crops. The modern equivalent is the 'debt' which forces countries to sell their output rather than consume it. In this way the debt crisis fitted in neatly with the overall picture. … The 'debt' guarantees, in straightforward fashion, that the value generated by export promotion will not fund local development. Export earnings effectively simply become debt repayment. In remarkable fashion, the North has its cake and eats it too" (Biel 2000:237-240).

Given the Bank's (and more so the IMF's) common demand, until recently, for currency devaluation in the developing world—a demand that invariably makes their exports far cheaper for people in the developed world—one could not help but to be sympathetic to Robert Biel's position, as expressed in the above quotation.

Dwelling mainly on a 1982 to 1990 dataset from the OCED, Susan George demonstrates the extent to which the Southern countries have remitted their Northern counterparts over the years through debt servicing. According to her, for the 108 months—from January 1982 to December 1990—the debtor nations of the South paid an average of US6.5 billion, per month, to the creditor countries of the North in interest alone. If payments of principal are added to the equation then the South-North remittance goes to an average of US$12.45 billion, per month, for the 108 months covered. Susan George further estimates that during that period, the North-South resources flow totaled some $927 billion, compared to a South-North resource transfer of $1,345 billion (in debt service alone). This amounts to a net South-to-North outflow of US$418 billion—which, according to her, is equivalent to the South supporting the North to the tune of six times the Marshall Plan with which the US financed the postwar recovery of Europe.

Based on these calculations, it is probably not controversial to agree with Susan George (2001:207) in observing that: "If the goals of official debt managers (i.e., the World Bank and the IMF) were to squeeze the debtors dry, to transfer enormous resources from South to North, and to wage undeclared war on the poor continents and their people, then their policies have been an unqualified success. If, however, their strategies were intended—as these institutions always claim—to promote development beneficial to all members of society, to preserve the planet's unique environment, and gradually to reduce the debt burden itself, then their failure is easily demonstrated." Such profoundly perturbing revelations about South-North resource transfer could also be found in a 1989 UNCTAD report which noted that since 1983, capital outflows from developing countries to the developed world exceeded that going in the reverse direction (UNCTAD 1989:38). What is perhaps worthy of reiteration here is the belief among many analysts that much of this resource transfer is instigated, or at least overseen, by the World Bank (and the IMF and, to some limited extent, the WTO)—the 'supranational clergy' or the 'unholy trinity' to borrow the phrases of De Rivero (2001) and Peet (2003), respectively.

This is how Abdoulaye Wade (once a Minister of State in Senegal) puts it in the specific case of Africa: "Two facts emerge from the World Bank's accounts. The first is that Africa is paying this institution more than it receives from it. Which means that, contrary to the received wisdom, African poverty is financing the long-term wealth of the rich countries. The second fact is that the Bank, on a global level, is in financial difficulties. It is therefore thanks to our repayments that it manages to survive (quoted in Rahnema 2001:208)."

With its exclusive focus on, and active involvement in, the economies of the developing world, coupled with the overwhelming power wielded by its First World members via the skewed voting formulae, it is not difficult to see why critics would perceive the Bank as an instrument of re- or neo-colonialism, especially given the widening North-South income gap. A corollary of the neocolonization charge is the attack that the Bank often uses its loans, and their attendant conditionalities, to interfere in the domestic affairs of developing countries and, in extreme cases, to undermine the basic sovereignty and political power of poor nations with highly austere conditions, which inexorably engender mass disenchantment (Mosley, Harrigan, and Toye 1995). We thus find De Rivero (2001), for instance, lamenting that:

"[U]nder the supervision of the IMF and the World Bank, the so-called developing countries….have lost democratic control of their national economic and financial policies. This supranationality is continuing to spread, and threatens even to overrun political aspects that were formerly the exclusive province of the sovereign state, such as state objectives, governance, and military expenditure." (p. 55)

Besides the alleged erosion of sovereignty, there are critics, such as Benjamin Barber (1996), who contend that the Bank and kindred institutions have jeopardized democratic development in many former Soviet Republics, in particular, by focusing strictly on economic policies and programs to the virtual neglect of social issues such as income distribution and poverty. According to Barber (1996:15) "this is perhaps why majorities in all but a handful of ex-Soviet lands have been busy reelecting former Communist officials … to their new democratic legislatures." Not only that, until the advent of the second and third generations of SAPs in the late 1980s and of the post-Washington Consensus in the late 1990s, the Bank was not really concerned about democratic and institutional reforms in the poor nations it dealt with. The general belief was that democracy was, perhaps, not conducive for economic reforms—hence the much-touted 'authoritarian advantage hypothesis' by which the human right abuses of such regimes as the Ferdinand Marcos government in Philippines, Augusto Pinochet's in Chile, and Jerry Rawlings' in Ghana were willfully overlooked by the Bank in pursuance of its SAPs. Writing on the specific case of Ghana, Boafo-Arthur (1999:17) had this to say: "the IMF and the World Bank could not have been oblivious to the various extra-legal measures put in motion by the PNDC (i.e., the Provincial National Defense Council government of Rawlings). The institutions simply turned a blind eye to the regime's excesses for the sake of the program." In fact, the tendency for new democratic governments to avoid the austere conditionality of the Bank, for fear of losing political votes, had been the main worry of the Bank. However, the Bank knows better now: for one thing, SAPs and other Bank initiatives have a better chance of success when pursued under democratic governance or side-by-side with democratic and institutional reforms relating to state capacity, rule of law, and property rights etc. (Przeworski and Limongi 1997).

While the Bank uses its conditionality to *purportedly* curtail corruption, economic mismanagement and other vices, and to promote specific economic policies and sectoral reforms, there are some indications that conditionality does not work well, especially as an anti-corruption tool, due to the basic economic problem of fungibility—the idea that money being used for one purpose inevitably frees up other money for other purposes which may or may not be productive or honest (Stiglitz 2003:46). The idea that the bank uses its conditionality to curtail corruption and economic mismanagement is debatable, though (and hence the emphasis on "purportedly"), given the bank's lending history in countries such as Indonesia and Lesotho.

The Bank has also come under intense criticism for its dogmatic adherence to neoliberal principles, couched in the

Washington Consensus. In particular, critics see the Bank's insistence on trade liberalization in developing countries as hypocritical, given that many of the advanced nations which control the Bank keep their own markets protected, especially when it comes to agricultural commodities for which developing countries have the so-called "comparative advantage." The assertion that 'free trade,' together with the theory of comparative advantage on which it is based, is a myth is gaining increasing currency even in mainstream academic discourse.

Perhaps nowhere is this case more forcefully presented than in Graham Dunkley's *Free Trade: Myth*, *Reality and Alternatives* (2005), where he demonstrates that indeed several leading economists have long been skeptical about the free trade doctrine than we are commonly led to believe. Like many critics, Dunkley is of the view that the prevailing free trade doctrine is "over-simplified, based unduly on questionable myths and assumptions … [entailing] changes which, along with many technological and developmental pressures, are undemocratic or non-consensual" (p.11). At the end of the day, we must note that most of the advanced countries, including Great Britain, the United States, and Japan, have long used selective protectionism to protect their infant industries and economic sectors for which they lack competitive edge. As Chomsky bluntly puts it: "One reason for the sharp divide between today's first and third worlds is that much of the latter was subjected to 'experiments' that rammed free market doctrine down their throats, whereas today's developed countries were able to resist such measures" (1998:361). A similar point is echoed by Chang and Grabel (2004) who note that "Britain and the USA, the most strident free-trade missionaries in the world today, actively utilized protectionist policy during the early years of their development" (p. 10). The past tenses used in the two preceding quotations should not deceive anyone into thinking that protectionism in the First World is perhaps a policy of the olden days; a complete reading of Chang and Grabel (2004) and Chomsky (1998) would show that protectionism and subsidies are still prevalent not only in the agricultural sector, but also in the defense and other high-tech industries of the West. No wonder allegations of disingenuousness continue to follow the Bank in its frequent insistence on free trade in the developing world.

Another neoliberal mantra that has come under simmering critical fire is privatization. A long-standing SAP conditionality is for borrowing nations to undergo drastic privatization and divestiture, on grounds that competitive private firms are likely to perform economic activities more efficiently than the State. While there is some truth to this, the Bank (and the IMF) has generally approached privatization rather rigidly, as though the State has very little or no role in the economy, be it in the production of utilities, such as water and electricity, or in the provision of social services, such as education, healthcare, and sanitation. Undoubtedly, privatization often turns State-owned enterprises from losses to profit. However, this is frequently done by way of wage freezes, employment retrenchments, and other precarious labour arrangements, most of which create socioeconomic problems of their own.

Moreover, the riddance of "Third World' governments from the economy often creates massive economic gaps, avenues for prize gouging, and monopolistic tendencies among private entrepreneurs. Stiglitz, for instance, writes of a situation in Côte d'Ivoire where many university students could not afford internet connections due to the high prices imposed by a private French firm which monopolized the telephone business in that country following privatization. And dwelling on his concept of 'accumulation by dispossession,' David Harvey demonstrates, in his characteristic thought-provoking manner, how the Bank and other neoliberal advocates use privatization to facilitate capital accumulation, benefiting Westerners and their transnational corporations. "If capitalism has been experiencing a chronic difficulty of over-accumulation since 1973," writes Harvey (2003), "then the neo-liberal project of privatization of everything makes a lot sense as one way to solve the problem… as it helps to create a stock of devalued, and in many instances undervalued, assets in some part of the world, which can be put to profitable use by the capital surplus that lack opportunities elsewhere" (p.149-150). And within the developing nations themselves, government officials and politicians have routinely used privatization to reward their cronies by selling State-owned enterprises to them at near-steal prices, at the expense of the general public.

Beside SAPs, perhaps no other area of the Bank's operations has engendered longer-standing and more vociferous public outcry than its funding of mega dams in developing countries. The numerous international protest and demonstrations over the nearly 400 Mayans who where massacred for refusing to relocate from their ancestral lands in the early 1980s for the construction of the Chixoy Dam in Guatemala; the more than 25,000 people whose fishing grounds were destroyed in the construction of the Pak Mun Dam in Thailand; and the thousands more who were displaced by the Bujagali Falls Dam in Uganda, the Nam Theun 2 Dam in Laos, the Ganges-Kobadak irrigation project in Bangladesh, and the Sardar Sarovar Dam on the Narmada Valley in northwest India attest to this. One would be hard pressed to find any other mega project that has brought greater international disrepute to the Bank, with regards to its efficiency, than the Sardar Sarovar project, whose adverse environmental impacts are well documented in the now famous *Morse Report*. Authored by an independent review team—led by the former UNDP chief Bradford Morse and his deputy, the Canadian human rights lawyer Thomas Berger—this report (published in 1992) invigorated the international outcry that compelled the Bank to finally stop financing the Sardar Sarovar project in India.

With hints from the Morse Report to the effect that the inefficiencies besetting the Sardar Sarovar project might be more widespread, the Bank undertook an internal review of its loan portfolio under the leadership of Willi Wapenhans, a former Vice President of the Bank. And "lo and behold," after reviewing about 1800 World Bank projects in some 113 countries, Wapenhans noted in his review (now known as the *Wapenhans Report,* leaked to the public in late 1992) that as much as 37.5 percent of the Bank's project completed in 1991 were 'unsatisfactory', up from 15 percent in 1981, with the worst performance recorded in the areas of water supply, sanitation, and agriculture. The Wapenhans Report also noted that the Bank had failed to enforce a whopping 78 percent of its own conditions in loan agreements on projects completed by 1991.

There is little doubt from any objective reading of both the Morse and Wapenhans Reports that several World Bank projects have had immense adverse consequences regarding loss of life, environmental destruction, and debt service burdens in the developing world (Caufield 1996; the World Commission on Dams 2005). Thus, the Bank's stated mission to reduce poverty leaves much to be desired; and its foot-dragging on the 2005 Gleneagles Declaration on Africa—by which the G7 (or the G8 minus Russia) seeks to provide some $40 to $55 billion worth of debt relief to Africa—feeds into its disingenuous and imperialistic image, at least in the eyes of critics. Certainly, the Bank needs to do more, given the deteriorating human condition and the worsening debt situation in the developing world.

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World Government

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Introduction

The idea of establishing a world government to bring peace and stability to the international system has been advanced for millennia, but widespread support for the idea peaked in the first half of the 20th century. At that time, technological advances made a worldwide government appear feasible, and the destructive power of modern weapons gave rise to the argument that it was necessary for the preservation of mankind. Over time, some observers have suggested that formation of a world government is possible, or even inevitable; however, they rarely make specific predictions of its timing. These observers typically argue that creation of a world government would be a positive development. Other analysts, though, contend that a successful world government could not be established easily or voluntarily. Therefore, any government system that overcame the inherent difficulties would be a system tending toward tyranny. The sharp criticisms faced by plans for world government and the changing nature of the international system have forced supporters to modify their proposals over time. The advancement of hundreds of proposals from a diverse array of citizens over the centuries, though, indicates that creation of a functioning world government holds intrinsic appeal.

An Inevitable World Government

Scholars coming from a variety of fields argue that long-term trends in world history will eventually yield a world government. Carneiro (2004) estimates that there were 600,000 autonomous political units in 1500 B.C., but fewer than 100 independent units by the turn of the 20th century. The end of the colonial period and the collapse of communist states temporarily reversed the trend, but Carneiro argues that governments have strong motives to control large territories as soon as technological advances make it feasible. Therefore, the trend of consolidation will continue until there is only one world government. Using similar logic but different calculations, Naroll (1967) and Marano (1973) plot the size of dominant empires against time and conclude that the successively larger areas will become coextensive with the entire world.

Sociologists and anthropologists suggest there is an innate human desire to be part of a broader cultural community. They also note that technological change and conquest have yielded a declining number of independent cultures. By the 20th century, numerous observers were discussing the possible emergence of a single global culture. Ginsberg (1953) and Benedict (1971) among others therefore argue that social evolution will lead to progressively larger communities, ultimately creating a world organization.

Alexander Wendt (2003), an international relations scholar, suggests that a world state is the inevitable outcome of the international system's development. He argues that all systems evolve until they reach a stable end-state. The desire to avoid conflicts prevalent in a system of anarchy and the struggle for recognition among states will promote collective identity and a stable world state. This state will only be created after stages of a state system, world society, and collective security show the benefits of unity and the ongoing dangers of independent action.

The varied arguments for long-term trends all face some important challenges. First, the motives and actions of the past may not continue into the future. Second, creation of a world government may be a step too far for practical or intellectual reasons. For example, most past empires have been created through conquest, but there may never be a state powerful enough to conquer and manage the entire world. Also, larger political units often have been motivated by the need to compete with others in the system for military or economic supremacy, but this factor weakens as one approaches a world state. Finally, many, although not all, of these scholars view the creation of a world government as a necessity. Therefore, the analyses may include a degree of wishful thinking.

The Case for a World Government

Even if long-term trends support the emergence of a world government, its creation would require human initiative (Wynner & Lloyd, 1944; Glossop 1993; Heater 1996). Supporters attempt to show the rationality and, in the view of some, the necessity of moving beyond the current international system. The driving force behind most supporters' arguments is a belief that world government would control humanity's naturally destructive tendencies and bring peace. Support for world government often has been greatest during, or in the years immediately following, great power conflicts. The vehemence of the argument first increased in the early-20th century when the destructive power of modern weaponry increased casualties into the millions, and then again mid-century with the advent of nuclear weapons. The logic is similar to the argument that domestic governments were created to save individuals from the dangerous "state of nature" by attaining a monopoly on the legitimate use of force. Thus, many world government programs, call for at least partial disarmament of states. Supporters suggest that the resulting peace would decrease casualties and other destruction, and also lessen the constant fear of annihilation that citizens have had to accept as part of nuclear deterrence strategies. Additionally, resources could be channeled away from military spending toward development projects. Some recent calls for a world government have suggested that the threat of a global environmental disaster has risen to join the threat of global war in necessitating change, but this view has not yet developed widespread support.

The environment is often cited, though, as an example of an issue that could be addressed better by a world government than by the current state-centric international system. Environmental damage, famines, epidemics, and poverty rarely follow state boundaries. Furthermore, the interdependence of modern countries means that problems originating in one area can spread rapidly. Recognition of these realities helped trigger formation of the UN, the WTO, and numerous other international institutions, but supporters of world government feel that political control must be further centralized to deal effectively with the problems. Additionally, a world government might more successfully coordinate global initiatives such as scientific and space exploration. In world government models based on a federation of independent states, the suggestion is that, even if the world government was not given the power to establish programs in all these areas, it would promote increased international fellowship, common purpose, and cooperative efforts by states.

Some advocates of world government further suggest that it would be better for the global economy. They hold to the idea that wealth and quality of life will be maximized if goods and services flow freely. In contrast, state governments pursue economic nationalism because they have an incentive to protect their own industries and regulate trade to the benefit of their citizens. State governments also typically establish tough immigration laws that limit the free movement of workers, thereby wasting labor resources and worsening income inequality.

Finally, some argue that global institutions could better regulate multinational firms.

Some proponents of a world government argue that it also would be able to spread positive political developments to areas of the world that lack them. Thinkers such as Dante, Grotius, and more recently Wilsonian liberals believe that adherence to international law will bring order to the world and allow for the negotiated settlement of conflicts. A world government might also promote protection of human rights and democratic systems by setting standards for state members, punishing violators through sanctions or judicial proceedings, and alleviating the worst abuses through humanitarian intervention and state-building.

Another point raised as far back as proponents in Greek city states is that there is a natural affinity among all humans, or a "cosmopolitan" community. In this view, loyalties to tribes, nations, or other less inclusive communities reflect limited technology, or are artificial creations of local governments seeking support from their people. Technological advancement has made it possible to be a "global citizen" in more than just a philosophical sense, so government structures need to adjust to new realities.

Opposition to a World Government

Supporters of world government have produced an extensive literature, but few specific proposals have generated sufficient support among citizens, political leaders, or academics to prompt major works challenging their feasibility. Some short opposition pieces exist (Niebuhr 1954; Lens 1983), but critique more often occurs in the context of scholars who are attempting to explain their view of how the current international system will remain unchanged (Waltz 1959; Claude 1971; Bull 1977). Some of the best summaries of critiques are found within works that ultimately support world government (Glossop 1993; Yunker 1993). Still, one can get a sense of the challenges to both the likelihood and positive view of world government by drawing together these varied sources.

Many raise the point that the world is too diverse to sustain a single governmental entity. They point to diversity along geographic, climatic, cultural, religious, ideological, and economic lines. Collectively, these differences mean that people around the world have very different self-interests, have differing economic and military capabilities, may have trouble communicating with each other, may base their societies and governments around divergent norms, and may oppose any institution trying to bring change from the outside. Over time, most empires have fallen because their constituent parts were too diverse and began to seek autonomy. Notably, those empires were relatively homogeneous in comparison to the entire world.

Due in part to existing global diversity, critics believe that few people truly feel part of a global community. They may feel curiosity about or sympathy for others, but their primary connections are to their own nation. Within international institutions, countries work for the common good, but are always mindful of their national interests. They rarely support initiatives that significantly challenge those interests. The virulent national and ethnic hatred displayed in the collapse of Yugoslavia, Rwanda, and elsewhere has led many to conclude that nationalism is far from obsolete. In fact, surveys show that only 15 percent of citizens say their principle identity is regional or global (Norris 2000). There is also extensive academic literature that suggests the creation of a strong community demands construction of an "other" who is outside of that community (Walzer 1992; Mouffe 2000).

This notion has been challenged, but remains untestable until further steps are taken toward a world culture (Dower 2000; Abizadeh 2005).

Another difficulty in establishing a world government is that the world's leaders and states benefit from the current system. Leaders enjoy holding power for a variety of reasons. Convincing them to voluntarily limit their own personal control or delegate powers to other levels of government is difficult. Cases of voluntary union of existing states are very rare in world history. States too enjoy benefits in the current system, such as recognition by others, sovereignty to establish domestic policies as they wish, and the ability to use the ultimate recourse of intimidation and war if others interfere with their decisions or refuse to accept diplomatic demands. Major powers are particularly hesitant to support any system that alters international politics since they stand to lose the most power under a world government, but likely would still bear the most responsibility to fund and supply that government.

Taken together, the difficulties of diversity, lack of global community, and lost benefits for key actors lead many observers to conclude that a world government could only emerge voluntarily in an international system that already had transformed itself in ways that might obviate the need for a world government. For example, if some force yielded a sense of global community advanced enough to support a world government, then that government might not be necessary since existing states would already be willing to act for the benefit of all. More crucially, if the system achieved the level of peace and trust necessary to convince state actors to disarm, then there would be no need for a world government to stop humanity's destructive nature.

World government opponents, therefore, hold that the only plausible way to establish a world government is for it to compel loyalty and disarmament from even the largest and most recalcitrant states. This outcome could occur if a single country became so powerful that it imposed the equivalent of a Pax Roma on the entire world, or if states voluntarily conceded power to global institutions that later evolved new functions to create a powerful world government. Under either scenario, opponents argue that a Hobbesian Leviathan and tyranny would likely emerge. Little dissent would be tolerated and the world government would use its monopoly on force to repress any moves to autonomy. The world government also might use its power to introduce radical policies such as forced redistribution of global wealth or mandatory limits on economic development to achieve environmental goals.

Supporters of world government generally assume that it will be a benign force, with leaders interested in the greater good. Critics, however, worry about the "Hitler scenario" of a dictator abusing the government's monopoly on force. These fears help explain why international institutions like the League of Nations and the United Nations were strictly limited in their abilities to challenge sovereignty and employ force, yet still faced the criticism that they represented too great a centralization of power.

Critics of world government also question the feasibility of governing on such a large scale, even with modern technology. Even if some issues were handled at the local level, establishing policies for a polity of over six billion would be a staggering challenge. Also, establishing democracy on a global scale would be hampered by the needs to establish a fair system of representation and to educate citizens on global issues. Additionally, world history demonstrates that citizens feel disconnected from large and unresponsive government bureaucracies. Finally, a world government may not be able to deliver the benefits its supporters proclaim. Many question whether a world government could guarantee peace given the prevalence of civil wars. Second, problems such as environmental damage and poverty, while exacerbated by a system of competing states, may not yield easily to the policies of a world government.

History of World Government Plans

Plans to create a universal government have been traced back as far as Ikhnaton, Pharaoh of Egypt (1375 BC). Similar ideas were voiced in China at least as early as the Shang rulers (*c*. 1000 BC). In subsequent centuries, leaders such as Alexander the Great and the Roman emperors sought to conquer the known world, although few left detailed explanations of their goals. Since the advent of printing, dozens of proposals for world government can be found.

Many of the early plans were not global in scope, but instead focused on the "civilized world," as known by the authors. Even after exploration and colonization enhanced global connections, many of the plans retained a European focus. This focus reflected the dominant powers of the era, but also resulted from the idea of spreading unity among Christian people. Christianity provided a degree of shared culture across Europe, but also a model for a hierarchal leadership structure. Most early plans relied on the emergence of a dominant political leader to bring stability to conflict-filled areas.

By the 18th century, support for a world monarch was waning. Plans began to center on transnational institutions or federal structures through which the world government was controlled by sovereign states that retained some important powers. In time, the model most often cited for guidance was the American federal system. Interestingly, from the time of the Napoleonic Wars through the end of the century, few fully-fledged plans were advanced. Instead, thinkers' efforts centered on ways--such as the Congress system and development of international law--to mitigate, rather than replace, the problems of the state system.

World War I shattered many people's confidence in the existing system. The Great Depression and World War II only reinforced these worries. Many people felt that the international system was spiraling downward, creating greater conflicts fought with ever more powerful weapons. Close to one hundred plans for world government were published between 1914-44. Heater (1996) helpfully organizes those plans into five categories. The first group hoped to develop the League of Nations into a true world government. Typically, these plans argued that the League needed to become more democratic and to be strengthened with the creation of an armed force. The second group focused on functionalism. These sought to build on efforts to end slavery, establish international laws of war under the Geneva Conventions, develop an International Postal Union and so on, to effectively establish a world government issue by issue. The third and fourth groups of plans wanted to go beyond existing institutions, but differed on whether the new structure should be global. Some proposed that regional groups with shared culture or a federation of democracies could be used as stepping stones to world government. Others sought a fully inclusive world government structure. Finally, although not always treated as world government plans, Communist and National Socialist ideologies pursued totalitarian world governments as the next step in humanity's scientific advance.

None of these plans ever came close to global implementation, but the plethora of proposals provides some measure of popular interest. Creation of world federalist groups, circulation of petitions, and international conferences are further evidence of popular support. The creation of the League, the UN, the World Bank, and other international institutions during this period demonstrates that even states' leaders were edging closer than ever before toward world institutions.

Post-World War II Plans

The emergence of the Cold War quickly derailed many world government proposals. As Yunker (2000) argues, creation of a federalist world government requires a high level of trust among countries, which became impossible during the Cold War. Both superpowers feared any world structure might be used as a tool of the other to impose its political and economic system globally. The split of democracy versus communism also highlighted continued ideological diversity. The post-Cold War era seems like a natural time for a resurgence of world government proposals. By the 1990s, other factors, such as focus on global issues like the environment, the emergence of a civil society of non-state actors, new developments in transportation and communications technology, and the rise of the European Union as a new model of how states could voluntarily limit their sovereignty also encouraged development of world structures. Notably, though, there has not been a huge surge in proposals after the Cold War, so the period after World War II can be treated as a whole. For clarity, these plans can again be organized into five classifications.

The first group of proposals are efforts to modify the UN into a world government. This summary excludes UN reform plans that assume the UN will remain an institution in a state-centric system. Grenville Clark and Louis B. Sohn's *World Peace through World Law* (1958) is considered by many academics to be one of the best books on the subject. The authors were international lawyers who sought to modify the UN Charter in three significant ways. First, they hoped to explicitly limit the sovereignty of states and give the UN authority to enact binding legislation for disarmament. Second, the UN would form a World Peace Force to enforce decisions after the gradual, but full, disarmament of states. Third, representation in the General Assembly would no longer be equal for all states, but instead would be based on a sliding scale of proportionality to population. Thus, the largest four countries would have thirty representatives and the smallest only one representative. Critics questioned whether states would accept these limits on their jurisdictions, and raised concerns about the dangers of a world government with a monopoly on force and unequal rules of representation.

Tim Murithi (2003), a UN official, has proposed a modification of the UN to meet modern realities. He believes that the UN has failed to respond to problems in the developing world and is too tied to old notions of state sovereignty. He follows many in suggesting the need for a global parliament to represent world citizens directly, but also advances new ideas such as a Council of Supra-nations for entities like the EU, a Committee of Sub-national Groups to represent ethnic groups, and closer ties with non-governmental organizations. The details of many of his proposals, though, are left to future global consultation. Again, the issue becomes whether one needs a world government structure to negotiate a world government structure.

The idea of functionalism has also continued, but in modified forms. A huge literature exists on the emergence of "Global Governance" through the creation of independent global institutions and regimes, and the emergence of a global civil society (Rosenau and Czempiel 1992; Diehl 1997; and Vayrynen. 1999). A seminal work in the area is a report of the Commission on Global

Governance (1995) entitled *Our Global Neighborhood*. This work argues for new policies and political structures to address emerging global challenges. Importantly, this work, and others like it, explicitly rule out the creation of a global government, which they associate with overwhelming centralized power, even as they seek to advance global institutions. This work has been challenged by many international relations scholars, including supporters of world government, who suggest that real governance cannot exist without a government, since today's institutions remain only sites for bargaining among states that retain their right to use force if necessary (Yunker 2004). They feel global governance is simply a myth created to hide the reality of a violent international system, but fear the myth may preclude true action to change the system. From another side, functional global governance is sharply criticized by those who feel that the UN, the WTO, or other institutions are becoming a "world government by stealth" as they gradually exert authority in areas previously reserved for states (Arnold 1997; Wallach & Woodall 1991)

Another collection of scholars has focused on the idea of "cosmopolitan democracy" based on creation of democratic systems at the local, state, and global level (Archibugi and Held 1995; Flak 1995; Holden 2000; Archibugi 2004). They also point to international interdependence, emerging international institutions, and an international civil society. They see the International Criminal Court as the one major recent advance in democratic institutional reform, but also point to the growing acceptance of non-governmental groups at UN conferences and other forums for discussion of immigration, finance, the environment, and human rights. They ultimately hope for a global parliament and constitution to allocate responsibility for issues to different levels of government. Again, though, scholars of cosmopolitan democracy explicitly say that they do not favor a world government with a sole institution and concentration of coercive power. Many of the scholars are European and are doubtless influenced by the success of the EU. They do concede that, while democracy has spread to many states, its progress has been slow at the international level.

The third idea of regional collaboration is still a focus with regional associations like the EU, ASEAN, the African Union, but the idea that they are a step to a global union has receded. Instead, they are commonly portrayed as ends in themselves bringing regional economic growth, and there is often at least an implicit argument that they will help regions compete with other regions. There is also still focus on uniting democracies, but this is now seen more in alliances against terrorism or ad hoc "coalitions of the willing."

Numerous plans that fall into the fourth category of new world institutions have been developed. One example, published by Guiseppe Borgese in *Foundations of the World Republic* (1953) was developed by a committee at the University of Chicago. Like many programs, this proposal calls for disarmament, but it also calls on states to address economic injustice, poverty, and labor exploitation. The central governing World Council would consist of councilors selected from nine Electoral Colleges, which generally followed geographic lines. This representation would reduce advantages held by states with large populations or large economies. Additionally, there was a Tribune of the People to defend the people from tyranny or neglect by the world government and a Chamber of Guardians that would oversee the armed forces.

Another proposal, by Richard Falk and Andrew Strauss (2001) published in the widely read journal *Foreign Affairs* notes public frustration with the lack of popular representation in global institutions, triggering events such as violent protests at WTO meetings. They also note two existing networks of non-governmental actors--civil society organizations and businesses--that remain uncoordinated and unrepresentative of all citizens. They suggest creation of a global parliament that could work in association with the UN General Assembly in a bicameral legislature. The ideas would not simply modify the UN, but would change the premise of an organization of states.

Economist James A. Yunker (1993) advances a plan in *World Union on the Horizon: The Case for Supernational Federation* that he feels corrects some of the problems of other world government proposals. His Federal Union of Democracies would have the power to enact laws, levy taxes, create a capital and other symbols of government, and maintain military forces. At the same time, states would retain important means to check tyranny and preserve sovereign control. They too could maintain an army and could secede from the union at their unilateral discretion. To deal with the problem that most representative designs favor poor countries, either because they have large populations or because there are more poor states than rich ones, Yunker suggests that measures would have to be passed by a 60 percent majority of states on two dimensions, population and material wealth. This effectively gives both poor and rich blocs of states veto power, which may reduce worries of one group imposing ideas on the other. This representation system might mean, though, that very few measures would ever pass. This system also assumes that wealth is an accurate measure of overall power. This assumption might be questioned by states such as Russia or North Korea who enjoy military strength disproportionate to their current economic size.

The last group of totalitarian visions from the early 20th century has largely faded as their prime country exemplars fell out of power. One could argue that religious fundamentalists now strive for a similar end, namely to move beyond state loyalty and to use political power to enforce societal goals. Given global religious diversity, it is difficult to imagine, though, how a particular fundamentalism could ever become a global, rather than regional, phenomenon.

Prospects for the Future

Over the last century, there have been both positive and negative developments for those seeking world government. Many logistical barriers have lessened. Today, citizens could be just as connected to leaders in a world capital as they are to those in national capitals. A universal world culture has not emerged, but norms--from human rights standards to the use of English as world language--are increasingly shared. The spread of democracy has lessened ideological conflict and raised the possibility of building world democracy around established norms. On the other hand, there are now many more independent actors in the international system than there were a century ago. Expansion of the European-dominated League of Nations would have been easier than expansion of today’s heterogeneous UN. There are also now more sub- and supra-state actors to consider. The global focus on democracy has also engendered the challenging expectation that a world government should directly represent citizens, as opposed to states. Additionally, international norms against non-intervention and empire now decrease the likelihood that a hegemon, such as the United States, would use its power to establish a government by force.

A second barrier to a world government has been fear of its possible negative consequences. Many still question how a fair system of representation could be established to prevent a world government from imposing one area's views. There also remains the view that a weak world government is unnecessary, but a strong world government risks tyranny. This issue is highlighted by the practical dilemma of whether to push for state disarmament and a world army.

Ultimately, a world government will not emerge unless supporters develop a better case for its necessity. In the past, arguments have rested primarily on the negative logic of avoiding war, or environmental disaster. These arguments have fully convinced some observers, but not a majority. If a new world war occurred or global warming seemed more imminent, perhaps views would change, but it is also possible that people would prefer the devil they know at a time of crisis. Thus, proponents must develop a solid positive case for benefits that a world government would provide. In their favor, the idea of world government has had an underlying appeal to people for centuries and the current state system, although relatively stable for the last four centuries, is itself a historically contingent phenomenon subject to change in the future.

Selected Internet Sites

World Federalist Movement www.wfm.org

Discussion of UN Reform www.refromtheun.org

UN's discussion of UN Reform www.centerforunreform.org

Association of World Citizens www.worldcitizens.org/index.html

World Governance Discussion Forum worldgov.info/

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World Trade Organization

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Introduction

The World Trade Organization (WTO) is an international organization established on 1 January 1995, with 128 member countries, to coordinate international trade and related policies and relations among its member. As of 2005, the number of member countries reached 148. Its Agreements spell out a number of objectives, including improved standards of living, full employment, expansion in the production of goods and services, sustainable development, expansion in world trade, and an enhanced share for developing countries in world trade. To achieve these ends, the WTO's Agreements commit its members to enter into "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations".

At the end of World War II, in an effort to prevent the recurrence of international hostilities and to promote peace, a number of international leaders planned to establish the International Trade Organization (ITO) as the third pillar—along with the World Bank (WB) and the International Monetary Fund (IMF)—of the international economic system. The aim of the ITO was to oversee the liberalization and coordination of world trade, but in addition to covering the area of commercial policy, the ITO articles covered areas such as employment, restrictive business practices, commodity agreements, and overall development and humanitarian concerns. The institution, however, was never established, in large part due to US opposition, but arguably also because of the breadth of its agenda. Instead, the General Agreement on Tariffs and Trade (GATT) came into place, as an interim agreement till the ITO could be formed. The GATT was not an organization, but basically a negotiating forum, joined together by a multilateral treaty among contracting country governments. It took up only the commercial policy chapters of the ITO, and pursued the objective of slowly liberalizing world trade by removing import quotas and export subsidies and gradually reducing tariffs, through periodic rounds of multilateral negotiation. From its inception GATT had many loopholes which allowed signatory countries to impose various kinds of trade restrictions. This, together with its limited reach, as well as the fact that it was a treaty rather than an intrusive organization, goes some way in explaining why the GATT system was adopted and survived for 47 years. But by 1995 GATT had evolving into the WTO.

WTO and its Mandate

The creation of the WTO was the result of the Uruguay Round of Multilateral Trade Negotiations under GATT (from 1986 to 1994), although it was not on the agenda when the negotiations were launched. Its creation can be attributed to three sets of factors. First, there was dissatisfaction with GATT. By the beginning of the 1980s it seemed that the GATT system was not functioning well and that protectionism was on the rise through various kinds of measures such as subsidies, tax rebates, and voluntary export restraints such as the 1974 'Multi-Fibre Agreement' under which the US and the European Community forced less-developed countries (LDCs) to limit the level and growth of exports to them. Indeed, many countries were following some form of industrial policy. Second, changing economic and political conditions also played a role. The successful export-oriented growth strategy of the East Asian countries was interpreted by many as showing the benefits of trade liberalization. Changes in patterns of comparative advantage made developed countries (DCs) exporters of services and high-technology goods made them more interested in extending the provisions of GATT to cover new areas, such as trade in services and the protection of intellectual property rights. The rising influence of exporting interests in the US and other countries and the increasing spread of transnational corporations (TNCs) which wanted external market access, and the rise of conservative governments in the US, UK and elsewhere, also militated in favor of its creation and its extension to new areas. Finally, the elaborate negotiation process covering a host of issues, in which different countries were interested, into one single package (the 'Grand Bargain') played an important role in making the countries come to an agreement and form the WTO.

Some of the key aspects of the WTO agreements were derived from the GATT agreements (see Narlikar 2005, on which the following discussion of the practices and procedures of the WTO draws extensively). The principle of non-discrimination is common to both, as are its two components, namely, the Most Favored Nation (MFN) rule and national treatment. The MFN rule requires that a product made in one member country must be treated no less favorably than a like good made in another member country, with some clearly specified exceptions (covering regional trade agreements and preferential treatment for LDCs). The principle of national treatment requires member countries to treat goods made in foreign countries no less favorably than like goods made domestically, after the former have met border measures applied by the home country. The principle of reciprocity—which makes countries reduce trade barriers reciprocally—is also common to both. The WTO is similar to GATT also in the following ways. It also relies on transparency, by requiring members to publish their trade regulations and notify changes and through periodic review by the WTO Secretariat. It makes commitments enforceable, through its dispute settlement mechanism which can authorize punitive measures. Finally, it allows exceptions or safety valves which allow governments to impose trade restrictions under certain circumstances.

However, in addition to the fact that WTO is an international organization with membership rather than a provisional multilateral treaty, and that it removed many of the exceptions in GATT, the WTO is different from the GATT in two major respects. First, all its agreements are held together by what is called the Single Undertaking, by which, rather than selectively accepting some agreements as in GATT, members had to accept all agreements or none at all. Second, WTO extended itself to issues that go far beyond border measures, not only covering the traditional area of trade in goods, but also covering trade in services (GATS), trade-related intellectual property rights (TRIPs), and trade-related investment measures (TRIMs).

On the liberalization of trade in goods, the WTO agreements built on GATT 1994 which, in addition to dealing with tariff barriers to trade in goods (as done in GATT 1947), also dealt with non-tariff barriers, technical barriers to trade, government procurement, anti-dumping and customs valuation within the Single Undertaking. Textiles, clothing and agriculture were integrated into the agreements. It was agreed that voluntary export restrictions and other non-tariff barriers be eliminated; tariffs significantly reduced; and safeguards, allowing temporary tariffs due to balance of payments difficulties, moderated. Even production subsidies which significantly affected trade were to be removed in some cases and severely restricted in others. According to the agreements, members are not allowed to raise their tariffs above the levels they have committed to, or been bound to, in their schedules. The WTO increased the number of products on which such binding took place. However, the actual degree of trade liberalization that occurred was much less than what is suggested by the bindings.

Member countries are allowed to temporarily suspend their obligations under a variety of provisions such as the Anti-Dumping, Countervailing Duties, Balance of Payments, infant industry and emergency safeguards provisions. Although these were in existence under the old GATT, they were not frequently used because countries could resort to bilaterally negotiated agreements like the "voluntary export restraints". With many of these prohibited, these provisions are more in use (Narlikar 2005:75).

Services were covered for the first time, under GATS, which deals with all commercial services. The pressure to do so came from the US and other DCs. Since many services require proximity between buyers and sellers, the liberalization of trade in services requires changes in domestic regulations on the movement of goods, capital and labor, and not just the reduction of tariffs. Government regulatory capacity, including the right to limit foreign investment, was curtailed in many sectors, but governments can continue to set standards and qualification requirements, provided that they apply to domestic suppliers as well. Special agreements apply to areas such as Financial Services, Telecommunications and Air Transport Services, and the Movement of Natural Persons, the latter dealing with the temporary movement of people and not immigration. Provisions were made to allow LDCs more time to satisfy the agreements, but it is clear that they have to follow the path to increasing liberalization.

The TRIMS Agreement requires member countries to phase out performance requirements imposed by host countries on TNCs, especially those related to trade. TRIMs are of two types. There are positive one, such as tax concessions to attract FDI. The negative ones prevent host countries from imposing restrictions on FDI. These include: local content requirements (which require foreign investors to obtain at least a minimum amount of inputs from host-country producers); limitations on the use of imported components; export requirements (requiring investors to export a certain proportion of their produce); local R&D requirements (conduct a part of R&D within the host country); technology transfer requirements (transfer technology to domestic partners); and requirements to match the use of foreign exchange to foreign exchange generated.

The TRIPS Agreement establishes obligations on all WTO members' domestic intellectual property rights policies where the standards are comparable to those of the major DCs, and stipulates how the enforcement of these obligations is to be carried out. The forms of intellectual property rights which are protected by the agreement include copyright, computer programs, trademarks, geographical indications, industrial designs, patents, undisclosed information (or trade secrets) and the layout designs of integrated circuits. Patents are for twenty years and longer than currently offered by most countries, and cover almost all product and process inventions. LDCs were granted some concessions, for instance, by being given longer periods of implementation.

Organization, Decision-making, Negotiation and Dispute Settlement

The WTO (reflecting its GATT background) is a member-driven organization, in the sense that the onus of negotiating, implementing and enforcing the agreements falls primarily on its member countries. In this it can be contrasted to the IMF and the WB, which can be called staff-driven organizations. The WTO Secretariat is small, its small budget comes from member contributions assessed according to trade shares, and it has a limited role of providing administrative and technical support for its members. Despite the fact that the powers, duties and conditions of service of the director-general, the head of the WTO secretariat, are determined by the members in the form of a Ministerial Conference, members have sometimes fought hard to install their preferred candidate in the position because it is a powerful one, as an agenda-setter and mediator in the negotiation processes.

The apex decision-making body in the WTO is the Ministerial Conference, comprised of ministers of trade issues of all member countries, and it is required to meet at least once every two years. The regular functioning of the WTO is conducted at the headquarters in Geneva where most of the members send their delegates. The highest body in Geneva is the General Council which meets regularly, and is open to all the delegates, to carry out the tasks assigned to it by the agreements and the Ministerial Conference and also meets as the Trade Policy Review Board and the Dispute Settlement Body.

Below this are three councils which deal with trade in goods, GATS and TRIPS and five other committees which deal with issues such as trade and the environment, trade and development, regional trade agreements and balance of payments restrictions. Below these are committees which are concerned with specific issues in goods and services (see Narlikar 2005 for further details). A very large and growing number of formal and informal meetings are held for all these bodies. Representation on these bodies and meetings is confined to member countries and their representatives. Corporate interests and non-government organizations (NGOs) can be represented, but only through their country governments.

Decision making at the WTO is based on a voting procedure that gives each member one vote, in contrast to the IMF and the WB which has a voting system based on weights based on contributions and weights in the international economy, and most major decisions are supposed to require the approval of a simple majority (again, in contrast to the Bretton Woods institutions, which require a 85% majority vote). In fact, however, most decisions at the WTO, as in GATT, are made by consensus, which is arrived at if no member present at the meeting in which the decision is under consideration formally objects to it. Moreover, decision-making at the WTO has relied on informal diplomatic procedures rather than formal rules. Although some informal consultations can involve the entire membership, others—such as the so-called Green Room meetings at the initiative of the director-general—involve smaller groups to which many members are not invited. Finally, the lack of specific rules about procedures governing meetings (even about how to bring conferences to a close) has resulted in improvised rule making, which has affected the outcomes of the meetings in ways that have been found controversial.

The decision-making process affects the evolution of the WTO's agenda, and this process in turn depends on the nature of the negotiation process among its members. All trade negotiations under the WTO are based on the two principles of Most Favored Nation (MFN) and reciprocity. Reciprocity makes concessions acceptable to interests within both of the negotiating countries. The Most Favored Nation clause extends concessions negotiated between two members to the rest of the membership (building in reciprocity to

MFN in the negotiation process). Beyond these, additional principles have been used. In earlier rounds of GATT, tariff negotiations normally occurred between the largest participants in trade in specific products, After the Kennedy Round, in the 1960s, multilateral, across-the-board, tariff negotiations were used—either by using a formula for reduction on all product lines, or, more recently, using a sector-by-sector approach. Negotiations are also based on issue linkages: since different issues may be important for different members, such issue linkage, reflecting the Single Undertaking concept—allows concessions across issues, thereby making it easier to arrive at agreements. The negotiating culture of the WTO involves the use of informal protocols on interaction in the Green Room and in corridors, rather formal meetings announced to all members. Accession to the WTO requires approval by a two-thirds majority, and begins as a bilateral process in which existing members can make demands on the aspirant country. Acceding countries cannot negotiate to obtain more concessions from WTO members than allowed by the WTO agreements, but can be asked by member countries to do more.

Disputes among members of the WTO are settled according to its Dispute Settlement Understanding. Members are obliged to abide by the rules of the WTO or face retaliation. A member can bring a complaint to the Dispute Settlement Mechanism in a number of situations. For instance, if a member considers that there is a breach in the rules by another member, or if it considers that measures imposed by a member nullify or impair a benefit to it of an agreement of the WTO even without a direct breach of the WTO rules. If, after an initial period of consultation between the parties to the dispute, unless there is a consensus in the Dispute Settlement Body (DSB, the General Council by another name) a panel is established to review the dispute. The Panel then provides its report to the DSB which adopts the report after a possible appeal. There is a time limit of a year from the initiation of the complaint to the adoption of the report, a period which can be extended by three months if there is an appeal. If the report is not implemented by the member against which the report rules within a reasonable period of time, the member bringing the complaint is authorized to retaliate. In some cases cross-retaliation is allowed, for instance when a member is allowed to suspend concessions under TRIPs as retaliation against the imposition of violations of trade regulations.

Appraisal

The WTO can be appraised from a number of perspectives: in terms of its basic role of coordinating trade and related policies of its members; in its espousal of trade liberalization; in the spread of its mandate to matters beyond trade policy; and in terms of the broad objective of improving living standards, especially in LDCs.

Trade Policy Coordination

The basic role of the WTO is in coordinating trade (and related) policies across its members, certainly an important and legitimate role. Trade policies adopted by countries have an impact on other countries, and the absence of coordination of these policies can lead to problems in terms of both efficiency and equity.

From an efficiency point of view, in the absence of policy coordination, if individual countries pursue policies that hurt other countries, there can be rounds of retaliation which makes all countries worse off, as has happened with “beggar-thy-neighbor” policies in the past. This problem has sometimes been depicted as a Prisoner’s dilemma game in which the dominant strategy of each country is to impose trade restrictions, whereas the best situation for the world is free trade. To depict this situation with such a game requires, however, that countries are better off imposing trade restrictions for a given policy followed by other countries, something that liberal trade economists—who believe that free trade is the best policy for a country—do not normally accept. If every country found itself in the situation that free trade is the best policy for it, given the policies adopted by other countries, then all countries would follow free trading policies (if they adopt policies according to their self interest), and there would be no need for trade policy coordination.

To make the argument for coordination one could proceed in one of two ways. Firstly, strong vested interests can force countries to follow policies—such as protectionism—which are against the broader interests of the country as a whole. In this case, international institutions, by binding countries to reciprocal agreements, can serve to coordinate trade policies, by allowing governments to adopt policies which are against the these vested interests or become more palatable them. Secondly, countries can, in fact, gain by restrictive trade policies. Large countries which can affect their terms of trade can use what are called optimum tariffs. There may also be a number of domestic "distortions" which can make trade restrictions desirable for countries, which we will discuss later. In these cases the Prisoner's dilemma situation arises, so that there is a need for policy coordination to improve efficiency.

From the point of view of equity, it can be argued that in the absence of multilateral coordination countries, there would either be no overall trade policy coordination, only bilateral negotiations without there being clear multilateral rules. Such negotiations would arguably yield agreements worse for LDCs than for DCs, given the relatively weaker bargaining power of the latter (due to their lower levels of income). International coordination through the WTO, can therefore lead to outcomes more favorable for LDCs, and therefore be more equitable.

Trade Liberalization

The fact that the international coordination of trade policy may be desirable from both efficiency and equity perspectives does not necessarily imply that free trade or even trade liberalization should be the appropriate goal of such coordination. It is possible, for instance, that LDCs can be better off with some form of trade restrictions, which may have the result of increasing their production and income, and hence trading opportunities for other countries, and lead to improvements for all countries. Thus, allowing trade restrictions for LDCs may be beneficial on both efficiency and equity grounds. But, in the absence of policy coordination, the world economy may not arrive at such favorable outcomes: for example, individual rich countries may not want these policies because they may make LDCs richer and able to compete with them in production, without significantly enlarging their markets since demand is spread around the world.

The WTO, however, takes it as axiomatic that free trade and hence trade liberalization is the best policy (leaving aside a few specific problems noted earlier). The basic case for this view can be made in terms of the Heckscher-Ohlin-Samuelson (HOS) approach which, in its simplest form, assumes "perfect" markets with the full employment of all resources, constant returns to scale, no "distortions" in production and consumption, and exogenous international prices (because of the small-country assumption). The approach implies that trade liberalization results in an unequivocal gain for the liberalizing economy due to a shift of resources to sectors in which it enjoys a comparative advantage, and to a reduction in the distortion in consumption created by the import tax (see Hoekman et al 2002).

Some modifications of this approach strengthen these beneficial effects of trade liberalization: if domestic monopolies exist, it can reduce the inefficiency due to this distortion; it can bring about greater productive efficiency by exerting competitive pressures and lead to the adoption of better technology, and by facilitating scale economies; and it can reduce rent-seeking and other directly-unproductive activities that allegedly result from import restrictions, reallocating resources to productive activities. These theoretical ideas are backed up with empirical analysis. Cross-country regression equations yield results which show that the expansion of trade and greater openness in general leads to better economic performance, and case studies suggest that protectionist countries do poorly compared to countries which liberalize their trade regimes (see Dutt 2006)

Neither theory nor empirical evidence, however, warrants such a favorable view of trade liberalization, especially for LDCs. Regarding theory, even the standard HOS results can be overturned by various kinds of "distortions", including rigid wages, externalities in production and consumption, and the possibility that economies may be large enough to affect their terms of trade (see Bhagwati & Srinivasan 1983). For instance, if trade liberalization results in a fall in the output of a sector with significant positive external economies, it can make a country worse off. Proponents of trade liberalization argue that these distortions are "pathologies" rather than representing "central tendencies" of the real world (Srinivasan & Bhagwati, 2001). Moreover, to the extent they do exist, that they are best addressed at the source (for instance, a production externality with a production tax or subsidy, rather than an import tariff).

However, such arguments—especially in the context of LDCs under WTO rules—miss several issues. First, for addressing many market imperfections, especially in LDCs with poor institutions and resource-strapped governments, tariffs may often be the most feasible instrument. Second, the WTO has restricted the use of domestic interventions which have a major affect trade. Third, and most importantly, when viewed from a dynamic perspective many "distortions" seem not to be "pathologies" but important aspects of development. Dynamic models of learning suggest that LDCs can gain by protecting their technology-intensive industries against competition from DCs which, for historical reasons, enjoy a static comparative advantage in them, thereby possibly stemming the tide of uneven development (Dutt 1990). This possibility is denied to them by enforcing trade liberalization.

Proponents of trade liberalization argue that it is in practice difficult to pick the "right" industries to protect, and even if not, they can be dealt with through other measures to promote technology transfers from the DCs. However, it is inappropriate to ignore the large literature on technological change in late industrializers (Amsden 2001) on the possibilities of using directed trade and industrial policy for developing domestic technological capability (which cannot just be transferred from abroad). In terms of empirical evidence, several cross-country studies examining the benefits of openness and trade policy liberalization can be criticized on methodological and empirical grounds, for instance, for confusing correlation with causality and for inadequate definitions of openness (see Rodrik & Rodriguez 2000). There are cases of highly inefficient import-substituting regimes and of successful trade liberalizations. However, many of the latter liberalized slowly and successfully after long and successful import substitution, and recent trade liberalization in Latin America and Africa has had arguably undesirable effects (Dutt 2006).

The history of the earlier attitudes towards trade liberalization in the DCs of today is instructive (Chang 2002; Dutt 2006). Many of these countries, including Britain, the US and Germany, made extensive use of various kinds of economic policies, including tariff protection, to promote industrialization during their early stages of economic development, and it is now generally agreed that tariff protection was crucial for the development of their key industries. Imperial countries often imposed free trade on their colonies and dependent countries, so that the letter enjoyed lower rates of protection than they or independent countries did. DCs only championed the cause of free trade after they achieved technological superiority. List has written that "[a]ny nation which by means of protective duties … has raised her manufacturing power … to such a degree of development that no other nation can sustain free competition with her, can do nothing other than to throw away these ladders of her greatness, to preach to other nations the benefits of free trade, and to declare in penitent tones that she has hitherto wandered in the paths of error, and has now for the first time succeeded in discovering the truth." (Quoted in Chang 2002:4-5).

Beyond Trade Policy

As discussed earlier, the mandate of the WTO has gone well beyond the coordination of trade policy to other kinds of policies, such as the protection of international property rights and policies regarding transnational corporations. For these extensions the WTO can be criticized as entering into areas that are fundamentally beyond its mandate because they relate not to border measures, but are associated with domestic regulation, taking the WTO well inside the realm of domestic governance. The argument has been made that these issues are closely related to international trade. The problem with this argument is that since many aspects of policy-making affect trade, it is not clear where the mandate of the WTO ends. The real reason for extending the mandate of the WTO is bargaining power. TRIPS provisions were incorporated on the insistence of the US which threatened to pull out of the negotiations if they were not included. This occurred as a result of pressures on the US government by organized business interests, including pharmaceutical manufactures.

Many of these extensions have adverse consequences for the development of LDCs. The TRIMs agreement seriously weakens the bargaining power of LDC governments vis-a-vis TNCs, preventing them from introducing export and domestic content requirements which have in the past proved useful to maximize the benefits that LDCs can obtain from FDI. The opening up of service sectors to trade and foreign investment at early stages of developments can aggravate foreign exchange problems due to profit repatriation, hurt local producers, and exacerbate international demonstration effects. The TRIPs provisions increase the cost to LDCs of technology transfer, They also create favorable conditions for TNCs which assert intellectual property rights on traditional processes used in LDCs in the areas such as foodstuffs, agricultural products, and traditional medicine. All this can be expected to have an unfavorable effect on the LDCs not only for technology transfers but also for balance of payments reasons due to increasing royalty flows (Dunkley 2000:189-90). The argument that the protection of intellectual property rights will actually increase the transfer of technology, for instance by making TNCs more willing to transfer the best technology which they would otherwise not, fearing copying by other firms, may be valid in some cases, but is unlikely to overturn the reduced transfer of technology due to the higher costs of transfer. It may be noted that in the past, many countries that are now rich freely appropriated technology from other countries, and the imposition of TRIPs can again be interpreted as "kicking away the ladder" (Chang 2003).

There have been moves to expand the reach of the WTO even further, to cover the so-called Singapore issues of investment, transparency in government procurement, competition policy and trade facilitation, as well as environmental and labor issues. Opposition from LDCs has prevented these issues from being included in the WTO agreements as of now, but pressures for such extensions emanate from a variety of sources. Corporate interests in rich countries argue that the low level of labor standards and environmental regulation in LDCs give their firms a competitive advantage against them. They also want to open up markets and investment opportunities abroad, especially in LDCs, by further restricting regulations and conditions on foreign investors, by imposing competition policy including policies regarding mergers and acquisitions, by removing special treatment of local firms in government purchases of goods and services. Environmental groups and labor activists want improvements in environmental and labor standards in LDCs. They also argue that the WTO rules takes away the sovereignty of countries in protecting their health and environmental standards by ruling against regulations on imported goods, and leads to a "race to the bottom" in terms of policies that regulate health, labor and environmental conditions. LDCs, however, argue against the incorporation of further domestic governance issues into the WTO's mandate. They argue that doing so would place serious restrictions on them in pursuing development, and appropriate macro and microeconomic policies. Incorporating environmental and labor standards would have the effect of incrreasing protectionism by rich countries against LDC products without solving the root causes of environmental and labor problems (given that exports are usually a small part of domestic production). Moreover, lower environmental and labor standards may be thought of as reflections of lower levels of development in LDCs, just as higher productivity is a reflection of higher levels of development in DCs, rather than as the deliberate use of policies to restrict trade (see Bhagwati 2004).

Biases against LDCs

In addition to the fact that trade liberalization and the extension of the mandate of the WTO to other issues have adverse consequences for LDCs, the particular ways these measures have been adopted and implemented biases them against poor countries. Consider the following examples.

First, despite some concessions shown to LDCs in terms of speeds of adoption of measures, members have been made to liberalize their trade policies while many DCs have persisted in the use of protectionist measures which discriminate against the imports of LDCs (see Raffer & Singer 2001; Stiglitz 2002). Indeed, DCs have continued to maintain high tariff peaks, especially on those products (including leather, rubber and textile products) which are major LDC exports. LDCs also face problems due to "tariff escalation" in DCs, according to which lower tariffs are charged on raw materials than on processed products, resulting in a disincentive against processing activities in them. Despite the agreement about the phase-out of the Multi-Fibre Agreement, tariffs on textiles continued to be very high in many DCs, because of the lack of specification of the timing of the process. Tariffs on agricultural goods also remain high in DCs, because the average tariff maximum requirement was met by reducing tariffs which were of little importance to LDCs. Although average tariffs are much higher in LDCs than in DCs (see Bhagwati 2004), it can be argued that it is not correct to equate equality of treatment with equity, given that DCs usually possess higher levels of technological efficiency in the production of many goods, because of their considerable production experience.

Second, if the TRIMs bargain took into account the interests of both host LDCs and TNCs, there may have been some mutually beneficial agreements. However the TRIMS benefits the TNCs disproportionately by establishing a code of conduct for the host country but not adopting the UN Code on Conduct for Transnational Corporations which protects the host countries.

Third, while LDC services sectors have been considerably opened up, the liberalization of services in semi-skilled sectors, in which LDCs have a comparative advantage, has been blocked (Raffer & Singer 2001:208).

Fourth, the cost of implementing many of the WTO provisions is high, and this creates special problems for LDCs. Several WTO Agreements—such as the customs valuation agreement (which requires members to bring their customs regulations in conformity with agreed standards for the valuation of imports) and TRIPs—make LDCs conform to the higher standards of the DC, and imply implementation costs on LDCs.

Fifth, the dispute settlement process in the WTO appears to be heavily biased against LDCs. Given the elaborate legal structure of the process, many LDCs face prohibitively the high costs of litigation. Thus, given the costs and time incurred, they are usually in no position to bring complaints against DCs even if there are valid grounds for so doing. Moreover, LDCs fear retaliatory complaints against them by these countries in the WTO, or other forms of bilateral retaliation outside the WTO. The structure of punishments also biases the system against LDCs. The rule that only the country which wins a complaint can take retaliatory actions against the perpetrator is more punitive for smaller LDCs than for DCs like the US. Since retaliations across issues is allowed, violations in intellectual property rights—which are likely to occur mainly by LDCs—can result in punitive retaliation on the trade front against them, thereby weakening their position.

Finally, recent moves towards greater cooperation between the WTO and the Bretton Woods Institutions, ostensibly for achieving "greater coherence in global policy making", is likely to further weaken the position of the South vis-à-vis the North in dealing with trade policy issues (Raffer & Singer 2001:216-7).

These biases may appear to be puzzling. Since countries are not forced into joining the WTO, one may wonder why LDCs would line up to become members, as they in fact do, and not leave the institution. Moreover, the WTO, unlike the Bretton Woods institutions, runs along formally democratic lines, each country having one vote. Since there are more LDCs than DCs, one would expect the former to prevail.

On the first issue, as discussed earlier, countries which do not join the WTO have to negotiate bilaterally with powerful countries like the US for access to their markets, without having any rights and security guaranteed by the multilateral system and its dispute resolution system (Stegemann 2000). If members left the WTO they would have to give up all of the cumulative gains that had been negotiated earlier. On the second issue, despite the nominally democratic decision-making structure of the WTO, a number of practices and procedures mentioned earlier, and the lack of resources and power of LDCs tilt the balance against them.

First, decisions are made by "consensus" rather than actual vote, following informal negotiations. Negotiations are pursued by representatives of small groups of countries in which the advanced countries are over-represented, as in the meetings in the so-called "green room" which excludes many LDCs. At these meetings specific LDCs are often bullied or paid off with bilateral negotiations outside the auspices of the WTO. Resource-strapped LDCs are unable to prepare for, and in many cases, even attend all the crucial meetings which they could (Das 2003). The organizational culture in the WTO has made many LDCs perceive the institution as a "rich man's club" and lose trust in the fairness of the negotiating process. The result is that they have viewed the negotiations as situations of conflict and zero-sum games, rather than positive-sum, cooperative enterprises. Ill equipped to negotiate in complex and time-consuming enterprises they have often followed defensive and obstructionist strategies, only to be pressured into consensus at later stages (Narlikar 2005). LDCs often complain that they cannot keep up with the frequent meetings of the Ministerial Conference. Countries which aspire to be members are in a particularly weak position, and in the eagerness to join, have been forced into making larger concessions than what is required by the WTO agreements at the time.

Second, the method of issue linkage in the negotiation process makes it easier to arrive at agreements, but it has been argued that it has also resulted in more powerful countries extracting disproportionately large concessions from weaker countries, sometimes making them making them pay several times for the same concession. The Like Minded Group of LDCs make such an argument when they point out the DCs have not kept up their side of the bargain in the Uruguay Round by reducing tariffs on goods of which LDCs are major exporters and asked for additional concessions in the subsequent, Doha, Round (Narlikar 2005:54). Linkages can also extend beyond trade and even beyond matters which are under the purview of the WTO, including carrots such as foreign aid in the form of grants, concessional loans and regional trade agreements, and sticks such as the withdrawal of concessions and special privileges. The problems of the effective functioning of democracies with huge economic disparities between people are emerging in the context of the WTO with wide disparities in economic power between member countries.

Third, the all-or-nothing method used in the Uruguay round weakened the position of LDCs. Countries, including the least developed countries, could become members of WTO only if they signed all of the provisions of the Uruguay round, in contrast to previous rounds of the GATT in which countries could decline membership in new accords like the Anti-Dumping code. If countries did not accept the new TRIPs and other provisions, they would have to give up all of the cumulative market access rights as negotiated in earlier GATT rounds. Countries not accepting the TRIPs provisions, therefore, would have to enter into bilateral negotiations with countries like the US.

Conclusion

The WTO has an important role to play in the international economic system by coordinating trade and related policies among countries. However, the way it has done so, that is, by forcing trade liberalization on LDCs, by extending (and further attempting to extend) its mandate to other area such as the protection of intellectual property rights, and by systematically biasing many of its procedures and practices against LDCs, it has not promoted efficiency and equity in the world economy in the way it could have.

Changes in the operation of the WTO to reduce some of the biases against LDCs can be made by reforming some of its features, such as the dispute settlement mechanism, negotiation methods, and the all-or-nothing method. Attempts to deviate from the advocacy of trade liberalization and other policies advantageous to DCs are less feasible, given their superior economic power.

This is not to imply that LDCs have *no* possibility of improving their position. First, with greater unity and preparedness they can become a more powerful bloc within the WTO and push for rules more in line with their interests, perhaps convincing DCs that many of these would be in their interests, too. Second, even within existing rules, there are possibilities for conducting industrial policy under the WTO. WTO law, in fact, does allow member countries to protect themselves from certain types of import competition for up to 8 years. This relates to competition that destabilizes their balance of payments; competition that threatens individual industries owing to a surge in imports (temporary safeguards); and an unfair trade practice, like dumping. Several types of subsidies are also allowed, including those to promote R&D, regional development and environmentalism. Amsden (2003:87) argues that "the liberal bark of the WTO appears to be worse than its bite" and that neo-development states in LDCs can continue to foster industrialization through reciprocal control mechanisms which require protected firms to satisfy performance standards, as they did in the successful countries of East Asia. However, the exceptions to import liberalization are more stringent than earlier GATT laws which, for instance, placed no time limits on protection, and in fact, allowed LDC members to use relatively high tariffs and non-tariff barriers. Subsidies on exports and for domestic, rather than imported, inputs are prohibited (other than for countries with a per capita income not exceeding $1000), and even subsidies on domestic production – if they can be shown to injure trading partners – are "actionable". Possibilities exist, but they are very limited.

Recent negotiations within the Doha round (which began in late 2001) are often reported to have broken down due to disagreements between DCs and LDCs. While this reflects the growing strength and confidence of LDCs in the negotiations, it also implies that the LDCs are unable to make the DCs reduce their tariffs and subsidies, especially on agricultural products.

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