

# SOUTHWESTERN JOURNAL OF INTERNATIONAL STUDIES

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## FROM THE EDITOR

It is with great pleasure that we are publishing Volume 2, Number 1 of the Southwest Journal of International Studies. This issue is especially noteworthy since it contains a wide variety of articles, a commentary and best student award papers for the Southwestern International Studies (SISA) Conferences of 2004, 2005, 2006 and 2007.

In the first article, Rogelio Garcia-Contreras describes and analyzes the continuing agent-structure debate by International Relations theorists and its origins. Joan Davidson, in the second article, examines Bosnia and Herzegovina's complex situation in Balkans by focusing on its foreign policy and its effort to be integrated into the EU. The third article by Pierre Canac analyzes the effectiveness of the economic and financial policy recommendations by the IMF and the World Bank to solve the problems of the less-developed countries. In the fourth article, Syed Serajul Islam contributes to the studies of ethnic nationalist separatist movements and conflicts by an in-depth examination of the situation in the Chittagong Hill Tracts region of Bangladesh. In the final article, Timothy Boylan assesses the status of the EU's Constitutional Treaty by analyzing the reasons why it has not been ratified and offers a possible strategy to resolve the problem.

Since this Journal is designed to provide a forum for a variety of opinions and positions we welcome the commentary submitted by Nivien Saleh on Arab Stereotypes. As we know, stereotypes are attempted shortcuts that put people into restrictive boxes that hardly describe them, are offensive and tend to misrepresent the vast majority of the people to whom they are meant to apply. Saleh's commentary tackles that issue by examining the common fatalism stereotype of the Arab cultures.

In the final section of the Journal, we included several excellent articles by students who won the best paper awards at the yearly SISA Conferences. On a yearly basis, students from a number of universities present their papers at the Conference and compete among each other to be selected as having the best paper and to be published in this Journal. Participation at the Conference by students of International Studies is encouraged and welcomed. Students who desire to participate should have a faculty sponsor, register for the Conference and submit a paper to the chair of their panel at least one week prior to the Conference.

Finally, I would like to thank all the authors for their patience for the long awaited publishing of this issue. I would also encourage those who would desire to have their articles printed to submit them to me at stefanovicd@appstate.edu. The articles should include an abstract and should not exceed thirty double-spaced pages and be in Times Roman 10 or 12 fonts. You may use footnotes or endnotes and should include a reference section at the end of your article. All papers should follow the APSA style.

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## **“I am you, you are me”: Exploring the Concept of Mutual Constituency in International Relations Theory**

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*In International Relations theory, the agent-structure debate has constituted one of the most intense and prolific debates in the discipline. The debate is intense, mainly because it has raised contradictory and argumentative views among hardcore international theories. It is prolific, mostly because it is thanks to those contradictory arguments that the discipline of International Relations has enriched its epistemological, ontological and methodological basis. The following paragraphs are then a modest attempt to describe the key aspects of this agent-structure debate by exploring some of the central premises of two of its major contributors: Kenneth Waltz and Alexander Wendt. The idea is to provide a clear view of each of these core perspectives, while acknowledging through the premises of different perceptions –from the rational assertions of structural realism to the post-positivist views of critical theory, postmodernism and social constructivism– that even if we might consider the mutual constituency of the Agent-Structure deliberation as a new debate in International Relations, the theoretical framework of this debate has been taking shape since the introduction of an agenda founded beyond the positivist rationale.*

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*“Structures are socially constructed”*  
– Robert Cox, 1992

*“Actors and Social Structures are mutually constituted”*  
– Alexander Wendt, 1995

Every time Structural Realism is discussed, the first impression one normally gets from this theoretical approach to the study of International Relations (IR) is that most of its central premises rest far away from the more elaborated and perhaps even more complicated philosophical and scientific statements developed by other theoretical arguments or schools of thought. Waltz’s Structural Realism, however, constitutes an incredibly sophisticated approach to the study of international relations, one which does not only deserve the recognition and importance that –without doubt– has had within the field, but more significantly, an approach that could be considered a threshold, a major paradigm in the development of the discipline, both, because of its achievements and limitations. The agent-structure debate is just one example of this argument and an interesting way to explore the valuable contribution of Structural Realism to the study of International Relations.

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\*The author thanks Dr. Jack Donnelly, Dr. Allan Gilbert and Dr. Gustavo Wensjoe for their support and guidance.

According to Jack Donnelly, although ‘neo-classical’ realism has recently made a modest comeback, most realist work since the 1970s has been more or less rigorously structural, largely as a result of the influence of Kenneth Waltz (Donnelly 2005, 34; Donnelly 2000). For Waltz, the international system is an anarchic system, a system which stability relies precisely in its anarchical condition. Waltz’s purpose is to offer an explanatory theoretical –scientific– approach to the study of International Relations based on the identification of law-like regularities. The original idea was to give Realism a better scientific structure that will account for the nature and complexity of international relations. According to Waltz, a system was composed by a structure and a set of interactive units. A decent, well-formulated theory of the International System needs then to include or consider both, the structure and the units that integrate such a system. Yet, highly concerned with its scientific goal, Waltz tried to avoid a proliferation of variables by concentrating exclusively on the structure of the international system (Waltz 1959) as a central component of his theory.

Of course Waltz’s decision was not randomly taken. Waltz argued that the international system was better –and as a matter of fact, exclusively– explained by its structure, only and precisely because its units and the interactions among them were shaped by the Structure, which in the case of the international realm is of an anarchic nature. In this regard, Waltz specifies that every political Structure is composed by three elements:

- An ordering principle
- A differentiation of function among units
- A distribution of capabilities across units (Waltz 1979)

Structural realism attempts to ‘abstract from every attribute of states except their capabilities’ (Waltz 1979, 99) in order to highlight the impact of anarchy and the distribution of capabilities (Donnelly 2005, 35). In the words of Waltz himself:

International structure emerges from the interaction of states and then constrains them from taking certain actions while propelling them toward others” (Waltz 1991, 29)

Therefore, despite great variations in the attributes and interactions of states, there is a striking sameness in the quality of international life (Waltz 1979, 66). In Structural Realism, hierarchy and anarchy are the two principal political ordering principles. Units either stand in relationships of authority and subordination –hierarchy– or they do not – anarchy (Donnelly 2005, 35). In his *Theory of International Politics* Waltz argues then that striking qualitative differences exist between politics conducted in a condition of settled rules and politics conducted in a condition of anarchy (Waltz 1976, 61).

Hierarchy, Waltz asserts, entails relations of super and subordination among a system’s parts, and that implies their differentiation (Waltz 1979, 93). Anarchic orders, however, have little functional differentiation. Every unit must put itself in a position to be able to take care of itself since no one else can be counted on to do so (Waltz 1979, 107). In consequence, differences between states, Waltz concludes “are of capabilities, not function” (Waltz 1979, 96). National politics consists of differentiated units performing specified functions. International politics consists, in contrast, of like units duplicating one another’s activities (Waltz 1979, 97; Donnelly 2005, 35). To put it in Donnelly’s words:

If all international orders are anarchic, and if this implies minimal functional differentiation, then international political structures differ only in their distributions of capabilities. They are defined by the changing fates of great powers. More abstractly, international orders vary according to the number of great powers (Donnelly 2005, 35)

Nearly obsessed with the role of power politics in International Relations, the importance in the distribution of capabilities among great powers and the relevance of force in the consolidation of balance of power, Structural Realism does profess an almost theological commitment to a particular theoretical position. As a matter of fact, more conservative approaches to Neorealism or Structural Realism, like Mearsheimer’s Offensive Realism (Mearsheimer 2001) seems to suggest that what is tragic about International Relations is not the anarchic dynamics of power politics, but the fact that great powers –i.e. the United States– have to deal with this terrible inconvenience, finding themselves in the middle of endless struggles for supremacy and stability. Instead of trying to offer an explanation or understanding on the nature of great power politics, some structural and offensive realist scholars even seem to complain about the tragic “manifest destiny” of great powers, namely: an endless security-seeking competition for power whose ultimate and almost sacred purpose –ironically– is not survival but supreme domination.

Yet, dominant discourses –critical theorists and social constructivists would argue – do not only help to preserve, but in fact reproduce the very same set of events that they are trying to explain. In fact, one of the major problems with International Relations theory, these critics argue, is that Realism has become the dominant discourse of the discipline, making difficult for international political practice to escape the dynamics of a so-called *realpolitik*. In *Perpetual Peace*, Kant argues that Realist *a-morality* does not even deserve a hearing, since its extreme considerations might as well materialize in the practice of politics (Kant [1887] 1965). Kant seemed to understand that the analysis of a specific problem and its eventual comprehension is in part defined by the way in which we decide to approach the problem in the first place.

In this particular sense, the narrowness and pre-established tendencies of structural realism are evident. Aware at least of this narrowness, some structural realists frequently justify such a problem by emphasizing the strong scientific commitment of this school of thought. In this regard, authors like John Mearsheimer defend their realist position by establishing the benefits of a theory that concentrates in the ‘real’ dynamics of world politics, as opposed of focusing on ideas or philosophical inquiries. The ultimate purpose of realist scholars, especially those who have adopted and followed the premises of structural realism, is to give some sort of scientific truth to the discipline. “Offensive realism do have a lot of limitations”, Mearsheimer says, “but a price must be paid if we want to develop scientific explanations”. Thus, trying to fulfill a self-imposed commitment with a positivist-based rationality, realists and Neo-realists in particular offer what some of them have even recognized as a limited account of International Relations.

For their critics, however, the problem seems to be not that structural realists had developed a clever theoretical artifice to prevent the proliferation of variables in the discipline, but a very conscious intention on their part to defend an argument that serves more their position as scholars than the fate of the discipline. In other words, the problem for some of the most visceral critics of Structural Realism is that, according to them, Realists scholars are very much aware of their school’s limitations but they pursue this train of thought anyway because of the convenient

academic status that the defense of such an argument has gained for many of them. To put it in the context of social de-constructivism, academics –not only states– are also influenced by the structures of power. The discourse generated in Universities or Research Institutes, scientific or not, is often manipulated to serve interests different from that of the discipline, offering the possibility to certain scholars of gaining status and prestige within the power structures of the same society they try to explain. In this sense, the most serious critique made to Structural Realism can be presented within the framework of Marcuse's notion of a benign repression: as a school of thought, structural realism appears to be tolerant and inclusive but in fact it is a discipline that discriminate on those theories that are formulated outside the conventional discourses of power, rejecting any possibility of enlightening or enriching its own arguments through the incorporation of more inclusive or critical views.

Aware of this situation, many structural realists have argued that certain Liberal Theories are, less accurate, but far more appealing to analysts and scholars than their own, simply because they give the notion of a more universal, benevolent, and inclusive approach of international affairs than the scenario offered by certain realist theories. However, and despite neo-realists attempt to insinuate that others are the ones developing theories to gain spaces and prestige, some of them have declared, at least implicitly, that Structural Realism not only is truly scientific, but far more accurate than other theories and, more importantly, far more 'real'. For them, international politics is about the competition for power among nation states so enough capabilities can be accumulated in order to ensure supremacy and survival. Thus, any scholarly effort to scientifically explain this rampant competition among states should be acknowledged and procured.

The irony is that structural realism seems to remain indifferent not only to other versions of the 'real' but to the fact that what is known as 'real' is nothing else but a socially constructed concept that provides very limited insights of that what is "actual" (Der Derian 1989). If in order to overcome its limitations Structural Realism has to provide a more critical approach of its own concepts, deconstruct its precepts and account for its history, then, the future of Realist versions like the ones formulated by Waltz or Mearsheimer are, to say the least, uncertain in the development of serious –and maybe even scientific– theoretical debates. Arrogance and self-contemplation are not a path for a truly scientific work. Paraphrasing Der Derian, realism urgently needs an account of the other, otherwise, realism won't be (Der Derian 1987).

In this regard, international critical theory just as much as some de-constructivist approaches offer an interesting argument in favor of the relevance, importance and significance of re-evaluating structural realism's basic assumptions. Social constructivism on the other hand, especially the one introduced by Alexander Wendt, does not only value many of the premises established by structural realism, but used them as its starting point in an apparent effort to improve the study of the discipline by accounting for neorealist's successes and shortcomings. It is as if Wendt's social constructivism, to paraphrase Der Derian, turned out to be nothing but an intellectual attempt to socially construct realism in an effort to save it. Let us explore then some of the main paths through which Critical International Theory and de-constructivist approaches have tried to do something similar to that: criticizing and de-constructing structural realism, in order to make some sense out of it.

## THE CRITIQUE AND SOCIAL (DE-) CONSTRUCTION OF STRUCTURAL REALISM

From a theoretical and epistemological point of view, Critical International Theory has developed a comprehensive and plausible approach to improve Realism by overcoming some of its structural limitations. Positivist or ‘scientific’ analyses remain crucial, and are indeed dominant in the United States, as the success of rational choice analysis or the Prisoner’s Dilemma demonstrates (Burchill et al. 2005, 2). But just like Scott Burchill and Andrew Linklater remind us, this is not the only type of theory available in the field:

An increasingly large number of theorists are concerned with a second category of theory in which the way that observers construct their images of international relations, the methods they use to try to understand this realm, and the social and political implications of their “knowledge claims” are leading preoccupations. These theorists believe it is just as important to focus on how we approach the study of world politics as it is to try to explain global phenomena. In other words, the very process of theorizing itself becomes a vital object of inquiry (Burchill et al. 2005, 2-3).

As a result of this growing interest, two debates structured International Relations scholarship during the 1980s. The first was between neo-realists and neo-liberals, both of which sought to apply the logic of rationalist economic theory to international relations, but reached radically different conclusions about the potential for international cooperation. The second was between rationalists and critical theorists, the latter challenging the epistemological, methodological, ontological and normative assumptions of neo-realism and neo-liberalism, and the former accusing critical theorists of having little of any substance to say about real-world international relations (Reus-Smit 2005, 188).

Yet, although neo-realists and neo-liberals engaged in a rationalist family feud, critical theorists challenged the very foundations of the rationalist project. Ontologically they criticized the image of social actors as atomistic egoists, whose interests are formed prior to social interaction, and who enter social relations solely for strategic purposes. They argued, in contrast, that actors are inherently social, that their identities and interests are socially constructed, and that they are the product of inter-subjective social structures (Reus-Smit 2005, 193). Epistemologically and methodologically, Reus-Smit reminds us, critical thinkers questioned the neo-positivism of social disciplines –in particular the new version of realism and its *realpolitik*. This is precisely what many authors started to call Constitutive Theory.

In the years since a flourishing literature has been devoted to addressing theoretical concerns due to a growth of interest in the discipline, much of this new literature has been created from the postmodern realms of constitutive theory. This focus on the process of writing IR theory originated, as I mentioned before, serious opposition and a fruitful debate. In response to the postmodern call for interpretive modes of understanding and epistemological attune to the unquantifiable nature of many social phenomena and the inherent subjectivity of all observation, some positivist scholars have argued that the excessive preoccupation with theory represents a withdrawal from an analysis of ‘real’ events and a sense of responsibility for policy relevance (Wallace 1996, 2; Burchill et al. 2005, 3). There is a parallel here with a point that Keohane made against post-modernism which is that the fixation with problems in the philosophy of

social science leads to a neglect of important fields of empirical research (Keohane and Nye 1977; Keohane 1988; Burchill et al. 2005, 3-4).

Constitutive theory refers to all the series of post-positivist critical theories that gave origin to the discipline's Third Debate. The famous Third Debate of International Relations encompasses both, the narrowly defined critical theory of the Frankfurt School as well as the postmodern international theories of the post-cold war world (Gaddis 1993). As a matter of fact, since the end of the Cold War, the two original debates in International Relations have been displaced by two new debates: one between rationalists and constructivists, and the other one, which we will discuss later, between constructivist and critical theorists. Critics of rationalist, more positivist approaches maintain that the discipline rests on unspoken or undefended theoretical assumptions about the purposes of studying international relations, and specifically on the belief that the discipline should be concerned with issues which are more vital to states than to civil society actors aiming to change the international political system (Smith, Booth and Zalewski 1997). In this regard, postmodern scholars like Steve Smith argue that all theories do this whether intentionally or unintentionally:

They 'do not simply explain or predict, they tell us what possibilities exist for human action and intervention; they define not merely our explanatory possibilities, but also our ethical and practical horizons' (Smith 1996, 13).

Smith questions what he sees as the false assumptions that theory stands in opposition to 'reality' –conversely that theory can be tested against 'reality' which is already 'out there' (Burchill et al. 2005, 4). The issue here is whether what is 'out there' is always theory-dependent and invariably conditioned to some degree by the language and culture of the observer and by the general beliefs of a society tied to a particular place and time. Critical approaches to the discipline have been equally keen to stress that there is 'no view from nowhere' (Nagel 1986).

In fact, if there is anything that holds together the disparate group of scholars who subscribe to 'critical theory' it is the idea that the study of international relations should be oriented by politics of emancipation. For critical theory, any assessment of the degree to which political events change world order depend on the extent to which various forms of domination are removed and on the way in which peace, freedom, justice and equality are promoted (Devetak 2001).

Critical theory has its roots in a strand of thought which is often traced back to the Enlightenment and connected to the writings of Kant, Hegel and Marx. In the twentieth century, however, Critical Theory became most closely associated with a distinct body of thought known as the Frankfurt School. It is in the work of Max Horkheimer, Theodor Adorno, Walter Benjamin, Herbert Marcuse and, more recently, Jurgen Habermas that Critical Theory came to be used as the emblem of a philosophy which questions modern social and political life through a method of immanent critique (Devetak 2001, 138). Critical Theory was largely an attempt to recover a critical and emancipatory potential that had been overrun by recent intellectual, social, cultural, political, economic and technological trends (Devetak 2001, 138).

According to Max Horkheimer of the Frankfurt School, the purpose of underlying critical, as opposed to traditional, conceptions of theory is to improve human existence by abolishing

injustice (Horkheimer 1972). As articulated by Horkheimer, this conception of theory does not simply present an expression of the “concrete historical situation” it also acts as “a force within [that situation] to stimulate change” (Horkheimer 1972, 215). In other words, it allows for the intervention of humans in the making of their history (Devetak 2001, 139). Thus, Critical theory is essentially a critique of the dogmatism it finds in traditional modes of theorizing. This critique reveals the unexamined assumptions that guide traditional modes of thought and exposes the complicity of traditional modes of thought in prevailing political and social conditions (Devetak 2001, 143).

In this regard, critical international theory rejects the idea of the theorist as an objective bystander. Instead, the theorist is enmeshed in social and political life, and theories of international relations, like all theories, are informed by prior interests and convictions, whether they are acknowledged or not (Devetak 2001, 160). A second contribution critical international theory makes is to rethink traditional/rational accounts of the modern state and political community. Against the positivism and empiricism of various forms of realism, Devetak reminds us, critical international theory adopts a more hermeneutic approach which conceives of social structures as having an inter-subjective existence (Devetak 2001, 150). “Structures are socially constructed” – that is, says Robert Cox:

They become a part of the objective world by virtue of their existence in the inter-subjectivity of relevant groups of people (Cox 1992, 138)

Allowing for the active role of human minds in the construction of the social world does not lead to a denial of concrete reality; it simply gives it a different ontological status (Devetak 2001, 150). Although structures, as inter-subjective products, do not have a physical existence like tables or chairs, they nevertheless have real, concrete effects (Cox 1992a, 133). Structures produce concrete effects because humans act as if they were real (Cox 1986, 242). Thus, one of Critical International Theory essential tasks is to account for the social and historical production of both, the agents and structures taken for granted by traditional theories (Devetak 2001, 150). Traditional more rational theories, such as Structural Realism, tend to take the state for granted, but critical international theory analyses the changing ways in which the boundaries of community are formed, maintained and transformed (Devetak 2001, 160).

In contrast to individualist ontological positions which conceive of states as atomistic, rational and possessive, and as if their identities existed prior to or independently of social interaction (Reus-Smit 1996, 100), critical International theory is more interested in explaining how both individual actors and social structures emerge in, and are conditioned by, history (Devetak 2001, 150). As presented by Richard Devetak in the conclusion of his essay on Critical Theory, Critical International Theory...

...does not only provide a sustained ethical analysis of the practices of inclusion and exclusion, but it also represents a potential alternative theory –and practice– of international relations by resting on the possibility of overcoming the exclusionary dynamics associated with modern system of sovereign states and by establishing a cosmopolitan set of arrangements that will better promote freedom, justice and equality across the globe (Devetak 2001, 160).

In response to this major epistemological opposition to rational theories, hardcore realists like John Mearsheimer have argued that critical theory is well-suited for challenging realism because critical theory is, by its very nature, concerned with criticizing “hegemonic” ideas such as realism, without having to lay out alternative futures (Williams, Goldstein and Shafritz 2006, 391). The central aim of Critical International Theory, Mearsheimer argues by quoting Critical Thinkers themselves, is

To seek out the contradictions within the existing order, since it is from these contradictions that change could emerge” (Cox 1987, 393). It is called ‘critical’ theory for good reason. Very significantly, however, critical theory *per se* has little to say about the future shape of international politics. In fact, critical theory emphasizes that, “it is impossible to predict the future” (Cox 1992, 139). Robert Cox explains this point: “Critical awareness of potentiality for change must be distinguished from utopian planning, i.e., the laying out of the design of a future society that is to be the end goal of change. Critical understanding focuses on the process of change rather than on its ends; it concentrates on the possibilities of launching a social movement rather than on what that movement might achieve (Mearsheimer 1995, 5-6; see also Cox 1987, 393).

Critical theorists have ambitious aims, Mearsheimer recognizes, but critical theory also has important flaws, and therefore it will likely remain in realism’s shadow (Mearsheimer 1995, 49). Nevertheless, and regardless if critics of Critical International Theory like John Mearsheimer have a point when they account for the lack of alternative futures, international relations scholars who use critical theory in order to challenge and subvert realism and structural realism, certainly expect to create a more harmonious and peaceful international system (Williams, Goldstein and Shafritz 2006, 392). More specifically, critical theory is concerned with affecting fundamental change in state behavior, despite the fact that some may think critical theorists may say little on how this process is possible.

Indeed, the very same action of critically theorizing about an international event by negating its assumed premises or, as Karin Fierke would say ‘denaturalizing’ them, (Fierke 1998, 13), constitutes in itself a tacit effort to demonstrate how affecting fundamental change in assumed rational state behavior is actually possible. Therefore, Critical International Theory offers a possibility to improve rational, more traditional approaches to the study of international relations by helping us “look again, in a fresh way, at that which we assume about the world because it has become overly familiar” (Fierke 1998, 13). Denaturalizing objective realities opens the door to alternative forms of social and political life, so, implicitly, critical international theory quasi denaturalizing critique serves “as an instrument for the de-legitimization of established power and privilege” (Neufeld 1995, 14).

In this regard, one foundational and ground-breaking attempt within critical international theory to denaturalize the overly familiar structures of power can be found in the sophisticated Marxist version of Jurgen Habermas’ historical materialism (Habermas 1979, 1984). In his *Theory of Communicative Action: Reasons and the Rationalization of Society*, Habermas starts by arguing that there are three kinds of knowledge:

1. The technical which provides mechanisms to dominate nature,
2. The moral which offers the possibility to create consensus, and

3. The emancipatory one, which purpose is to overcome unnecessary forms of repression (Habermas 1984)

With this categorization in mind, Habermas argues that every social theory needs to provide the possibility of emancipation, meaning that it needs to offer the chance to disregard and overcome constraining or coercive discourses. And this is precisely what Realism –and in particular Structural Realism –does not offer. In fact, as I mention above, one of the main problems of this particular version of Rational Theory is that Realism is a self-fulfilling, self-explanatory theory that preserves and reproduces the status quo in its efforts to provide an explanatory account of it.

By theorizing on the basis of Marx’s historical materialism, critical theorists try to provide Realism with illuminating and hopefully helpful insights to make it more accountable. Critical Theory scholars argue that historical materialism do improve International Relations theory by introducing not only a dialectical way of constructing theory –based on constant criticism of dominant concepts– but also by offering hierarchical notions of international power –instead of the idea of horizontal rivalry among equals. More importantly, Critical Theory offers a far more extended vision of the international realm by highlighting the importance of certain dominant civil societies in the construction of hegemonic orders with a significant role assigned to International institutions, in what Gramsci would call hegemonic historic blocs.

A slightly different, although equally interesting approach to the limitations of Realism is offered by Der Derian’s postmodern version of social de-constructivism. Deconstruction is a general mode of radically unsettling what are taken to be stable concepts and conceptual oppositions. Its main point is to demonstrate the effects and costs produced by the settled concepts and oppositions, to disclose the parasitical relationship between opposed terms and to attempt a displacement of them (Devetak 2005, 168). According to Jacques Derrida:

Conceptual oppositions are never simply neutral but are inevitably hierarchical. One of the two terms in the opposition is privileged over the other. This privileged term supposedly connotes a presence, propriety, fullness, purity, or identity which the other lacks (for example, sovereignty as opposed to anarchy). Deconstruction attempts to show that such oppositions are untenable, as each term always already depends on the other (Devetak 2005, 168)

From a postmodern perspective, the apparently clear opposition between two terms is neither clear nor oppositional. Derrida often speaks of this relationship in terms of a structural parasitism and contamination, as each term is structurally related to, and already harbors the other. Hence, to inquire into the agent-structure debate or into state’s (re)constitution, as postmodernism does, is partly to inquire into the ways in which global political space is partitioned. The world is not naturally divided into differentiated political or ontological realms, and nor is there a single authority to carve up the world (Devetak 2005, 175). Consequently, postmodernists are less concerned with what sovereignty is, and far more concern with how it is spatially and temporally produced and circulated. How are specific configurations of space, sovereignty and power established? What are the implications of these constituencies?

In an attempt to address these very same issues, Der Derian argues that a de-constructivism of realism requires to step back, to look wider and to dig deeper (Der Derian 1989). Post-Positivist

accounts do offer a possibility for a different approach towards dominant International Relations insights, to the extent that they present first, a critical approach on the traditional notions of the discipline; second, a deconstruction of the sovereign/anarchy relation –Ashley’s double reading version of the paradigm (Ashley and Walker 1990)– and third, a genealogical view on the history of the state (Bartelson 1997).

With this in mind Der Derian states that a plausible way to develop a good deconstruction of rational theories would be to apply Nietzsche’s principles of Genealogy, Semiology and Dromology to the consolidation of the task (Der Derian 1989). Genealogy, then, would mean to provide a construction and re-construction of the history of realism, in order to understand how it is that present versions of the theory came to be and how it is that other no so relevant, even ignored, versions of realism have never reached the academic discourse. In the words of Richard Devetak, Der Derian’s genealogical method is nothing else but an effort to expose the intimate connection between claims to knowledge and claims to political power and authority (Devetak 2005, 187). Semiology on the other hand would regard current versions of Realism, like the ones offered by Kenneth Waltz or John Mearsheimer as exclusive and unreliable, since they are based on short-sited, non critical concepts. And finally, Dromology would consider the traditional notion of national security –based on territoriality and the concepts of sovereignty and non-intervention– as hardly difficult, if not impossible, to accomplish under current international conditions.

This, as Richard Devetak puts it, holds especially significant implications for the sovereign state.

Most notably, it means that the sovereign state, as the primary mode of subjectivity in international relations, must be examined closely to expose its practices of capture –inclusion– and exclusion. Moreover, a more comprehensive account of contemporary world politics must also include an analysis of those transversal actors and movements that operate outside and across state boundaries (Devetak 2005, 187).

Der Derian’s postmodernist account is a serious epistemological attempt to liberate Realism –and Structural Realism in particular– from its narrow account of International Politics by offering what he sees as a better constructed new version of the theory. Postmodernism seeks to rethink the concept of the political without invoking assumptions of sovereignty and re-territorialization. By challenging the idea that the character and location of the political must be determined by the sovereign state, postmodernist like Der Derian or Jens Bartleson seek to broaden the political imagination and the range of political possibilities for transforming international relations (Devetak 2005, 187).

Thus, if realists could accept that the way in which we conceive ourselves defines the way in which we conceive the world and vice-versa, the theory would have taken a significant step towards a better understanding of the discipline. What Realism needs is a critical and paradigmatic approach that not only recognizes the inter-subjective nature of interests and identities, but the essential role of “the other” in the construction of one’s own identity. Surprisingly enough, Der Derian as well as other International Relations Scholars like Richard Ashley or Friederic Kratochwill have identified in Structural Realism a plausible mechanism to overcome the limitations of more recent versions of Realism. The fact that, for instance, Morgenthau’s realism offers in the eyes of these scholars a better possibility for engaging

Realism in a dialectical reformulation and examination of itself (Morgenthau [1948] 1973), suggests the immense limitations of today’s versions, since it is clear, from the perspective of some of this post-positivist scholars, that neorealist approaches like Mearsheimer’s or Waltz’s, urgently need a better account of key international issues, such as the process to consolidate international institutions, peaceful means for conflict resolution, the problematic issue of intervention –even if humanitarian– and the role of morality in power politics.

The consequence of taking postmodernism’s critique of totality and sovereignty seriously is that central political concepts such as community, identity, ethics, agent, structure and democracy are rethought to avoid being persistently re-territorialized by the sovereign state. Indeed, de-linking these concepts from territory and sovereignty underlies the practical task of a postmodern politics or ethics (Devetak 2005, 187). But as Richard Devetak writes in his recent essay on Postmodernism

It should be noted, however, that postmodernism, as a critique of totalization, opposes concepts of identity and community only to the extent that they are tied dogmatically to notions of territoriality, boundedness and exclusion. The thrust of postmodernism has always been to challenge both epistemological and political claims to totality and sovereignty and thereby open up questions about the location and character of the political (Devetak 2005, 187).

The fact is, in any event, that under the umbrella of the broad and fruitful post-positivist critique, modern and postmodern critical theorists stood united against the dominant rationalist theories. However, as this post-positivist critique began to open up spaces for more philosophical and epistemological questions about the ‘actual’ and empirical location of the political, its character and limitations started to change; as the critique began to demand the analysis and understanding of the concrete effects of the mutual constituency phenomenon or the moral purpose of the state –if any– a catalyst force started to take shape within the analytical parameters of post-positivist international relations theory. This catalyst force we know today as Social Constructivism.

### **SOCIAL CONSTRUCTIVISM AND THE CATHARSIS OF THE AGENT-STRUCTURE DEBATE**

Constructivism is characterized by an emphasis on the importance of normative as well as material structures, on the role of identity in shaping political action, and on the mutually constitutive relationship between agents and structures (Reus-Smit 2005, 188).

Just as rationalists –namely neorealists and neoliberals– were internally divided, so too were their critics. On one hand postmodernists opposed all attempts to assess empirical and ethical claims by any single criterion of validity, claiming that such moves always marginalize alternative viewpoints and moral positions, creating hierarchies of power and domination (Reus-Smit 2005, 193; Foucault 1977; Der Derian 1987). On the other, modernist recognized the contingent nature of all knowledge –the inherent subjectivity of all claims and the connection between knowledge and power– but they insisted that some criteria were needed to distinguish plausible from implausible knowledge claims, and that without minimal, consensually grounded ethical principles, emancipatory political action would be impossible (Reus-Smit 2005, 194; Marcuse 1964; Habermas 1984; Horkheimer, 1972).

Despite its novelty as a discipline of analysis, Constructivism challenged the rationalism and positivism of neo-realism and neo-liberalism alike, while simultaneously pushing critical theorists away from a meta-theoretical critique to the empirical analysis of world politics (Reus-Smit 2005, 188). Thus the new constructivist approach came as a solution for the serious and almost denigrating intellectual *impasse* in which the discipline had fallen. Constructivism turned out to be, perhaps without noticing it, the formal theoretical venue through which International Relations theory started to look more like an organized, civilized, congruent and coherent discipline, than a random, disseminated, at times informal, and almost always hostile intellectual debate.

Constructivists, although divided between modernist and postmodernists, have all sought to articulate and explore very specific ontological propositions about world politics, as an effort to overcome the limitations of rational approaches and with the idea of giving some critical international theory positions a far more concrete and empirical quality. The articulation of a constructivist theoretical outline for the study of international relations has modified the angles and axes of debate within the field in a dramatic and refreshingly important way. As Reus-Smit reminds us:

It has long been the ambition of rationalists, especially neo-realists, to formulate a general theory of international relations, the core assumptions of which would be so robust that they could explain its fundamental characteristics, regardless of historical epoch or differences in the internal complexes of states (Reus-Smit 2005, 202)

For Constructivists, however, such ambitions have little relevance. The constitutive forces they emphasize such as ideas, norms and culture, and the elements of human agency they accentuate, such as corporate, group and social identity are all inherently variable. As a matter of fact, constructivists repeatedly insist that their approach is not a theory of international relations, but rather an effort to create an analytical framework. The one notable exception to this tendency is Alexander Wendt who embraced an epistemological position called ‘scientific realism’ and embarked on the ambitious project of formulating a comprehensive social theory of international relations (Reus-Smit 2005, 202), placing himself in direct competition with Kenneth Waltz, the other ambitious International Relations scholar from the positivist school.

It is precisely in the agreements and disagreements between Neo-Realist, Kenneth Waltz, and Social Constructivist, Alexander Wendt that I believe a more comprehensive, inclusive and sophisticated IR theory started to take shape. Their intellectual but not necessarily direct debate on the nature of the field, the constituencies of theory or the appropriate methodology, as well as the mutual critique to their alleged contributions to the discipline, have made of International Relations an interesting, vigorous and prolific field in social sciences.

For instance, where neo-realists emphasize the material structure of the balance of military power, and Marxists stress the material structure of the capitalist world economy, constructivists argue that systems of shared ideas, beliefs and values also have structural characteristics, and that they exert a powerful influence on social and political action (Reus-Smit 2005, 197). Indeed, according to Alexander Wendt there are two reasons why they attach such importance to these structures:

1. Cause material resources only acquire meaning for human action through the structure of shared knowledge in which they are embedded, and
2. cause normative and ideational structures are thought to shape the social identities of political actors (Wendt 1995, 73).

Furthermore, and perhaps more importantly, constructivist argue that understanding how non-material structures condition actors' identities is important because identities inform interests and, in turn, actions (Reus-Smit 2005, 197). These significant contributions to international relations theory allowed social constructivists to conclude one of the most revolutionary and ground-breaking ideas in the relatively short history of the discipline. Constructivists contend that agents and structures are mutually constituted. Normative and ideational structures may well condition the identities and interests of actors, but those structures would not exist if it were not for the knowledgeable practices of those actors (Reus-Smit 2005, 197). So as Reus-Smith, Andrew Linklater, Scott Burchill and other major IR scholars may conclude: Wendt's emphasis on the 'supervening' power of structures, and the predilection of many constructivists to study how norms shape behavior, may suggest that constructivists are *structuralists* just like their neo-realist and Marxist counterparts (Reus-Smit 2005, 197).

The synthesis of this perspective can be found in the fact that constructivism embodies characteristics normally associated with the “English School” (Linklater and Suganami 2006). The interest of social constructivist in international history, their stress on the cultural differences among nation-states, and the fact that they have taken up on the idea that states form societies more than systems, show relevant point of convergence with the English School. These similarities with the English School, as well as its emphasis on empirically informed theorizing over meta-theoretical critique have allowed social constructivists to develop an orientation much less confronting to mainstream IR schools, despite its critical thinking roots. The result then has been an actual possibility to have respectful, prominent and useful debates within the discipline.

One of these debates is, precisely, the Agent-Structure debate. As Reus-Smit reminds us, this debate finds its roots in the slightly different, yet significant epistemological understanding that rationalists and constructivists have of actors and their interests:

Rationalists believe that actors' interests are exogenously determined, meaning that actors, be they individuals or states, encounter one another with a pre-existing set of preferences. Neo-realists and neo-liberals are not interested in where such preferences come from, only in how actors pursue them strategically. Society –both domestic and international – is thus considered a strategic domain, a place in which previously constituted actors pursue their goals, a place that does not alter the nature or interests of those actors in any deep sense. Constructivists, in contrast, argue that understanding how actors develop their interests is crucial to explaining a wide range of international political phenomenon that rationalists ignore or misunderstand (Reus-Smit 2005, 197).

While constructivists point out that institutionalized norms and ideas work as rationalizations only because they already have moral force in a given social context, realists and neorealists have long argued that ideas simply function as rationalizations, this is, as ways of masking actions really motivated by the crude desire for power (Reus-Smit 2005, 198). Now, what turns out to be really interesting is the role that states play in all this. According to Waltz, states –

which are the most important actors of the international system— must always inter-act within an anarchic environment that ultimately and necessarily ends up shaping their aims, interests and intentions (Waltz 1979). Therefore, from a neo-realist perspective, within the anarchic conditions of the international realm, states are all like-units whose main purpose is *NOT* the acquisition or accumulation of power but its simple survival. In other words, and despite the common association of Structural Realism with the notion of power, Waltz's conception of states as all-like units allows for a quasi-*constructivist*, non-linear understanding of the international arena.

Since every sovereign actor (unit) of the international system interacts as equal with other sovereign actors (units) in the anarchical environment of international relations –at least in theory and thanks to the fact that they mutually recognized each other as such – the only Structural element that really matters among these units is the distribution of capabilities among and across them. If the ultimate imperative were to survive, then the distribution of capabilities across the members would be the essential valve to define their power and position in the system, as well as all the other relations of coexistence that evolved from them, including the influential notion of balance of power.

Indeed, several authors have followed this intriguing contribution to the study of International Relations, many of them with no other aim but of criticizing the very same foundations of Waltz's Structural Realism. Some of these scholars have criticized Waltz's state-centrism, others have questioned the theory's emphasis on political-military capabilities, many have argued against Waltz's perceived inability to account for international change, and the most have just gone on and on with all of the above.

Yet, as we have mentioned before, it is precisely because of this major response to the premises of Structural Realism that the major and more fruitful debates in the discipline have developed. The Agent-Structure debate is one of these fruitful results, and –just as we also mentioned before– this debate draws on the far more inclusive, historical and institutionally oriented approach offered by the English School. The English School focused neither on the system of states nor upon the community of human kind, but upon what it regards as the basic reality which Realists and Idealists ignore: International Order (Bull 1977). On this regard and in order to keep it simple, one should try to account for Bull's distinction between an international system and an International Society. As Andrew Linklater notices, by establishing the necessary elements of every society, i.e. property rights, security and the *sine qua non* promise-maintenance system, and by making the informed decision of theorizing about the relevance of War and its effects (Linklater 1990), Hedley Bull was able to distinguish an interesting paradoxical feature of the State System: International Order exists in spite of and even in the context of Anarchy (Bull 1977). This apparently irrelevant paradox constituted in fact a whole new perspective in the study of international relations, opening the door for modern and postmodern critical international theory and all social constructivist theories that emanated from it.

The fact that Bull identified clear elements of international order within the anarchical structure of international society helped him conclude: First, the idea that the international system is affected by the units as much as it is affected by the structure; Second, the notion that states were not the only major actors in international relations; and third, most significantly for our purpose,

the ontologically revolutionary and epistemologically sophisticated notion that Agents and Structure are mutually and dialectically constituted (Bull 1977).

The relevance and importance of Bull’s last observation remained pretty much unattended by the main authors and scholars of international relations theory, whose central epistemological and ontological concern was not this mutual constitution between agents and structure, but the apparent paradox of an organized anarchy. In fact, the so-called first and second waves of modern IR scholars concentrated their efforts so much on the discipline’s attempt to explain the principles and dynamics of the geopolitical and ideological phenomenon known as the Cold War that they ended up pretty much ignoring any other theoretical or historical model. As a result, never a theoretical re-consideration of the actors in international relations has been more pertinent than in the period when the states of Eastern Europe and the former Soviet Union reasserted their national sovereignty and independence, and attempted to make the dual transition toward a democratic and a free market regime. In other words, as soon as the Cold War model ceased to exist, it became imperative for everyone within the discipline to reexamine many of the premises on which IR theories, paradigms and debates were built, especially those regarding power and strategic absolutes. With the nature, number, and magnitude of structural and systemic changes that took place at the end of the Twentieth Century, part of the challenge for the student and scholar of the discipline was to determine which approaches remained appropriate and which became less helpful. (Williams, Goldstein and Shafritz 2006, xviii)

A student that did just that was Alexander Wendt. Wendt’s Social Constructivism has played a mayor role in bringing to life the Agent-Structure debate. For Alexander Wendt, Waltz’s conception of the international system is under-theorized. Neorealists drew an erroneous distinction between the structure of the system and the structure of its component units, failing to appreciate its mutual, although sometimes unclear, constitution. In its attempt to improve the deficiencies of Structural Realism, Wendt argues that Sovereignty (one of the *sine qua non* concepts of Waltz International system) is an institution that depends on the implementation of rules that exist only in virtue of certain inter-subjective understandings and expectations (Waltz 1995). In other words, Wendt’s notion of Sovereignty is not shaped by the structure of the Anarchic system, but it is, in contrast, an integral part of that structure.

In fact, it might even be argued that some Constructivist elements are present in Waltz’s theory: Sovereignty only works if it is recognized by other like units. For Wendt actors and social structures are mutually constituted, so when states engage in mutual recognition they not only determine their own identity, but also the social structure of the system of which they form part. According to Wendt, Waltz does not talk about anarchy on the abstract but about a particular kind of Anarchy defined by cultural patterns – *anarchy is what states make of it*. As a result, Waltz was forced, first, to develop a very limited approach to International Relations and second, to start reducing one unit into another due to his explicit intention of accomplishing scientific accuracy.

To support his critique of Structural Realism, Wendt offered two principles of Social Constructivism which main purpose were to negate neorealist’s key assumptions (Wendt 1999). One was the idea that self-interested notions are not a constitutive part of Anarchy and other was that meanings arise out of interactions. In other words, Wendt offered an extensive critique of

Waltz's Structural Realism not only by arguing like Ruggie that the second analytical element of any political structure matters –namely, the differentiation among units– but that such units are in fact constitutive of and constituted by the structural forces of the system. Just like Andrew Linklater, who proposes a Fourth Image for International Relations in terms of the dialectics of inclusion and exclusion, Wendt proposes a fourth element of political structure in order to go from structure to action; Wendt named this element the inter-subjectively constituted structure of identities and interests in the system. Thus, for example, if states would stop to follow the inter-subjective norms of sovereignty, their identity as Sovereigns, and even more, as states would disappear. Social configurations are neither objective nor subjective, but inter-subjective constructions. The social process is one of constructing and reconstructing social relationships and international events are no exception.

## CONCLUSION

In the very last paragraph of Hedley Bull's conclusion of his book *The Anarchical Society*, Bull states: “the search for conclusions that can be presented as solutions or ‘practical advise’ is a corrupting element in the contemporary study of world politics, which properly understood is an intellectual activity and not a practical one” (Bull 1977, 308). Bull's remarks constitute, in my opinion, the best way to conclude a theoretical International Relations paper. More of a synopsis than an actual conclusion, this final words are meant to emphasize the profound epistemological impact that the agent-structure debate in particular, and the rationalist and constructivist debate in general, have had on the evolution and improvement of the discipline as a whole.

The academic subject of International Relations is only now beginning to emerge from its powerful disciplinary myths. Yet, these myths remain very influential since, as Ken Booth would argue, the misconceptions and simplifications on which these myths were based are still congenial to the emotions and interests of the overall Anglo-American academic community (Smith, Booth and Zaleski 1997, 332) and more importantly, to the overall Anglo-American political interest –also known today as the political interest of the West, regardless if this interest is defended or promoted in Iraq by an Iraqi, from Deli by an German, or at Wall Street by a Bolivian.

In this sense, the development of an Inter-Subjective approach that allows –among other things– for a revolutionary approach to the state and its pre-assumed characteristics, might be one of the greatest contributions of Wendt's social Constructivism to the study of International Relations. Despite all his critics, who have argued that Wendt takes for granted almost all of the same premises over which Waltz built his theory, we can conclude that Alexander Wendt did in fact give to Waltz's Structural Realism more epistemological and ontological tools towards the consolidation of a more solid and methodological approach to the study of International Relations. The Agent-Structure debate is not an irrelevant one. It constitutes, in fact, the basis over which more complicated notions of construction and de-construction can and will be developed.

The intellectual sensibility that now reflects and expresses this unprecedented situation, the over-determined outcome of the modern and rational mind's extraordinary development of increasing sophistication and self-deconstruction (Tarnas 1991, 394), constitutes the postmodern paradigm.

But the debate has barely started. Post-rational scholars of international relations are yet to provide a coherent and comprehensive set of theories that allow for a solid and consistent dialogue with rational IR scholars and their obsession with the discipline’s capacity to predict and to account for international events with scientific accuracy. The Agent-Structure debate has contributed to the distinction between constitutive and explanatory theories and by doing so, it has constrained the discipline to be tolerant of ambiguity and pluralism, shaping it into a form of knowledge that is –in the words of Richard Tarnas– relative and fallible rather than absolute or certain.

Although intransigent or provoking in many respects, the ‘reality’ of world politics must in some sense be carved out by means of the human mind and will, which themselves are already enmeshed in that which they seek to understand and affect (Tarnas 1991, 396). The agent is not the passive reflector of the world or of its explicit or implicit order. The agent, in contrast, is always active and creative in the process of perception and cognition of the very same reality it tries to understand. The agent is evolved from, embedded in, and defined by a structural reality that is radically alien to it, and moreover cannot ever be directly contacted in cognition. Thus, reality is in some sense constructed by the mind, not simply perceived by it. But this construction is far from being sovereign. Instead, it is the result of an endless social interaction that shapes the structure but is also determined by it. The Agent-Structure debate reminds us in a subtle yet emphatic way that world politics do not exist as a thing in itself, independent of interpretation; rather, it comes into being only in and through interpretations. So yes, perhaps the discipline is far more complicated than what positivists scholars initially thought, but it is this complexity what makes it as interesting as it is fascinating.

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## **Bosnia And Herzegovina's Foreign Policy: A Multi-Level Game**

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*Bosnia and Herzegovina's foreign policy is extraordinarily complex and a source of both contention and opportunity. The government negotiates policy with the Office of the High Representative, the EU, its Balkan neighbors, its parliamentary parties, its entities and its ethnic groups. All actors perceive EU integration as essential to future stability and development but the constitutional reform necessary for membership creates conflict. European integration runs contrary to ethnic segregation. Economic interests collide with nationalist sentiments founded in the very real wars and atrocities of the past decades. The prerequisite of reform prior to accession talks delays BiH's membership in the European Union. Although previous constitutional reform efforts failed, a synergistic linkage of the issues of entities, entity voting and decentralization might produce a compromise and an accord, thereby opening the path to EU accession.*

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### **NEGOTIATING A FOREIGN POLICY FOR A NEW ERA**

Bosnia and Herzegovina's foreign policy provides sources of both contention and opportunity for the young state. Foreign policy can serve the state's aspirations of stability and development if Bosnia and Herzegovina (BiH) is able to integrate into the European Union (EU). Yet, foreign policy is entangled in ethnic tensions and must meet the security interests of competing ethnic groups. BiH Ambassador Kusljagic states that the lack of a well defined foreign policy is attributable to the "total predominance of internal policies over the foreign policy, and in particular of lack of internal consensus on strategic internal political issues" (2006, 103). Thus, policy makers negotiate with their foreign counterparts, but also with diverse domestic actors. Foreign-policy leaders navigate between the demands of their parties, their coalition partners and their constituents. Sometimes domestic actors withhold support for policy unless a better deal is attainable. Each actor hopes to benefit from foreign policy, and the negotiations between the BiH policy makers and their foreign counterparts interact with the negotiations between the BiH policy makers and various domestic actors. Ethnic politics and the legacy of the war further complicate the search for support and compromise. Policy makers must operate under the supervision of the UN's Office of the High Representative (OHR) and EU's Special Representative (EUSR). Kusljagic contends that BiH's foreign policy often fails to achieve the interests of the state, because it stretches to satisfy the Bosniaks, Serbs and Croats as well as the international community (2006, 104).

The broad objective of this paper is to develop a deeper understanding of the complexity of BiH foreign policy. Numerous challenges to democratization, development and stability exist. Elite leadership and cooperation constitute potential keys to progress, but elites remain torn between ethnonationalism and globalization. Beck suggests, however, that "glocalization" of the region

offers the possibility of multiple loyalties and a cooperative conceptualization of borders (2000, 47-52). Integration within the Balkans and then of the Balkans into the EU appear critical to BiH, Balkan and European stability. Yet, the process promises to be slow and incremental because BiH and the larger Balkan region are junctions of civilizations where diverse religious and cultural traditions converge. Exclusive notions of identity based on fragmentation compete with the inclusive interpretation of such globalization (Beck 2000, 51). Vachudova concludes that ultimately the pull for democratizing Eastern European states to cooperate and gain EU admission will overwhelm domestic nationalist resistance (2001, 3-6).

This paper accordingly contends that the outcome of BiH foreign policy depends upon the interaction of a variety of actors, but significantly upon the pressure levied by the citizens of BiH and the institutions of Europe upon policy-making elites in the government. Whether citizens demand that their leaders pursue economic growth or extreme nationalist claims looms as a significant issue. Whether European organizations stay engaged in the region hovers as another critical factor. The state must navigate between public and international demands. Yet, Europe's presence supports the development of civil society and the public looks favorably at the benefits of regionalization. Both Europe and the public remain committed to conflict transformation, economic growth and regional stability. These conditions offer the space for the leadership to forge compromises that enhance the interests of the state, its citizens and the international community. These conditions also suggest that BiH elites and groups eventually must accept the demands of membership in the Europe Union because the costs of exclusion are too great both to their political careers and the state's economic development (Vachudova 2001, 9-10, 34-35).

This research specifically assesses the likelihood of the passage of constitutional reforms necessary to facilitate state sovereignty and coherence and thereby meet the criteria for EU accession. The issue of accession criteria highlights the relationship between domestic and foreign politics in BiH. The OHR and EU link constitutional reforms to the process of accession but ethnic groups within BiH hold conflicting positions on the reforms. Leaders must respond to constituents at both the international and domestic level. The controversy concerning constitutional reform also illustrates the trade-offs that EU accession and integration demand and the diverse perspectives domestic groups hold on such integration. The analysis in this paper, building upon Putnam's two-level game theory, emphasizes the multiple levels of negotiation involved in forging policy in BiH. The use of a multi-level game highlights the factors which facilitate cooperation and pro-integration policies. The research concludes by examining if a common ground exists for compromise within BiH.

## **Two-Level Games**

Putnam demonstrates that international and domestic politics have an interactive effect upon a state's foreign policy. He argues that the causality of policy-making is not simply unidirectional. Assumptions that domestic politics cause an international outcome or that international politics cause a domestic outcome fail to focus upon the general equilibrium ultimately achieved when domestic and foreign policy interaction occurs. Putnam contends "At the national level, domestic groups pursue their interests by pressuring the government to adopt favorable policies, and politicians seek power by constructing coalitions among those groups. At

the international level, national governments seek to maximize their own ability to satisfy domestic pressures, while minimizing the adverse consequences of foreign developments. Neither of the two games can be ignored by central decision-makers..." (1988, 434).

Putnam explains that the size of the domestic win-set matters for policy-makers. The win-set is the spectrum within which the constituents and their legislators will accept a foreign policy. National leaders typically can negotiate a larger win-set when the issue is less salient, the issue is salient to fewer people, the population is homogeneous, or civil society is weak (1988, 442-447). Indeed, the ethnic heterogeneity and tension in BiH and lack of a clear legislative majority suggests that the win-set typically will be small because the preferences of heterogeneous constituents must be met. While this view generally seems true, EU accession offers a case where the population seems overwhelmingly to support membership and thus the win-set might become slightly larger than for other issues. Additionally, while the win-set might seem narrow on cases where the population's preference is heterogeneous, it also might be the case that some issues only mobilize a certain part of the population. Thus what matters is the specific homogeneity/heterogeneity of the particular sub-group which the issue mobilizes. This can be seen with agricultural trade and the fact that BiH farmers have set aside their ethnic diversity to protest regional free trade deals. Not only do the farmers become homogeneous by focusing upon sectoral interests rather than nationality, but heterogeneous components of the constituents are not mobilized by the issue.

Putnam concludes his discussion of win-sets by explaining that leaders may be forced to engage in an "involuntary defection" (1988, 438-439) from a negotiation/outcome if their constituents provide them with limited negotiating room. In other words, a deal is foregone because policy-makers and their foreign counterparts cannot reach agreement within the win-set. The OHR and the EUSR certainly hold this concern regarding BiH's constitutional reforms. The fact that the deal reached between ethnic leaders in April 2006 failed to win approval from the legislature highlights the complexity of achieving an accord which satisfies sufficient groups. Yet, Vachudova's research demonstrates that this has not been the outcome for other transitioning states in Eastern Europe.

Putnam also explains that issue linkage can expand the size of the win-set and thereby affect the ability to successfully negotiate. "Synergistic linkage" refers to offering tradeoffs so that constituents accept a package (1988, 447). Putnam focuses upon the fact that "Economic interdependence multiplies the opportunities for altering domestic coalitions (and thus policy outcomes) by expanding the set of feasible alternatives in this way..." (1988, 448). Indeed, this remains the hope of the OHR and EUSR. The synergistic linkage of EU accession and its benefits to constitutional reform illustrates an attempt to provide tradeoffs to compensate groups who appear to lose under constitutional reform.

The nature of the government also matters and Putnam highlights the significance of ratification procedures, party discipline and state autonomy. In the case of BiH, these concerns hold substantial relevance. Ratification procedure is critical because the Dayton Accords currently require the support of at least one-third of each entity delegation in the legislature for passage. Also critical is the fact that parties lack a firm hold on their ministers. BiH parties still are evolving and ministers tend to break rank and desert the party. The April 2006 vote on

constitutional reform witnessed defections in the Croatian Democratic Union (HZD) and the Bosniak Party of Democratic Action (SDA). Factionalism continues to dominate legislative parties. Thus, weak parties and coalition government in a consociational system narrow BiH's likely win-set. Not only must policy receive support from each of the three ethnic groups, but multiple parties represent each group in the legislature.

Putnam also explains that the greater state autonomy, the more likely the win-set will be wide (1988, 449). The fact that civil society in BiH is developing and fragmented provides the state with only relative strength. While the state certainly possesses strength vis-à-vis society, the notion of an institutional capital (Brunell 2005) and an embedded state (Evans 1995) is absent. The concentration of power in the entities and cantons and the tripartite make-up of the state bureaucracy constrain state autonomy and reinforce the likelihood of a limited win-set.

Finally, Putnam demonstrates that the strategies of the negotiators influence the outcome. Negotiators can increase the likelihood of a deal by offering side payments or good will (1988, 450-455). Certainly, the OHR provides a host of incentives for cooperative leaders and elites. In this way, the OHR can restructure outcomes or engage in "suasive reverberation." Putnam explains suasive reverberation as international pressure which sways the domestic level so that domestic leaders alter their win-set (454). In this case, the OHR can persuade ethnic elites and entity leaders to change their demands. Yet, negotiators also can hurt a deal if they guess wrong in the face of uncertainty about what domestic constituents will accept (Putnam 1988, 452). In BiH uncertainty seems to be a serious problem because parties are vocal about these issues and because negotiating teams usually include multi-ethnic staffs. As the failure of the April 2006 compromise highlights, negotiators guessed wrong about the willingness of legislators to accept the deal.

Although Putnam focuses upon two-level games he does acknowledge the greater complexity of multi-level games such as negotiations involving the EU (1988, 449). In fact, BiH seems to be a multi-level case of the interactive nature of international and domestic politics and why it is difficult to cleanly separate international and comparative politics. In order to understand BiH's policies both its domestic and international politics must be studied simultaneously.

### **Multi-level Games and the Foreign Policy of BiH**

The foreign policy of Bosnia and Herzegovina (BiH) is even more complex than the typical two-level game. Putnam assumes two levels. Level I centers on negotiations between the state and other sovereign actors while Level II involves domestic politics (Putnam 1988, 436). BiH policy making might be understood as a type of interactive multi-level game (with four or possibly even five levels). Table 1 compares the BiH multi-level game with the two-level game. Policy-makers in the executive deal with voters and legislators. They also still negotiate with other states. This depicts the two-level game. In the case of BiH, however, foreign policy emphasizes relations with neighbors in the western Balkans, particularly Slovenia, Macedonia, Montenegro, Croatia, Serbia and Albania. These two levels (i.e., BiH with its Balkan neighbors and BiH with its domestic constituents) interact and arguably are more intertwined and complex than typical. For example, in February 2007, Slovenia concluded an agreement with BiH to pay social security compensation to BiH citizens which dates to employment earnings during the Yugoslav era. The relationship is complicated because most of these states gained independence only in

the past fifteen years and previously (with the exception of Albania) existed as constituent republics of Yugoslavia. Decades of a common language and economy create shared interests, but a history of secession, ethnic cleansing and religious tensions magnify differences and complicate policy. Curak defines the situation as one of “small Balkans with big nationalisms” (Foreign Policy Initiative July, 2006, intro). Thus, it is not only the leaders of BiH who seek to satisfy BiH legislators and voters. At times, the Serbian government appeals to Serbs living in BiH and the Croatian government appeals to Croats in BiH. Moreover, Serbian politicians within the BiH leadership appeal to Serbian voters, just as Croatian politicians within BiH appeal to Croats and Bosniak politicians appeal to Bosniaks. The fact that politicians of different ethnicities within the BiH government and the region act based upon nationality interest rather than state interest leads to a third-level game, i.e., a game between ethnic leaders within the region and BiH executive in which each ethnic leadership positions to produce the best foreign policy for his or her national interests understood as ethnic interest. Indeed, Kusljagic explains that “...the BiH Ministry of Foreign Affairs functions mainly through its parallel/separate ‘ethnic communication channels’”, which results in ethnic interests dominating state interests (2006, 107).

**TABLE 1. COMPARISON OF TWO-LEVEL AND MULTI-LEVEL GAMES**

LEVELS	TWO-LEVEL	MULTI-LEVEL
I	Foreign Actor - State Government	Foreign Actor –State Government of BiH (Global Actors: OHR, EUSR, US, NATO)
II	State Government – Constituents in Legislature, Parties and Public	Foreign Actor – State Government of BiH (Foreign Actor: Former Republics of Yugoslavia)
III		Former Republics of Yugoslavia- Entities’ Governments and Population
IV		State Government of BiH – Entity Governments
V		State Government of BiH –BiH Legislature, Parties and Public

This third level overlaps a fourth level which occurs between the state leaders and the entity leaders of BiH and the entity leaders and their constituents. The Dayton Accords created two entities within BiH, The Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS). These entities are based on ethnic division so that most Bosniaks and Croats live in FBiH and most Serbs live in RS. The entities also retain significant autonomy in the areas of foreign trade, economic policy, police powers, media control and education. In February 2007, for example, the Prime Minister of RS, Milorad Dodik, sold a majority stake in Bosnia’s only oil refinery to Russia’s state owned oil company. Likewise, leaders of the entity governments sometimes make nationalist appeals to their constituents that run counter to the attempts by some BiH central government leaders to promote cooperation and integration. Thus, Dodik frequently links the issue of an independence referendum in RS to events in Kosovo.

Finally, a fifth level to the BiH policy game exists. This level introduces the institutions of Europe as a player. The OHR and EUSR still maintain ultimate control over decisions and policies in BiH. The OHR can remove political leaders, overturn laws, and ban parties.

Additionally, the institutions of Europe (including the European Bank for Reconstruction and Development and the Organization for Security and Cooperation in Europe) heavily influence policy because they provide funds for the economy and peacekeepers for stability. These European institutions clearly favor regional and ethnic integration. States (such as Macedonia and Croatia) that comply with Europe organizations' objectives and values receive favorable treatment. BiH leaders are conflicted because often the interests of these institutions (i.e., cooperation and integration) run contrary to the interests of their constituents (i.e., ethnic segregation). The EU wants BiH to reform the constitution so that power shifts from the entities to the central level and so that the bureaucracy is efficient and cohesive and policy becomes coherent. Constituents desire the economic progress which the EU subsidizes and regional integration facilitates, but they disagree about constitutional reform (Toal et al. 2006, 69-71). Thus, rational economic policy and state building collide with emotional ethnic sentiments founded in the very real wars and atrocities of the past.

### **The Complexity of Multi-Layered Foreign Relations**

BiH foreign policy certainly suggests a complex, multi-layered game. The state mirrors the complexity in its tri-partite presidency which includes a member elected by each of the constituent peoples, the Bosniaks, Serbs and Croats. So too, ethnic balance is an objective throughout the bureaucracy. The desire for fair and complete representation, however, leads to bureaucratic redundancy at the central, entity, canton and local levels of government to the extent that personnel costs are seventy percent of BiH's budget. Additionally the desire for a representative legislature leads to cumbersome structural and procedural requirements. In the case of the constitutional reforms, two-thirds of the House of Representatives and one-third of each entity must pass the legislation. Currently, twelve parties are represented in the forty two-member legislature. The most influential parties are the Party of Democratic Action (SDA), the Party for Bosnia and Herzegovina (SBiH), the Serbian Party of Independent Social Democrats (SNSD), the Social Democratic Party (SDP), the Serbian Democratic Party (SDS) and the Croatian Democratic Union (HDZ). The SDA, SBiH and SDP all claim to be multi-ethnic, but most Serbs and some Croats contend these parties are Bosniak.

The Bosniaks and Croats live in the FBiH, while the Serbs dominate the SR. Central government leaders must deal with entity leaders. Most notably, the Serb representative in the presidency, Nebojsa Radmanovic, does not lead his SNSD party. Rather SR Prime Minister Milorad Dodik heads the party. Dodik often appeals for support to Serbia as do his HDZ counterparts to Croatia. Foreign policy too remains atypical. As aforementioned, the Dayton Accords endowed FBiH and SR with the right to engage in foreign relations. Finally, the OHR and EUSR still retain powers which constrain BiH sovereignty.

Voters elected a new government in October 2006. The failed constitutional reform and EU accession heavily influenced voters. While most voters of all ethnicities agreed that constitutional reform was necessary, voters also opposed the failed reforms and disagreed on the correct direction of reform. At the same time, public opinion overwhelmingly tended to favor EU membership (Toal et al. 2006; Rose 2004). Additionally, the electorate expressed concern about corruption and unemployment which they identified as being exacerbated by the politics of nationalism. In fact, voters punished the three incumbent nationalist parties by defeating their

reelection to the tri-partite presidency. Table 2 shows presidential election results for 2002 and 2006. The SDA, HDZ and SDS lost their seats respectively to the SBiH, SDP and SNSD.

**TABLE 2. BiH PRESIDENTIAL ELECTION RESULTS**

PARTY	2002 Percent Votes	2006 Percent Votes
<b>BOSNIAK SEAT</b>		
SBiH (Party for BiH)	34.8	62.80
SDA (Party for Democratic Action)	37.2	27.53
<b>CROATIAN SEAT</b>		
SDP BiH (Social Democratic Party)	17.5	39.56
HDZ (Croat Democratic Union)	61.5	26.14
<b>SERBIAN SEAT</b>		
SNSD (Party of Independent Social Democrats)	19.9	53.26
SDS (Serb Democratic Party)	35.5	24.22

(Source: OSCE Office for Democratic Institutions and Human Rights)

The HDZ and SDS also lost legislative seats while the SBiH and SNSD won additional seats. The parliamentary election results from the Organization of Security and Cooperation in Europe are presented below in Table 3. Many analysts perceived these results as a rejection of the hardline nationalists and their politics that traded economic progress (including rationalization of the government operations and EU accession) for ethnic causes.

**TABLE 3. BiH HOUSE OF REPRESENTATIVES (2006)**

POLITICAL PARTY	SEATS
<b>FBiH Seats</b>	
SDA (Party for Democratic Action)	8
SBiH (Party for BiH)	7
SDP (Social Democratic Party)	5
HDZ (Croat Democratic Union)	3
HDZ 1990 (Croat Democratic Union 1990)	2
BPS (Bosnian Herzegovina Patriotic Party)	1
NSRzB (Through Work to Betterment)	1
DNZ (People's Democratic Union)	1
<b>RS Seats</b>	
SNSD (Party of Independent Social Democrats)	7
SDS (Serb Democratic Party)	3
PDP (Party of Democratic Progress)	1
SBiH (n.b.: in coalition with SBiH members from FBiH)	1

SDA (n.b.: in coalition with SDA members from FBiH)	1
DNS (Democratic People's Union)	1

(Source: OSCE Office for Democratic Institutions and Human Rights)

From the electorate's perspective then, the priorities for the new leadership should be the strengthening of the effectiveness of the state in order to promote democratization and economic development. Both goals are linked to foreign policy because the EU offers development and supports democracy. Furthermore, BiH cannot become a viable actor in regional or global politics unless it moves to democratize and reintegrate. Ongoing internal ethnic tension diverts resources and time necessary for economic reconstruction and external relations. Corruption and economic inefficiency prey on a weak BiH. Presidents Radmanovic, Haris Silajdzic, and Zeljko Komsic must strengthen the state and this requires that they create a relationship in which the leadership communicates, cooperates and compromises.

Such cooperation encounters various impediments. Radmanovic initially seems unprepared to embrace unity, while the Serbs and some Croats are suspicious of the extent to which Silajdzic and Komsic will represent all the citizens and ethnicities of BiH. Silajdzic, the Bosniak winner from SBiH, challenges the long-term viability of the Dayton Accords and favors an elimination of the entities. Silajdzic contends that governance must shift from the entity levels to the central level if political and economic security and stability are to be achieved. During the campaign, Silajdzic and Radmanovic engaged in heated nationalist rhetoric. Radmanovic insists on the inviolability of RS under the Dayton Accords. Silajdzic now must demonstrate that his emphasis on unity arises from a real commitment to all individuals and ethnicities within BiH rather than a desire to destroy the RS. Likewise, the Croatian winner, Komsic, supports unification. Komsic's multi-ethnic SDP advocates a reformist and pro-European platform. Both Kosmic and Silajdzic must prove that their plan for strengthening the central state benefits Serbs and Croats as well as Bosniaks. President Mesic of Croatia's comment that Kosmic's election was legitimate should help his status.

Of course hefty debates will ensue. All three men have historical, political and personal reasons to be stubborn about their positions. Cooperation will not come from harmony but from shared interests. Yet, Kosmic, Radmanovic and Silajdzic should appreciate that the public grew dissatisfied, rejected the extreme nationalists and supported a new leadership. The presidents know that previous hardline positions failed to produce results. The leaders recognize that state-building must occur so that institutional capital is created to address economic difficulties and forge foreign policy. Thus, the men must communicate and find common ground to advance security and stability. They also must use their leadership positions to assuage doubts among their constituents. If Silajdzic and Kosmic set aside ethnic labels, Radmanovic might temper nationalist appeals. This then will open the space for BiH to develop as a European state and thereby move forward its European relationships.

Radmanovic's SNSD defeated the extremist SDS for the Serb seat. Yet during the campaign the previously moderate nationalist SNSD proposed a referendum vote on the secession of the RS. SR Prime Minister and SNSD leader Dodik frequently vacillated on the secession issue. Concern quelled when Serbian President Tadic reaffirmed his opposition to secessionism in RS, but Dodik still occasionally stirs nationalist sentiment with the suggestion of a referendum to

determine the future of the RS. The support of a referendum seemingly places the SNSD of Radmanovic in direct opposition to Silajdzic and Kosmic and in defiance of the OHR and EU. Still Dodik insists upon the SNSD's commitment to the Dayton Accords. Since the election, Dodik claims that his commitment to RS autonomy is consistent with Dayton. These pronouncements seem to be part of an effort to gain leverage in negotiations. After all, members of the SNSD did vote for constitutional reform in the last parliament. Regardless, while the position of the SNSD is not entirely settled, the party certainly indicates more interest in cooperation than the SDS does. Toal et alia suggest that the SNSD advocates a Euro-nationalist or Euro-pragmatist position while the SDS embraces a paleo-nationalist approach. The paleo-nationalists focus on reestablishing a greater Serbia while the Euro-nationalists hope to preserve their own identity while embracing Bosnian and European identities (2006, 70). Thus, cautious optimism follows the election. Former High Representative Christian Schwarz-Schilling shares this sentiment about the election. He commented on German radio that "the election went very well" and "One must give these people a chance now. One should not bring these parties into disrepute for being in part nationalist." Perhaps if Silajdzic and Kosmic truly take a moderate position in these discussions, then Radmanovic will feel comfortable in retreating from extremist demands. On inauguration day, both Silajdzic and Radmanovic voiced interest in overcoming differences and moving BiH into Europe.

The membership of the Parliament also influences the likelihood of an elite compromise. The SDA holds nine seats, and the party did favor the constitutional reforms of April 2006. Whether the divided SDA opts to pursue ethno-religious extremism or moderation will be critical. A moderate SDA would be open to the reforms necessary to move BiH toward real sovereignty. A moderate SDA could cooperate with the eight members of the SBiH and five members of SDP to lead an agenda committed to reform and necessary to complete an EU Stabilization and Association Agreement. Indeed, moderate SDA members could sway SBiH away from positions which advocate total elimination of the entities and toward compromise. If nationalist elites possess the political will, the SDA could cooperate with the SDP and SBiH and nurture a moderate democratic center among the representatives of the Federation. Together these three parties hold twenty of the Federation's twenty-eight seats in the legislature.

The HDZ also supports constitutional reform. The HDZ is the smallest nationalist party, but represents about sixty to seventy percent of the Croats. The party experienced splits between its extremists and moderates, and currently the moderate HDZ holds three seats while the extremist HDZ 1990 holds two seats. The radical faction advocates autonomy or irredentism, but opposition from Zagreb weakens its case. The opposition of the HDZ 1990 extremists to the reforms did play a pivotal role in the April 2006 defeat of the constitutional revisions, however, since the elections their parliamentary numbers declined. The moderate faction of HDZ, like its counterpart in the SDA, supports cultural autonomy but political unity. HDZ advocates reform which strengthens both the central and local governments at the expense of the entities. Recently the moderate faction's appeal increased both because of Croat dissatisfaction and due to waning support by Croatia for the ultra nationalist cause. The fact that Croats constitute only about fifteen percent of the BiH population limits the HDZ's bargaining status with the international community and pushes the party toward a compromise solution. The Croats simply lack the clout which the Serbs wield with approximately thirty-nine percent of the population.

Finally, SNSD recent electoral victories are critical because the SDS indicates little willingness to compromise to build a unified BiH. The SNSD won seven parliament seats and the SDS captured three seats. The decline of SDS popularity among Serbs is critical for the future of BiH. Unlike the Bosniak nationalist SDA and the Croat HDZ, there is no moderate faction in the Serb SDS. Hardliners and “paleo-nationalists” continue to dominate the SDS, so that the SNSD becomes the hope for a cooperative Serb leadership. Yet, the SNSD must win support for reform from other RS parties in the parliament in order to form a majority coalition from within the RS. The SDA and SBiH representatives from the RS should provide that support. Meanwhile, Dodik and the SNSD probably will continue to use the threat of referendum and secession during negotiations knowing that the international community, including Serbia, absolutely rejects this option.

Constitutional reform is essential for state building and economic development, but also for BiH to reestablish itself as an actor in the region. Good relations with Serbia and Croatia will positively affect relations between ethnic groups in BiH. On a broader scale, domestic ethnic politics affects BiH’s status with European organizations and states. In turn, stability in the Balkans and membership in the EU offers BiH an atmosphere in which conflict transformation can occur. Obviously challenges exist for the leadership. The violent past creates the climate for real fear and distrust. Hostile nationalist rhetoric dominated the election campaigns.

An intricate and layered multi-level political game now challenges the BiH leadership. The tripartite presidency must negotiate foreign policy on five distinct but porous and interactive levels. First, they must negotiate with the West, the US, the EU, and the OSCE. BiH requires the technical and financial assistance of Europe. The people of BiH desire membership in Europe. Yet, the EU will not sign an association agreement with BiH until hundreds of new laws pass. Furthermore, the Commission on the European Communities reported that it cannot successfully negotiate an agreement with BiH until it “presents a single, coherent national position.” Relations and ultimately membership in the EU depends upon the leadership building domestic support for a cooperative foreign policy.

BiH will be particularly disadvantaged if it is excluded from the European Union while other former republics of Yugoslavia enjoy the benefits of membership. This relates to the second level. BiH must cooperate with Croatia, Montenegro, Serbia and Macedonia. Dealing with Croatia, Serbia, Montenegro and Macedonia at first might appear both difficult and insignificant. Yet relations with BiH’s immediate neighbors are an absolute precondition for peace and stability, and admission to Europe (Mazower 2003, 160-161). Again the layers of foreign policy interact. Accordingly, ethnic leaders must be conscious of not only the level above their neighbors (i.e., Europe) but also the levels below their neighbors (i.e., the entities and people of BiH). Elites cannot stir up nationalist sentiment among the people. Internal domestic strife will complicate relations with neighboring states and the West. In this light, the 2002 declaration affirming the inalterability of borders between BiH, Croatia and Serbia is an accomplishment. Yet, much work remains. For example, the EU and OSCE recently urged the implementation of the Sarajevo Declaration on the resolution of the refugees and displaced people.

BiH elites also should pursue collective security arrangements with Croatia, Serbia, Macedonia and Montenegro. Collective security acknowledges that the security of each state depends upon the security of all states. Collective security also recognizes the linkage between traditional

national security concerns and economic, ethnic and environmental security. Such arrangements counter the tendency for any single state to become dominant. These arrangements also logically coincide with each state's desire for membership in the Partnership for Peace and eventually NATO. Finally, the establishment of collective security can create the foundation for a "bloc diplomacy" which can then serve as the basis for negotiating with the EU, US, West, and to some extent the Near East. Such bloc diplomacy can facilitate a proactive policy-making geared to advancing the interests of the region. The reality is that BiH's Balkan neighbors are moving toward bloc diplomacy and advantages exist for those states that take the lead in establishing the rules for collective security. Croatia is an EU candidate country and bidding for a UN Security Council seat. Regional cooperation in the Balkans is a priority for the EU and a qualifying indicator for EU integration. Failure to cooperate only hurts BiH's position with other European actors. The West cares about intra-Balkan stability and wants to see progress in the region, so again the relationships are interactive.

Finally, leaders must also "play the game" of foreign policy between one another and with their parties and constituents at the regional, central and entity levels. For example, Radmanovic must deal with Belgrade, the SNSD in Parliament and Dodic. Ethnic leaders are torn between their traditional nationalist relationship with their parties and constituents and the reality that their constituents are frustrated by the stagnation in BiH (Toal et al. 2006, 67-70). Thus, the ability of the Serbian, Croatian and Bosniak leadership to attain consensus affects their collective and individual interactions with the BiH polity and external actors. This is a demanding expectation given the recent past and the relative inexperience of the leadership. Nevertheless, positive options seem to be limited – progress depends upon compromise. Such cooperation will facilitate economic development and ethnic stability both within BiH and within the Balkan region. Again, the levels of policy making interact as regional negotiations affect and interact with internal politics. Croatia, Montenegro, and Macedonia are moving toward cooperation with one another and the West. BiH elites cannot hesitate too long or the West might grow frustrated. Although some leaders and citizens wish that the OHR and OSCE depart BiH, no one hopes to be isolated from the West.

### **Constitutional Reform, EU Accession and Foreign Policy**

EU accession clearly occupies a position of prominence in BiH foreign policy. Polls consistently indicate that seventy to eighty-five percent of the public favors membership. People endorse integration for both political and economic reasons (Organization of Security and Cooperation in Europe 2003; Rose 2004; Toal et al 2006; UN Development Program 2007). From the political perspective, EU membership supports stable democratic institutions, rule of law and respect for human and minority rights. States invited to accede must demonstrate consolidated and vital democracies. The EU serves as an incentive for BiH elites to follow democratic rules and provide rights even if they do not believe in them. Other critical reforms necessary for membership included privatization of the media, de-politicization of the judicial system, professionalization of the police and civil service, and decentralization. Many people believe accession will force an end to corruption (Davison 2004). Sergi demonstrates that simply the negotiation of accession leads to an increase in productivity attributable to foreign direct investment in technology and labor (2004, 14-16). Citizens also believe that EU membership provides enhanced economic opportunities. For this reason, professionals particularly support

membership. The managerial class as well as the young, urban, and well-educated drive the integration momentum. Businesspeople stand to gain substantially from the liberalization of trade. The young also anticipate the benefits associated with being able to work anywhere in the EU.

Yet, Krastev looks at EU accession more harshly, and concludes that the EU subscribes to an elitist guided development/integration paradigm. Experts devise and implement policies without seeking domestic dialogue or considering winners and losers, thereby diluting democracy (2003, 44-45). Pehe highlights concerns that new states should enjoy time to define their political culture and actually develop democratic values before joining the EU where the Commission dictates policies to them (2004). Linked to this is a view often voiced by the right that EU membership deprives states of their newly won independence, and as such is contrary to notions of democracy resting upon popular sovereignty. The degree to which the EU increasingly elevates bureaucracy and regulates state level legislation seems contrary to the creation of cultures of democracy, especially in states like BiH where political culture is not well developed, civil society is weak or fragmented, and parties are not linked to the polity. Demanding that BiH accept all the terms of the EU *acquis* seems an inherently illiberal and paradoxical approach to democracy which negates the significance of elections and holds popular sovereignty in suspension (Davison 2004).

Additionally concerns focus upon the costs of accession and the fact that the distribution of these costs is such that the poor, old and rural tend to assume them. Costs to labor and agriculture will increase, as will costs associated with environmental regulation. Workers and farmers will bear high costs (Tucker et al. 2002, 558). Residents of less densely populated regions will not enjoy the benefits of industrial centers (Sergi 2004, 17). Fears exist that tax increases will accompany the value-added tax harmonization. People also worry about cuts in programs and increases in taxes associated with the stabilization program necessary to achieve fiscal compliance (Davison 2004).

Still, the EU assumes a status as a force for democracy, development and rule of law in BiH. The EU is perceived as more democratic than the operation of the BiH national and entity governments, and thus the significance of the EU's bureaucratization and democratic deficit recede. Membership enhances democracy, personal security and economic opportunity. A variety of opinion polls during the past five years highlight the public's overwhelmingly positive reactions to the EU (Rose 2004; Organization of Security and Cooperation in Europe 2003, UN Development Program 2007 "Main Report Quantitative Survey," 15, 17; UNDP 2007 "Conclusions, Lessons Learned and Policy Advice," 18). Citizens are aware of the limitations and disadvantages of accession but they also acknowledge membership's benefits and identify with the idea of Europe (Toal et al. 2006; European Union Commission 2005; UN Development Program 2007 "Main Report Quantitative Survey," 31, 44).

Thus the BiH leadership must move beyond its stalled nationalist positions with regard to nation-state building so that it can move toward EU membership. BiH cannot engage its neighbors or the West unless the leadership commits to cooperation, compromise and consensus. Relations based on democracy and rule of law increasingly dominate the politics of the region and Europe. These institutions also are key issues in the negotiations on a Stabilization and Association

Agreement (SAA) and positive factors for BiH's future (European Union Special Representative in Bosnia and Herzegovina 2006). Since November 2005, the OHR has focused upon the desire of all ethnic peoples and elites to join the EU in order to encourage the renegotiation of the Dayton Accords. BiH elites now must incorporate democracy, rule of law and the role of civil society into their constitution and their policy-making.

This current situation highlights a particularly complicated, serious and unusual problem. Under the terms of the Dayton Accords, the RS and the FBiH both possess foreign policy-making powers. The entities also hold wide powers in the functional areas of policing, the media and education. The overlap of central government and entity jurisdictions impedes foreign policy coherence and leads to inefficiency and corruption within the state. The Council of Europe estimates that the government budgets of BiH account for 60% of the GDP (2006). Consequently the OHR and EUSR support constitutional reform with incentives and link such reforms to EU membership. The international community and BiH government strive to establish synergistic linkages and employ suasive reverberation. Indeed, the international community believed they had crafted acceptable constitutional reforms in April 2006, but defections of members of parliament led to a narrow two vote defeat of the measures. The negotiation and passage of reforms now confront the new leadership, but as Table 4 summarizes the multi-level game presents complexity and requires diplomacy.

**TABLE 4. THE MULTI-LEVEL GAME OF CONSTITUTIONAL REFORM AND SAA**

GENERAL MULTI-LEVEL GAME	SPECIFIC CONSTITUTIONAL REFORM LINKED TO SAA MULTI-LEVEL GAME
Foreign Actor – State Government of BiH (Global Actors: OHR, EUSR, US, NATO)	OHR, EUSR – State Government of BiH
Foreign Actor – State Government of BiH (Foreign Actor: Former Republics of Yugoslavia)	SERBIA & CROATIA– State Government of BiH
Former Republics of Yugoslavia- Entities' Governments and Population	SERBIA & CROATIA- FBiH, RS, SDS, SNSD, HDZ
State Government of BiH – Entity Governments	State Government of BiH – FBiH & RS
State Government of BiH –BiH Legislature, Parties and Public	State Government of BiH –BiH Legislature, Parties and Public

The opponents of the previous reform pose diverse objections. The Bosniak opponents favor the total elimination, rather than merely the weakening, of the entity governments. Conversely, the Serbian opposition rejects any reform that weakens the entities. Some Croatian opponents concur with this Serbian position, but generally the Croats opt to hold out for constitutional reforms which strengthen local government. Thus, for the BiH to comply with the accession terms, the negotiating positions and win-sets of some of the actors must change on some issues related to the constitutional reforms. The fact exists that the EU's win-set cannot change. BiH cannot negotiate better terms at the international level. The EU can adjust timetables, but ultimately BiH must accept and implement the *acquis* in order to gain membership. Further Serbia and Croatia's own desires to join the EU dampen any support they might provide the

constituent peoples. In light of this, it seems that new efforts to pass the reforms must focus upon widening the win-set of domestic actors through synergistic linkages and the offering of good will side payments.

One example of good will is the promising of political appointments in exchange for cooperation. This tactic frequently is employed in the BiH to nurture domestic consensus. Unfortunately, this tactic has the disadvantage of deprofessionalizing the civil service and politicizing negotiations. Additionally, it may exacerbate the problem of ethnic identity. For example, the RS was guaranteed a position on the EU negotiating team as a quid pro quo for police reform (Foreign Policy Initiative March 2006, 6). In the long term such a strategy challenges state autonomy, strengthens ethnic influence and thereby narrows the win-set.

The Foreign Policy Initiative of BiH suggests the adoption of a National Forum on Accession to the EU similar to the process instituted in Croatia (March 2006, 1-2). The National Forum brings society directly into the discussion on accession. Indeed public opinion polls conducted prior to the April 2006 vote indicated high levels of dissatisfaction with the lack of disclosure regarding the constitutional reform negotiations (International Institute for Middle East and Balkan Studies 2006). Debates and negotiations could include civil society, the business sector, farmers and youth groups. Despite ethnic differences these groups all express support for EU membership and groups such as Dosta and Grozd already actively express the opinions of the youth. The benefit of this approach is that such a forum incorporates homogeneous sectoral groups rather than ethnic groups. A forum also offers the public an “ownership” of the reforms.

Many analysts suggest that domestic ownership must replace the sense that the international community dictates policy (Ahmetasevic 2006). More significantly, homogeneous societal groups permit a wider win-set for the state’s negotiations than heterogeneous ethnic groups that demand that the state find the areas in which multiple win-sets overlap. Public opinion across all nationalities desires EU membership, concurs that the current constitution is unworkable and identifies frustration with government inefficiency (Toal et al. 2006, 67-68; Rose 2004). Sixty-one percent of the people deem it acceptable to change the constitution in order to gain EU admission (Toal et al. 2006, 70). Further, the electorate expressed support for more moderate leaders in the October 2006 elections. It seems that while the public prefers to retain both its ethnic identity and join the EU, if forced to choose it deems the need to join the EU as the priority (Toal et al. 2006, 69). Thus, incorporating these groups into the decision process would alter domestic coalitions and permit parliamentary parties to compromise on ethnic demands. This then seems a beneficial strategy, but probably is not sufficient.

The parties and legislative representatives still hold the key to advancing negotiations because the public and the civil society are relatively weak. Ultimately the legislature must pass the reforms. Public opinion coupled with a national forum offers support to wavering legislators and provides leverage to gain acceptance of the constitutional reforms, but the presidents and parliamentary party leaders must in fact lead. The April 2006 reform negotiations won the support of seven parliamentary parties. The SBiH rejected the reforms because it opposed entity voting. The legislation failed by only two votes. The reforms would have passed even without SBiH acceptance except that one SDA minister and several HDZ ministers defected. The failure of the reforms to pass suggests the need for wider win-sets.

Passage of the legislation requires the vote of twenty-eight of the forty-two representatives, and at least ten FBiH ministers and five RS ministers. The fact that legislation previously had wide support, but was opposed by the SBiH is cause for both optimism and pessimism. The reforms came close to passage, but their rejection by the SBiH now is problematic. While current SBiH leader and Bosniak president Silajdzic maintains opposition to entities and entity voting, he also recognizes that citizens want to enter the EU and expresses willingness for compromise. Indeed, the intensity of Silajdzic's campaign probably provoked his nationalist rhetoric. Silajdzic now explains, "There are, of course, serious differences about the way and the path for reaching this goal and these differences have to be solved with patience, agreement and the taking into consideration different opinions" (RFE/RL Newline 2006). Likewise, at their inauguration, Serbian President Radmanovic concurred that BiH must move forward and that this required overcoming differences. Radmanovic still voices support for some constitutional change. Further Radmanovic and Kosmic share some common ground in that the SNSD and SDP both are social democratic, pro-western parties.

Nonetheless, passage of the reforms seems to require a widening of the win-set through synergistic linkage of the issue of decentralization to the fundamental points of constitutional controversy. With this linkage, the key issues include the degree of centralization of the state, whether entities should exist, and whether entity voting should continue. Generally Serbian parties demand the continuation of the entities and entity voting while Bosniak and Croatian parties oppose both issues. Yet, the intensity of feeling varies and while Serbs are unlikely to permit the elimination of the RS they might concede entity voting. Likewise, Bosniaks and Croats might be willing to ignore the existence of the RS if the power it wields through the entity vote is tempered.

Currently the SDA, the largest party is willing to keep the constitutional reform package of April 2006 that allows for both entities and entity voting. By contrast Silajdzic's SBiH wants both entities and entity voting eliminated. The SBiH position reflects the views of the majority of Bosniaks who want a unitary state (Toal et al. 2006, 68). The SDP vows to wait and consider the package the SDA-SBiH coalition returns, but suggests it will support their compromise (Mustajbegovic 2007). The HDZ argues that the status quo is unacceptable and discriminatory to Croats, and favors a unitary state with decentralized policy implementation. This view is consistent with the opinion of a plurality of Croats (Toal et al. 2006, 68; Irwin 2004, 67). The SNSD continues to accept the necessity of constitutional change but like the SDS and a plurality of Serbs demands the entities continue to exist (Toal et al. 2006, 69, 71). Table 5 summarizes the parties' positions on the key issues.

The overwhelming majority of legislators from both entities view decentralization as desirable. Indeed, this view reflects public opinion in which sixty-four percent of the public and majorities of all ethnic groups found it acceptable (Irwin 2004, 66-67). This becomes critical because the European Council suggests that the RS should concede entity voting if the constitution provides protections for minorities specifically through decentralization and the existence of entities (2006). Under a decentralized scheme, the central and local governments would divide power and entities would exist symbolically. While Serbian representatives feel equally committed to entities and entity voting, Bosniaks and Croats seem more likely to accept the existence of entities if entity voting is eliminated. Within the FBiH, more representatives unequivocally

**TABLE 5. PARTY POSITIONS ON KEY CONSTITUTIONAL ISSUES**

<b>PARTY</b>	<b>SEAT S</b>	<b>DECENTRALIZE D</b>	<b>ENTITIES</b>	<b>ENTITY VOTING</b>
<b>FBiH</b>				
SDA	8	Yes	Preferably not	Preferably not
SBiH	7	Ok	No	No
SDP	5	Yes	Preferably not	Preferably not
HDZ	3	Yes	Preferably not	No
HDZ 1990	2	Yes	No	No
BPS	1	Ok	Preferably not	No
NSRzB	1	Yes	Preferably not	No
DNZ	1	Yes	?	?
<b>RS</b>				
SNSD	7	Yes	Yes	Yes
SDS	3	Yes	Yes	Yes
PDP	1	Yes	Yes	Yes
SBiH	1	No	No	No
SDA	1	No	No	No
DNS	1	Yes	Preferable	Preferably not

oppose entity voting than entities, and a weakened entities without entity voting might swing the SBiH to accept the reforms. Acceptance becomes possible because decentralization within the entities protects Croats and Bosniaks in the RS. Decentralization also might win the votes for the reform package of HDZ and even HDZ 1990 members, particularly because Zagreb clearly opposes irredentism. The trade-off of entities and decentralization for an end to entity voting also would assuage concerns at the international level with the OHR and EU. Such a solution protects the rights of individuals and non-constituent peoples, treats every voter equally, and moves BiH toward governmental efficiency.

The solution depends then on whether a Serbian win-set accepts entities and decentralization without entity voting. The RS would continue to exist and the rights of Serbs in the FBiH would be secured. Serbs still would retain a veto in the House of Peoples. The reforms would promote economic efficiency and move BiH toward the EU. Yet, the end of entity voting would eliminate the Serb veto in the House of Representatives as well as the guarantee of a Serbian president through the tri-partite arrangement. Ultimately the issue for Serb leaders, as with their Bosniak and Croat counterparts is whether as Kujundžić challenges they are willing to place state interests before ethnic interests. Or the question is, as Beck hints, whether Serbs embrace multiple identities in order to benefit from glocalization.

### **BiH Foreign Policy**

Stable and cooperative relationships between the constituent peoples of BiH would situate it to better respond to the complexity of its geopolitical position within the Balkans and between West and East. Although BiH is in Europe and sees its future in European institutions, it cannot deny

its historical relationships with Russia and the Near East. The challenge for BiH is to engage in bloc diplomacy and to turn its position at the crossroads of the West and East into an advantage. Cooperation in energy, transport, and the fight against organized crime benefits all states. Sarajevo once served as a great marketplace and this again can occur. BiH can become a hub for banking, tourism and airline connections, but stability is an essential prerequisite. The state must be efficient and corruption and strife must end. BiH's geopolitical position sometimes is perceived as a curse. In fact, as the crossroads of civilizations BiH offers much to a glocalizing world, but only if stable.

Again, this returns the focus to the multi-level game. Stability depends upon the elites in BiH assuming the role of leaders and initiating a cleansing of old animosities and politics. Prior to the election, Christian Schwarz-Schilling warned, "Empty rhetoric has been the scourge of this country for much too long...You cannot eat rhetoric, it doesn't create jobs, it doesn't staff schools or equip hospitals; and it won't secure visa-free travel to the EU". Therefore, the Serbian, Croatian and Bosniak leaders must commit to the establishment of a state foreign policy. The challenge for the newly elected leaders is immense. Contemporary foreign policy with its multiple layers and non-state actors presents complexity even to states with well financed and seasoned foreign ministries. Foreign opportunities exist for BiH, but only if internal hostility and intolerance ends. Influence in the region and beyond requires the strength of a single vision and this begins with the constitutional reform.

Putnam's model provides important benefits for an understanding of BiH foreign policy because it emphasizes the interaction between negotiating levels and the complexity of policy-making. Putnam highlights the significance of tactics particularly suasive reverberation, win-set size and synergistic linkage which prove critical with BiH. Yet, the BiH case also suggests additional elements of the foreign policy process for further consideration. As globalization advances, a state's control of contacts between foreign actors and its public weakens. Additionally, international intervention constrains the sovereignty of weak states. Putnam's model requires adjustment for such cases. The current model primarily focuses on the state balancing the demands of foreign actors and domestic constituents. Yet, globalization, integration and intervention temper the state's role both as intermediary and foreign policy-maker. This research reveals the fact that the state is not always an intermediary. The case includes a third level at which foreign states (such as Serbia and Croatia) directly appeal to citizens of BiH. Further study also should examine a level at which institutions such as the OHR and EU interact with the public. In the BiH case, international actors penetrate internal politics, and foreign and domestic actors both pressure the state regarding EU membership. This presents a different situation than Putnam focuses upon in which the state's position is balancing competing foreign and domestic demands and striving "to reconcile domestic and international imperatives simultaneously" (Putnam 1988, 460). Thus, while Putnam's model identifies the importance of interactions between domestic and foreign policy, the model requires expansion to understand the depth and nature of these interactions. Research now should consider how these interactions vary given different levels of globalization, international intervention, and state strength.

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## United States Hegemonic Power and Global Finance

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*This paper attempts to demonstrate that the major financial institutions' (IMF and World Bank) one-size-fits-all policy recommendations, rather than solving the economic and financial problems experienced by poor countries, are part of the problem. These financial institutions, acting on behalf of the wealthy countries, mainly but not only the U.S., have systematically blamed the poor economic performance of the less-developed countries on the bad implementation of necessary macroeconomic reforms. Such argument is no longer convincing. Instead I will argue that the system itself is dysfunctional as the international monetary arrangement that governs economic and financial transactions is asymmetric and benefits the rich and powerful at the expense of the poor and weak. I propose the formation of a more symmetric monetary system that will constrain the hegemonic power of the U.S.*

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Since the WTO meeting in Seattle in 1999 failed to start a new round of trade negotiations, it has become obvious that many countries - mainly developing ones - and elements of civil society have rejected the current globalization process. Although trade issues were the primary focus of the Seattle meeting and the subsequent WTO meetings in Doha, Cancun, and Hong Kong, this paper will address another important aspect of globalization. I will attempt to demonstrate that our current international monetary arrangement is asymmetric and serves the interests of some countries, i.e. the industrialized and wealthy ones, better than others. Although the WTO has often been portrayed as the main villain by anti-globalizers, its two sister organizations, the World Bank and the IMF are much more insidious due to the fact that they are bigger, have more resources and larger staff, and are more tightly controlled by the developed countries, especially the U.S. I will also try to demonstrate that reforming the international monetary system is no longer a utopian dream and will make a proposal for reform of the system that should make it more balanced.

In an attempt to answer these questions, the paper will proceed in eight stages. I will start by revisiting some important accounting identities that should be very familiar to students of economics, but perhaps not to those less inclined toward the dismal science. These identities link the external accounts of a country to two macroeconomic variables, national saving and investment (gross fixed capital formation). The second section will explain the choices available to countries as far as exchange rate systems are concerned. The relationship between all three variables, saving, investment, and the current account balance (reflecting the external position of a country), is affected by the type of exchange rate system in use. Balance of payment crises occur when investors think that a country's external position is not sustainable and cannot be restored without a major adjustment in exchange rates and other financial variables (interest rates). Two types of balance of payment crises, the "old-fashioned" and "high-tech" ones will be

discussed in the third section. The following section will show how the IMF, unfortunately, has tended to follow the “one size fits all” principle in resolving crises. The reason why the IMF prescribes the same medicine, regardless of the type of crisis, is linked to the fact that IMF economists tend to be more concerned about the health of Wall Street investors than the well-being of the debtor countries they are supposed to help. Thus they tend to blame financial crises on the misguided economic policies followed by governments rather than on the dysfunctionality of the system brought about by the asymmetric power relationship among the various actors. This asymmetry will be explained in section five. One often-mentioned suggestion that has been made to reduce the likelihood of crises consists of fixing the exchange rate either permanently (dollarization) or semi-permanently (currency board). Section six will explain why such reforms would only increase the asymmetry in the international financial system and could only benefit Wall Street firms, not the most deprived people in poor countries. This leads us to a basic question: Are the International Financial Institutions still needed? This question will be addressed in section seven. Finally, I will make a proposal for reforming the international monetary system in the last section, before some concluding remarks. The objective of this reform proposal is to make our system more symmetrical and more democratic. This cannot be achieved though without some serious cooperation among all our political leaders.

### **SOME USEFUL ACCOUNTING**

I will start with some useful accounting rules. First, the main reason why countries export is to pay for their imports. Thus importing is “good”, as it allows us to consume goods produced by others, while exporting is “bad” since we are sending to foreign countries goods that cost us dearly to produce. When countries import more than they export, they need to borrow from foreigners in order to pay the part of imports not covered by exports. Thus countries that run trade balance deficits must be selling bonds (or other assets) to foreigners, implying that they must be borrowing from them. Running trade deficits year after year causes the foreign debt to grow larger and larger, and the interest payments made to the foreign holders of the bonds to also get larger and larger. Developing countries cannot continuously run trade deficits year after year as they are unlikely to attract enough lenders willing to purchase their bonds. The US, which happens to be the largest foreign debtor in the world, has so far found plenty of investors, both private and public, willing to hold its bonds. Most other countries, especially developing countries, will find it much harder to finance their foreign debt. This is so because they will have to issue bonds denominated not in their domestic currency but in dollars, requiring them to earn dollars to pay the interest on their foreign debt. Thus a country such as Argentina needs to export goods to acquire the dollars it needs to finance its foreign debt. On the other hand, because its foreign debt is in dollars, the US could simply print dollars to finance it using no real resources in the process. Clearly the US is reluctant to use such a method, as it would be inflationary and would cause foreign investors to become disinclined to invest their savings in the US. They might even require that, in the future, the US issue bonds denominated in a currency other than the dollar to finance its trade deficits. The dollar would then lose its status of international reserve currency. Could such a scenario occur? The answer is yes, but it is unlikely as long as there is no other alternative currency ready to take its place.

A second accounting rule can be derived from the one just mentioned. In a closed economy, firms can finance their investments in plants and equipment only by using the savings of

domestic residents (national savings). Thus  $S = I$ . In an open economy it is possible for Investment in plant and equipment to be larger than national saving (or  $S < I$ ). This is so because firms can also use the savings of foreigners to finance that portion of their investment that is not covered by national savings. In such a case, firms will be borrowing from foreigners. However, as mentioned above, countries that borrow from foreigners must also be running trade deficits. Thus it must be the case that when  $S < I$ , Imports  $>$  Exports. Thus countries that do not save “enough” end up having a trade deficit that is financed by borrowing from abroad. This is an important feature as it explains why the IMF requires developing countries to implement tough austerity measures (forcing their residents to save more and governments to tighten their budgets) as a pre-condition to obtain a loan. As a result, these developing countries end up following pro-cyclical (contractionary) macroeconomic policies when they are experiencing an economic crisis.

Market forces can also compel a country to adjust its external account. Thus if a country has a trade deficit and cannot borrow from abroad (due to the reluctance of foreign investors to lend or due to capital flight), the currency of this country will depreciate or fall in value. It could even collapse causing a foreign exchange crisis. The depreciation will increase the price of foreign goods relative to domestic goods (terms of trade deterioration), stimulating exports and reducing imports. At the same time, interest rates will increase forcing residents to consume less and save more and firms to reduce their investment in plant and equipment. In this case, such austerity is imposed not by the IMF but by the market (whether we like it or not, financial markets are globalized!). In theory, the IMF intervention, because it is accompanied by new loans (with strings attached), should make it easier for countries to implement the required economic reforms. However, some countries prefer to shun the assistance of the IMF and will instead use capital controls in order to prevent capital flight and remove some of the pressure on their exchange rate and interest rates. Malaysia did just that in 1997 and Chile has occasionally used some mild forms of capital controls in the past.

## **EXCHANGE RATE SYSTEMS**

It used to be that countries could choose between a fixed exchange rate, a flexible exchange rate, or a continuum of possibilities between these two extremes. Today, semi-fixed (or semi-flexible) exchange rates are not an option as these hybrid types tend to lack credibility and therefore are not stable. The decision to adopt a fixed or flexible exchange rate depends on two factors: first whether a country wants to keep some control over its monetary policy and second whether the country wants to allow capital to flow freely in and out. This issue is often referred to as the policy trilemma (or trinity): The optimum policy combination, if it were possible, would be for a country to adopt a fixed exchange rate system (to reduce uncertainty in trade and investment-related matters), perfect capital mobility (to optimize resource allocation worldwide), and an independent monetary policy (to be able to control the domestic economy). Unfortunately, such an ideal combination is not possible. To understand why, assume that a country decides to lower its interest rate (by following an expansionary monetary policy). With a lower interest rate relative to the rest of the world, capital would flow out of the country in search of a higher rate of return in other countries. This would put downward pressure on the exchange rate, which could not remain fixed. Thus this country would either need to adopt a flexible exchange rate system or prevent capital from flowing out in order to be able to maintain

its currency peg. This scenario demonstrates that a country must select two of those desirable features and forsake the third one. Let's look briefly at the choices that various countries or groups of countries have decided to make. The US has chosen to have a floating exchange rate for the dollar in order to be able to keep control over its domestic monetary policy while allowing capital to flow freely<sup>1</sup>. This choice makes a lot of sense, as it allows the U.S. to maintain its sovereignty over domestic economic policy while benefiting from capital inflows (foreign borrowing) that are essential to finance its trade deficit. It is unlikely that the US would adopt any other possible combination, as allowing the dollar to float freely against most other major currencies gives the US room for maneuver that it might not otherwise have, such as control over its domestic economy and the ability to delay the payment of its foreign debt. The twelve European Union (EU) members that have adopted the euro as their currency have chosen to fix their exchange rates permanently among each other. As capital is perfectly mobile within them, these countries have lost control over their monetary policy. As a matter of fact they do not even have their own individual central bank and the common monetary policy of the 12 eurozone members is administered by an independent entity, the European Central Bank (ECB), located in Frankfurt, Germany. Note however that the eurozone, as a group, has a flexible exchange rate (i.e. the euro floats freely against the dollar and the yen), and that the ECB has control over the monetary policy of the 12-member eurozone. The third possible alternative is perhaps best exemplified by China. China has a fixed exchange rate whereby the yuan was pegged to the US dollar between 1994 and July 2005 and is now pegged to a basket of currencies including the dollar (allowing for some limited flexibility against the dollar), and an independent monetary policy. However capital is not allowed to move freely in and out of China. China is currently under tremendous pressure, from the US and to a lesser extent from the EU, to allow its currency to float freely and to remove its capital controls. Given China's fairly large current account surplus vis-à-vis the US (around \$202 b in 2005<sup>2</sup>), it is believed that this would allow the yuan to appreciate against the dollar, making Chinese goods more expensive in the US. How much the yuan would have to appreciate against the dollar to have a significant effect on the US trade balance is not clear. It could very well be that the US might replace its Chinese imports by imports from some other countries, thereby leaving its trade balance unchanged. A large change in the value of the yuan could also have a destabilizing effect on Asian foreign exchange markets, as the dollar may depreciate not only against the yuan but also against other Asian currencies<sup>3</sup>. In any case, there is no clear consensus at this time on the impact that such a major exchange rate realignment could have on the world economy. One may also be wary of the motivation of US policymakers when they so adamantly request that China changes its modus operandi.

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<sup>1</sup> For the most part the U.S. allows capital to flow freely. However there are some exceptions. Countries such as Iran have in the past seen their assets being frozen. More recently, DP World, a Dubai-owned company was not able to take over operations at U.S. ports.

<sup>2</sup> One needs to understand though that bilateral current account balances are rather meaningless (although members of the US Congress find meanings in them). More meaningful is the fact that China's overall current account surplus is about \$100 b while the US current account deficit is approaching \$800 b. Thus, the US contribution to the global economic imbalance is a lot larger than China's contribution.

<sup>3</sup> The dollar could also fall against the euro, threatening the economic recovery of EU members, causing further disruptions worldwide.

## BALANCE OF PAYMENT CRISES

Typically, balance of payments crises occur under a fixed exchange rate regime. Like various other observers, I will make a distinction between two types of crisis: The “old-fashioned” type is caused by overvalued fixed exchange rates, and large current account deficits, as in Mexico (1994), Brazil (1999) and Argentina (2001); the “high-tech” crises combine domestic financial deregulation of a weak financial sector, inappropriate capital account liberalization, and (usually but not necessarily) large current account deficits. This second type of crisis affected various Asian countries starting in Thailand (1997) before spreading quickly to Malaysia, Indonesia, the Philippines, Hong Kong, South Korea, and Taiwan. Of these countries, only Hong Kong did not have to devalue its currency, while China was not affected at all thanks to its capital controls. These two types of crisis differ by the underlying factors responsible for the current account deficits. Although current account deficits are always linked to a lack of national savings (S) relative to Investment (I) by firms in plant and equipment, the low national savings can have two main causes, either a low government saving (when the government runs a budget deficit) or a low private saving (saving of business firms and households). In the “old-fashioned” crises mentioned above, the current account deficit is linked to a large government budget deficit, while in the “high-tech” crises, the current account deficit is related to the heavy borrowing (i.e. low private saving) of banks, financial companies, and corporations. Notwithstanding the fact that it is always dangerous to follow pro-cyclical macroeconomic policies, the disregard for the sources of the current account deficit while prescribing a policy response shows a total disregard for the people affected by the crisis. Unfortunately, the IMF prescribed the exact same remedy (fiscal austerity and higher interest rates) for both the Asian high-tech crisis and the Latin American old-fashioned crises. By prescribing the same medicine, the IMF probably contributed to cause the economic conditions in many Asian countries to deteriorate further and spread to a larger number of countries. However, Stanley Fisher (AER 2003), who was the first deputy managing director of the IMF between September 1994 and August 2001, is adamant that the IMF did the right thing during his tenure.

I will further investigate these two types of crises by first discussing briefly the Mexican crisis of 1994. Mexico’s current account deficit was large at 8% of its GDP. It had to be financed by selling assets to foreigners (borrowing). To make matters worse, the deficit was mostly financed by issuing short-term bonds, a large fraction of which were denominated in dollars. Investors, both domestic and foreign, started to lose confidence in the ability of Mexico to continue financing its current account deficit and started to anticipate that the Mexican government would have to devalue the peso. Expecting the devaluation, investors adjusted their portfolios by buying dollars and selling pesos. This capital flight forced the Mexican government to devalue the peso by 15% in December 1994. Unfortunately this proved insufficient as the initial devaluation fueled speculation of further devaluations, forcing the government to let the peso float freely sending it into a free fall. There is no doubt that the Mexican crisis was unavoidable given Mexico’s poor economic conditions and political uncertainty<sup>4</sup>. However, the severity of the crisis and the large depreciation of the peso were largely unwarranted, reflecting the financial

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<sup>4</sup> In 1994, several political factors shook the confidence of foreign investors: the assassination at a rally in Tijuana of Luis Donaldo Colosio, a candidate in the presidential election and the Chiapas uprising following the launch by the U.S., Canada, and Mexico of the North American Free Trade Agreement

markets overreaction, and calling into questions the soundness of the international financial system (although, subsequently Mexico recovered fairly quickly from the crisis).

The high-tech crisis that struck Thailand is somewhat similar to the Mexican crisis of 1994, in the sense that, like Mexico, Thailand had a large current account deficit. Like in Mexico, financial markets overreacted when the Thai currency, the Baht, fell by more than 50% against the dollar. However, the similarities end here. In Thailand and other Asian countries, it was mainly the private sector, banks and financial companies, which had borrowed heavily from foreign countries by issuing short-term bonds, in order to be able to provide loans to real estate developers. When it became clear that the real estate developers had overestimated the demand for the newly constructed commercial and residential units, they defaulted on their loans to banks, forcing financial companies in turn to default on their loans. The real estate market collapsed, leading to a banking crisis, panic, and a full-fledged foreign exchange crisis. Investors, as always in such conditions, overreacted and started to move their funds out of other Asian countries causing the Thai crisis to first spread to Malaysia and Indonesia before reaching other countries. It is interesting to note that the economy of Indonesia, a country that had a fairly small current account deficit of less than 4% of its GDP (while that of the U.S. is approaching 7%), was seriously damaged by this crisis that originated in Thailand. The Indonesian rupiah lost 75% of its value, an estimated 17 million Indonesians fell below the poverty line, and the economy shrank while it had been growing at a fairly fast rate prior to the crisis. Two main characteristics make the Asian crisis different from the Latin American ones mentioned above. First, the heavy short-term borrowing by private banks in Asia was made possible by the domestic financial deregulation that had previously taken place, while new regulations were not put in place and financial firms were for the most part left un-supervised. This allowed banks to finance projects that suited political leaders (“crony capitalism”) but were unsound financially. Second, the liberalization of capital accounts (allowing the free movement of capital across borders) allowed banks and firms to issue short-term bonds in foreign currencies (thereby borrowing from foreigners). It is interesting to note that in spite of the recent Asian crisis (that did not affect China!), Western countries have been requesting that China deregulates its domestic economy and removes its capital controls, thereby allowing the free movement of capital in and out of China. Chinese leaders are quite reluctant to do so in the near term as they fear that such measures might destabilize their economy in light of the weakness of their domestic financial system. They have clearly stated that they will liberalize their economy as soon as they have put in place the reforms that they deem are necessary to prevent the type of crisis that affected other Asian countries following the liberalization of their financial markets and their capital accounts. Apparently the Chinese have learned that the cautious, step-by-step approach to reform is less risky than the big bang approach preferred by the IMF and the US Treasury!

### **THE IMF HEAVY-HANDED APPROACH**

Sometimes it is hard to believe that with such a talented pool of economists working for it, the IMF often contributes to making a financial crisis worse instead of alleviating it. Generally the IMF provides conditional loans to countries that face balance of payment crisis. Not only are those funds usually insufficient to counter the recessionary liquidity crunch resulting from the speculative capital outflows, but the accompanying conditions tend to make the crisis worse.

Usually the conditions include the following elements: First the country must tighten its monetary policy and raise interest rates. This is designed to stop the fall in the value of the currency by making domestic assets (bonds) more attractive. However, the higher interest rates also reduce investment by domestic firms and may force debt-burdened firms to default on their loans. As a result of such pro-cyclical policy, real output is likely to fall and unemployment to rise, exacerbating the crisis. Second, the country must reduce its budget deficit by running a primary budget surplus (revenues minus expenses of the government excluding interest payment on the debt). To achieve this, the IMF often requires that a country eliminate its subsidies on food and energy, increasing poverty and possibly causing social unrest (as happened in Indonesia) in total disregard of the need to provide social safety nets during hard times. It is as if the IMF did not realize that the Asian crises were generally not caused by reckless governments, but by wasteful private borrowers taking advantage of a lightly regulated and supervised domestic financial environment. Clearly, in the case of Asia, the IMF misjudged the devastating impact of capital outflows on each individual country and the contagion caused by the herd behavior of institutional investors. Third, not content with forcing the countries in crisis to apply the monetary and fiscal brakes in violation of the most basic lesson of Keynesianism to deal with economic downturns, the IMF requires countries to engage in a program of structural reforms even though the country is in the midst of a crisis, as if there was not a better time to undertake such a task. Thus the IMF policy may require the closure and dismantlement of bankrupt financial institutions during the crisis, increasing the panic of investors and leading to a run on all banks, including healthy ones. A preferable approach would consist of putting in place the proper regulations with the necessary supervision before liberalizing the financial sector. This process may take many years in less-developed countries, explaining why the step-by-step approach is preferable.

### **RESERVE CURRENCIES AND THE ASYMMETRIC POSITION OF THE RESERVE CENTER**

Between the end of World War II and 1973 the world economy was operating under the Bretton Woods fixed exchange rate system. The dollar was essentially the only international reserve currency and the central banks of all the countries had to hold dollar reserves and stand ready to buy and sell dollars in order to maintain the fixity of their exchange rate. When the dollar price of every currency was fixed, the exchange rate between any two currencies in the world (called cross-rate) was also fixed. The asymmetry in such a system arises because the US had a special position in the system due to the reserve currency status of the dollar. Unlike the other countries, the US never had to intervene in the foreign exchange market to maintain the fixed exchange rate. This is due to the fact that when there are  $N$  countries and  $N$  currencies in the world, there are only  $N-1$  exchange rates against the dollar. Thus only  $N-1$  countries had to intervene to fix the  $N-1$  exchange rates, thereby freeing the US from having to intervene. Thus the US could enjoy the benefits of having a fixed exchange rate, without having to intervene in foreign exchange markets. Unlike any other country, the U.S. could partake all three characteristics of the policy trilemma, fixed exchange rates, independent monetary policy and perfectly capital mobility. Thanks to this privilege, the US was able to use its monetary policy to control its domestic economy while the other countries had to adjust their monetary policy (and interest rates) to maintain the fixity of their exchange rates. To illustrate this point, assume that the US experienced a recession. Its central bank could use an expansionary monetary policy, lowering

the US interest rate relative to the interest rate in other countries, to stimulate its economy. As interest rates on non-US bonds were now relatively higher than interest rates on equivalent U.S. bonds, investors would wish to hold more of them, selling dollars and purchasing other currencies. This would cause the value of these other currencies to strengthen against the dollar, forcing all non-US central banks to intervene in the foreign exchange market, buying dollars and selling their currencies, to keep the exchange rate fixed. In the process, these other central banks would expand their money supply bringing their interest rates down toward the US interest rate. Thus the reserve country has the power not only to affect its own economy, but the economy of all the other countries, regardless of whether or not it benefits them. The asymmetry in the system is partly responsible for its demise, as it caused numerous policy disputes between the US on the one hand, and other countries on the other.

In theory, the system was supposed to impose some constraints on the US ability to expand its money supply at will. This was so because the US was obliged to trade gold for dollars on demand at the fixed price of \$35 per ounce. This should have restrained the ability of the US to print money to avoid running out of gold when dollar holders wished to exchange their dollars for gold at the fixed price. In reality though, foreign central banks were initially willing to hold onto their dollar reserves since the dollar was considered a perfect substitute for gold, and since dollar reserves, held in the form of US Treasury bills, unlike gold, paid interest. Eventually, when it became obvious, that the world holding of dollars was much higher than the amount of gold held by the US central bank, a crisis of confidence erupted that brought the system down.

When the era of floating exchange rates started in 1973, it was thought that the new system would be more symmetric than the previous one that all central banks would regain control over their monetary policy, and that destabilizing speculation would be eliminated. Unfortunately, experience showed otherwise. Although it is true that the system is somewhat more symmetric, countries, especially the developing ones, that followed expansionary monetary (and fiscal) policy, in order to stimulate their economic growth, experienced high inflation and currency depreciation, forcing them to reverse their policies or even to re-adopt a fixed exchange rate system (currency board system and dollarization, as explained below). In the end, monetary expansion, even under a flexible exchange rate system, tends to be unsuccessful in stimulating growth in developing countries and will only result in unwanted inflation and depreciation. In addition, even speculation can occur under a flexible exchange rate system. As traders expect a currency to depreciate and start selling it, speculators jump on the bandwagon causing the currency to collapse (and overshoot its equilibrium value). Thus, even under a flexible exchange rate, small countries' control over their macroeconomic policy is more illusory than real.

It was also thought that a flexible exchange rate system would isolate a country from disturbances originating in a foreign country, including large ones. This is not necessarily the case. For example, when most Asian currencies weakened following the crisis in Thailand in 1997, countries such as Mexico, which had adopted a flexible exchange rate following its 1994 crisis, suffered as US importers substituted cheaper Asian goods for relatively more expensive Mexican ones. Mexico could not respond to the resulting slowdown in its economy by expanding its money supply as this would have led to the weakening, or even collapse, of the peso, an unacceptable outcome to the Mexican authorities even under a flexible exchange rate system. Another example of such transmission of economic shocks across borders occurred in

1979 when the Federal Reserve shifted to a very contractionary monetary policy in order to reduce the US double-digit inflation rate. This resulted in high dollar interest rates that pushed the US into recession. The resulting lower US imports in turn forced the rest of the world into recession. This change in policy was to a large extent responsible for the debt crisis of the 1980s as developing countries found themselves unable to pay the interest on their dollar denominated debt. The appreciation of the dollar resulting from the high US interest rates only made the problem worse by increasing the local currency value of developing countries' debt.

Thus, we can safely say that the system did not become significantly more symmetric with the advent of floating in 1973. Most countries were not free to follow independent macroeconomic policies as they chose to reduce the variability of their exchange rates. In other words, most countries realized very quickly that they could not let their exchange rates fluctuate widely without harming their economy. Only the US central bank and to a lesser extent the European Central Bank have been able to adopt a policy of "benign neglect" with regards to the value of their exchange rate (although US policy makers would not admit it in public!). Consequently, the system did not change in 1973 as much as we may like to believe. Asymmetry still prevails as developing countries cannot afford to let their currency depreciate significantly. Although Europe and Japan have acquired the ability to conduct more independent monetary policy, the fact that the dollar is still by far the most significant component of most central banks' reserve assets contributes to uphold the hegemony of the US. This remains the case even though the euro and the yen have gained some importance as international reserve currencies. Thus our current floating rate system is not too dissimilar from the asymmetric reserve currency system of the Bretton Woods era when the US was the dominant country.

There is another important asymmetry. When developing countries borrow from foreigners, their debts are denominated mostly in dollars, and occasionally in euros or yens. On the other hand when rich countries borrow, they issue debt denominated in their own currencies. Thus the US will sell bonds denominated in dollars to finance its current account deficit. This asymmetry constitutes a tremendous benefit to the rich countries. To see why, suppose that the US experiences a decline in the demand for its products. This will reduce the world demand for dollars causing the dollar to depreciate. US foreign liabilities (debt) that are denominated in dollars will not change in value, while the dollar value of US-owned foreign assets, denominated in foreign currencies, rise in value with the depreciation of the dollar. Therefore, as the US suffers a negative international shock, the dollar depreciation will cause a wealth transfer from foreign countries to the US, thereby offsetting the negative impact of the shock.

Unfortunately poor countries are likely to suffer a lot more under similar circumstances. Like in the US case, a fall in the demand for their products will cause a depreciation of their currencies. However, since their foreign liabilities are denominated in a stronger currency and they do not generally own large amount of foreign assets, they will suffer a significant loss of wealth. Thus, not only their income but also their wealth will fall. This inability to borrow in one's own currency stems from the asymmetric structure of the international monetary system that makes it harder for poor countries to finance their debt. However some economists argue that bondholders in wealthy countries would be willing to hold the bonds of poor countries, even if those were issued in the local currencies, as long as poor countries were following responsible economic policies. I do not believe that this is the case due to market failure and extreme risk

aversion on the part of bondholders, i.e. the overpricing of risk forcing poor countries to issue bonds with high interest rates and short maturities. Incidentally, foreign bond holders are willing to hold long term US bonds that pay a low interest rate, even though the US is following fiscal policies that could be characterized as being irresponsible!<sup>5</sup>

### CURRENCY BOARDS AND DOLLARIZATION

Given that many developing countries have not performed well under a flexible exchange rate system, several of them have adopted a currency board arrangement in order to peg their currency credibly to that of a leading country, either the dollar or the euro. Strictly speaking, under a currency board arrangement, a country is required to hold foreign reserves to back its monetary base. All the currency that is issued by the central bank must be fully backed by foreign reserves. The central bank is not allowed to hold domestic assets (government bonds). Under such a system, speculators should be discouraged from selling the domestic currency as the central bank should never run out of foreign exchange reserves to defend its currency. However, the Argentinean currency board that lasted from 1991 to 2001 allowed for a small fraction of the monetary base to be backed up by US dollar-denominated Argentinean government bonds. In theory, a currency board is supposed to work pretty much like a “vending machine”. Anyone with pesos should confidently be able to exchange them for dollars at the central bank since it should have all the foreign reserves it needs to buy back the pesos. Such a system has two major drawbacks that constitute its Achilles’ heels. Since the central bank is legally not allowed to purchase domestic assets, it cannot act as the lender of last resort when the financial system is under stress. In addition, as we have seen above, under a fixed exchange rate system and perfect capital mobility, a country cannot use monetary policy to stabilize its economy. Thus if unemployment is high and rising, the cost of maintaining the exchange rate fixed becomes so high that the government comes under intense pressure to abandon the currency board peg altogether. Argentina certainly encountered both problems, a financial panic and high unemployment in 2001, resulting in the abandonment of its currency board arrangement. Instead of letting the peso float, Argentina could have instead dollarized its economy, as suggested by some economists at the time<sup>6</sup>, by adopting the dollar as its only currency. Under dollarization, a devaluation becomes impossible. The US Federal Reserve would have been in charge of conducting monetary policy for Argentina, without being accountable to the Argentinean people, a probably unacceptable outcome politically. In addition, the US would be unlikely to take Argentinean economic conditions into account when setting its domestic interest rate, forcing Argentina to acquire the dollars it needs by exporting more (or borrowing more). If the dollar happened to be strong against the currencies of Argentina’s trading partners, Argentina’s economy would suffer. Dollarization is an asymmetric system that would have put the US in control of the Argentinean economy even though it did not have the interests of Argentina foremost in its mind.

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<sup>5</sup> As a matter of fact, following 9/11, the real rate interest on short-term US treasury bonds was approximately zero. Thus the U.S. was getting interest-free loans to finance its deficits.

<sup>6</sup> Steve H. Hanke, Professor of Applied Economics at the John Hopkins University in Baltimore, has been called “the father of the currency board.” He has served as economic advisor in Yugoslavia (1990-91), Lithuania (1994-96), and Argentina (1995-96).

## ARE THE INTERNATIONAL FINANCIAL INSTITUTIONS STILL NEEDED?

Created at the Bretton Woods Conference of 1944, it is fair to ask today whether the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank) are still needed in their present form. At that conference two plans were competing, the American plan under the direction of Harry Dexter White and the British plan under the direction of John Maynard Keynes. White and Keynes were competing for the relative dominance of the countries they represented. As White got the upper hand, the US was able to force its vision upon the design of the IMF in sharp contrast to Keynes' proposal for the creation of an International Clearing Union (ICU) instead. White was thus made chairman of the commission charged with establishing the IMF, while Keynes was neutralized by being given the less prestigious chairmanship of the commission charged with establishing the World Bank. While the IMF is a smaller institution, it is clearly the most important player as it focuses on macro policy issues<sup>7</sup> that have a more global scope. The IMF follows a quota system, by which members must pay a quota based on their relative size in the world economy. Members that face balance of payment difficulties can then borrow an amount now beyond 150% of their quota thanks to the creation of various special credit facilities over the years<sup>8</sup>. Subsequently debtor countries that receive IMF loans are required to take the steps necessary to reduce their balance of payments deficit, no matter the sources of those deficits. Thus deficit countries, i.e. developing countries, are required to reduce their deficits even though those deficits may be created by increases in the price of imported oil, decline in the prices of commodities that they export, or rise in the interest rates on their debt – all events over which they have no control. In addition, they are not given much time to reimburse those loans as they are fairly short-term and must be repaid within five years. Keynes' ICU would have operated quite differently as it was conceived as a world central bank able to create credit by issuing its own money called the *bancor*. Another interesting feature of Keynes' plan was that both the surplus countries and the deficit countries would have been required to take the necessary steps simultaneously to address their balance of payment disequilibria. By spreading adjustment responsibilities across countries, Keynes had in mind a symmetric arrangement that the U.S. rejected. One possible way to reform the IMF would consist of adopting many of the ideas proposed by Keynes, transforming it into a world central bank (and international "lender of last resort") responsible for regulating world liquidity and spreading the responsibility for adjustment symmetrically among surplus and deficit countries – focusing more of its attention on the industrialized countries than it currently does<sup>9</sup>. Clearly, this won't happen any time soon if ever, and I will suggest below a more modest reform proposal.

Unlike the IMF, the World Bank does not rely directly on contribution from member governments. Instead, most of the funds from which the Bank makes loans to poor countries (at unsubsidized market rates) come not from members' subscription shares, but from borrowing on

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<sup>7</sup> The World Bank was given the less prestigious task of rebuilding Europe after WWII, a role in which it was clearly eclipsed by the Marshall plan, and of providing development aid to poor countries.

<sup>8</sup> During the 1997 Asian crisis, financial support for Thailand, Indonesia, and South Korea amounted to 505%, 490%, and 1939% respectively of their quota (Desai, p. 214).

<sup>9</sup> For example, the IMF could start by putting pressure on the industrialized countries to abide by their commitment toward the 0.7% of their GNP in development aid. This corresponds to a shortfall of approximately \$150 billion a year, half of which is from the U.S. alone.

world capital markets where its “triple A” rating allows it to borrow at the lowest market rates available. To become members of the World Bank countries must first belong to the IMF and must buy shares in the Bank based on their quotas in the IMF. As decisions are made by vote with the weight of each nation’s vote proportional to its quota in the IMF or the size of its shareholding in the World Bank, the U.S. controls about 17% of the total votes in both institutions, enough to be the only country able to veto a policy decision that it dislikes since a 85% majority is required for adoption in most cases. This is where the IMF and the World Bank are seen to operate quite differently not only from the various UN agencies, but also from the WTO itself, institutions which follow the “one nation, one vote” system. Instead, the IMF and the World Bank are on the “he who pays the tab, picks the menu” model.

In 1960, as it became clear that a large number of poor countries had reached the limits of their ability to service their debts with the World Bank, a new facility was created, the International Development Association (IDA), in order to make loans at concessionary rates (often zero percent) for long time periods (35-40 years) with grace periods up to 10 years. Although the IDA is really a special fund of the World Bank, unlike the World Bank, it is dependent on contributions from high-income member governments allowing those rich countries, mainly the U.S. which contributes the largest share of IDA funds followed by Japan, to influence IDA lending. Ngaire Woods (2003) gives several examples where the U.S. has threatened to reduce its contribution to the IDA in order to force the World Bank to adopt policies preferred by the U.S.

As the ability to make additional loans depends on an increase in IMF quotas or the replenishment of IDA funds, both institutions must continuously deal with the threat of the U.S. using its veto power in attempting to influence decisions beyond its contribution. The relationship between the U.S. and the two institutions is made more complicated by the domestic political arrangements peculiar to the U.S. where the Treasury and the State departments focus on influencing the IMF and the World Bank respectively, while Congress tries to influence both institutions directly and indirectly through its influence on the Treasury and State departments. This system of checks and balances creates uncertainty and is manipulated by U.S. officials who evoke the intransigence of Congress to intimidate the other members into submitting to U.S. demands. Thus in 1997, while an increase in IMF quotas was being negotiated, the U.S. Congress established the International Financial Institutions Advisory Commission or Meltzer Commission – clearly not an independent and unbiased analyst - to make recommendations for future U.S. policies toward multilateral economic institutions. The commission’s final recommendation reaffirmed the belief that the U.S. had the right to set down the terms and conditions guiding the activities of the international institutions, thereby strengthening the dominance of the U.S. administration. Such posture is quite remarkable given that in theory outside political influence on the work of the international financial institutions is prohibited. Article IV section 5 of the World Bank’s articles of agreement states that, “*The Bank and its officials shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighted impartially in order to achieve the purposes stated in Article I.*”

Staffing of the Washington D.C. based IMF and World Bank is also indicative of how the U.S. exercises its influence upon these institutions. While the articles of agreement specify that the heads of each institution are to be appointed by their executive board, by long-standing convention the World Bank president is always an American, the IMF Managing Director is always a European, and the IMF Deputy Managing Director is always an American. In turn, the heads of both institutions are responsible for the appointment of the staff subject to approval of their respective boards. In fact, for all senior appointments, the approval of the U.S. is de facto necessary. Even at the junior level, the U.S. exerts tremendous pressure for its nationals to be hired by both institutions<sup>10</sup>. This is much facilitated by the fact that the U.S. was able to make English the only working language and to prevent the use of national quotas for hiring. In addition, one can say that “U.S. knowledge” is embedded in each institution, as the graduates in Economics and Finance of universities that teach in English are strongly favored.

Aware of the ability of the U.S. to use its veto power, senior managers at the IMF and World Bank are unlikely to even make recommendations to their Boards that risk U.S. disapproval. Consequently the staff does not waste its time preparing such recommendations. Such pervasive self-restraint clearly undermines the ability of both institutions to serve the interests of the poor countries they are supposed to help, while serving instead the interests of the only hegemonic power whose capacity to influence decisions goes far beyond its monetary contribution.

Although the World Bank serves the interests of the U.S. administration in place, its priorities have somewhat shifted over the years as different U.S. administrations do not have the same exact objectives. Thus there was a clear change in World Bank policies in 1981, following the election of Ronald Reagan. Robert McNamara had been president of the World Bank since 1968 and had pushed the Bank toward putting more emphasis on poverty alleviation. Although some progress had been made toward alleviating poverty during his tenure, thanks to a significant increase in the provision of loans for agriculture, health, education, and urban development, the poorest of the poor did not see any improvements in their conditions as most loans were beyond their reach. The World Bank, even during this poverty alleviation phase of its existence, would not promote income redistribution policies or disturb inequitable patterns of land ownership. Nonetheless any amount of poverty alleviation was too much for the Reagan administration to put up with, and in 1981, McNamara was quickly replaced by A.W. Clausen, a banking executive with no knowledge of development. This appointment underlines the change in philosophical approach that accompanied Reagan to Washington. The World Bank was going to start lending mostly to private enterprises with the participation of private commercial banks under an expanded number of conditions, which were extremely unforgiving toward poor countries. Those numerous conditions eventually led to the formulation of what we now know as the “Washington Consensus” which eventually became synonymous with “market fundamentalism”, “neoliberalism”, and “global laissez faire”.

It was not until the appointment of James Wolfensohn by Bill Clinton in 1996 that the World Bank returned to its poverty alleviation theme, including the social inclusion of women, indigenous people, and the unemployed, the provision of public goods, environmental and

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<sup>10</sup> See Ngiare Woods (2003) p. 16.

human sustainability, and policy “ownership”<sup>11</sup>. At the time of this writing, no one is sure what Paul Wolfowitz, the new Bank president, has in mind, other than the fact that - to the despair of most environmentalists - he seems to favor the funding of big infrastructure projects that were favored during the bank’s early years. Other than that, he has been very clever at disguising his agenda, although he seems to be inclined to fight corruption in developing countries, a somewhat lofty goal that is probably not attainable given the ambiguity of the concept itself<sup>12</sup>.

The close association between the U.S. administration on the one hand, and the World Bank and the IMF on the other hand, has not allowed these institutions to serve the interests of the loan recipients. While one may agree with Stanley Fisher (2003) that borrowers cannot control the banks from which they receive loans, it is clear that conditionality is an ineffective means to attain certain objectives and that without strong domestic support from poor countries, reformist policies will not be sustained. Thus poor countries should have the right to discuss various policy approaches with the international financial institutions and choose a policy option that is not preferred by the institutions. Only if they “own” such policy, will they be more likely to work for its success.

It is interesting to note that as Stanley Fisher was the first deputy managing director of the IMF during and after the Asian financial crisis (until August 2001), Joseph Stiglitz was the World Bank chief economist during the period following the crisis from 1997 to 2000. However, unlike Fisher, Stiglitz did not hesitate to criticize World Bank and IMF policies while he was at the World Bank. Such strong criticism coming from a U.S. economist (and 2001 Nobel laureate) called for a response from the U.S. Treasury Secretary, Lawrence Summers, a former World Bank chief economist himself. Unhappy about the highly critical comments made by Stiglitz about the World Bank and IMF policies, he put pressure on James Wolfhenson, then World Bank president, to restrain Stiglitz. Wolfhenson found himself in a difficult situation, as his relationship with Summers had been somewhat stormy in the past and he agreed with many of Stiglitz’ ideas that he, as President of the World Bank, was in no position to defend. In order to be reappointed for a second term, Wolfhenson had to agree to Summers’ demand to get rid of Stiglitz. It was also around this time that Stiglitz published an article in the *New Republic* very critical of the IMF policies during the East Asian crisis. The first paragraph of this article, which caused Summers to be incensed, sets the tone for the rest of the article:

*Next week’s meeting of the International Monetary Fund will bring to Washington, DC many of the same demonstrators who trashed the World Trade Organization in Seattle last fall. They’ll say the IMF is arrogant. They’ll say the IMF is secretive and insulated from democratic accountability. They’ll say the IMF’s economic ‘remedies’ often make things worse—turning slowdowns into recessions and recessions into depressions. And*

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<sup>11</sup> Policy “ownership” refers to the notion that developing countries must feel that they are involved in discussing with the international financial institutions various policy options and that they make the final decision.

<sup>12</sup> The *Financial Times* of January 31, 2006 reports that Mr. Wolfowitz was criticized by some members of the Bank’s staff for excessive pay and open-ended contracts for previous colleagues that he brought with him from the administration of George W. Bush to the World Bank. One of these colleagues is Suzanne Rich Folsom, as head of the Department of Institutional Integrity, the unit that investigates allegations of fraud and corruption associated with bank projects and allegations of staff misconduct. It is clear that Mr. Wolfowitz, like his former boss, does not intend to go through the same due process to improve governance standards inside and outside the institution he is leading.

*they'll have a point. I was chief economist at the World Bank from 1996 until last November, during the gravest global economic crisis in a half-century. I saw how the IMF, in tandem with the US Treasury Department, responded. And I was appalled.* (Stiglitz, 2000, 1)

Thanks in large part to Stiglitz's criticism of IMF policies during the Asian crisis, Asian countries started to distance themselves from the IMF by accumulating huge amounts of foreign exchange (mainly dollar) reserves. Such accumulation of reserves, at a huge cost to the Asian countries<sup>13</sup>, is designed to make them independent from the IMF in the advent of a future crisis. Asian countries have not been the only one to accumulate international reserves. In Latin America, both Brazil and Argentina have recently used a portion of their reserves to pay back the entirety of their IMF loans, thereby regaining their independence from this institution and freeing themselves from its conditionality. Clearly such move weakens to some extent the international financial institutions, especially the IMF, pressing them to find new sources of income to support their existence.

Recently, several high ranking officials have made various proposals to reform the IMF. These officials have included Rodrigo Rato, IMF's managing director, Raghuram Rajan, IMF chief economist, and Mervyn King, governor of the Bank of England. While the two IMF officials propose more incremental reforms for their institution, the governor of the central bank of England wants more radical reforms to be implemented. The IMF officials want the IMF to focus more on surveillance and crisis prevention and think that the IMF should continue to offer financing to countries in need of balance of payments support. Rajan believes that it is inefficient for individual countries to accumulate foreign exchange reserves in order to insure themselves against the occurrence of future balance of payments difficulties. Instead he believes that countries, including Asian ones, would be more willing to rely upon the IMF if instead of providing conditional loans when times get bad, the IMF provided credit lines in good times to be withdrawn without conditions during bad times. He also argues that the U.S., Europe and Japan have to accept constraints on their own economic policies. Clearly this last change would increase the legitimacy of the IMF and the symmetry of the system, but is unlikely to be implemented as long as the IMF staff is not independent from a board that is dominated by the U.S., Europe, and Japan. Mervyn King suggested the replacement of the current board by a non-resident board that would meet some six to eight times a year to act on a supervisory capacity and would cease to micromanage the IMF. This would allow the IMF staff to provide rigorous and independent analysis on all member countries and to publish its findings without interference from the board, regardless of how critical it is of its largest and most powerful members. King also believes that the role of the IMF as lender of last resort is much reduced and that the fund should retreat from financing activities. However such conclusion may be somewhat premature given that current economic conditions are fairly tranquil but may deteriorate in the future. Although King's idea of making the IMF staff independent from the board would clearly make

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<sup>13</sup> The opportunity costs to Asian central banks of holding such dollar reserves are huge. They earn about 1-2% on them while they could earn anywhere between 10% and 20% by investing in their domestic economies rather than holding U.S. Treasury low-interest bonds. In addition, accumulating such large quantities of reserves tends to be inflationary, another non-trivial cost. If the costs are high, it must be that the benefits must also be high, if not higher. Among them is the benefit of being independent from the IMF, and the benefit of keeping their currency undervalued, thereby stimulating exports.

the IMF more legitimate and the financial system more symmetric, I doubt that this idea has any chance of seeing the light of day. As a matter of fact, the U.S. idea of reform is extremely limited. The U.S. agrees to fine tune the voting weights of board members by increasing the size of Asian countries' quotas thereby giving them a larger share of the votes on the board. However to make room for the Asian countries, the U.S. is proposing to combine the eurozone members so that their overall share of the votes would be reduced. This proposal would ensure that the U.S. votes would not be diluted so that the U.S. would remain the only country with veto power. Clearly the Europeans would never agree to that even though they themselves have a disproportionate share of the votes on the board. The U.S. also agrees with Rato that the IMF should focus more on surveillance, especially on exchange rate issues. In other words, the U.S. would like the IMF to put more pressure on China to revalue its currency, the yuan. Clearly the U.S. wants to continue controlling the IMF board while the IMF staff would focus more on those issues that are of particular interest to the U.S. It is my view that as long as the IMF staff cannot act independently from the board and the U.S. remains the only individual country with veto power, that the legitimacy of the IMF will be questionable and its long-term relevance, if not survival, will be very much in doubt.

### **REFORMING THE INTERNATIONAL MONETARY SYSTEM**

The International Financial Institutions are only the guardian of the international monetary system. Although the previous section has been somewhat critical of those institutions, it is not clear whether the current international monetary system is worth preserving. International financial institutions have in the past focused on strengthening macroeconomic and financial policies in developing countries, but the problem may be caused by the instability of global financial markets and macroeconomic and financial asymmetries, factors not under the control of less developed countries. However, if the problem is due to the international asymmetries described in this paper, the appropriate remedy must include reducing those asymmetries. As explained above, the fundamental asymmetry is caused by the fact that the dollar, and to a lesser extent the euro and the yen, are international currencies whose values are determined by national policies. Thus when the U.S. uses its monetary policy to manage its business cycle it affects the dollar exchange rate, thereby creating externalities for other countries that are not internalized (i.e. taken into account) by U.S. policy makers who are not required to coordinate their macroeconomic policies with those of other countries. In contrast, in order to maintain their "credibility" the periphery or developing countries must adhere to "the rules of the game" - i.e. follow contractionary macroeconomic policies at times of crisis - while the center countries do not have to.

Given that current international financial institutions fail to serve the needs of poor countries, some mechanism should exist to compensate them for the fact that markets are not perfect. If not, poor countries will remain at the mercy of volatility and contagion of financial markets, will be unable to attract sufficient private capital flows, will remain vulnerable to the fact that they have no macroeconomic policy autonomy to protect themselves against global shocks, and will remain unable to provide social protection for their people. To achieve these objectives, I propose the creation of regional or sub-regional blocks that achieve a high level of integration comparable to the EU. This regionalism must be expanded to other areas besides trade and must be supported by the creation of the necessary institutions to represent the whole region or sub-

region. These regional institutions should compete with our existing international financial institutions to provide development bank services, emergency financing, technical support and expertise, surveillance, and macroeconomic policy coordination both within and between regions. Such competition will force the international financial institutions to reform themselves if they do not wish to become irrelevant. As explained above, one such reform would require the IMF to compel the industrialized countries to better coordinate their policies in order to avoid the severe global imbalances that plague the world economy today. Interestingly, when the Asian countries proposed the creation of one such regional institution, the Asian Monetary Fund, in 1997, the U.S. strongly opposed the idea. Nevertheless, in 2000 the ASEAN countries plus China, Japan, and South Korea revived this idea by instituting a swap arrangement between them to be used at times of financial crisis thereby bypassing the IMF. This is only a first step, but it is a step in the right direction. Eventually, regions would form various monetary unions similar to the European Monetary Union. One difference though is that in Europe monetary integration was identified as a prerequisite to trade integration, while in other regions the main purpose of such monetary unions would be to allow the region to gain some bargaining power during international negotiations and make the international financial system more symmetrical. Although such difference in emphasis would mark a change with current practices, there is no reason why it could not a priori be done.

The Asian crisis was different from previous crises in the sense that it convinced many economists that our current financial system was seriously flawed and that something had to be done to save it. Recall that none of these countries had large budget deficits, overly expansionary monetary policies, or excessively high inflation rates at the onset of the crisis, although, on the minus side, they had fragile banking systems<sup>14</sup>. Nevertheless, several of them were sequentially hit by speculators as the crisis spread from one country to another at a very rapid rate. Before describing the specific attributes of a more symmetric international financial architecture, it is important to keep in mind the following assertions made earlier in the paper:

- Given that exchange rate stability is more important for small developing countries than for large or developed countries, the new system must be a hybrid system.
- According to the policy trilemma, a country must choose two of the following three characteristics: fixed exchange rate, perfect capital mobility, and independent monetary policy. Thus it may make a lot of sense for a country or a sub-regional group, in spite of my next point, to restrict the movement of capital to reduce the volatility of exchange rates and maintain some control over the domestic economy.
- Due to improved communication technology, it has become harder for small countries to impose restrictions on the movement of capital in the long run, as traders and speculators will eventually find ways to evade those controls. Such restrictions also tend to reduce efficiency and to promote corruption.
- If capital controls cannot be maintained for long, developing countries' choices are between a flexible exchange rate with some *limited* control over monetary policy or a perfectly fixed exchange rate (currency board system, dollarization, or monetary union) with no control over monetary policy.

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<sup>14</sup> One might even argue that those East and South East Asian countries looked somewhat like China today, with the difference that China, benefiting from hindsight, is resisting pressure mainly from the U.S. to liberalize its capital account and make its currency, the yuan, fully convertible.

- Before allowing capital to move freely, and open up the financial account, sound safeguards and strong supervision of the domestic financial institutions must be put in place.
- Given that under a fixed exchange rate regime, the central bank cannot act as a lender of last resort, credit lines provided by private banks, regional banks, or the international financial institutions should be established and drawn upon if needed at times of crisis without conditions<sup>15</sup>. Presumably their mere existence would deter speculators from trying to start a run on the banking system.
- Developing countries need to finance capital inflows through equity portfolio investment or direct foreign investment, rather than through the issuing of bonds. The issuance of short-term bonds in particular should be discouraged (perhaps by using a capital inflow tax, a form of mild capital control). Such measures would reduce the probability of default by tying the country's payments to foreigners to the health of its economy, making such payment only under good economic conditions. Unfortunately, the flows of capital to the developing countries has recently slowed to a trickle for two basic reasons; on the one hand, the US is sucking most of the world's savings to finance its current account deficit (approaching 7% of its GDP), and on the other hand, the risk of investing for the long term in developing countries is perceived to be extremely high.

Keeping these considerations in mind, I propose the creation of an international monetary system with a reduced number of currencies thanks to the creation of several new regional currencies, similar to the euro. Those countries that are members of a monetary union would agree to fix their exchange rates permanently since the fact of replacing a multitude of national currencies by a single regional currency eliminates exchange rates altogether. Such fixed exchange rate system is preferable to a currency board system or dollarization because it is a symmetric system whereby no country would be allowed to dominate the other members of the monetary union. Only countries that belong to the same region and whose economies are structurally compatible<sup>16</sup> would form a monetary union. It is fairly obvious that because the US and Argentina do not satisfy these conditions, the peso should not have been pegged to the dollar for such a long time (1991-2001). Currently, there are two main monetary unions, the European Monetary Union which has twelve members but whose membership is likely to increase in the future, and the Communauté Financière Africaine (CFA) Franc Zone in Western Africa. The CFA franc zone has 13 member countries<sup>18</sup>, all former French colonies, and has been in existence since 1945. Its

<sup>15</sup> This is the measure supported by no less than the IMF chief economist, Raghuram Rajan.

<sup>16</sup> The literature argues that only countries that belong to the same so-called Optimum Currency Area (OCA) should adopt a common currency. Although I won't enter into details here for lack of space, suffice to say that such countries should be fairly close geographically, should trade a lot with each other, and should have fairly synchronized business cycles. However, I do not support this reasoning, as it has been shown by Rose and others (for example Andrew K. Rose and Eric van Wincoop in *American Economic Review*, 2001) that the adoption of a common currency causes the amount of trade among countries to increase. Thus I consider the amount of trade between countries and the synchronization of their business cycles to be endogenous variables that are affected by the existence of a common currency. Therefore it is not appropriate to make monetary union conditional on these variables.

<sup>17</sup> The term "structurally compatible" is used here to refer to countries within the same region that have similar factor endowments (leading to intra-industry trade, a form of trade based on economies of scale that is less disruptive than inter-industry trade).

<sup>18</sup> Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal, Togo, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, and Gabon.

common currency is the CFA franc and its economic performance has been no worse than that of neighboring countries that utilize a floating or managed floating exchange rate system. I envision the possibility of having similar arrangements in other parts of the world, such as in South America, South East Asia, and perhaps the Middle East and North Africa.

In the case of such monetary unions, we still need to resolve the issue of how to manage the relationship between each monetary union and the rest of the world. In the case of the EMU, the euro is allowed to float freely against most major currencies, including the dollar and the yen. In the case of the CFA franc zone, the CFA franc was pegged to the French franc until 1999 through a currency board arrangement, as France was the main trading partner (and former colonial master). Currently, it is pegged to the euro. It is highly questionable though whether such currency board arrangement is the best possible system as it is clear that the EU countries and the African countries that belong to the CFA zone are probably not structurally compatible; their economies are too different for this to be the case. As a matter of fact there was a 50% devaluation of the CFA franc in January 1994, and given the current strength of the euro, the CFA franc is again overvalued calling for another devaluation. In the end, the CFA franc should probably be allowed to float against the euro (and other major currencies). The floating of exchange rates does not preclude that governments should have no role in managing short-term international capital flows. Speculative capital flows among distinct regions can cause excessive exchange rate volatility that bears no relationship with economic fundamentals. Ideally regional currencies would have some partial values as international monies as determined by the economic weight of the regions that they represent. Moreover, given the heavier weight of regional currencies compared to national currencies, the exchange rate of regional currencies should be more stable than the exchange rate of national currencies<sup>19</sup>.

In summary, I conceive of a world with fewer regional currencies, all managed by independent regional central banks. Those regional currencies would be linked among themselves through a system of flexible exchange rates similar to the one that exists today between the euro and the dollar or the euro and the yen. Some national currencies, such as the US dollar and probably the Japanese yen and the Chinese Yuan, would continue to exist. Optimally, the central banks in charge of managing those regional and national currencies would cooperate with each other in order to coordinate their monetary policies in such a way as to take into account the repercussions on other countries of their actions. In other words, in an ideal world, no central bank and no government would implement a policy change without informing and discussing with other governments their intentions. A reformed IMF could be charged with ensuring that those regional and large country central banks coordinate their policies. With fewer currencies and larger and more powerful regions, no single hegemonic actor would be able to dominate the system to benefit the few at the expense of the majority. In order for the regional central banks to preserve their monetary policy autonomy, it might be necessary to maintain selective capital account controls between regions, even in the presence of floating exchange rate regimes, in order to discourage speculative cross-regional capital flows.

Although there has been some talk about the possibility of the US and Canada adopting a common currency, this is unlikely to happen as the US would never accept giving up its dollar

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<sup>19</sup> Clearly, the euro has been a lot less volatile since 1999 than the Italian lira or even the French franc prior to that date.

and Canada would never accept using the US dollar as its domestic currency. Dollarization would not be in the best interest of Canada, as it would result in an asymmetric system that would entrench the US dominance over its Northern neighbor, something unacceptable to most Canadians. Similarly a monetary union between all three NAFTA countries is unlikely to happen under terms simultaneously acceptable to all three, the US insisting upon dollarization to maintain its dominant status and Canada and Mexico rejecting such asymmetric system. South American and South East Asian countries do not seem to be ready yet to form separate monetary unions as nationalism remains too strong in many of these countries. Until it becomes obvious to the people concerned that nationalism is a destructive force that undermines the move toward regional integration and a more symmetric international financial system, a flexible exchange rate between national currencies is the preferred option. The alternative, dollarization, the approach followed by small countries in Latin America such as Panama since 1904, Ecuador since 1999, and El Salvador since 2001, is by far much riskier. In spite of the lack of structural compatibility between their economies and the US, these countries have locked themselves into a system that is unlikely to take their interests into account, as the US – conscious of its exceptionalism - will remain a country that systematically puts its national interest first in spite of the international status of its currency. Moreover, dollarization is not easily undone, thereby condemning these dollarized economies to remain subservient to the US for many years to come.

## CONCLUSION

In our interdependent world, small developing countries are unlikely to be well served by existing exchange rate systems, either fixed or flexible. Such systems cannot work well as long as some countries will continue to “go it alone” pursuing their narrowly defined selfish national interest. No international monetary system can function well as long as countries do not follow well-coordinated responsible economic policies while taking into account the repercussion of their actions on the economies of other countries. That is especially true of large countries whose policies may have a large impact on small countries. My proposal for reform includes features of both a fixed and flexible exchange rate system while attempting to make the system more symmetric to increase the likelihood that countries will take into account the benefits of cooperating with each other.

In the end, countries, like people, are motivated mainly by their own interest, and not that of the world as a whole. Although it is possible to design rules and regulations that force people to behave according to some social norms, restraining the actions of some governments is much harder. Certainly, reforming the architecture of the international monetary system is not sufficient to bind sovereign governments, especially those of large countries. Making the system more symmetric, as I have argued in this paper, will only make it a little more likely that countries will coordinate their policies and cooperate with each other by taking into account the effects of their policy changes on other countries. International financial institutions that are independent of large countries’ governments must also be able to play a role by compelling all member countries, including the rich and powerful, to follow the same rules. The IMF and the World Bank should not be permitted to survive in their current form.

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## THE LOGIC OF ETHNIC VIOLENCE: THE CASE OF CHITTAGONG HILL TRACTS OF BANGLADESH

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Ethnic nationalist movements have become a common concern for many Third World countries. As a reaction to religious and social persecution, minority racial, ethnic, religious, or linguistic groups have demanded autonomy or independence. For example, the tribes in the Chittagong Hill Tracts (CHT) region of Bangladesh, constituting less than 1 percent of the total population of Bangladesh, are demanding separation. The region is a geographically isolated part of Bangladesh. Ethnographically, the tribes in the region are different from the majority group: the Bengalis. They are of Sino-Tibetan descent and are mostly Buddhists, Hindus, or Christians; the Bengalis in Bangladesh are mostly Muslims. The tribes are divided into thirteen tribal groups.<sup>1</sup> Since 1971, when Bangladesh became an independent nation-state, they have demanded independence or complete autonomy and have initiated guerrilla insurgency movements to achieve their goals.

Social scientists have presented a variety of theories to explain the causes of, and remedies to, ethnic nationalist movements. Primarily, there are two competing viewpoints: "primordial" and "situational." While the primordialists<sup>2</sup> regard ethnic movements as a manifestation of a persisting cultural tradition based on primordial sources of ethnic identity, the situationalists<sup>3</sup>

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<sup>1</sup> They are Chakma, Marma, Tripura, Tanchangya, Riang, Murang, Lusai, Bunjogeas and Pankhos, Kukis, Chak, Khumi, Mro, and Kheyang. The Chakmas, Marmas and Tripuras constitute 90 per cent of the tribal population. For details see, Mizanur Rahman Shelley, *The Chittagong Hill Tracts: The Untold Story*(Dhaka: Centre for Development Research, 1992), pp. 44-52.; T.H. Lewin, *The Hill Tribes of Chittagong and the Dwellers Therein With Comparative Vocabularies of the Hill Dialects*(Calcutta: Bengal Print; H.H. Risely, 1892); R.H.S. Huchinson, *An Account of Chittagong Hill Tracts*(Calcutta: Edward T. Dalton, 1872); Lucien Bernot and Lucien Denise, "Chittagong Hill Tribes," in Stanley Maron, ed. *Pakistan: Society and Culture*(New Haven: Human Relations Area Files, 1957); Pierre Bessaignet, *Tribesmen of the Chittagong Hill Tracts*( Dhaka: Asiatic Society of Pakistan, 1958), Alexander Mackenzie, *History of the Relations of the Government With the Hill Tribes of the North-East Frontier of Bengal*(Calcutta: Home Office Department Press, 1884).

<sup>2</sup> For an outline survey of the primordialist position, see James McKay, "An Explanatory Synthesis of Primordial and Mobilizationist Approaches to Ethnic Phenomena," *Ethnic and Racial Studies*, vol. 5, No. 4(1982). The main exponents of this viewpoint are J. S. Furnival, M.G. Smith, Rabushka and Shepsle, and Clifford Geertz. For details see, John A. Armstrong, *Nations Before Nationalism* (Chapel Hill: University of North Carolina Press, 1982). Anthony D. Smith, "The Ethnic Sources of Nationalism," *Survival*, 35, 1, (Spring 1993J. S.): 50; Donald L. Horowitz, *Ethnic Groups in Conflict* (Berkeley: University of California Press, 1985); J. S. Furnival, *Colonial Policy and Practice* (Cambridge: Cambridge University Press, 1948). Clifford Geertz, ed. *Old societies and New States: The Quest for Modernity in Asia and Africa* (New York: Free Press of Glencoe, 1963). Rabushka and K.A. Shepsle, *Politics in Plural Societies* (Columbus: Merill, 1972), John Rex "Ethnic Identity and the Nation State," *Social Identities*, 1, 1 (1995): 24. Edward. Shils, "Primordial, Personal, Sacred, and Civil Ties," *British Journal of Sociology*, 8 (1957): 130-45.

<sup>3</sup> For an outline survey on situational approach see Jonathan Y. Okamura, "Situational Ethnicity," *Ethnic and Racial Studies*, vol. 4, No. 4(1981). See also, N. Kasfir, *The Shrinking Political Arena: Participation and Ethnicity in African Politics* (Los Angeles: University of California Press, 1976); C. Young, *The Politics of Cultural Pluralism* (Madison: University of Wisconsin Press, 1976); Walker Connor, "Nation-Building or Nation-Destroying?" *World Politics*, xxiv (April 1972); Cynthia Enloe, *Ethnic Conflict and Political Development* (Boston: Little, Brown 1973);

interpret these movements as a response to a differential treatment. The primordialists believe that people are usually ethnocentric and therefore they exhibit a trust and preference for members of their own cultural group and, conversely, distrust other cultural groups in the same society. Ethnic identity is a given, or a natural, phenomenon. Smith pointed out that “the acquisition of a particular piece of territory, which was felt to ‘belong’ to a people as they belonged to it,” favours ethnic crystallization and survival.<sup>4</sup> In essence, the primordialists argue that in a society divided by various ethnic and cultural groups, it is common to have a separatist tendency. The essential independent variable is ethnic identity that leads to political assertiveness and separatism, regardless of the existence of inequality or dominance.<sup>5</sup> The situationalists, on the other hand, hold the view that an individual may be a member of a minority group without necessarily having any conscious attachment to the ethnic group. However, a situational threat arising from historical, socio-economic, or political circumstances may arouse that otherwise dormant ethnic consciousness.

The situationalists share competing views. According to Huntington, there has to be a historical, political, or economic circumstance for the translation of this separate consciousness into action-based movements.<sup>6</sup> Hechter suggests that such a movement develops if and when the majority group follows a policy of “internal colonialism.”<sup>7</sup> According to Gurr, this happens because of “relative deprivation.”<sup>8</sup> Brown adds that minority nationalist movements arise because of “the manipulation of ethnic sentiment by ethnic minority elites for promoting their own career and status”<sup>9</sup> According to Lake and Rothchild, “ethnicity is a tool used by individuals, groups or elites to obtain some larger, typically material end.”<sup>10</sup>

In recent years some scholars like Byman and Birch have argued that ethnic separatist movements could be due to the combination of all factors rather than for a single factor.<sup>11</sup> However, these movements become violent if and when the state uses too much force, as well as socio-economic and political measures to suppress the minority group. In these situations aspiring separatist elites exploit this sentiment to gain support for independence or secession. Ethnic movements become violent or linked to terrorism as government persecution increases.

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Wendell Bell and Walter Freeman, eds., *Ethnicity and Nation-Building: Comparative International and Historical Perspectives* (Beverly Hills, Calif: Sage Publications, 1974); Ernest Q. Campbell, ed. *Racial Tensions and National Identity* (Nashville: Vanderbilt University Press, 1972). Ted Robert Gurr, *Peoples versus States: Minorities at Risk in the New Century* (Washington, D.C.: United States Institute of Peace Press, 2000). David Lake and Donald Rothchild. Eds. *The International Spread of Ethnic Conflict: Fear, Diffusion, and Escalation* (Princeton, NJ: Princeton University Press, 1998). Peter Jackson, and Jan Penrose, Eds. *Construction of Race, Place and Nation* (London: UCL Press, 1993). Paul R. Brass, *Ethnicity and Nationalism: Theory and Comparison* (Newbury Park, CA: Sage, 1991). Samuel P. Huntington, *Political Order in Changing Societies* (New Haven: Yale University Press, 1968).

<sup>4</sup> Anthony D. Smith, “The Ethnic Sources of Nationalism,” *Survival*, 35, 1, (Spring 1993), p. 50

<sup>5</sup> Heraclides, Alexis, *The Self-determination of Minorities in International Politics* (London: Frank Cass, 1991), p.8

<sup>6</sup> Huntington, *Political Order in Changing Societies*

<sup>7</sup> Michael Hechter, *The Celtic Fringe in British National Development* (Berkeley: University of California Press, 1975).

<sup>8</sup> Gurr, *Peoples versus States: Minorities at Risk in the New Century*, p. 51

<sup>9</sup> David Brown, *The State and Ethnic Politics in Southeast Asia* (London: Routledge, 1994)

<sup>10</sup> Lake and Rothchild. Eds. *The International Spread of Ethnic Conflict: Fear, Diffusion*, p. 5

<sup>11</sup> Daniel Byman, “The Logic of Ethnic Terrorism.” *Studies in Conflict and Terrorism* 21 (1998): 149-169; Anthony Birch, *Nationalism and National Integration* (London: Unwin Hyman, 1989). Anthony H. Birch, “Minorities Nationalist Movement and Theories of Political Integration,” *World Politics*, vol. 30, No. 3(1978), pp. 325-344;

Byman suggests that when faced with the violent activities of ethnic separatists, the state may either try to promote rival identities, or it may engage in group punishment. The latter strategy “usually backfires, and only drives moderates to the terrorist camp.”<sup>12</sup> There is also no place for moral outrage in countering ethnic terrorism because that leads to further group cohesion. Of course, the success of the separatists depends not only on the cohesion of groups, as Gurr suggests, but also on the mobilization of both internal and external supports. The state must convince the leaders of the ethnic group in question that they would be better off by working within the current system. In brief, Byman suggests that three methods should be followed by a state to deal with the ethnic separatists: (a) empowering the ethnic community, (b) winning over moderates, and (c) encouraging self-policing.<sup>13</sup> Overall, Byman argues, a policy of confrontation may not be helpful in preventing ethnic terrorism. Rather, a policy of accommodation is necessary to reduce the tensions created by ethnic terrorism. Do these theoretical propositions apply in the case of Bangladesh? This paper attempts to analyze the crisis in CHT using Byman’s model.

## Background

The main roots of the crisis in the CHT rest on the land issue, the transfer of population from plain districts and the control of the administration by non-inhabitants. Besides, deprivation and exploitation in social, cultural, economic and political fields, and the program of assimilation of the indigenous hill people into the majority Bengali population are the other bones of contention. The CHT region was ceded to the British East India Company in 1760, but it was administered as a separate and independent region for strategic reasons. It was ruled by tribal chiefs who collected revenues for the British government; in return, the British did not interfere in the customs and regulations of tribal life. After the creation of Pakistan CHT maintained separate status but, in 1963, the first amendment to the Constitution of Pakistan eliminated the tribal area status of the CHT region. Once the administration of the CHT region was integrated with the central administration, the Pakistani government attempted to accelerate the process of industrialization in the area. To this end, a hydroelectric project was constructed on the Karnafuli River in the Rangamati District of the CHT region. The construction of the Kaptai Dam facilitated the rapid industrialization of East Pakistan but, nearly 100,000 people were displaced without adequate compensation or rehabilitation. The government estimated about US \$59 million was needed for compensation, but only \$2.6 million was actually provided. It was alleged that the Revenue Compensation Office, which was fully staffed by Bengali officials, was corrupt and that it discriminated between the tribes’ members and the Bengali settlers. It was further alleged that the Bengalis were the first to receive compensation, whereas the tribal members had to bribe officials to get their compensation.<sup>14</sup>

In 1971, Bangladesh became independent, but the government of Bangladesh continued the policies of the government of Pakistan in the CHT region.<sup>15</sup> The Constitution of Bangladesh made no special provisions for the CHT region, and the first national budget of Bangladesh in 1973 made no developmental allocations for the CHT region. The Constitution of Bangladesh

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<sup>12</sup> Byman, “The Logic...,” p. 151.

<sup>13</sup> Ibid. p. 51

<sup>14</sup> Bertil Linter, “Tribal Turmoil,” *Far Eastern Economic Review*, April 5, 1990. P. 24

<sup>15</sup> Wolfgang Mey, ed. *They Are Now Burning Village After Village: Genocide in the Chittagong Hill Tracts, Bangladesh* (Copenhagen: International Work Group for Indigenous Affairs, 1984).

further aggravated the situation. It declared the nationality of the people of Bangladesh as “Bengali”<sup>16</sup> rather than “Bangladeshi,” which primarily denied the separate identity of the tribes’ people.

### LINKAGES BETWEEN VIOLENCE AND CONFLICT RESOLUTION

During the British colonial rule and in the united Pakistan, the CHT tribes remained silent, despite the exploitation. The insurgency movement really began after the independence of Bangladesh. The government of Bangladesh initially pursued exclusively the “control model,” while since the late 1980s, it has followed a mixture of “control” and “persuasion” models of compromise and conciliation by providing some autonomy to the region and by including the elites in central and local administrations. Under the first model, the government attempted to eliminate the separate identity of the tribes and then attempted to populate the area with Bengalis in order to make a demographic shift in the region. In order to develop the area, the government undertook massive development projects. Rather than stopping the insurgency, these initiatives aggravated the sentiments of the tribes. It was only in 1997 that the government of Bangladesh signed a peace agreement with the insurgents.<sup>17</sup>

In the aftermath of independence, the tribes were asked to forget their ethnic identity and become Bengalis. In an electoral speech in 1973, Sheikh Mujibur (Mujib) Rahman, the newly elected president, declared, “from this day onward the tribals are being promoted into Bengalis.”<sup>18</sup> This attitude helped to crystallize the sense of nationhood among the tribes. Furthermore, the Bangladesh Parliament passed a bill in 1974 declaring Bangladesh a unicultural and unilingual nation state. The stage was thereby set for creating a homogeneous nation-state patterned around the dominant Bengali culture. Manabendra Larma, an elected Member of Parliament (Jatiya Sangsad) and tribesman, expressed the anxiety of his people at this cultural intrusion by the central power structure when he stated in Parliament, “Our main worry is that our culture is threatened with extinction.... We want to live with our separate identity.”<sup>19</sup> From the ideas of one language, one culture, and one nation, the Mujib government moved toward the concept of one national party in 1974. Mujib had little sympathy for any dividing tendency.

The second strategy of the government aimed at ameliorating the centuries-old neglect of the area by undertaking massive development projects. The government hoped that rapid development of the area would bring economic benefits to the people and reduce the gap between the core and the periphery. In 1973, the government decided to set up a separate board for the development of the CHT; the board was finally established in 1976. The major objectives of the board were “to encourage the local participation and decentralization of decision-making

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<sup>16</sup> Government of the Peoples Republic of Bangladesh, *The Constitution of the People’s Republic of Bangladesh* (Dhaka: Ministry of Law and Parliamentary Affairs, 1972).

<sup>17</sup> Syed Serajul Islam, “The Insurgency Movement in the Chittagong Hill Tracts of Bangladesh: Internal and External Dimensions,” *Journal of Third World Studies*, Vol. 20, No. 2 (Fall 2003), p. 137

<sup>18</sup> Sudhin Kumar Chakma, *Social Change in Chakma Society in the CHT of Bangladesh* (Poona: Unpublished Ph. D. Dissertation, 1986), p. 49

<sup>19</sup> Cited in Syed Anwar Hussein, “Religion and Ethnicity in Bangladesh politics,” *BIIS Journal* (Dhaka), Vol 12, No. 4 (1991), p. 440

in the preparation and implementation of development programs throughout the CHT.”<sup>20</sup> In order to achieve the objectives, many new schools, colleges, roads, hospitals, and cottage industries were established in the region. However, the tribes viewed all the development projects negatively. They regarded the educational institutions as a state-sponsored program of mental regimentation in order to acculturate the tribes’ people into Bengali culture and to integrate them into the mainstream of Bangladesh society. They alleged that the roads were built in order to provide easy access to the Bengalis and to the army, and that they facilitated the unbridled exploitation of the resources of the CHT. In 1983, the government provided entrepreneurs with special incentives for investing in the area -- tax relief, interest reductions on bank loans, and tax holidays-- for 12 years, but since the tribal people lacked necessary capital and skills, these incentives were primarily designed to benefit the Bengali business community. All of these complaints arose primarily because the tribal leaders were neither members of the CHT Board nor were they consulted before the formulation of development strategies. In reality, the government totally disregarded the wishes and aspirations of the tribes.

The government also undertook a strategy to populate the area with Bengalis, who were provided with numerous benefits and incentives. The migration of Bengalis to the CHT became particularly problematic because of the political designs of the Bangladeshi government. The real motive behind this settlement was the government’s policy to colonize the CHT by bringing about a demographic shift in the region. Once the *Shanti Bahini*, a military wing of a CHT party, started killing the migrated Bengalis, the government sent security forces and the army into the area. A full-scale guerrilla war ensued. The army began to act independently of the civil administration because it received unlimited power. A multitude of news regularly came out reporting killings, destruction of villages, plunder, rape, and torture committed by the army. By 1981, continuous clashes between the forces of the army and the *Shanti Bahini* resulted in thousands of casualties, which led to an exodus of approximately 70,000 tribal people to India.<sup>21</sup>

After the assassination of President Ziaur Rahman in 1981, and a short interim government, General Hussain Ershad came to power in 1982. The regime initially followed the force model, but within 3 years it began to adopt a policy of compromise. The government first declared a general amnesty for members of the *Shanti Bahini* and urged the refugees to come back. Then the government asked the *Bahini* to list its demands. The *Bahini* responded with the following demands: (1) self-determination within Bangladesh with a separate legislature, (2) restitution of all lands taken by Bengali immigrants since 1970, (3) constitutional arrangements for the preservation of the indigenous cultures and their identities, (4) free movement and commerce within the district, (5) freedom from official harassment, and (6) a paramilitary force recruited from among the ethnic groups.<sup>22</sup> In response to these demands the government partially conceded and approved a bill on March 1, 1989, which signified the first real hope for an end to the vicious and bloody conflict in the CHT.

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<sup>20</sup>Amena Mohsin. *The Politics of Nationalism*, p. 120. M. M. Huq, “Changing Nature of Dominant Social Forces and Interventions in the Chittagong Hill Tracts,” *The Journal of Social Studies* (Dhaka), Vol. 56 (1992).

<sup>21</sup> The total number of refugees in India is a controversial figure. The government of Bangladesh maintains that the number never exceeded 40,000

<sup>22</sup>Syed Serajul Islam, “The Tribesmen of Chittagong Hill Tracts in Bangladesh,” *Asian Culture Quarterly*, Vol. 25, No. 2 (Summer 1997), p.74

Accordingly, the CHT was divided into three districts: Rangamati, Khagrachhari, and Bandarban. In each district, a local council consisting of officials directly elected by the people of the region was set up. The councils were largely autonomous bodies responsible for civil administration, including the appointment of the police. The chairmen of the councils, invariably tribesmen, were given the rank of deputy minister. The councils were entrusted with the power to approve or prohibit the transfer or sale of land rights and also to repossess land fraudulently or corruptly obtained. Furthermore, the tribes were given special quotas for government service as well as for admission into schools, colleges, and universities.

However, all of these steps did not satisfy all members of the *Shanti Bahini*. First, it was alleged that the District Councils Act of 1989 had no constitutional basis because it was only an act of Parliament that could be replaced or changed at any time. Secondly, the Act was conspicuously silent on the issue of Bengali settlers. Third, there was no provision to return land occupied by Bengalis. Consequently, the militant members of the *Bahini* continued their underground operations, and the demand for full autonomy continued to be made. The tribal refugees also remained in Tripura, India.<sup>23</sup>

In July 1992, the government constituted a nine-member committee to recommend a solution on the CHT to the government. In the backdrop of the initiative of the government, the Parbattya Chattagram Jana Samhati Samiti (PCJSS), a CHT peoples association, unilaterally declared a cease-fire for 3 months beginning in August 1992. Until March 1996, seven rounds of talks were held between the committee members and the PCJSS leaders but nothing was achieved. In October 1996, the government formed a new eleven-member committee to try to resolve the CHT problem. After a year of meetings and negotiations between the Committee members and the PCJSS leaders, a peace accord was signed and executed on December 2, 1997,<sup>24</sup> which apparently brought peace in the region, despite strong protests by opposition political parties and extremists in the *Shanti Bahini*. The government gave special priority and additional budget allocation for the implementation of existing projects and formulated new projects for the development of the CHT area. Any new law in connection with the CHT was to be enacted in consultation with and on the advice of the Regional Council.<sup>25</sup> It was also agreed that no 'khas' (government owned) land in the CHT region could be purchased, sold, or transferred without the permission of the council. In 1998, after the agreement, nearly 70,000 Jumma (tribal) refugees living in camps in India were repatriated to their homes.

After the accord was signed, the government went ahead with its implementation, but it began to face a number of difficulties. First, the opposition political parties, Bangladesh Nationalist Party (BNP) and the Jamaat-I-Islami, staged street protests against the peace accord by declaring it as a loss of Bangladeshi sovereignty. More importantly, the disaffected political groups in the CHT considered the accord to have failed to respond to their aspiration of full autonomy. These

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<sup>23</sup> Government of Bangladesh, *Government Response to the Demands of the PCJSS* (Dhaka: Ministry of Home Affairs, 1993); Bertil Lintner, "Autonomy Plans Fails to Appease the Rebels Intractable Hills," *Far Eastern Economic Review*, (April 5, 1990), pp. 22-24

<sup>24</sup> For details, see Government of Bangladesh, *Chittagong Hill Tracts Treaty, 1997*

<sup>25</sup> The most salient feature of the accord is the establishment of the CHT Regional Council comprising the local government councils of the Three Hill Districts. It has 22 members, and its tenure is 5 years. The regional council chairman, who has to be a tribal and who has the status of state minister, as well as other members of the Regional Council, are elected by members of the Three Hill District Councils.

included the *Pahari Gono Parishad* (PGP, or Hill Peoples Council); the *Pahari Chhatra Parishad* (PCP, or Hill Students Council); and the Hill Women Federation (HWF) who argued that the accord had failed “to reflect the genuine hopes and aspirations of the peoples of the Chittagong Hill Tracts...constitutional guarantee of full autonomy, restoration of traditional land rights, demilitarization of the area, and withdrawal and resettlement of the Bengali settlers in the plain land.”<sup>26</sup> The disaffected activists of the *Shanti Bahini* also condemned the accord and, continued to create law-and-order problems in the area. Tensions emerged between the main tribal group, which had signed a peace accord with the government in December 1997, and the smaller dissident groups, whose demands for full autonomy and independence had not been met by the accord. Each group accused the other side of targeting its members. In early 2001, three foreign nationals were abducted in the forests of the Rangamati Hill District; after a month of negotiations, the hostages were released.

Consequently day by day violence began to increase. Whatever disputes existed regarding the contents of the accord, one of its prime limitations was the lack of a time frame for its implementation. Even the PCJSS started protesting against the non-implementation of the CHT Accord. The following major unimplemented provisions were considered to be crucial: a) the non-withdrawal of (all except a few) non-permanent military camps; b) the non-transfer of land and law and order matters to the District Councils; c) the passage of the CHT Land Commission Act of 2001, in violation of provisions of the Accord (reducing the geographical jurisdiction of the commission and providing too much power to its non-indigenous chairperson); d) the non-commencement of the work of the Land Commission; e) the appointment of non-indigenous persons to the post of (cabinet rank) Minister for Chittagong Hill Tracts Affairs and the Chairperson of the Chittagong Hill Tracts Development Board. f) the inclusion of non-permanent residents of the region as voters in the recent parliamentary elections; and g) the inclusion of non-indigenous people within the list of the “internally displaced.”<sup>27</sup>

Since the 1997 Accord was neither fully implemented nor was accepted by the opposition, insurgents became active and sporadic violence took place everyday. However, in 2003 a serious incident sparked by the continuous violence and the abduction of a Bengali took place in Mahalchhari Upazila.<sup>28</sup> It was a watershed in the sense that this was the first time after the Accord that such an incident took place at such a large scale. The extensive area between the Lemuchhori village on the one extreme, Babupara at the centre, and Kerengyanala on the other outer limit, that consists of several square kilometres was affected. A mob consisting of Bengalis as well as army members assaulted Hill people and started burning homes. The widespread

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<sup>26</sup> [www.satp.org/bangladesh/Assessment-Bangladesh2000.htm](http://www.satp.org/bangladesh/Assessment-Bangladesh2000.htm), 05/30/2001

<sup>27</sup> Meghna Guhathakurta, “Ethnic Conflict in a Post-Accord Situation: the Case of the Chittagong Hill Tracts,” An unpublished paper presented at the University of Mumbai in 2004.

<sup>28</sup> Ibid. On 24 August 2003, Rupom Mohajon, 30, son of Bijoy Mohajon, and a settled Bengali resident of Babupara, was abducted and a demand for ransom made to his family. This incident resulted in growing tensions between the local Bengali and Pahari communities. That evening, and again the next day, 25 August 2003, local Bengali businessmen held a meeting in the Babupara Bazaar area demanding Rupom’s immediate release. At that meeting, which was held under the leadership of the local BNP leader, Dewan Abul Kalam Azad, and the banner of the ‘*Bangali Shommonoy Parishad*’ (Bengali Coordination Council), they announced a *hartal* (strike) and road blockade the next day. Later that afternoon, some of them apprehended the Chairman of *Shindukchori Union Porishod*, when he came to the Bazaar, and beat him and held him overnight against his will in a local shop.

extent of the arson attacks in all the affected villages resulted in the burning and destruction of the majority of houses belonging to Hill people, as well as the incineration of tall coconut trees and even water pumps used for irrigation. The incident forced thousands of people to flee in terror and be displaced from their homes and villages. A threat of prosecution was issued against those Hill people who dared to protest or open their mouths. Some of the possible implications of this incident for the future political landscape of the Hill Tracts were: (1) occupation of land, (2) targeting of economic power, (3) divide and rule, and power politics, (4) use of sexuality as an instrument of terror, (5) using processes of internal displacement and rehabilitation, and (6) strengthening settler vote banks for the future.<sup>29</sup>

The BNP-led four party coalition that came to power in 2001 did not implement the unimplemented provisions of the 'CHT Peace Treaty' during its five-year long term. In 2003, "the CHT Regulation 1900" was amended in order to transfer both civil and judicial proceedings from the Deputy Commissioner and Divisional Commissioner (executive) to the judges of the court with the idea of providing true justice to the people. However, this also was not implemented.<sup>30</sup> Before leaving the office in 2006, the coalition handed over power to a 'neutral' interim caretaker government headed by the President of Bangladesh Iajuddin Ahmed.

The 14-party grand opposition alliance led by Sheikh Hasina's Awami League opposed the interim caretaker government for its alleged 'biased' role for BNP-Jamat coalition in the election preparations. Political crisis deepened in the country with violent confrontations between the 14-party grand alliance and the outgoing coalition and the interim caretaker government over conditions for free, fair and credible elections. At least 50 people were killed and several hundreds were wounded in these confrontations. On 24 July, 2006, dozens of tribal villagers in the Chittagong Hill Tracts were severely beaten reportedly by soldiers, in the Manikchari sub-district, in Khagrachari. In this backdrop, President Iajuddin Ahmed invoked the emergency rule in December 2006 and gave sweeping power to the military to control 'law and order' in the country. Soon he himself resigned from the post of Chief Advisor to the caretaker government under mounting popular pressure. This paved the way for the formation of a new interim caretaker administration headed by Fakhruddin Ahmed in January 2007. The new interim caretaker administration backed by the country's strong military postponed the general elections due to be held on January 22, 2007 for indefinite time and imposed a ban on all political activities and freedom of the press. CHT is not exempted from this rule. Two top tribal leaders have been killed and 15 others including Satyabir Dewan the General Secretary of the PCJSS have been arrested and jailed. Nearly 15,000 young tribals who are being sought by the forces are reportedly hiding in different villages and jungles to avoid arrest.<sup>31</sup> The army and the police have arrested dozens of leaders and activists from both sides of the Jumma (tribals) political divide -- the United People's Democratic Front (UPDF) and Jana Samhati Samiti (JSS).<sup>32</sup>

On the other hand, the *Shanti Bahini* leaders are getting old, and losing grip over the emerging hill dynamics. There are new actors operating in the region, and they are periodically clashing with each other. In fact, smuggling, criminal gangs, extortionists, the Rohingya refugees from Burma etc are hurting the traditional interactions in the CHT. Bengali settlers and the tribal

<sup>29</sup> Guhathakurta, "Ethnic Conflict in Post Accord Situation,"

<sup>30</sup> Interview of Raja Devashis Roy, Chakma Circle Chief, with *Prothom Alo*, June 17, 2007.

<sup>31</sup> Amnesty International Report, 2007-02-26

<sup>32</sup> Hill Watch Human Rights Forum NEWS No. 19/2007, June 05, 2007

inhabitations are still fighting over land and other privileges; and there are serious disputes between the tribal groups. Due to all these events some tribals do not want army to be totally withdrawn as it will create a lack of security. Soldiers from ten to fifteen military camps have been withdrawn in 2007.<sup>33</sup> However, a complete army withdrawal is not likely to happen because it will not only create a security vacuum but it will also destabilize the region. Therefore, the tribal leaders expect that a separate police force consisting of both tribals and Bengalis be formed to insure daily law and order in the CHT region.<sup>34</sup>

## CONCLUSION

The autonomy movement of the tribals in the CHT of Bangladesh emerged because of a number of events and improper governmental action. Since colonial times, the government in Bangladesh has been interested in the political domination of the tribes and economic exploitation of the resources in the CHT region. After independence, the government urged thousands of Bengalis to migrate to the CHT in order to supersede the tribal majority in the region. In fact, the tribes now constitute only 50 per cent of the population in their homelands. In the region, “land grabbing” became very obvious. Since independence, various multinational corporations were invited to set up industries in the region. These industries, however, were geared to meet the export market rather than to meet local needs. In fact, for Bangladesh, this became the major area to earn foreign exchange. Moreover, the Kaptai Dam was constructed in the region and has become the main source of hydraulic power in the whole country. This pattern of economic development disrupted the tribal economic order and drove the people to the economic periphery. Politically speaking the government used the force model to integrate the tribes into mainstream Bengali culture by introducing change without the approval of the local tribes. Since this change did not directly address the tribals their economic conditions remained stagnant, their social conditions were in jeopardy; and their laws, culture, and customs were in danger of disintegrating. Thus, the tribes had no choice but to resort to violence and to a “war of attrition.”

It appears that the severity of deprivation made the insurgency movement in the CHT more aggressive, a factor that meets the first requirement of Byman’s model. In the name of counter insurgency, massive violations of human rights were committed by the military. These included cases of extra-judicial killings, torture, abduction, persecution, forced eviction, destruction of homes and properties, and wide scale arrests and detention. There were also as many as eleven massacres of Hill people, the most known among these occurred at Longodu, Logang and Naniarchar. Although inquiry commissions and other investigative processes were initiated following public protest, of some of these incidents, none of their findings ever saw the light of day. The military continued to enjoy impunity regarding all allegations of human rights violations. The failure to address these actions legitimized the hegemonic control of the Bangladesh state and Bengali nationhood over the Hill people, coming to epitomise the notion of ‘peace without justice’<sup>35</sup>. Thus, even in the aftermath of the Accord we see that the lack of any provision of justice, as well as the very limited withdrawal of the military camps has contributed to the persistence of military hegemony in the region.

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<sup>33</sup> Interview of Raja Devashis Roy, Chakma Circle Chief, with *Prothom Alo*, June 17, 2007.

<sup>34</sup> *Ibid.*

<sup>35</sup> Guhathakurta, “Ethnic Conflict in a Post Accord Situation,”

In the final analysis, it seems Byman is correct in stating that ethnic movements become violent or linked to terrorism as government persecution increases and that moral outrage to counter ethnic terrorism just leads to further ethnic group cohesion. This case study also appears to support the idea that in order to deal with the ethnic separatists the government should follow the methods of (a) empowering the ethnic community, (b) winning over moderates, and (c) encouraging self-policing.<sup>36</sup> Overall, it seems to be accurate that a policy of confrontation may not be helpful in preventing ethnic terrorism. Rather, a policy of accommodation is necessary to reduce the tensions created by ethnic terrorism. The government should promote economic development in the region, focus on local issues with much greater efforts on human resource development and education facilities, and most importantly create institutions to allow participation of the tribes in their own affairs in the CHT region. If the government is accommodating, then a separatist movement will falter. It is the magnitude of state's socioeconomic and political intrusions and its repression of minorities that seem to have had much to do with the increasing rate of violence by the separatists. One may find similar trends in many other separatist movement cases. The Sunni Muslim Berbers in Algeria and Morocco, for example, have lessened their violent activities because both governments have made concessions to the cultural interests of the Berbers and have accommodated them with a degree of economic and political powers. Similarly, the Sikhs in India's Punjab have become gradually less violent because the degree of deprivation there is not that significant; in fact, many Sikhs hold top positions in the Indian civil and military bureaucracies. Furthermore, not all Sikhs are in favour of independence; for example, the Akali Dal, a pro-Sikh party, does not support the separatist cause. Consequently, the separatist movement has failed to mobilize either internal or external support. Conversely, the autonomy movement in Bangladesh in 1971 turned into an independence movement because the Bengalis were severely deprived and exploited and the Pakistani government was not interested in any kind of compromise with the Bengalis. On the contrary, the tribals of Bangladesh's CHT received a mixture of treatment and therefore there have been ups and downs in the rate of violence of the separatists. The 1997 peace treaty was a step forward, but if it is not fully implemented violence will increase. The government must take steps to immediately demilitarize the Chittagong Hill Tracts region and then reach further peaceful agreement with the tribal peoples. If these actions are taken the possibility of any further violence in the region will be eliminated.

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<sup>36</sup> Byman, "The Logic...", p. 151

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## **The Unexpected Failure and Uncertain Future of the European Union's Constitutional Treaty: Prospects and Proposals**

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*This study assesses the status of the Constitutional Treaty (CT) of the European Union in the aftermath of the “No” votes by France and the Netherlands in mid-2005. It does so by examining a number of unexpected, and ironic, elements behind the rejection of the document. It then surveys five proposals for the future—recommendations to abandon, modify, edit, or push along the document—and evaluates each in light of the current political, economic, and social debates. This section concludes that the ironies present in the mid-2005 “No” votes have neither diminished nor disappeared, and that they will continue to make problematic any attempt to revise or revive the Constitutional Treaty. In the conclusion, one strategy is identified as a possible avenue toward progress and reform.*

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This study assesses the status of the Constitutional Treaty (CT) of the European Union in the aftermath of the “no” votes by France and the Netherlands in mid-2005. It does so by examining a number of unexpected, and ironic, elements behind the negative vote in France. A survey of proposals that would abandon, modify, or push forward the Constitutional Treaty follows, and discusses the key strengths and weaknesses within each position. A concluding section attempts to assess the future of the debate, and identifies a number of unavoidable and conflicting factors that will make problematic any attempt to successfully enact and ratify the Constitutional Treaty as it stands.

### **LOOKING BACK: IRONIES**

In mid-2005, the Constitutional Treaty of the European Union was rejected by two of the founding members of the EU: France and the Netherlands. The high percentage of French and Dutch citizens who went to the polls and the high percentage of “No” votes (55% and 62%, respectively) made the rejection definitive and clear. This happened despite a strong lobbying effort by each government and the forward momentum of nine other member states' votes to ratify in the preceding seven months.

The back-to-back failures to ratify left leaders in Europe bewildered and concerned. The EU was said to be in crisis, as there was no “Plan B” in place in case of a failed effort. As a result, EU leadership called for a year of reflection, to enable member states to engage in some combination of assessment, conversation, and planning. Interestingly, a number of member states that had planned to ratify went ahead with the process, with Luxembourg holding a referendum and five others opting for parliamentary approval. With little else settled by late 2006, the time of reflection was extended. The further extension allowed for Germany to take control of the EU

Presidency, and for France to hold its presidential elections in the first half of 2007; each was considered to be of significance for the future of the Constitution.

Scholars, politicians, critics, activists, and commentators have spent the last two years attempting to determine why the document failed in France and the Netherlands.<sup>1</sup> Supporters are dodging the words “defeat” and “crisis” while trying to better develop a strategy for reviving and reintroducing the Constitution, or some version of it. Opponents are seeking definitive principles and conclusions that can bolster the argument that the document has been shelved, the project is finished, and that efforts to bring it back from the dead are both illegitimate and anti-democratic. Most assessments focus on the aims of the document, and either extol its blueprint for a more unified, efficient union or decry its sinister aims to further centralize and bureaucratize power in a distant and elite-populated Brussels.

What has often gone unnoticed (or, at the least, unappreciated) are the ironies that emerged from the referendum battles and eventual “no” vote in France. An examination of three of those ironies, each with politics and economics intertwined, can provide a degree of insight into the current challenges facing the European Union as it seeks to determine what to do next with the Constitutional Treaty (CT). What lies behind these ironies has not gone away, and they present formidable, if not insurmountable, difficulties for proponents of the CT. While attempting to pinpoint an exact endpoint for the CT would be nothing more than speculation, the factors discussed below can help sort out the various options currently being debated and identify both the strengths and the weaknesses within them.

### **The French Disconnection**

The Constitutional Treaty, as framed during the Convention on the Future of Europe and approved during the Intergovernmental Conference of 2004, was largely a French creation. Yet, less than two years later, the document was rejected by France, as the first member state to say “no” after nine nations had ratified. This unforeseen outcome has presented EU leaders with a particularly difficult quandary as they attempt to keep the Constitution both intact and afloat. In the year to come, France has to be brought into the “yea” column if the document is to have any hope of surviving. The centrality of France to both the downfall and potential comeback of the Constitutional Treaty was described as follows.

On May 29 of last year, French voters rejected the draft of the new EU constitution in a nationwide referendum. Although not unexpected, their vote plunged the European Union into a long period of uncertainty. It also signaled that France itself is in crisis. In saying no to a draft worked out largely by their own leaders, French voters effectively disowned those leaders—and, in the process, exported their crisis to the EU. European integration and the EU constitution had largely been French endeavors, and France had long been Europe's natural leader (Kramer 2006, 126).

The Convention on the Future of Europe, which spanned 16 months in 2002-2003, was tasked with studying the key questions that enlargement posed for the future of the EU, and providing

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<sup>1</sup> This first section focuses on France. For an excellent survey of the Dutch referendum and why the Constitutional Treaty was rejected, see Hylarides, 2006.

recommendations for change. The Laeken Declaration of 2001 had determined a list of 56 questions that the Convention was to consider, and these questions were grouped into four main categories:<sup>2</sup>

- A better division and definition of competence in the European Union.
- Simplification of the Union's instruments.
- More democracy, transparency and efficiency in the European Union.
- Towards a Constitution for European Citizens.

It is worth noting that the word "Constitution" makes its first appearance in the final category. Previous intergovernmental conferences had not used this term in conjunction with proposals for reform. It was not used in the Treaty of Nice.<sup>3</sup> But it did appear in the Laeken Declaration. The text itself did not indicate whether this was meant to be an invitation to consider a constitution or not. If it did, it was made in a rather oblique way. The key language is in the final paragraph of the following text taken from the Laeken Declaration:

The European Union currently has four Treaties. The objectives, powers and policy instruments of the Union are currently spread across those Treaties. If we are to have greater transparency, simplification is essential.

Four sets of questions arise in this connection. The first concerns simplifying the existing Treaties without changing their content. Should the distinction between the Union and the Communities be reviewed? What of the division into three pillars?

Questions then arise as to the possible reorganization of the Treaties. Should a distinction be made between a basic treaty and the other treaty provisions? Should this distinction involve separating the texts? Could this lead to a distinction between the amendment and ratification procedures for the basic treaty and for the other treaty provisions?

Thought would also have to be given to whether the Charter of Fundamental Rights should be included in the basic treaty and to whether the European Community should accede to the European Convention on Human Rights.

The question ultimately arises as to whether this simplification and reorganisation might not lead in the long run to the adoption of a constitutional text in the Union. What might the basic features of such a constitution be? The values which the Union cherishes, the fundamental rights and obligations of its citizens, the relationship between Member States in the Union?<sup>4</sup>

The language of Laeken is more summative and speculative than it is directional. There appears to be a "thinking out loud" about where greater simplification, transparency, and reorganization might lead. In the meantime, the Convention was to confront the questions formulated in Laeken and deliver recommendations. However, soon into the Convention, it was clear that something unforeseen was taking place. And, these developments were inspired by, led by, and dominated

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<sup>2</sup> See the four headings under the section entitled "Challenges and Reforms in a Renewed Union." The text of the Laeken Declaration can be viewed on the *Europa*, the website of the European Union, at: [http://europa.eu.int/constitution/futurum/documents/offtext/doc151201\\_en.htm](http://europa.eu.int/constitution/futurum/documents/offtext/doc151201_en.htm)

<sup>3</sup> For an overview of the Treaty of Nice, see Nugent 2003, 81-92.

<sup>4</sup> *Europa* website, *supra* note 2.

by France. What had been commissioned to be a convention that would help facilitate enlargement and integration was transformed into a constitution-writing convention.

Specifically, former French President Valéry Giscard d'Estaing took control of the Convention, redefined its purpose, and set out rules for its debate and decision-making. Soon after, member-state governments took notice of the shift in the Convention's focus, and began to send higher-level personnel to represent them in the proceedings. As one scholar observed,

As Chairman, Valéry Giscard d'Estaing was firmly in charge. The Convention's decision-making procedure involved no voting by representatives and indeed no standard democratic procedure of any kind. The convention was to adopt its recommendations by "consensus," with Valéry Giscard d'Estaing defining when a consensus existed. The representatives of the candidate countries participated fully in the debate, but their voices were not allowed to prevent a consensus among the representatives of the EU15. Chairman Giscard d'Estaing had enormous control over the debate and final control over the actual text (Baldwin 2006, 9).

Control over the process of constitution writing had a direct impact upon the substantive provisions of the document. The EU Constitution ended up, to a large extent, as France's vision of Europe's future. Often termed "Social Europe," it advances a French vision of economics and social policy, with greater institutional and governmental involvement in areas such as trade and more active protection of pensions, health care and retirement benefits.

There is a poignant irony tied to the French rejection of the Constitutional Treaty. It was brought about by the complete failure on the part of the French proponents of the document to convey its benefits to a majority of the French citizenry. What was supposed to be a reflection of France's vision of a restored and resurgent Europe was rejected as being a threat to French interests and priorities. Jeorges states that, "There can be little doubt that the perceived dismantling of the French welfare state through the integration process, the portrayal of Europe as a neo-liberal deregulation machinery, the anxieties such Europeanization and globalization provoked amongst the French had a substantial impact on their 'non'"(2006, 3). In the end, the French found enough reasons to reject a document that—in the eyes of its key framers—advances a French view of Europe's future. The French no vote's main accomplishment was, for the foreseeable future, stopping any chance of making the European Union more "social." Surveying the battle within the French left, one scholar noted,

The Yes-Left reformists argued that the EU could best succeed by incrementalism, and that the constitution had to be seen in the broad sweep of European history, including a century of socialist support for European integration. The text might not have been as progressive as they would have liked, but it did include *only* improvements on the social front and establish a satisfactory framework for future political, social, and economic struggle.... Reformers also stressed the importance of institutional and democratic innovations introduced in the constitution, such as the new right of petition and the Charter of Human Rights; these would be lost by a No vote, while the preexisting treaties, the actual target of leftist criticism, would simply remain in force (Nicolaidis 2005, 15).

France remains a major player within any strategy to reform the European Union. The European Union cannot simply “work around” France as it considers its next step with the Constitutional Treaty. Any plan to revise or revisit the CT must do so with an eye on the French, and take into account what may or may not find approval among the majority of them. The problem is, the French “No” vote is neither easily understood nor remedied. Despite the best intentions of the Constitution’s framers, and the high-profile leadership of a French former head of state, the end product occasioned more confusion and concern than it did support and approval. There have been hopes that the last two years of evaluation and analysis of the French rejection would bring about some kind of *denouement*, and that, with the puzzle solved and the complexities understood, the French could be appeased and the ratification process could proceed. That, however, has not occurred. As the survey in the latter half of this essay will demonstrate, there is very little evidence that a well constructed and easily explained plan, which will motivate the French people to reconsider their past actions, exists.

### **ECONOMIC ARRANGEMENTS: FROM UNIFIER TO DIVIDER.**

The agreements and arrangements that were to become the European Union had their beginnings with the end of World War II. As the separate European states emerged from the devastation of war, long-held perceptions of commonality began to take on a new significance and a new urgency. Two blunt realities confronted them: another war such as this could not be allowed to happen again, and no nation was going to be able to recover from *this* conflict on its own. The problem was that Europe needed to recover as a continent and with a unified effort. There was a major impediment to this, as Gurfinkiel explains:

The Continent, however, included Germany. It was one thing, and a fairly easy thing, for the three Low Countries to coalesce into a single economic unit known as Benelux. The Nordic nations, too, quite naturally set up various kinds of cooperative institutions. Along similar lines, some observers... briefly hoped to bring together the Latin countries: France and Italy first, then a post-Franco Spain and a post-Salazar Portugal. But Germany, even in the truncated form of the Federal Republic that had been carved out of the three Western occupation zones, was still the most populous country in Europe and its largest industrial base. Europe without West Germany would not work; West Germany without Europe might fail (2005, 43).

There was a “damned if you do, damned if you don’t” quality to the choices that the European nations faced in the 1940s and into the 1950s. Reactions and assessments were driven as much by emotion as by reason. The Germans could not be trusted, but they could not be ignored or excluded. Any hint of closer union among the European nations was tainted with memories of the Nazi propaganda machine that extolled the virtues of unity—within a unified Nazi superstate. Any talk of political integration ran into the vivid and ugly remembrances of a very recent past. Yet, some plan had to emerge. As Gurfinkel states,

The way forward, then was to circumvent politics by focusing on economics. This is what Jean Monnet, the planning commissioner of postwar France and staunch advocate of the “United States of Europe,” had in mind when, along with his fellow Catholics Konrad Adenauer of West Germany, Robert Schumann of France, and Acide de Gaspari

of Italy, he drafted the Treaty of Rome in 1957. Europe was to be organized, first and foremost, as a common market. This, properly administered over the course of one or two decades, would enable it to achieve American levels of productivity. Then—and only then—would political and social integration follow (2005, 44).

Europe was, first and foremost, an economic union (Elazar 2001, 36). And, for almost 30 years, the arrangement worked well. In fact, some nations that were initially skeptical about the European Common Market became eager to join. Economic success led to enlargement, and an enlarged EU saw significant gains in economic size and productivity. The 1970s saw Denmark, Ireland, and the United Kingdom join. In the 1980s, Greece, Spain, and Portugal were added. In the 1990s, Austria, Finland and Sweden acceded, and a union of six original signatory states<sup>5</sup> swelled to fifteen. Yet, enlargement based on economics came at a price. The growth of economic power and influence was neither checked nor matched by a corresponding development of political institutions or arrangements. As Gurfinkiel concludes,

But there is a cloud to every silver lining, and a nemesis to every success story. The problem of Europe was that Monnet's twist—economics first—led to a bizarre, quasi-political arrangement. The European Commission, in charge of setting wages and prices and much else besides, grew as powerful as, and in some respects more powerful than, the constituent nation-states. At the same time, no offsetting center of democratic power—either a European Parliament with teeth, or an elected European president—emerged (2005, 45).

This marked the beginnings of what has been termed the “democratic deficit,” the perception that EU institutions had become too powerful, too detached from popular will and unaccountable to national electorates. The “permissive consensus,” whereby elites moved integration forward with the tacit support of the people, was beginning to be challenged (Smith 2005, 8-9). Beginning with the Danish rejection of the Maastricht Treaty in 1992 and continuing with the Irish rejection of the Treaty of Nice in 2001, cracks began to appear in the economic structure that had undergirded the decades of integration and expansion.

During the debates in France, it became readily apparent that opposition parties, interest groups, and key spokespersons were going off script. Rather than confining their criticisms and comments to the specific provisions of the text and focusing on what was new in the document, accusations swirled around parts of the text that simply restated and codified existing arrangements—arrangements that were mostly economic. Of greatest concern was that approval of the Constitutional Treaty would incorporate the British system of “liberal” economics across the continent and would leave France powerless against the destructive effects of globalization. Try as they might, the well-funded “oui” effort spearheaded by the Chirac government could not convince the majority of French voters that the Constitutional Treaty would extend and enhance a French vision of Europe's future. The vivid image of the Polish Plumber, the symbol of an unbridled, unregulated economic system that would occasion a flood of cheap labor from the newly acceded Eastern Bloc nations, became *the* vision of France's economic future. One study observed that,

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<sup>5</sup> France, Italy, Germany and the three “Benelux” states: Belgium, Netherlands, and Luxembourg.

So why then did the French vote ‘no’? The reasons for the outcome, no doubt, were manifold and ranged from the articulated to the subconscious. But it is hard to doubt that there was a close relationship between the majoritarian negative vote and the belief that the Constitutional Treaty undermined the element of the European patrimoine which the French, and Europeans in general, cherish more: *the European social model*. Among the ‘no’ voters, many felt that the Constitutional Treaty was too generous to market freedoms. Post-referendum surveys have revealed that almost one third feared its harmful effect on employment while one fourth were concerned about the French economy and the labour market. One fifth said it was ‘too liberal’ (Eriksen, Menendez, Stie, and Trenz 2005, 10).

What began as a touchstone for European integration has now become a flashpoint for disagreement and dissent. The social programs and protections championed by the French are strongly resisted by the British. The calls for greater protectionism and regulation by the established, “Old Europe” countries of the West are rejected by the emerging “flat tax” economies of the newly-acceded Eastern nations. The immigration flows that symbolize employment and greater economic opportunity for the smaller, former Soviet Bloc nations are perceived as an unwelcome threat to the larger, more developed nations. Economic arrangements, at the core of European unification, have become the source of difference and division.

A quick look at the three referenda held in the established EU countries is illustrative. Spain, which had greatly benefited from EU funding over the past 20 years, gave the Constitutional Treaty an unenthusiastic, though largely positive, vote of approval. In the Netherlands, whose economy “went from being one of the best performers in the European Union to one of the worst,” 70% of the electorate came out to vote, and 55% voted to reject the CT (Hylarides 2006, 86). Dutch voters acted upon a simple calculation. They were the largest per capita contributors to the European Union, and they did not perceive that the benefits of the arrangement were commensurate with the costs. In France, there was a cluster of reasons why the Constitutional Treaty was voted down, but two important ones were French fears of being overwhelmed by globalization and market forces and a fear that an influx of non-French workers into the country would cripple the economy and undermine the social safety net (Dehousse, 2006, 155). Economic considerations drove all three early referenda (Gurfinkiel, 2005, 39-40). And, in two out of the three ratification votes, the Constitutional Treaty was rejected by impressive margins.

Economic concerns have neither dissipated nor disappeared since the ratification votes in France and the Netherlands. This, coupled with greater interest in popular approval of any further treaties through referenda, has turned the EU’s historical arrangements upside-down, and promises to complicate any reconsideration of the Constitutional Treaty.

### **DEMOCRACY BY WAY OF REFERENDUM: INTEGRATION AND DISINTEGRATION**

The erosion of consensus around and confidence in the European Union’s economic arrangements became more pronounced in the 1990s. The difficulties encountered with ratifying the Maastricht Treaty was one of the first signs of growing skepticism and resentment toward the

EU. The debates and deliberations in Nice accentuated the discontent that many member states felt. This discontent was coupled with a concern over the forthcoming enlargement to 25 member states in mid-2004 (Gray and Stubb 2001). At the close of the Nice Treaty negotiations, the participants committed themselves to another intergovernmental conference, to suggest further amendments to the EU treaties and to address the need for greater transparency before, and accountability to, the citizenry. Julie Smith observed that,

Already at the Nice Summit in December 2000 the leaders of the then 15 Member States recognized the need to make the integration process more relevant to the citizens. Thus, when they launched the Convention on the Future of Europe in 2002, the aim was to find a way of bringing Europe closer to the people, of making the Union more democratic and transparent. The European Council hoped that the Convention process itself would open up a dialogue in Europe, and it was hoped that agreement on the Constitutional Treaty could be reached by Spring 2004 in order that the Treaty could form a key part of the debate in the European Parliament elections that year (2005, 8).

Within the Convention there were involved and spirited debates, but these debates did not occasion or inspire popular discussion about the work of the Convention. The hope that a dedicated internet site would bring about greater popular interest and involvement also failed to materialize (Smith 2005, 8). Thus, neither the process of constitution making nor the content of the final draft of the document captured the interest or imagination of the European people (Norman 2003, 327-328). The “legitimacy gap,” the perception that EU leadership had grown increasingly distant from and unresponsive to popular will, had not closed. As a result, the focus then shifted to the ratification phase.

At the close of the Convention it was proposed that the Constitutional Treaty be approved via a Europe-wide referendum.<sup>6</sup> However, some critics considered this option too “federal,” and the procedures for ratification were left to the individual member states (Whitman 2005, 676). The Danes were the first to declare that they would hold a referendum, and this increased the pressures for similar actions in Luxembourg, the Czech Republic, and the Netherlands. In these cases, the political parties in power perceived that automatic parliamentary approval would be seen as lacking legitimacy. Opposition parties saw referenda as a vehicle for greater citizen awareness and participation in addition to their own concerns about democratic legitimacy.

However, it was Britain and British politics that provided the “tipping point” for referenda, as Prime Minister Tony Blair announced that the UK would opt for popular approval of the Constitutional Treaty. Soon after, French President Jacques Chirac came under pressure to give the French a similar voice in ratifying the Treaty. Former President Giscard d’Estaing had recently gone on record stating that “to consult the French people on this subject is a reasonable

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<sup>6</sup> The text of the resolution reads as follows: “The Convention recommends to the Inter-Governmental Conference that the draft European Constitution be approved not only by National Parliaments and the European Parliament but also by the citizens of Europe in binding referendums. These referendums should take place in accordance with the constitutional provisions of the member states. They should be held simultaneously on the same day... Those member states whose constitutions do not currently permit referendums are called upon to hold at least consultative referendums.”

and positive risk and it is right to take it.” He added that “all Constitutions that have been adopted by France have been adopted by referendum” (Whitman 2005, 677). The stage was set.

It was first hoped that the Convention on the Future of Europe would both address and, to some degree, lessen the perceived “democratic deficit.” When that did not occur, EU leaders looked to the ratification process as a forum for deliberation and consensus-building. Referenda, EU leaders hoped, would spur citizens to take a closer look at the Constitutional Treaty, debate its contents, and better understand its provisions. J.H.H. Weiler identified this “procedural” or “processual” factor a year before the Convention on the Future of Europe when he stated that, “The process of adopting a constitution—the debate it would generate, the alliances it would form, the opposition it would create—would all, it is said, be healthy for the democratic and civic ethos and praxis of the polity” (2001, 59). Popular involvement would lead to popular consent, and a major step would be taken to restore public confidence in the goals, policies, and leadership of the European Union.

A referendum, however, can be an unpredictable mechanism and a dangerous tool. People do not always hold up their end of the bargain by keeping focused on the project at hand. Rather, a referendum can be utilized for other purposes: to send an inexpensive message of disapproval to the government in power, to express discontent toward governing elites, or to cast a retrospective vote on developments only marginally related to the specific text in question. In mid-2005, the French and Dutch used the referendum—the most direct and democratic procedure for approval—to reject a Constitutional Treaty that was designed to lessen, if not remedy, key aspects and elements of the legitimacy gap. There is a small irony here: all of the efforts to make the framing and ratification more accessible to the people led to its downfall. A document that was to connect Europeans more directly with the European Union through inclusion of the Charter of Fundamental Rights was defeated by the very democratic process that better connected the people to its approval. In short, the more democratic process defeated a more democratic document.

The circumstances leading up to the French and Dutch referenda have important implications for the future of the Constitutional Treaty. It could be speculated that the No votes in 2005 would lead EU citizens to reconsider the wisdom of using referenda. However, a March, 2007 poll by Open Europe with a total sample size of over 17,000 (1000 people in France, Germany, Italy, Spain, Poland, Britain, and Romania and 500 respondents in other member states) found that a large majority (75% across all countries) want a referendum on any new treaty which gives more power to the EU. A majority in every member state, ranging from 87% of the Irish to 55% of Slovenians, want a referendum.<sup>7</sup> If anything, momentum in favor of referenda has seen a dramatic increase since mid-2005. As will be discussed in the section that follows, any strategy for re-introducing the Constitutional Treaty for fresh consideration will need to keep these polling numbers, and realities, in mind.

### **Looking Ahead: Prospects and Possibilities**

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<sup>7</sup> The poll results can be seen at Open Europe’s website: <http://www.openeurope.org.uk/media-centre/pressrelease.aspx?pressreleaseid=31>.

The full breakdown of the results can be seen at: <http://www.openeurope.org.uk/research/mainfindings.pdf>.

The rejection of the Constitutional Treaty did not leave the European Union without a charter of governance. Rather, the treaties already in place (Rome, Amsterdam, Maastricht, and Nice) have remained in force, and the EU continues to operate under them. For some scholars and observers, this turn of events places the European Union in a crisis. For others, rejection of the Constitutional Treaty means very little, and may end up having a positive impact. For now, there is no shortage of opinions about what may or should happen next. The next section examines and evaluates five of the most frequently discussed recommendations.

### **Get On With It: The Constitutional Treaty Is Dead.**

This first option is more of a non-option, or a contention of what is not going to happen. In short, the stunning French and Dutch votes, with such large numbers voting “no” in such high percentages, means that the Constitutional Treaty is dead on arrival. Within this overall view three strands of thinking can be detected that come to the conclusion that the CT is better left on the shelf, and that any further efforts to revive, resuscitate, or resurrect it are either ill-advised or illegitimate.

First, there is a “those were the rules” camp. Here, observers claim that there were agreed-upon procedures, those procedures were followed, and that all should abide by the results. The idea of listening to the people, the claim of popular sovereignty, and the discussion over the “democratic deficit” all play into this perspective.

Second, a number of scholars have pointed to the decided *lack* of a crisis in the aftermath of the French and Dutch referenda. De Burca notes,

Did the negative results of the French and Dutch referenda on the treaty establishing a European Constitution indicate or precipitate a political crisis within the European Union? On one account, the answer is no. While this particular initiative may have failed, business goes on as usual within the Commission, Council, Parliament, and elsewhere in the EU machinery. New policies continue to be generated, laws are passed, the 25 Member States carry on cooperating on a daily basis, and the existing legal and political structures continue to operate as they have. Given that a documentary constitution was not necessary in any immediate or practical sense, the failure to enact this particular text may have bruised some political egos, relegated to the back-burner a number of interesting reforms, and disappointed those who promoted its drafting, but it did not cause anything that could be termed a crisis (2006, 6).

The Constitutional Treaty was not occasioned by an economic or external crisis, and none has followed since its rejection. The main impetus behind the CT was that the enlargement of the European Union would require a number of institutional reforms. The CT was framed alongside the negotiations that brought ten new member states into the Union in May of 2004. It was the European Union of 25, not 15, that had to ratify the document. Yet, almost three years into an enlarged Union (of now 27 members), it could be said that the big story is that there is no big story. Popular opinion remains relatively positive toward the idea of a Constitution, but without

any sense of intensity or urgency about how or when it may be reconsidered.<sup>8</sup> There are no reports of gridlock within the main decision-making bodies. The future of the CT appears as a hot button issue within political debates and campaigns, but not as a practical, everyday concern for the vast majority of Europeans. Andrew Moravcsik, who is most representative of this viewpoint, concludes that,

Looking back in 50 years, historians will not see the referendums as the end of the EU—not even the beginning of the end... The current EU constitutional settlement, which has defined a stable balance between Brussels and national capitals and democratic legitimacy through indirect accountability and extensive checks and balances, is here to stay (2005, 143).

While stopping short of the “if it ain’t broke...” cliché, scholars such as Moravcsik do challenge proponents of the CT to identify if and where a crisis has emerged since mid-2005 (Moravcsik 2001, 161-187). Thus far, no evidence has surfaced.

A third perspective on leaving the Constitutional Treaty on the shelf might be termed the “This Time Its Different” view. Much has been made of the fact that the growth and development of the European Union has not been without rejections and defections by member states. The Danes voted down the Maastricht Treaty and the Irish rejected the Treaty of Nice, only to be brought back for a second vote following negotiations and concessions by EU leaders. However, critics contend that this isn’t simply a “set-back” *a la* the Danes with Maastricht or the Irish with Nice, where a few promises can be secured, adjustments made, and affirmative votes obtained. Rather, there are significant and substantive differences in the French and Dutch “no” votes, and there is little to indicate that the opinions and forces behind those “no” votes have softened or changed. Richard Whitman has concluded that the strategies employed after past referendum “no” votes do not provide instructive lessons for the present. He notes the following three distinctions:

First and crucially, the “no” vote in France, one of the founders of the integration project and a key player and animator in the subsequent development of integrations from the Coal and Steel Community through the European Economic Community to the European Union, simply matters more than the previous “no” votes in Denmark and Ireland. Second, the high turnouts in both France and the Netherlands, 69.7 per cent and 62.8 per cent respectively, did not call into question the validity of the vote, as was the case in the first Irish vote on the Treaty of Nice, where only 35 per cent of the electorate voted. Third, the nature of the campaign in France and the Netherlands made it difficult to identify those elements of the Constitutional Treaty that were the subject of particular public concern. The referendum debates in both countries focused on issues connected to domestic political discontent, concerns about present and possible future economic and social policy, or unhappiness with recent EU initiatives such as enlargement or the single currency, so that it was difficult to disentangle objections to specific elements contained within the treaty. This rules out the “reassure and re-vote” strategy pursued in the past after the Irish and Danish “no” votes (2005, 681-682).

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<sup>8</sup> As measured by *Eurobarometer*. Note especially that majorities in both France and the Netherlands are still supportive of some kind of constitution. View at: [http://europa.eu.int/comm/public\\_opinion/archives/eb/eb64/eb64\\_first\\_en.pdf](http://europa.eu.int/comm/public_opinion/archives/eb/eb64/eb64_first_en.pdf).

Together, these three perspectives offer solid support to the view that the Constitutional Treaty had its chance, that significant majorities in two of the founding members of the European Union rejected it, and that it is not in the best interests of the European Union to try to bring it back for reconsideration. Some scholars, including Andrew Moravscik, have asserted that the EU can continue, effectively and successfully, with the status quo (2005). And, as the following survey of other options will show, simply “getting on with it” has an elegant simplicity, and can be easily explained and easily understood. It does not need to confront anew the ironies and conflicts that led to the referendum defeats.

### **Let the Ratification Process Continue for all Member States**

An intriguing line of thinking asserts that all EU member states should have the opportunity to ratify the document before any definitive decisions are made concerning its future. There is a theoretical and a technical component to this view. In theory, all member states should allow their citizens or their elected representatives to approve or reject the document. All of the (now) 27 member states signed off on the document, and all should have the chance to debate its merits and either ratify or reject it on the national level. Allowing a completion of the ratification process would put all nations on a similar footing, and would then provide a clear mapping of where all members stand. Technically, it can be argued that Declaration 30 of the Constitutional Treaty commits member states to complete the ratification process in order to determine whether the threshold number of approvals—twenty—has been reached.<sup>9</sup> If this “supermajority” of approvals is obtained, the matter would be referred to the European Council.

The question of whether to continue ratification in the face of the French and Dutch votes is more complicated than it appears at first glance. Again, theoretical and practical elements can be identified. Some observers see further ratification votes as illegitimate, as they would ignore and undermine the significance of the French and Dutch decisions. Since approval must be unanimous, the impact of further voting becomes moot. de Burca has observed that, for some, “this option is inherently undemocratic since it proceeds with the attempted ratification of a text which by definition cannot be ratified through such a process, since it ignores the results of the French and Dutch referenda” (2006, 212) This hearkens back to the arguments made by the “get on with it” camp discussed above. Democratic processes for ratification were agreed to and put into place, the votes were taken, and majorities in France and the Netherlands said no. To keep the process open is to implicitly change the rules, and that undermines democratic legitimacy. As was discussed in the first section of this paper, attempts to bypass what are perceived as democratic processes would exacerbate an already contentious issue within the process of further EU enlargement and integration.

However, a number of countries have gone ahead with ratification since June of 2005. The Latvian Parliament ratified the Constitutional Treaty in early June of 2005, just days after the Dutch “no” vote. Cyprus followed suit later that month. In July, Malta ratified via Parliamentary vote and Luxembourg approved the document by referendum, with 56% of voters

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<sup>9</sup> Declaration 30 of the Constitutional Treaty provides that, if four-fifths of the members states have ratified within two years of signing off on the document, the matter would be referred to the European Council to determine what further steps might be taken. It is widely believed that this section was included in anticipation of one or more “no” votes during the first round of ratification.

in favor of the CT. After these four “soon after” approvals, Estonia ratified it in May of 2006 and Finland in December of the same year. In all, six member countries have ratified it *after* the French and Dutch “no” votes, nearly and equal number to those who had ratified it leading into late May of 2005. Depending on who is keeping score<sup>10</sup>, each member’s standing is as follows:

- **Ratified** (16): Austria, Belgium, Bulgaria, Cyprus, Estonia, Finland, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Romania, Slovenia, Spain.
- **Nearly Ratified** (2): Germany, Slovakia.
- **Rejected** (2): France, Netherlands.
- **Delayed/ Postponed** (7): Czech Republic, Denmark, Ireland, Poland, Portugal, Sweden, United Kingdom.

There has been considerable attention paid to the fact that a majority of member states have now ratified the document. For supporters, this means at the very least that some further action should be taken to ensure that the constitutional treaty is not shelved. In theory, at least, it is claimed that there should be significance to having a majority ratify the document.

There are also practical arguments that can either support or subvert the claim that the ratification process should be seen to the finish. Proponents of letting the process continue—whether they are fans of the Constitutional Treaty or not—point to the history of rejection, accommodation, and incremental change that has marked the development of the European Union since its beginnings. Magnette (2005) defines this as a “gradualist strategy” that has enabled Europe—beginning with the European Steel and Coal Community—to cobble together treaties that, through concession and accommodation, brought together countries with very different goals and priorities. He observes that, “The agreement ratified by the Treaty of Rome was the first in a long series of package deals, in which each partner accepted the whole because it considered that its benefits outweighed the concessions it had to make” (2005, 16). All along the way, treaties have run into opposition and rejection. The first word has not, thus far, been the last word. So why jettison a constitutional treaty that is, in effect, a document that codifies, simplifies, and harmonizes all of the former treaties? With the benefit of hindsight, proponents ask exactly *why* it is different this time. To allow two early ratification votes to jettison the entire process would run counter to the long-term experience of the European community. Complete the process, and then determine whether the French and Dutch may then wish to revisit their stands on ratification.

There is a certain appeal to the above argument, especially as it is fortified with the fact that six member nations have gone ahead with ratification since the Dutch vote. Should the German and Slovakian approvals clear constitutional muster, the total number of “yes” votes would climb to eighteen. Seven members would be left to go ahead with ratification votes.

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<sup>10</sup> The number most cited for yes votes is 16 (as of February, 2007), yet this number is arrived at through varied assumptions. Romania and Bulgaria ratified in May of 2005 as a precondition to joining the EU in January of 2007. Add in these two new member states, and the tally is 16. Germany and Slovakia have ratified in their respective parliaments, but final approval is needed in the constitutional courts of each country. Add these members in, and the tally for yes votes is 18.

Ah, but what a group of seven they are! Unfortunately, a quick tallying of numbers does not tell the whole story. While one may want to tread carefully around the “big state/small state” issue, the size and significance of the six member states that ratified the CT after the French and Dutch does not match up with that of the seven “postponers.” And size is not the only concern. The seven holdouts are among the most “Euroskeptical” of all member states. They include the former holdouts Denmark and Ireland, and are led by the United Kingdom, where a referendum has been promised and where polls consistently show solid opposition to any further entanglement with the EU.<sup>11</sup> In reality, there could be four or five “no” votes within the remaining seven, and this could lead to a distressing outcome in which the requisite twenty nations have ratified the CT (sending the process to the European Council) while seven (including heavyweights France, Netherlands and the United Kingdom) have rejected it. Add to this mix the possibility of referenda with high “no” votes (even if they pass) or an increase of popular discontent over parliamentary ratification that bypasses popular involvement. Leaders, politicians, and candidates for office may well conclude that the political risks involved with pushing ratification along far outweigh any clear and measurable benefit. And add to *that* mix a cluster of pivotal elections in many of the key “rejected” and “postponed” nations, and the practical benefits of holding ratification votes are neither many nor impressive.

### **Implement a Broad Renegotiation of the Current Text**

There are two flavors of the renegotiation and complete renegotiation proposals. The former would stay within the confines of the current text and seek to do as little as possible to it. The latter would call for a new Convention to fully reconsider and redraw a new constitution. Since there is no political will, and therefore little chance that a new Convention will be proposed to start over and draft a “better” agreement, this section will focus on the first version.<sup>12</sup>

What gives hope to those who seek a minor re-working of the text is the fact that, by and large, French and Dutch citizens still think that a constitution is a good idea. Eurobarometer polling indicates that impressive majorities in both France and the Netherlands remain positive about some form of constitution becoming the new EU charter.<sup>13</sup> This has led proponents to call for a renegotiation of the text—in other words, make the necessary “corrections” to the CT and begin a fresh round of ratification votes. Two assumptions underlay this position. First, there are clear, identifiable reasons why the French and Dutch rejected the document. Second, those reasons can be accommodated with minor adjustments made to the text.

As of this writing, this position has the odd distinction of having the most vocal support among high-profile European leaders—especially German Chancellor Angela Merkel, who holds the EU Presidency for the first half of 2007—and the least chance of succeeding. There are important, and valid, considerations that motivate the advocates of this view. One is that, at some point, the provisions of the Treaty of Nice will need to be revisited and changed. In fact,

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<sup>11</sup> See the March, 2007 poll results from Open Europe, *supra* note 7.

<sup>12</sup> For a short treatment and rather quick dismissal of “complete renegotiation” option, see Sebastian Kurpas and Justus Schonlau. 2006. “Deadlock Avoided, But Sense of Mission Lost? The Enlarged EU and its Uncertain Constitution.” *CEPS Policy Brief*. Centre for European Policy Studies. No. 92. February. p.8 .

<sup>13</sup> See the Eurobarometer survey from December, 2005; six months following the French and Dutch referenda, *supra* note 8.

the key players at the Nice summit knew that the treaty was both faulty and incomplete, and thus made provisions for an inter-governmental conference in 2004 to complete the process of revision and reform (Baldwin 2006, 7). This set the stage for the Convention on the Future of Europe and the Constitutional Treaty. Further, Nice made allowance for EU expansion to 27 and no more. If the European Union desires further expansion, it will need to revisit Nice.

The question of democratic legitimacy comes into play here as well. While it has been argued that reviving the ratification process would ignore the democratic processes whereby France and the Netherlands rejected the document, others take a broader view of the past years of constitution-making and stress that this strategy *reflects* a commitment to democratic legitimacy. For example, de Burca frames it as follows:

Arguments for this option include (i) the claim that the Convention process which contributed to producing the constitutional text generated a greater degree of legitimacy for its contents than almost any previous EU or EC treaty, (ii) the assertion that the Constitution contained many valuable new provisions on which a broad degree of consensus had been found, and (iii) the argument that, as a document which was signed unanimously by 25 states, it is deserving of a fresh consideration, albeit under circumstances which take seriously the concerns reflected in the referendum no-votes (de Burca 2006, 212).

A further consideration concerns the text itself. The Constitutional Treaty is the product of numerous compromises, concessions, and bargains. Its framers attempted to bring all interests into the Convention, and draft a document that would build bridges across the main fault lines in the emerging Union of twenty-five nations: large and small members, newly-acceded Eastern members and the mature economy Western states, nationalists and integrationists. Any tinkering with the text and any one of these balances can be disrupted. Former President of France and Convention Chair Valéry Giscard d'Estaing had these dynamics in mind when he warned against having amendments proposed. "If you touch the equilibrium, the system collapses. If you try to gain by getting satisfaction here and there, the system collapses and you have the whole thing starting again."<sup>14</sup> The same warning may apply to "tweaking" the text to accommodate members states that fail to ratify. This is an important substantive point. Changes in the text come by adding and subtracting. An addition may be a threat to a carefully thought-out compromise. A subtraction may eliminate a critically important guarantee or provision. Closa sums up this point as follows: "(T)he Constitution is a complete package that includes various interconnected compromises by the Member States that cannot easily be de-constructed" (2005, 2)

Tied to this is another, related concern. Renegotiation of the text presupposes knowing a clear reason, or set of reasons, why the Constitutional Treaty was rejected. It assumes that an examination of the "no" votes can determine what citizens want. Again, the French "no" was a complicated affair, and found the far right and the far left joined in a common cause. Scholars and observers have identified a cluster of reasons behind the French rejection of the text with little coherence or connectedness between them (de Burca 2006; Gurfinkiel 2005; Kramer 2006).

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<sup>14</sup> Reported by Brandon Mitchener in the *Wall Street Journal*, July 11, 2003. "Birth of a Nation? As Europe Unites, Religion, Defense Still Stand in the Way." pp. A1 and A6.

And, the French case study is not unique. In one of the last polls conducted before Luxembourg ratified the Constitutional Treaty, “70 per cent of respondents who wanted to vote “no” said their choice was a reaction to enlargement, 59 per cent did not trust European institutions, 58 per cent wanted to renegotiate the treaty, 55 per cent found the text too complicated, and 48 per cent disagreed with Turkish accession” (Poirier 2005, 6).

Not only are there different reasons for opposing the Constitutional Treaty within member states—what Closa refers to as the problem of identification—but there is the additional challenge of a “problem of congruency” between these demands: “citizens in different countries appear to want different and indeed opposing reforms of the EU” (Closa 2005, 2). A tweaking of the text that might motivate a French majority to ratify, if it were possible to identify the right basket of necessary adjustments, would likely alienate voters in other member states. If some of those other member states opted for referenda, it is likely that the May/June 2005 experience would be repeated and the Constitutional Treaty would again be rejected.

### **“Cherry Picking:” Selectively Incorporating Parts of the Constitutional Treaty**

If there is a “frontrunner” option in the aftermath of a tumultuous 2005 and an inconsequential 2006, this is it. It has garnered a fair amount of attention, as it has been championed by Nicolas Sarkozy, French Interior Minister and the leading candidate to succeed Jacques Chirac as President of France. It has been described as the “pragmatic” option, as it allows incorporation of the most important elements of the Constitutional Treaty by means other than referenda or parliamentary approval. Proponents of this view, which include a number of national leaders and politicians at the EU level, marshal arguments similar to those who have called for renegotiation of the text. They assert that the Constitutional Treaty was a successful cooperative effort that was approved by all 25 member states in late 2004, that there is evidence that the ratification’s “no” votes had little to do with the specific provisions within the document, and that the core changes in the CT can be identified and approved without significant conflict or controversy. Their hope is that careful, visible, and incremental consideration of the most important parts of the text will—if not gain wide public approval—will at least avoid widespread public resistance.

The problems with “cherry picking” select provisions from the text parallel those identified in the previous section. Three factors hamper this option. First, the desire to pick out important, though non-controversial, elements and put them forward for approval bumps into the reality that the important elements *are* the controversial ones. You can have one, or the other, but not both. What might be considered as core elements of the grand bargain—the reform of the European Council voting rules, the permanent presidency within the Council, or the reform of the composition of the European Commission—were among the most contested proposals during the Convention, and were agreed upon only after other incentives were included and bargains were struck.

A second perspective would take issue with the “either-or” nature of reviving important, though non-controversial, provisions is the contention and claim that there is no agreed-upon list. What French and German leaders may identify as the essentials may not square with what the Poles and Spaniards would. Which cherries get picked? Mr. Sarkozy has his list, but thus far there is little evidence that there is widespread acknowledgement of or support for it. Closa’s problem of

congruency applies here. Even if a list of important and non-controversial proposals could be found, the list likely would not mesh with a list generated by another member state.

Finally, the “cherry picking” option cannot escape the charge that it bypasses and diminishes the agreed-upon democratic process and the will of the people expressed in the French and Dutch referenda. Despite the claim that the Constitutional Treaty reflects important elements of democratic openness in its framing, it cannot be ignored that it was decisively rejected in the equally democratic process of its ratification. An *Economist* article disdainfully referred to this viewpoint as “No Means Yes” in describing the seeming willingness of EU elites to ignore the negative verdicts of the May/June 2005 referenda and press on with the process of approval. The question of which provisions will be chosen and put forward for approval, and how such proposals will be received by national leaders, the media, and the citizenry at large, remains to be seen.

Before concluding this section, it should be noted that some legal scholars contend that some “cherry picking” has already begun. While it may be questioned whether such a process could begin without attracting the attention of the media, there may be hints that both substantive and procedural changes are being adopted. de Burca explains,

In the meantime, and perhaps not entirely unconnected with the first strategy, a process of cherry-picking has begun, with several of the constitutional treaty’s novel provisions being proposed or implemented by other means. This does not seem to be a particularly coordinated strategy, since some of the proposals have been made by members of the national parliaments, while others have been made by the Council of Ministers. For example, the Conference of Community and European Affairs committees of European parliaments (COSAC) has proposed moving ahead with a form of collective subsidiarity monitoring the forthcoming EU legislative proposals, not dissimilar to that which was envisaged by Article 6 of the Protocol on the Application of the Principles of Subsidiarity and Proportionality, which was annexed to the Treaty Establishing a Constitution for Europe. More recently, the Council of Ministers has decided to change its rules of procedure by opening the meetings where it acts in a legislative capacity (under the so-called ‘co-decision procedure’) to the public, a change similar to that which would have been introduced by Article I-50(2) of the constitutional treaty. Others have mentioned the ‘citizens’ petition’ for a legislative initiative as another of the constitutional treaty’s provisions which could be cherry-picked and implemented without much legal formality (2006, 214).

Whether initiatives of this kind can be seen as an entrée for further attempts at cherry picking remains to be seen. These developments could be interpreted as “foot in the door” steps that could lead to further, more substantial proposals. Since they seem to enhance greater transparency and accountability, both being desirable democratic virtues, it is difficult to envision strong opposition to them. However, moves to incorporate more high-profile and more easily understood provisions may trigger greater media and public interest... and alarm.

The ratification process started quietly and positively, with a cluster of the newly acceded Eastern member states holding nearly-unanimous parliamentary votes. The hope was that a

string of “yes” votes, coupled with a positive first referendum in Spain, would build positive momentum for the tougher battles in France and beyond. Perhaps a variation of the same strategy is emerging here, with small, technical, and non-controversial provisions being considered and implemented by means “other than.” Perhaps this strategy—if there is a strategy—will work this time. However, momentum can carry a controversial plan only so far, and the preference for popular approval of substantive changes in EU arrangements has grown, not diminished, since the French and Dutch votes.

### **Consider Procedural Reform for Ratification**

As a student of the U.S. Constitution and one who is examining the process of EU constitution-making from a comparative perspective, some of the most intriguing questions involve procedural rather than substantive issues. The preceding options mostly have dealt with ways in which to revise, shorten, selectively draw from, or abandon the text. Here we look at proposals to reform the ratification process. The assumption behind these proposals is that the Constitutional Treaty was rejected not so much because of its content, but because referenda were combined with a unanimous voting requirement. In a previous paper on the ratification process, it was concluded,

...that the constitutional text as it stands cannot and will not be ratified by all (or nearly all) of the current EU member states even after the extended period of reflection has passed. As a consequence of this, some revision of the text, the procedures for ratification or both need to be considered. I am very aware that these suggestions for change would have been considered far-fetched at best before the season of ratification began. At this point, it is impossible to predict which, if any, of these options will receive serious consideration. Yet, two uncomfortable and unavoidable facts remain. First, the problems and challenges that brought about the Convention on the Future of Europe have not disappeared. The economic challenges of globalization, the questions surrounding enlargement and the ongoing need for more effective and streamlined decision making all need to be addressed. Second, two core member states have rejected the constitution by substantial margins. The lesson gained from Ireland after its rejection of the Nice treaty in 1992 simply will not do here. A short pause, a minor reworking of the text and a re-vote worked for a small, single rejection. Few, if any, observers see this pattern as applicable to France and the Netherlands. So, in short, something needs to happen, but not a recycling of the current text (Boylan, 2007).

While such a conclusion does not dismiss any of the prior options tied to the text, it does point to a consideration of procedure. Rules often determine outcomes, and it is clear that the ratification rules set in place for the Constitutional Treaty have contributed to the current impasse. A number of proposals for procedural change have been put forth, though most revolve around a reconsideration of the unanimous voting requirement.

This is an intriguing, though imperfect adjustment. It has the appeal of a successful precedent, in that the American colonies used a supermajority requirement to ratify its Constitution in 1787-

1788.<sup>15</sup> It also changes the locus of power. In a unanimous voting scheme, every member state is a veto of one. In theory, 26 of the current EU members can ratify the Constitutional Treaty, and a final “no” vote from the 27<sup>th</sup> can scuttle the entire process. Note the “in theory” aspect to this. With large states such as France and the Netherlands rejecting the Constitutional Treaty, it is difficult to imagine the other member states going forward and ignoring such a significant setback. However, if Slovenia and Malta were to be the lone dissenters, a very different scenario might unfold, with the ratifying bloc pressuring the “junior” members to revisit their votes or opting to go forward without them.

With a change to a supermajority voting procedure, the dissenting members have something clear and tangible to lose by saying “no.” The supermajority threshold may be met, and the “no” nations end up excluded from the newly constituted Union. Whether this change would be an improvement or not is open to debate. Member states solidly in favor of the Constitutional Treaty may welcome a more approval-enabling scheme. Those with a strong possibility of rejecting the document may find it problematic, risky, or threatening.

Eliminating the unanimous voting requirement would require change on two levels. First, Article 48 of the Treaty of European Union would need to be revised or amended to remove the unanimity requirement. Then, Article 477 of the Constitutional Treaty—requiring unanimous approval before it comes into force—would need similar revision. Within this process, the majority or supermajority number needed for ratification would need to be finalized (with four-fifths being the number most frequently mentioned).

There are some interesting advantages to this move. It would keep the ratification process alive, and would allow member states who have not ratified the chance to do so without thinking that the process is moot. All member states could make their choices and have their say, and then the EU as a whole could step back and assess the results. This option has the appeal of fairness, in that all nations would have equal standing in having ratified or rejected the draft treaty.

However, the ratification process is not at the starting line, and the present situation makes such a procedural reform both complicated and difficult. One scholar has asserted that any substantive changes to the Constitutional Treaty would make it a new document, which would require a fresh round of ratification (Closa 2005, 3). Otherwise, there would be a “bait and switch” quality to the process, where the rules are changed at the halfway point. Further complicating matters is the fact that any move to eliminate the unanimity requirement must be approved unanimously. Again, that would not be in the best interests of those member states that have committed to a referendum and where public opinion is negative toward ratification (Closa 2005, 4). There is a protective aspect to a unanimous voting requirement. A nation that rejects the Constitutional

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<sup>15</sup> This was, however, the second try after the Articles of Confederation. There are some compelling reasons why the Articles were doomed to failure, but the most important procedural flaw was that all laws required a supermajority to pass and any amendments to the document needed unanimous approval. Given the varied interests and priorities held by the 13 colonies, it was difficult to pass laws and impossible to approve an amendment. For a fine description of the EU’s ratification task in the light of the American experience, see Rakove, Jack. 2003. “Europe’s Floundering Fathers.” *Foreign Policy* 138(September/October), pp. 28-38.

Treaty cannot be left behind and excluded by those who ratify. Moving to a supermajority requirement could result in a map of Europe looking like a member/non-member checkerboard, with non-ratifying states dispersed among the newly constituted EU. Strategically, the costs of exclusion are high, while the costs of some-arrangement-other-than-the-Constitutional-Treaty are comparatively low. The chance of getting all members states to change the unanimity rule runs into the same problems as the general ratification of the CT. Interests, priorities, and goals widely vary across member states, and the aftermath of the French and Dutch “no” votes has, if anything, magnified rather than lessened those different and varied views.

The difficulties tied to substantive changes in the Constitutional Treaty are neither solved nor rescued by procedural reforms. Rather, the constraints that surround strategies to modify or “cherry pick” portions of the text are reflected in proposals to jettison the unanimity requirement in favor of a supermajority ratification scheme.

## CONCLUSIONS

An examination of the variables leading to the French and Dutch “no” votes and a survey of possible options now being considered by EU leaders point a number of conflicting and inescapable factors. They can be summed up as follows:

- Doing nothing may work for a while, but, at some future point, some adaptations will have to be made. The Treaty of Nice does not have an acceptable, long-term division of powers between the EU and its members, and does not make provision for further enlargement after Romania and Bulgaria join(ed) in 2007.
- There never was a “Plan B” document or strategy in place just in case the Constitutional Treaty failed. At present there is no political will to scrap the CT and start over with a new convention.
- Both adding to and trimming back the text of the current Constitutional Treaty and changing the procedural requirements for ratification create significant problems and face significant obstacles—and may likely run into definitive “no” votes from other member states.
- The “cat” of referenda democracy has been let out of the bag. In order to gain political capital and achieve a sense of legitimacy, politicians in key member states promised a referendum on the Constitutional Treaty. It is difficult to envision the process continuing further without putting the document before the people for popular approval. And, it is difficult to envision the process not encountering more “no” votes.

Where does that leave the Constitutional Treaty? An assessment of the options available to decision makers does not look promising. Doing nothing will work for a while, but most observers agree that the framework of Nice will not hold up over the long haul. Adjustments to the text must confront the questions of what to adjust—whether by adding new provisions or by selectively incorporating key provisions—and how those choices will affect the agreements and compromises that underlay the text as it stands. And, as we approach the two year mark since the French and Dutch rejection of the document, there is little evidence of any significant or growing popular support for reviving the ratification process.

The one avenue that may work would be an incremental adoption of technical, non-controversial measures with positive symbolic value. As previously discussed, the adoption of mechanisms and provisions that create greater accountability and transparency within the EU institutions may be perceived as a positive development. Small successes may lead to more substantial adoptions of provisions in the Constitutional Treaty. Again, there is perhaps one final irony here: that bypassing the more democratic process of referenda could allow the EU to incorporate policies and procedures that enhance democratic values and goals within the current framework of governance. Yet a slow, patient, attentive adoption of political and institutional—rather than economic and social—elements may allow EU leaders to achieve the “next best thing:” a more unified, workable, and coherent framework without the controversy and confusion of a 70,000 word constitutional charter.

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## COMMENTARY ARE ARABS FATALISTS?

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As a professor who teaches Middle Eastern politics I endeavor to advance intercultural understanding. A recent encounter makes me believe that a great deal of work lies ahead.

Orientalists – those European academics of the 19<sup>th</sup> century who studied the Middle East to confirm their own cultural superiority – often referred to inhabitants of that region as “fatalists.” In their view, the followers of Islam had remained untouched by the Enlightenment that had swept Europe. While Europeans had learned to lift their traditions into the light of reason and critically examine them, Muslims continued to practice their faith with naïve submission to the will of Allah. Five times a day they turned to Mecca, invoking God, the Merciful. Because they placed their fate into the hands of the Almighty, they had little drive to accomplish things by themselves. As a consequence, they remained untouched by material or political success. The nations of Europe therefore had to step up and introduce modernity into the Arab world. The British tended to Egypt, Palestine, Transjordan and Iraq. France, in turn, took care of Syria and Lebanon. Libya fell to the Italians, and in Northern Africa, France looked after Tunisia, Morocco, and Algeria.

I had always thought that labeling people of the Middle East as “fatalists” was a thing of the past, an error of European imperialists. That Edward Said’s book *Orientalism* had corrected the notion of the childlike Arab who sat under a palm tree, fanned himself, and waited for God do to his job. If anything, I believed, 9/11 had steered academics in the opposite direction, because the vast literature on militant Islam and holy war depicts Arabs as active militants who envy the West for its progress and seek its destruction. The notion of Arab fatalism – I was convinced – was no longer in currency.

Well, I was wrong. The old stereotype is alive and well, and it floats through the hallways of American universities. A few weeks ago I attended a faculty luncheon. A military historian from the Hoover Institution delivered the keynote address. The night before he had given a lecture about the war in Iraq, because he had just returned from the ravaged country and been invited to discuss his insights.

During the luncheon, he shared with the assembled professors his thoughts about American politics, prospects for the global commons, and the state of higher education. Members of the audience asked informed and interesting questions. At some point the door opened, and two late arrivals joined the gathering. One of them raised his hand and asked: “What are we going to do about the fatalism in the Middle East? A while ago I was in Jordan, and I took a ride with this taxi cab. The driver drove the car at breakneck speed. I told him to slow down, but instead of doing it, he just said ‘*In sha Allah* – if God wills it – we will still be alive tomorrow.’ So I want to know: what is to be done about all this fatalism?”

Taken aback, I turned to the guest next to me, who taught at a Pennsylvania institution. With a subdued voice I commented: “How can this man generalize from one taxi driver to millions of people?” My neighbor whispered back: “It’s because Arabs always say ‘*In sha Allah*.’ My Arab students do that a lot. They say ‘*In sha Allah* I’ll see you in class tomorrow,’ but instead of being there when class starts, they are late. So I’ve started to tell them ‘*In sha Allah* you’ll come to class on time from now on.’” I could tell that my neighbor also considered Arabs as fatalists. To my surprise, our keynote speaker did nothing to correct the teller of the Jordan anecdote either. Instead of pointing out that the idea of Arab fatalism is an ideological remnant of imperialism, he bought into the terms of the question and suggested ways in which U.S. foreign policy might help the Middle East overcome its deficiencies.

I find all of this unsettling, and for three reasons. First, that I witnessed three scholars from three different institutions agree on the image of the fatalistic Arab makes me believe that the image is widespread in American academia. Second, the United States is deeply involved in Middle Eastern affairs, and students may have questions about the Arab world that they will ask their professors. I am convinced that as teachers we inflict damage if we pass on stereotypes about a foreign culture. For by doing so, we ensure that its bearers are viewed as less than our equals, and true dialogue becomes difficult. Third, such stereotypes have a profoundly negative impact on our Arab students, and since they are in our care we must ensure that they are treated with respect.

So let me share my comments. First off, the gentleman who told the anecdote of the Jordanian cab driver generalized from the behavior of one person to the inhabitants of an entire world region. The Arabic-speaking Middle East is home to at least 170 million people. Add to that eighty million North Africans, seventy million Iranians and just as many Turks. As any research methods book admonishes us, it is improper to generalize across a large population unless we do so by carefully devised rules of inference. In commenting on his experience as he did, the faculty member resembled a foreign visitor to the United States who saw a speeder and concluded that Americans were breakneck drivers. Such an inference is fallacious and does not apply to millions of Americans.

Second, the Jordanian cab driver does not exemplify a fatalistic outlook on life, because he exhibited a great deal of agency when he put his foot on the gas pedal. Had he been a true fatalist, he would have leaned back in his seat and waited for God to drive the car for him. After all, what does fatalism mean? It means that an individual has an extrinsic locus of control. In the given Arab example it means giving up responsibility for one’s fate, and laying all decisions into the hands of the Creator. And this in turn means saying good-bye to one’s agency.

The gentleman at the luncheon may have arrived at his interpretation by combining two facts. First, the cab driver stated that he would live another day if God chose that he should. Second, there was a high probability that the taxi would hit an object and that the taxi driver would die. And so my colleague concluded that his driver was emotionally prepared to give up his life at God’s behest.

This could perhaps be interpreted as semi-fatalism, because on the one hand the driver took action and tried to shape his fate, while on the other hand he left it up to his Creator to decide whether he should perish. I offer an interpretation that is more mundane. Borrowing vocabulary from rational choice theorists, I refer to the driver's behavior as "risk-taking behavior." Such demeanor is widespread in American society, and who does not believe it should take a trip to Las Vegas. The statistically expected loss from betting on a single number in European roulette amounts to 1/37 of the bet. So why do so many of us flock to the roulette table anyway? We do so because we are convinced that we will beat the odds and get lucky. Many of us place a bundle of chips on a number and ask God or fate or coincidence to decide whether we will leave the gambling hall richer than we entered it. Our hope, of course, is that fate will side with us. Is, then, the interpretation correct that all gamblers are fatalists? Are all Americans who invest money in the stock market and risk losing it fatalists?

To me the cab driver's behavior looks a lot like that of a hedge fund manager (as we all know, managing hedge funds is risky business). The driver is not paid by the hour, but by the number of customers he delivers to their destinations at any given time. So the more customers he delivers in the same window of time, the more income he generates. With that in mind, he took the risk of a crash because he thought his driving skills would help him avoid obstacles even at great speed and make more money. So maybe we might accuse this man of suffering from inflated self-confidence. Convinced that speeding was safe, he probably did not want to discuss his actions with his passenger. So, when he said "*In sha Allah* we will still be alive tomorrow," he did not express true willingness to lay his fate in God's hands. Instead, he chose a polite way of avoiding an unpleasant conversation.

The third point I want to make is a generalization that I base on years of interacting with Arabic speakers. When Arabs say "*In sha Allah*," they normally do not imply that they are ready to die, should God choose to let the sky drop on their heads. It is a formula that acknowledges God's sovereignty over all things. Used in day-to-day conversations, it means "I will do my best to make this happen." So, if someone says: "*In sha Allah* I will come tomorrow," this should be read as meaning: "I am going to come tomorrow." So why do Arabs say "If God wills it I will come tomorrow" if all they mean is "I am going to come tomorrow?" This is a good question. My simplest answer is to counter with a question: Why do we say "how are you doing?" suggesting that we are interested in a person's medical history, when all we mean is "hello"? "*In sha Allah*" and "how are you doing?" are expressions that form part of society's cultural repertoire. They are signs that should not be translated word for word, but as part of a whole web of meaning.

Fourth, I have never seen an Arab who has waited for God to do her work. Those Arab citizens whom I have met all have interests. Just like our interests, theirs are defined by cultural context. And just like we do, they pursue their interests within the constraints of the doable. That we perceive people of the Middle East as "not getting anything done" may have to do with the fact that we do not understand what their specific goals are and that we tend to devalue any objective that we do not fathom for ourselves.

Moreover, in societies that are marked by poverty, illiteracy, and authoritarianism, individuals have little social mobility, no matter how much desire for personal advancement they have.

Now what about the interjection that my neighbor's Arab students are late for class? That, in my view, has less to do with lack of agency or religious prescriptions than with socialization. These students come from cultures that embrace an understanding of time quite unlike ours. Time can be measured in many ways. Some of us rely on a digital clock that cycles through the hours of the day and advances through the days in the calendar. Others measure time by the location of the sun and the moon. Again others count the rings in the trunk of a tree or the layers of sediment in the soil. Some look to the forest's cycle of growth and decay, others become aware of the passage of time when they see their children grow up.

Trite as they sound, these examples capture the fact that time is what we learn it to be. Most of us in the United States experience time as monochronic and linear. We look back at the past, because it furnishes us with a history and an identity, and we look even more towards the future, because it forms the canvass for our aspirations. Our society values persons highly when they are in their working years and contribute to the economy, and it devalues those who have passed retirement age. Our days are defined by a schedule, and we are serious about punctuality. Personal relationships are less important than the schedule – if we have an appointment at work, conversations with friends or family time will be cut short.

Other cultural communities - and this includes Native American, Latin American, and Arab societies – tend to favor a polychronic understanding of time. In their communities, older human beings are held in high esteem. Personal relationships matter a great deal, and deserting a guest for an appointment that is coming up is considered rude. Appointment times are viewed as negotiable. For a person who has been raised to honor personal relationships and subordinate schedules, it must be difficult to abide by a cultural regime that privileges schedules and subordinates personal relationships.

I am, of course, aware that students who study at an American university need to abide by the rules that govern the institution. I also acknowledge that students who are late may simply be so because they felt like skipping class. However, adjusting to our perception of time may be more difficult for Arab students than we acknowledge, for even though our time perception influences deeply how we act, most of us are unaware that we hold a culturally specific notion of time. Imagine you visited a foreign country, spent time with a local resident, and were asked to stay with him for an hour longer even though you have another appointment coming up and will be late for it. Would it be easy?

In conclusion, there are numerous ways in which we can choose to interpret the conduct of human beings from another culture. Some of these ways are demeaning, because they portray these persons not only as different, but also suggest that they are inferior. Once we give into the notion that those who differ from us are not our equals, two-way dialogue ends, and the one-way imposition of values begins. This in turn has pernicious effects for the persons who suffer the imposition. In the spirit of intercultural communication I therefore suggest that we do not resort to the fatalism metaphor, if we can interpret conduct in ways that are less pejorative.

God willing, we will succeed in ditching those stereotypes.

## TRADE POLICY AND ACCESS TO PHARMACEUTICAL PRODUCTS IN DEVELOPING COUNTRIES\*

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*There is a critical need for a serious reevaluation of the relationship between two contending issues facing developing countries: on the one hand, that of intellectual property rights (IPR) protection, as championed by the TRIPS agreement of the WTO, and on the other hand, that of access to life-saving medicines at affordable cost. Adherence to global trade rules regarding intellectual property is a requisite condition for members willing to participate in the global trade regime. Yet, strict enforcement of IPRs adversely affects access to medicines in low-income nations, as patent protection invariably leads to price increases. These price increases enable manufacturers to recoup research and development costs and investment risks. A careful examination of the merits of both issues is presented, along with some of the difficult trade-offs that are being debated in the global politico-economic arena, especially in the context of humanitarian crises such as the HIV/AIDS pandemic. This paper argues that critical issues of public health should take precedence over harmonization of global trade regimes. It supports the need for further flexibilities in TRIPS to facilitate access to life-saving medicines in developing countries but in a manner that is mutually supportive of both affordable health and of intellectual property - without forgoing the benefits of developing novel drugs.*

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The evolution of the international trade system spans a period of more than 50 years during which a progressively increasing number of countries have begun participating in trade liberalization commitments. This progression has resulted in the current multilateral trade regime, embodied and legitimized by the World Trade Organization. Changing trade realities of recent years, however, have created new forms of trade issues, addressed through the incorporation of responsive trade rules into the WTO framework. One such response has been the establishment of the *Agreement on Trade-Related Intellectual Property Rights* (TRIPS). It provides a comprehensive mechanism for protecting patents, trademarks and industrial designs, while safeguarding research and development (R&D) incentives and facilitating the recovery of development and production costs.

However, as important a trade and research-investment provision as TRIPS may be, stronger patent protection in most cases leads to significant increases in the price of pharmaceutical products. This price increase places a severe challenge to the already strained budgets of developing countries, rendering essential drugs unaffordable to millions of people in poor nations.

Although there are many factors that influence access to effective treatments such as quality diagnosis, distribution, available financing and adequate domestic health-care infrastructure, price - inflated by patents - is one of the greatest barriers (Dommen 2002; Pecoul 2001). As a result of these factors, less developed countries (LDCs) are especially vulnerable in matters of access to life-saving medicines and health treatments. According to Dommen, citing

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statistics from the World Health Organization (WHO), more than one-half of the population in some parts of Africa lacks regular access to essential drugs (Dommen 2002, 23-24).

Another alarming side effect of more expansive patent protection is the legal restrictions it places on generic pharmaceutical competitors. Especially affected are those countries with already established and highly effective domestic generic pharmaceutical industries, such as Brazil and India. By limiting domestic generic competition, stronger patent regimes place constraints on a viable means of exerting powerful downward pressure on the price of pharmaceutical products. Thus, developing countries face an immediate dilemma between the long-term benefits of trade liberalization and participation in the WTO regime on one hand, and the immediate harms on public health triggered by such participation on the other. Most significantly, the AIDS pandemic has raised some difficult questions in defining what is deemed “appropriate” with regard to patents and the long-term market-exclusivity protections they offer.

This paper will begin by discussing the current intellectual property regime as sanctioned by the WTO. It will also analyze the most recent waiver to the TRIPS agreement, reached in the forum of the WTO on August 30, 2003. It will then assess the plights of developing countries and discuss diseases that are largely prevalent there – in particular HIV/AIDS, malaria and tuberculosis. The paper will also focus on two developing countries with high levels of domestic generic pharmaceutical production and with successful records of exerting downward pressure on the price of medicines. Following will be a discussion of the various pharmaceutical industry claims and the industry’s rationale for stronger patent protection. This paper will conclude by reevaluating the trade-off between trade rules and corporate profits on one hand and their effects on developing countries’ public health on the other. The thesis of this paper maintains the primacy of public health and defends the need for further flexibilities in TRIPS designed to assist developing countries’ access to life-saving medicines at affordable costs. Such objectives, however, should only be achieved in a manner that is mutually supportive of both affordable health and of intellectual property, without forgoing the benefits of developing novel drugs, especially those targeting diseases prevalent in the developing world.

The case of trade policy and its effects on the affordability of pharmaceutical products in developing countries is as paramount as it is politicized. It sheds light on the immediate conflict between the benefits of trade liberalization and participation in world trade and the harms on public health triggered by such participation – for membership in the WTO requires abiding by WTO rules. Furthermore, it could be argued that the world trade regime is still inadequate in responding to the plight of developing countries. Sustained political lobbying by powerful pharmaceutical giants, as part of their efforts to protect markets, research incentives and profits, has further exacerbated the issue of priority between trade regime rules and access to life-saving medicines.

## **PATENTS AND INTELLECTUAL PROPERTY**

Intellectual property refers to any creative invention of the mind that is developed and produced through a distinct idea or process, and then used in commerce. Patent rights are a form of intellectual property, along with trademarks and copyrights, and are the standard means of encouraging innovation and fostering scientific pursuits in any industry (Danzon 2001). Yet patents provide the patent holder with a limited monopoly power for a minimum of 20 years that excludes others from unauthorized capitalization on the uniqueness of the invention by means of making, selling or using the patented product or technology. Thus, patents provide patent holders

with incentives to invest in R&D and facilitate the returns on investment by prohibiting competitors from “free-riding” on the patented invention (Condon 2002, 97). Patent holders receive exclusive market rights on their inventions, however, only in exchange of disclosing the patented process or invention, which would encourage the public use and reproduction of the invention/process once the duration of the patent expires. This is especially important in the pharmaceutical industry, where knowledge of technology use and adaptation are crucial in disseminating generic versions of pharmaceutical products for the wider public health use. As Condon points out:

Private patent rights in the pharmaceutical field do not benefit just the owners of patents. They also serve the interests of the public, by promoting the development of new pharmaceuticals; of governments, by advancing public health objectives; and of generic competitors, by providing them with a source of technological information and research data, new products, and new commercial opportunities (Condon 2002, 97).

Protection of intellectual property rights is important to any industry which is knowledge-driven and which entails a considerable investment in knowledge that is limited to the general public. The pharmaceutical industry is one such industry, where patent rights and protection are of utmost importance. Thus, the pharmaceutical industry’s willingness to invest in a market and bring its technology there is a function of how adequate a protection that market provides of intellectual property rights (IPRs).

### **International IPR Regime**

The protection and harmonization of intellectual property on a global scale lies within the jurisdiction of the World Trade Organization, which came into effect on January 1, 1995, improving upon the trade regime of its predecessor - the General Agreement on Trade and Tariffs, the GATT. The WTO established the progressive introduction of intellectual property rights and patent protection in a global context through the aegis of the *Agreement on Trade Related Property Rights* (TRIPS). TRIPS was one of several multilateral agreements established at the end of the Uruguay Round of multilateral trade negotiations which lasted from 1986 to 1994; it marked the first time in history that issues of intellectual property and investment concerns were incorporated into the global trade regime. As it is, the framework of TRIPS demands a minimum standard of patent protection in the domestic IPR legislation of each WTO member state, and its multilateral obligations are binding and enforceable through the WTO dispute settlement mechanisms.

The TRIPS Agreement was one of the most difficult topics of the Uruguay Round for it placed industrialized nations’ interests largely in opposition to those of the developing world. There was a strong sense of concern among developing countries that consolidated intellectual property protection would increase the leverage and, in some cases monopoly power, of multinational corporations from the developed world vis-à-vis developing countries. Developing nations finally agreed to the establishment of TRIPS in return for concessions in other areas of importance to them, such as agriculture. Furthermore, developing countries feared unilateral diplomatic and trade sanctions placed on them by members such as the US, which would be discussed in greater detail below.

The TRIPS was pushed on the international trade agenda primarily by developed, industrialized countries such as the United States, Japan, Germany and Switzerland, with strong domestic industries having a significant interest in the creation of a coherent, rules-based system of international trade management and protection of IPRs (Maskus 2000b). Such industrialized nations, lobbied by their domestic industries, maintain that a lax and divergent international IPR regime undermines their comparative advantages in certain highly technology-gear sectors such as pharmaceutical production. In the case of the pharmaceutical industry, products can be illegally copied by others, albeit with some effort. This risk of IPR expropriation jeopardizes the profits of pharmaceutical developers. Therefore, industries such as the pharmaceutical industry lobby their national governments to enforce the maximum protection of their interests under TRIPS (Condon 2002). Developing countries, on the other hand, claim that TRIPS ignores the inherent economic, political, legal and technological asymmetries between developing and developed nations, as well as the stark differences in their research and development capabilities, by attempting to harmonize the global patent regime according to developed-world benchmarking (Chang 2001; Lanoszka 2003; Sharma 1997).

### Principles and Obligations of TRIPS

The main rules for implementing the global intellectual property regime as championed by TRIPS are consistent with the liberal international economic and trade order of the World Trade Organization and its principle of nondiscrimination. This principle serves as the overriding rule for implementing and managing free trade as sanctioned by the WTO. Some of the general legal tenets of TRIPS are outlined below:

**Table 1: TRIPS – General Principles and Obligations**

<b>ARTICLE</b>	<b>OBJECTIVES</b>
<b><u>Article 3 – National Treatment</u></b>	<ul style="list-style-type: none"> <li>▪ WTO members prohibited from discriminating against foreign companies doing business within their borders by ways of favoring domestic companies</li> <li>▪ WTO members required to provide foreign companies with IPR protection no less adequate or comprehensive than provided to domestic companies</li> </ul>
<b><u>Article 4 – Most Favored Nation</u></b>	<ul style="list-style-type: none"> <li>▪ WTO members prohibited from discriminating between different foreign companies – i.e. favoring business entities from one member state at expense of another</li> </ul>
<b><u>Article 7</u></b>	<ul style="list-style-type: none"> <li>▪ IPRs to be enforced in ways that promote the innovation and transfer of technology to the mutual advantage of producers and users</li> <li>▪ IPRs to be enforced within the context of a balanced economic and social welfare</li> </ul>
<b><u>Article 63 – Transparency</u></b>	<ul style="list-style-type: none"> <li>▪ WTO members obliged to disclose laws, regulations, judicial decisions and revisions of domestic IP regime that may affect treatment of</li> </ul>

IPRs inside their borders
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*Source:* Condon 2002; Dommen 2002; WTO, 2001

Developed nations were obliged to conform to TRIPS and provide for the full intellectual property rights protection within their domestic laws by January 1, 1996, one year from the entry into force of the WTO. Developing countries and countries in transition were given until the year 2000 to comply. Developing countries that did not have a prior history of product patents, such as India, were given until 2005 (Tikku 1998; Fink 2000). The transition period for least-developed countries was 11 years and the initial deadline to assume their TRIPS obligations was January 1, 2006. In 2001, following the *Doha Declaration*, that deadline was extended to 2016 (Condon 2002, 104; Sharma 1997, 66; Van Eeckhaute 2002, 24; Van Thiel 2003, 5; WTO 2001, 1 ; WTO 2003, 2) .

### **The Dilemma of TRIPS**

With the TRIPS Agreement, intellectual property rights were brought into the realm and jurisdiction of the World Trade Organization. This move accredited the IPR regime with the binding rules and thorough dispute settlement procedures of the WTO, which significantly strengthened its enforceability, as compared to the previous unenforceable and vague standards delegated by the World Intellectual Property Organization (WIPO). However, since its onset, a serious controversy was associated with TRIPS in the distribution of potential costs and benefits that could arise under a global system of stronger intellectual property rights. This debate has been especially heated in the area of patents on pharmaceutical products because the monopolistic character of patents has a direct impact on the price of patented medicines. As the bulk of pharmaceutical technology and product patents in the world (in some studies as high as 90%) are held by pharmaceutical multinationals in industrialized countries, patents render the majority of drugs for developing-world prevalent diseases inaccessible to millions of people in developing countries (Dommen 2002, 26; Kobori 2002, 11; Maskus 2000b, 169; Oxfam 2001, 11).

The pharmaceutical industry is enormously dependent on the degree of global IPR protection in its economic decisions of developing pharmaceutical products. Stronger IP protection safeguards and promotes patent rights, generates incentives for innovative firms to invest in research and development activities and allows pharmaceutical manufacturers to recoup their costs in a 20-year-long competition-free market environment. Patent protection thus serves as an incentive for future medical research and development activities on the part of pharmaceutical companies and consequently, for the creation of new drugs. The logic of TRIPS further states that a stronger intellectual property regime would stimulate transfer of technology, an especially important issue for the developing world. Clearly, the higher the risk that intellectual property would be violated, the less likely a firm would be to expose its technological innovation and exclusive knowledge to a given market (Condon 2002, 103). However, patent protection also provides patent-holders with a monopolistic advantage where they can charge prices as high as the market can bear in order to maximize their returns on investment. This makes the price of patented pharmaceutical products largely incommensurate with production costs.

The ongoing AIDS pandemic raises some especially difficult questions regarding patents and their impact on the accessibility and affordability of pharmaceutical products. Schulz, citing

statistics from South Africa's *Treatment Access Campaign* in 2000, provides an example of the considerable differences in the wholesale prices of several HIV- treatment drugs, due to differences in the levels of patent protection embedded in the domestic laws of three countries: South Africa, India and Thailand. Domestic patent laws in South Africa have traditionally provided developers with considerable patent protection, whereas India and Thailand have dismissed the notion of patents on pharmaceutical products, maintaining that patent protection is unjustifiable in matters of public health (Schulz 2000, 147):

**Table 2: Comparison of Wholesale Prices for Some HIV-drugs**

Medicine	Chemists pay in South Africa	Thailand/India	Quantity
Fluconazole	R 80.24	R 1.78	150 mg capsule
Combivir (AZT/3TC)	R 20.00	R 5.43	300 mg + 150 mg
AZT	R 5.54	R 2.38	100 mg
3TC	R 22.80	R 16.30	150 mg
Nevirapine	R 31.75	R 12.00	200 mg
DDI	R 10.90	R 6.00	150 mg
D4T	R 26.00	R 2.75	40 mg

*Source:* Schulz 2000, 147

The Catch-22 nature of patents, however, is further exacerbated by the fact that inadequate IP protection in many developing countries provides a disincentive for pharmaceutical companies to develop drugs for diseases prevalent in the developing world, such as AIDS, tuberculosis and malaria (Danzon 2001; Lanjouw 2001; Lanjouw 2003; Resnik 2001). Since the pharmaceutical industry is propelled by innovation, it is therefore highly dependent on patent protection to sustain its research, market share and profits. It is a costly and risky industry due to the high cost of chemical compound development, bio research and clinical trials. In 2000, the Pharmaceutical Research and Manufacturers Association (PhRMA) estimated that the average cost of developing a single drug is \$500 US million and only a small portion of the researched chemical compounds ever reaches the market (Condon 2002, 99; Maskus 2000b, 53). Furthermore, again according to the pharmaceutical industry, only 30 % of new drugs that reach the market are profitable (Resnik 2001, 27; PhRMA 2001, 1). Thus, the industry follows market incentives very closely for its research and development activities, and the weak patent protection environments in many developing countries create weak investment incentives for pharmaceutical firms to develop drugs of particular concern to those countries.

Instead, about 90 % of the over \$65 US billion invested annually in health R&D by pharmaceutical companies and Western governments is not focused on the treatment of tropical problems and diseases plaguing the developing world. Rather, it is focused on problems faced by the 10 % of the global population living in the developed world, such as baldness, obesity and depression (Thomas 2002, 259; Pecoul 2001, 2). Furthermore, of the 1233 new drugs that have entered the global market between 1975 and 1997, only 13 pharmaceutical products were targeted specifically at tropical infectious diseases, such as malaria (Thomas 2002, 259; Barnard 2002, 164-165). In 2000, the World Bank also addressed the issue of the stark global disproportions in health research. It made public a report by the *Global Forum on Health Research*, which also concluded that less than 10% of global health research was ascribed to the 90 % of the world's health problems, mainly found in developing countries.

## Evolution of Flexibilities in TRIPS

Since its onset in 1995, the Agreement on TRIPS has attempted to balance the pertinent interests at stake – access to affordable medicines in developing countries and patent protection. There has been pouring criticism however that TRIPS still gives more weight to the profit interest of national and international patent systems at the expense of public health and of poor people's interest in gaining access to drugs at prices they can afford (Joseph 2003; Resnik 2001; Schulz 2000). Woven in the TRIPS framework are two flexibilities that give developing countries, afflicted by situations of public health emergency, the freedom to override patent protection to a certain extent. These two flexibilities are confirmed by Article 27 of TRIPS, which allows for the exclusion of inventions from patentability as a measure to protect human, animal or plant life, or health, or to avoid serious environmental degradation.

**Prior to the WTO Development Round of Negotiations in Doha, Qatar.** The two flexibilities, or safeguard provisions in the event of national emergencies, concern the so-called *parallel importing* and *compulsory licensing*. Under Article 6 of TRIPS, which deals with exhaustion rights, parallel importation of patented goods is permitted. Article 31 of TRIPS permits Member states to authorize other use of the patent through means of compulsory licensing. Through parallel importing, governments can permit a product manufactured under a patent in one country but sold at lower prices in another country, to be imported from the second country without the consent of the patent holder. This importation right, however, is limited and further involves the issue of patent exhaustion. Compulsory licensing, on the other hand, is in effect forcing a patent owner to share his/her invention with others before the patent has expired. It allows governments to permit a person other than the patent owner to produce the product without the owner's permission. However, the compulsory license can only be awarded in cases where the applicant has previously attempted to obtain the license voluntarily on reasonable commercial grounds. In addition, the patent holder has to be fairly compensated when the compulsory license is issued. In the event of national public health emergency, though, a compulsory license can be granted without first seeking to voluntarily attain it from the patent owner (Danzon 2001, Van Thiel 2003).

However, prior to Doha, provision (f) to Article 31 of TRIPS maintained that the issuance of compulsory licenses should be predominantly for the supply of the Member's domestic market. Thus, the provision made the production and sale of compulsorily licensed products predominantly for domestic consumption. Exportation of products under compulsory licenses was made illegal, as well as their importation by a third party to the licensing agreement. Provision (f) to Article 31 therefore placed an enormous obstacle to those member states with inadequate or non-existent domestic pharmaceutical production capacity, or generic pharmaceutical industry. Having a generic pharmaceutical industry enables a country to produce prescription drugs that are chemically equivalent to brand-name products, but that are instead dispensed more cheaply under their generic chemical names. Due to the provision, Member states with insufficient or no manufacturing capacity in the pharmaceutical sector could not make effective use of the compulsory licensing flexibility of TRIPS, even in the case of public health emergency. These members, predominantly from Sub-Saharan Africa as well as least developed countries were inherently shortchanged, for they were the ones most vulnerable to public health crises and in need of help in the event of national health emergencies. They were placed at a disadvantage for they could not avail themselves of the legal flexibilities provided to them in

TRIPS, since compulsory licensing only helped countries with already an established pharmaceutical production capacity. Pharmaceutical manufacturers on the other hand, especially those in the developed world, regarded the flexibilities of TRIPS as an infringement on their market exclusivity, legally issued to them by the granting of patents as championed by TRIPS. They also regarded the flexibilities of the Agreement as a hindrance to their right to adequately recoup a justifiable investment risk and earn a sufficient return on their research and investment. Other shortcomings of the interpretation and implementation of the TRIPS flexibilities involved the ambiguity regarding the definition of what constituted “a national emergency” (Van Thiel, 2003).

**The Doha Development Round.** Prior to Doha, the developing world aggressively searched for international forums in which to express its discontent with TRIPS, which further exacerbated the North-South divide. Negotiations on additional flexibilities in the TRIPS Agreement were imperative, especially within the context of the looming AIDS pandemic. The pending necessity to come to a legally binding solution on the question of to what extent public health considerations should be allowed to override existing rules on the protection of pharmaceutical product patents could only be reached within the framework of WTO. The reason was that TRIPS was the only international mechanism that provided “a number of enforceable minimum standards of intellectual protection while at the same time providing for a certain flexibility to override those patent rights for public health reasons” (Van Thiel 2003, 7).

On November 14, 2001, the Fourth Ministerial Conference in Doha, Qatar, affirmed the primacy of public health over the issue of pharmaceutical patent rights in TRIPS (Kobori 2002; Van Eckhaute 2002). The Doha Declaration on TRIPS was an important achievement and a milestone for developing countries in that it extended and clarified certain flexibilities of particular interest to them. It recognized the gravity of the public health problems faced by developing and least-developed countries, especially those of AIDS, tuberculosis and malaria. The Declaration also emphasized the importance of interpreting and implementing the TRIPS Agreement in a manner that fully supported public health, through the full use of flexibilities such as parallel importation and compulsory licensing. The Doha Declaration maintained each nation’s right to determine for itself what constituted a ‘national emergency’; it also extended the transition period for the least-developed nations in assuming their TRIPS responsibilities to 2016. The freedom to determine for themselves what constituted “national emergency” or “situation of extreme urgency” allowed nations to interpret the gravity of the situation according to the nature of the disease, rather than the number of infections. Thus, even nations with low infection rates for AIDS, or any other life-threatening condition, could avail themselves of the TRIPS flexibility to acquire cheaper medicines through compulsory licensing. At Doha, Brazil and India, in a concerted effort, used their combined leverage in the WTO to further the issue of establishing a public health exception to patent rules on the multilateral trade negotiations’ agenda (Condon, 2002, 123).

However, the Doha Declaration did not clarify entirely the ambiguities and controversies of the TRIPS provisions. Article 31 (f), dealing with the domestic market supply of compulsory licenses, was not addressed. Furthermore, despite emphasis on the fact that TRIPS was to be interpreted and implemented in a “manner supportive of WTO Members’ right to protect public health, and in particular, to promote access to medicines for all,” controversies remained in abundance (World Trade Organization 2001, 1). The issues the Doha Declaration could not come to an agreement about were: a) which countries should be allowed to import drugs using

compulsory licensing, b) what products could be licensed, c) for what diseases, d) from which exporter, and e) under what safeguards (Van Thiel 2003, 13). Thus, as Kobori maintains, although TRIPS established the primacy of public health concerns, it was but a limited achievement and “but the first step” (Kobori 2002, 19).

**August 30, 2003 Decision.** Prior to August 30, 2003, the main limitation of the TRIPS compulsory licensing flexibility was that a country had to have a reasonably sophisticated domestic pharmaceutical industry in order to produce generic (compulsorily licensed) drugs at a lower cost. The majority of the world’s developing countries, however, lacked viable pharmaceutical production capabilities.

The Agreement reached by WTO member governments on August 20, 2003 finally settled the remaining piece of unfinished business on patents and public health that was left from Doha. It addressed directly provision (f) of Article 31 of TRIPS, which governed that products made under compulsory licensing must be predominantly for the supply of the domestic market, and made it easier for poorer countries, unable to manufacture medicines domestically, to import cheaper, generic versions of patented products made under compulsory licenses. The August 2003 decision in effect waived the domestic-market exclusivity provision of Article 31 (f). The WTO Director-General, Supachai Panitchpakdi, called it a “historical agreement for the WTO” (World Trade Organization 2003, 1). Thus, developing nations without domestic generic production capacity were no longer excluded from the flexibilities of TRIPS. The August 2003 decision was a milestone achievement in multilateral trade negotiations in that it addressed a very important developing country grievance and recognized the extremity of the issue’s implications to the developing world. The WTO members agreed that the waiver would last until the article is amended.

The August 2003 decision now allows *any WTO member country* to export pharmaceutical products made under compulsory licenses. *All WTO member countries* are also eligible to import under the decision, but 23 developed countries have announced voluntarily that they will not use the flexibilities of the system to import. A number of other countries have announced that they will only use the system in the case of emergencies or extremely urgent situations. These countries are: Hong Kong China, Israel, Korea, Kuwait, Macao China, Mexico, Qatar, Singapore, Chinese Taipei, Turkey and the United Arab Emirates (World Trade Organization 2003, 3).

### **National IPR Regimes**

Despite being the first globally binding and comprehensive set of IPR standards and despite its most recent flexibilities, interpretations of TRIPS have been highly contested by developing countries. Along with considerable differences between developed and developing nations, intellectual property rights legislations and law-enforcement capacities differ widely across developing countries in terms of degree. The highly divergent national laws and property rights protections in the world are increasingly finding one another out of discord. They are also becoming increasingly incompatible with the harmonization of policies and markets as envisioned by the WTO and TRIPS. Thus, TRIPS remains a “work in progress” whose further evolution and clarification of procedures will be subject to a constant revision during future rounds of multilateral trade negotiations (Maskus 2000b, 6).

The global coverage and implementation of TRIPS is rendered incomplete due to different national economic environments, different political dynamics, as well as different national legal frameworks and enforcement capabilities. While developed nations and some newly industrialized countries (NICs) regard stronger patent rights protection as encouraging innovation, product development, and a more stable R&D environment for their competitive and highly innovative national firms, stronger IPRs may place an enormous burden on developing countries. The developing world is especially vulnerable in the pharmaceutical sector, where developing nations are overwhelmingly importers of new technologies (Joseph 2003; Lanoszka 2003; Maskus 2000a; Maskus 2000b; Schulz 2000; Sharma 1997; Oxfam 2001). Moreover, some critics argue that developing countries, and even more so the NICs, tend to have a comparative advantage in the imitation and adaptation of new technologies tailored to the appropriate conditions of their domestic realities, and assimilating them more tacitly into the local setting (Chang 2001, 299; Schulz 2000, 149). Therefore, while patent rights as championed by TRIPS safeguard new inventions, they hinder activities leading to imitation and adaptation in the developing world, where such activities have turned into industries providing employment, building human capital and technical skills (Condon 2002, 118; Maskus 2000b, 236 & 240;).

Thus, the reach of and conformity to the TRIPS regime should at least be reconsidered with regards to its potential adverse effects on the developing world, at least in the short-run. Many argue that intellectual property should be devoid of exclusivity because it thwarts efforts of dispersing know-how to the local level, an especially important issue for developing nations (Richards 2002; Schulz 2000, Sharma 1997). Developing countries further maintain that TRIPS is not suited to their economic realities. Indeed, implementation of stronger intellectual property rights could make some nations, especially the least-developed ones, worse off. As Schulz points out, “stronger protection of property rights is not necessarily socially superior to a system which gives room for more imitations” (Schulz 2000, 149).

However, international variations on IPRs influence trade flows. For example, as many proponents of strong IPRs maintain, a nation with a consistent record of ample patent protection would attract larger volume of foreign investment and R&D activities as it provides security for the incentives to invent. This in turn would induce the effective transfer of technology, as those in possession of it would function in an environment free of risk for their technology, investment, and ultimately profits. Consequently, this would lead to modernization of the domestic business sector, as capital inflows abound. Therefore, full integration and participation of poor countries into the global system of trade (the WTO and its agreements) would result in economic growth and development (Lanjouw 2001; Maskus 2000b).

Nevertheless, although the implementation of TRIPS is expected to facilitate an investment-friendly environment in developing countries, some argue that a strong IPR regime is not a significant determinant of foreign direct investment (FDI) and that the anticipated benefits for developing countries are at best uncertain (Chang 2001, 30; Lanoszka 2003, 186). Lanoszka provides an example with China, which despite being one of the “most consistent violators” of foreign intellectual property rights, has nevertheless experienced a significant increase in the inflow of FDI over the past 20 years (Lanoszka 2003, 186). Moreover, Chang relies on historical evidence to argue that the importance of intellectual property rights protection to economic development is often given more credit than it deserves (Chang 2001, 287-293). He further claims that the now-advanced countries did not respect and promote IPR protection until very late in their development, and that “compared with the developing countries of yesterdays, the contemporary developing countries seem to be behaving much better in many ways” (Chang

2001, 293). Lastly, a 1993 study by the United Nations of the relationship between FDI and IPRs concluded that “there are neither theoretical nor empirical grounds to maintain that a higher level of property protection will in general attract more FDI or affect its compositions” (Tikku 1998, 100).

In the area of pharmaceutical products, especially for life-saving drugs, the divergence in national IPR regimes is to a significant extent influenced by the domestic generic capacity of countries, particularly in the developing world. Thus, the generic pharmaceutical capacity of developing countries directly affects these nations’ stands on intellectual property right protection. Discussed here are the cases of Brazil and India, two of the most potent generic drug manufacturers in the world. Generic drugs are prescription drugs that are chemically equivalent to brand-name (patented) drugs, but are dispensed under their generic chemical name. Because manufacturers of generic pharmaceutical products employ the technical innovation and chemical research already developed by the manufacturers of the patented versions, they avail themselves of the technological invention without having to invest capital in it. Thus, manufacturers of generic pharmaceutical products generally incur only production and distribution costs. In a sense, generic manufacturers “free ride” on the R&D activities and investment risks assumed by the manufacturers of patents; yet, as a result, the drugs they produce are significantly cheaper than their patented counterparts.

**Patent Regime in Brazil.** Brazil is a nation with substantial generic manufacturing capacity; it has developed its national patent laws in such a manner as to utilize to the fullest extent the flexibilities of TRIPS. The synergy between the timely and comprehensive initiatives of its government, the concerted actions of its domestic generic industry and non-governmental organizations, and the proactive use of compulsory licensing has made Brazil a success-story in the fight against AIDS (Bastos, 1999; Passarelli 2002; Teixeira 2003). Although there is still no cure for HIV/AIDS, treatment drugs called “antiretroviral drugs” (ARVs) dramatically reduce HIV-related morbidity and improve the quality and length of life for many HIV-positive people. In 1996, a presidential decree guaranteed all Brazilian citizens free access to essential medicines, such as ARVs, in the fight against HIV/AIDS and established the foundation of Brazil’s AIDS treatment program (Bastos 1999; Joseph 2003; Passarelli, 2002; Teixeira 2003). Currently, as Passarelli points, more than 100,000 HIV-infected Brazilians are receiving free ARV drugs.

The Brazilian government has been actively involved in Brazil’s AIDS treatment program and has adopted measures in accelerating the access and affordability of ARV medications. In 1993, using money from its own treasury, the Brazilian government matched a \$125 USD million World Bank loan to fight AIDS (Bastos 1999, 90). Furthermore, it has been utilizing compulsory licenses to their fullest potential in promoting local generic pharmaceutical production; it has also been effectively negotiating with pharmaceutical multinational companies for price concessions, through the threat to issue further compulsory licenses (Bastos 1999; Joseph 2003, 7-8; Passarelli 2002; Teixeira 2003). In 2001-2002, the Brazilian government, through its Ministry of Health, negotiated drastic price reductions with pharmaceutical giants such as *Merck*, *Roche* and *Abbott Laboratories*. As a result, the price per capsule for the ARV *Indinavir* was reduced by 64.8%, from \$1.33 US to \$0.47 US; the price per capsule for the ARV *Efavirenz* was reduced by 59.0%, from \$2.05 US to \$0.84 US; the price per capsule of the ARV *Nelfinavir* was reduced by 40.0%, from \$1.075 US to \$0.64 US (Teixeira 2003, 83). In August of 2001, the Brazilian Ministry of Health successfully negotiated an agreement with Switzerland’s

*Roche* to reduce the price of the ARV *Viracept* by 40%, making the Brazilian price 30% of the price in the USA (Condon 2002, 121).

Before 1997, pharmaceutical products could not be patented in Brazil, which gave a free reign to local pharmaceutical manufacturers who wished to generically replicate them for a wider public consumption. The new Brazilian law however - the *Industrial Property Law of 1996* - currently provides inventors, pharmaceutical producers included, with exclusive patent rights for 20 years in accordance with TRIPS. Despite Brazil's new legislative adherence to TRIPS, the 1996 law also states that to maintain patents, the patent holders are required to manufacture their products locally, and merely importing a product into Brazil is not enough to satisfy the law's requirement (Condon 2002, 120). The law also grants considerably broad procedures for issuing a compulsory license (Maskus 2000b, 173). As such, Brazil's patents law states that all patents, regardless of who owns them or who funds their creation, shall be subject to compulsory license unless they are locally manufactured. Brazil's current law has thus triggered complaints in the WTO by many multinational pharmaceutical giants such as *Pfizer* of the USA and *Roche* of Switzerland who argue that the patent law of 1996 violates the WTO principle of *national treatment*, specified in Article 3 of TRIPS (Condon 2002). The stipulation of the 1996 law, however, is especially important to local generic industries because it eases the transfer of technology and promotes the flow of foreign scientific knowledge and inventive activity in Brazil. Consequently, this builds up the domestic technological capacity and development potential of Brazilian generic manufacturers and facilitates the production and export of cheap versions of patented products. It has also strengthened Brazil's ability to produce and export enough generic drugs to countries that need them, especially in AIDS-thorn Africa.

In 1999, another presidential decree allowed the compulsory license of pharmaceutical patents in the case of a national emergency. In the late 1990's, the rapid increase of HIV/AIDS cases in Brazil led the government to actively place patented AIDS drugs under license. It awarded these licenses to local government and private laboratories, which in turn began producing generic versions of the drugs for the nationwide AIDS program (Condon 2002; Teixeira 2003). As a result of Brazil's AIDS program and generic production capabilities, the HIV/AIDS death rate in Brazil has been reduced by approximately 50% since 1997 (Condon 2002, 120; Joseph 2003, 444; Teixeira 2003, 74; WHO 2002, 6). The occurrence of common HIV-related opportunistic infections, such as cryptococcal meningitis has also declined by 60 to 80% (Teixeira 2003, 79). In 2002, after five years of free access to ARV drugs, a 70% reduction in new HIV cases was reported in Sao Paulo and Rio de Janeiro (Teixeira 2003, 80). Moreover, the Brazilian Ministry of Health has been especially instrumental in the successful distribution of free ARV drugs, as spelled out in its pharmacological guidelines. Of the 15 ARVs currently listed in its pharmacological guidelines for HIV drugs, seven are locally produced generic formulations (Teixeira 2003, 81).

In 1998, Brazil was the sixth largest market for pharmaceutical products in the world. It is also the largest market in Latin America. Its successful and growing domestic generic industry, however, has been shifting the composition of the players in the industry, with local companies actively investing in and modernizing production facilities in their effort to increase their output of generics. The Brazilian generic manufacturers *EMS* and *Medley* dominate the generic pharmaceutical market, which comprises of over 30 companies, and together account for more than 50% of sales. Over 80% of sales are acquired by only five companies, shedding light on the oligopolistic nature of the generic pharmaceutical market in Brazil. *Far-Manguinhos* is another

prominent Brazilian generic drug company that supplies approximately 40% of the ARVs used in Brazil's national anti-HIV/AIDS program (IMS Health 2003, 2).

In 2001 and 2002, the Brazilian government invested heavily in strengthening the generic production of private pharmaceutical companies, as well as of national laboratories. Attracted by these financial incentives, international generic companies, such as India's *Ranbaxy*, Canada's *Apotex* and Germany's *Hexal* began setting up local production facilities in Brazil in an effort to limit their dependence on imports (IMS Health 2003, 2). As the demand for generics increases, multinational pharmaceutical companies are also attempting to gain a share of the Brazilian market, with *Novartis* of Switzerland and *Abbott Laboratories* of the U.S.A. already present.

Apart from the previously discussed success of the Brazilian generic drug industry in saving human lives, the crucial role of Brazil's domestic generic sector is also evident in its effect of lowering prices for medicines. Since Brazil began making generic versions of HIV/AIDS drugs, the price of patented equivalents has decreased substantially, because competition exerts a downward pressure on price (Condon 2002, 120; Teixeira 2003, 83; Pecoul 2001, 62). According to Teixeira, the prices of ARVs produced within Brazil fell on average by 82% between 1996 and 2001, while the decrease was only 40% for imported ARVs during the same period (Teixeira 2003, 83). According to Condon and Pecoul, after the Brazilian government introduced AIDS drugs generically, prices of equivalent branded products dropped by 79% between 1996 and 2000, while the prices of medicines without generic competitors fell only by 9% in the same period (Condon 2002, 120; Pecoul 2001, 62). As the Brazilian Ministry of Health reports, the average cost per patient per year treated with ARVs has decreased by more than half in the last few years (Teixeira 2003, 81). Therefore, the close availability of generic pharmaceuticals both saves lives and reduces the price of medicines. Judging from the experience of Brazil, the effectiveness and success of any AIDS treatment and prevention program is clearly dependent on the degree to which it allows for the concerted efforts of government, national health and private sector institutions.

**Patent Regime in India.** India has been one of the most fierce opponents of stronger intellectual property rights and has been vocal in the WTO in its dislike for the TRIPS Agreement. India, with highly- educated workforce and highly skilled technological professionals, has been at the forefront of pharmaceutical technological adaptation, and unlike other developing nations, "India is not in dire need of foreign technological experts to gain access to and understand technology" (Tikku 1998, 106). Instead, it has modified its technological potential to its own advantage by concentrating on "custom synthesis of complex molecules and basic formulations" in the development of high value-added generics (Tikku 1998, 104).

India, the world's fourth largest drug producer by volume, has argued within the forum of the WTO that compulsory licensing is perfectly justifiable with respect to pharmaceutical products and inventions because of the primacy of public health and access to affordable life-saving medicines. Under its current law, the *Patents Act of 1970*, India does not give full recognition to patents for pharmaceutical products. It protects only "process patents" rather than "product patents" for a period of seven years from the date of application. (Condon 2002, 100; Fink 2000, 2-4; Watal 2000, 733 & 734). Thus, in regards to pharmaceuticals, an inventor cannot patent the molecular formula itself in India, but rather only the recipe for the step-by-step process that leads to the final product. Therefore, Indian generic drug companies have been successfully reverse-engineering patented drugs and selling the generic versions at significantly lower prices than the patent owners. Reverse engineering results in the imitating of existing patented brands

without the hefty investment into research and development of new drugs. In fact, Indian pharmaceutical companies generally spend only a very little amount, as percentage of their sales, in the development of new drugs (Choudhury 2003, 1 & 2; Fink 2000, 9; Tikku 1998, 104). Nevertheless, the Indian pharmaceutical industry has thrived since the implementation of the 1970 Patents Act and by the year 2000 domestic pharmaceutical production, the majority of which consisted of generic drugs, accounted for 70% of the Indian pharmaceutical market (Choudhury 2003, 1).

In a study by Jean Lanjouw, conducted in 1995 and published in 1997, the relative prices of four patented drugs were compared in three countries: the United States, the United Kingdom and India. One of those drugs was *ranitidine*, a histamine receptor antagonist used to treat ulcers. Its price was 26 times higher in the United Kingdom and 57 times higher in the United States than in India (Maskus 2000b, 163). Another comparative study reported by *Doctors Without Borders* in 2000 examined wholesale prices of the patented and generic versions of the ARV *fluconazole*, patented by *Pfizer*. Based on differential pricing criteria, *Pfizer* sold 200mg of the ARV in the USA for \$12.20 US; in Guatemala for \$11.84 US; and in Kenya for \$10.50 US. However, the generic version of the 200mg capsule of *fluconazole*, produced by the Indian pharmaceutical manufacturer *Cipla*, was sold in India for only \$0.64 US (Thomas 2002, 253). Furthermore, according to UNAIDS - the joint United Nations Program for HIV/AIDS - the annual cost in 2000 for triple combination of HIV/AIDS therapy in the USA ranged from \$10,000 to \$15,000, whereas the annual cost for a triple combination offered by a generic Indian manufacturer ranged from \$800 to \$1,000 (Thomas 2002, 261). As Watal also argues, “it is the virtual absence of patents in the pharmaceutical sector that is widely credited in India with having created competition in the new pharmaceutical markets and with having brought down prices to amongst the lowest in the world” (Watal 2000, 734). Another pertinent fact is that as of 1993, the patented market segment in India accounted for only 10.9% of the total sales value of the top-500 pharmaceutical products in India; the overwhelming majority of the Indian pharmaceutical market was comprised of generic products (Fink 2000, 30).

The pharmaceutical industry in India, largely devoted to generic production, has been among the nation’s fastest growing sectors, while its international presence has also become significant. In 1998, India accounted for over 6% of bulk drug exports on the global market (Tikku 1998, 104). *Ranbaxy Laboratories*, one of the largest Indian drug companies, had manufacturing facilities in eight countries and sold its products in 40 countries in 1998. Other Indian companies, such as *Kopran*, *Lupin* and *Torrent*, have also established global manufacturing bases (Tikku 1998, 104). The number of Indian pharmaceutical companies with physical international presence has been growing steadily since. This is why developed-world pharmaceutical companies find India’s patent laws so problematic – as generic companies take market share away from original brand manufacturers, patent-holders lose the pharmaceutical market in India, as well as in other countries that import drugs from India or are in other ways exposed to lower-cost Indian medicines (Resnik 2001, 28).

*Ranbaxy Laboratories* is the one of the largest Indian pharmaceutical companies and is currently the largest generic supplier in France (<http://www.ranbaxy.com>). It ranks among the top 100 pharmaceutical companies in the world and has been rated the ninth largest generic company worldwide (<http://www.ranbaxy.com/profile.htm>). Other prominent generic manufacturers in India are *Cipla* and *Aurobindo Pharma*, the latter being founded by P.V. Ramaprasad Reddy – also a founder of another Indian pharmaceutical giant, *Dr. Reddy’s Laboratories*.

However, due to the global IPR harmonization championed by TRIPS, India will have to amend its patent laws by 2005 to allow for full pharmaceutical products patent protection. Once India implements the TRIPS patent regime, Indian drug companies may not be able to produce and export cheap copies of patented drugs to the world's poorest patients until the patents run out, generally after 20 years. Thus, the implementation of TRIPS in India in 2005 may seriously place generic equivalents of patented drugs out of reach for poor consumers.

As Choudhury points out, however, "the good news is that the new patents regime does not necessarily spell the end of generic drugs – each year some twenty to forty medicines go 'off-patent'," so that there should be ample sources for imitation and adaptation. He also claims that projections for the future show that by the year 2010, 90% of pharmaceuticals trade in India will still be in generics (Choudhury 2003, 2). Furthermore, the August 30, 2003 amendment to TRIPS allows for import and export of compulsory licensing of pharmaceuticals in the case of public health emergencies. It is also important to note that patent protection as required by TRIPS will only extend to newly-developed chemical formulations that have entered the market since 1995, and pharmaceutical products already on the market will not be affected.

Nevertheless, in moving from the current status quo in India to a fully protected patent structure, studies show that drug prices are likely to increase significantly, alongside a significant decrease in welfare, and that the very presence on the market of off-patent medicines, or generics, has an important role in restraining price increases and welfare losses (Fink 2000; Watal, 2000). As Fink suggests, the impact of TRIPS on newly-developed drugs entering the market would be the following:

...if future drug discoveries are mainly new varieties of already existing therapeutic treatments, the impact [of stronger patent protection] is likely to be relatively small. If newly discovered drugs are medicinal breakthroughs, however, prices may be significantly above competitive levels and static welfare losses are relatively large (Fink 2000, 29).

## **THE DEVELOPING WORLD, DISEASES AND ACCESS TO HEALTH**

For reasons of weak patent protection, the developing world does not represent a lucrative market for pharmaceutical corporate giants. In 2000, the *Global Forum for Health Research* reported that only 10% of the global pharmaceutical R&D budget of over \$65 US billion was ascribed to finding cures for diseases that account for 90% of the global health burden, the overwhelming majority of which in developing countries (Thomas 2002, 259; Oxfam 2001, 7 & 33). According to the World Health Organization's *World Health Report* for 2000, the major causes of death in developing countries were: Pneumonia, causing 3.9 million deaths annually, HIV/AIDS with 2.6 million deaths, Tuberculosis with 1.7 million, and Malaria with 1.1 million deaths per annum (Oxfam 2001, 10).

Being among history's worst epidemics, however, HIV/AIDS is the single most devastating disease, with alarmingly rapid increases in rates of infection, which defies national boundaries and has become a true pandemic. Despite its global impact, though, the HIV/AIDS pandemic is most widely spread in the developing world, home of around 95% of HIV-positive people (Kobori 2002, 12; Joseph 2003, 427; Thomas 2002, 252; Oxfam 2001, 33; WHO 2002, 1). At the end of 2000, the World Health Organization (WHO) reported that there were 36.1 million people in the world living with HIV/AIDS and over 21 million deaths caused by it. By 2002, the number of people living with the disease had grown to 42 million (WHO 2002, 1).

South-East Asia, Asia Pacific, the Caribbean, Latin America and Africa are currently facing the most severe tolls.

The worst affected region in the world, however, is Sub-Saharan Africa where 9% of the adult population between the ages of 15 and 49 are HIV-positive and more than 25 million people are currently infected. The southernmost part of Africa is especially hard-hit with adult rates of infection at the end of 2001 of over 38% in Botswana, 33.7% in Zimbabwe, and 20.1% in South Africa (Joseph 2003, 427). Moreover, by 2010 the life expectancy in South Africa is projected to decline by 20 years as a result of HIV/AIDS (Oxfam 2001, 4). Despite these shocking statistics however, the African continent - which comprises 13% of the world population - accounts for only 1.3% of the global pharmaceutical market, mainly due to the effect of patents on the affordability of life-essential drugs (Joseph 2003; Pecoul 2001; Thomas 2002). In December 2002, the World Health Organization's *HIV/AIDS Treatment Access Coalition* reported the following information regarding ARV coverage in developing countries - it demonstrates the immense inadequacy of global ARV-therapy coverage, as only 5.3 % of HIV-positive people in the developing world who are in need of antiretroviral treatment have access to it:

**Table 3: ARV Coverage in Developing Countries, December 2002**

<b>Region</b>	<b>Number of People on ARV Therapy</b>	<b>People in Need of ARV Therapy</b>	<b>Coverage</b>
Sub-Saharan Africa	50,000	4,100,000	1%
Asia	43,000	1,000,000	4%
North Africa, Middle East	3,000	7,000	29%
Eastern Europe, Central Asia	7,000	80,000	9%
Latin America, Caribbean	196,000	370,000	53%
<b>Total</b>	<b>299,000</b>	<b>5,557,000</b>	<b>5.3% (Average)</b>

*Source:* WHO 2002, 1

The AIDS pandemic however is not only a humanitarian crisis. It is also an economic problem of devastating proportions, which destabilizes the workforce and creates political and social turmoil. In 2000, the *International Labor Organization* and the *Kaiser Foundation* estimated that South Africa, the country with the largest HIV/AIDS population in the world, would lose 10.8% of its workforce by 2005 and 24.9% of its workforce by 2020. It also reported that the country's annual economic growth rate will fall by 0.3 – 0.4% per year for the following 15 years (Barnard 2002, 160). Furthermore, it has been estimated that through the year 2005, the pandemic will reduce the per capita GDP growth by 0.3% in countries that are struggling to grow by 1% per year (Condon 2002, 96).

The argument in favor of stronger patent protection maintains that as rapidly developing countries move up the “technological learning curve” to a position of absorbing and even developing more sophisticated technologies, the interest in safeguarding intellectual property rights would gradually increase, especially in economically emerging nations such as India, China, Malaysia, and Mexico. Greater patent protection in developing countries would generate higher levels of domestic innovation, which would be better suited to the local needs and

environment than foreign innovation. It would also facilitate the dissemination and acquisition of information and skills and may significantly influence developing countries in becoming greater sources of innovation themselves. Moreover, countries that enforce weak IP standards, or none at all, tend to remain dependent on uncompetitive firms that rely on imitation rather than innovation (Maskus 2000a; Maskus 2000b).

However, among the most adverse implications of stronger patent rights on the developing world is their impact on price increases for pharmaceutical products. The higher price of patented medicines creates a huge discrepancy between public health budgets and the cost of treating even minor diseases. Thus, the price of patented drugs renders them largely inaccessible in developing countries. In South Africa for example, where majority of ARV drugs are under patents, the cost of monthly HIV treatment in 2001 was around 4,000 rands, whereas the average monthly income was 600 rands. Furthermore, the per capita monthly income in Latin American countries such as Honduras, Guatemala and Nicaragua remains well under US \$125, whereas monthly ARV therapy costs on average US \$300 (Pecoul 2001, 62).

While the precise effects of stronger IP standards may vary across countries, it has been estimated that average price increases for pharmaceutical products could range from 200 to 300% for many low- and middle-income countries (Oxfam 2001, 3). For ARV treatments specifically, patented products cost between three to fifteen times more than their generic equivalents (Oxfam 2001, 4). In 2000, the *Doctors Without Borders'* HIV/AIDS Medicines Pricing Report indicated that the patented version of the ARV *stavudine* in South Africa was more than four times higher than the generic version of the same drug in Brazil. For the ARV *fluconazole*, the patented drug cost 11 times more in South Africa than the generic equivalent in Brazil (Oxfam 2001, 26). Price comparisons between Pakistan, which has traditionally provided strong patent protection, and India, which has one of the strongest generic-drug industries, indicate price differentials of 3 to 14 times in favor of generic brands (Oxfam 2001, 27).

Prices of patented drugs may be sustainable in the developed world due to government subsidies and private insurance and healthcare programs. Developing countries, however, are faced with very limited health budgets. In 2001 for example, if Zambia were to buy the necessary ARV drugs for all its HIV-positive citizens in need of antiretroviral therapy, it would have had to spend approximately \$2 US billion, or 57% of Zambian GDP (Thomas 2002, 252). Moreover, most poor people in developing countries pay for healthcare out of their own pockets (Oxfam 2001, 12, 14; Joseph 2003). In Sub-Saharan African countries, almost two-thirds of total spending on pharmaceutical products is made by households; in South Africa that figure is close to 80% (Oxfam 2001, 15).

## **THE PHARMACEUTICAL INDUSTRY, ITS CLAIMS AND INTERESTS**

The pharmaceutical industry is one of the most profitable businesses worldwide, but its lucrative environment is a function of high risk, substantial sunk costs, and financially onerous research and development expenditures. In 1999, the top ten pharmaceutical firms in the world had an average profit margin of 30%, whereas a profit margin of 10% is considered excellent in most industries (Resnik 2001, 13). Another characteristic of the industry is that the global pharmaceutical market is truly global in scope, with foreign production and distribution channels that go beyond national boundaries. As an industry, it is both hierarchical and intensely competitive (Maskus 2000b, 52 & 53).

The industry is hierarchical in that the global pharmaceutical market is dominated by a relatively small number of very large multinational entities, headquartered in industrialized nations such as the United States, the United Kingdom, Switzerland, Germany, France and Japan. These private enterprises conduct the majority of the basic pharmaceutical research. The 2003 Scrip's Report on the top 100 pharmaceutical companies in the world ranked the following firms in the top 10 positions for 2003, based on their global sales and operating profits:

**Table 4: Top 10 Pharmaceutical Company Positions for 2003**

	Company	Rank by Sales	Pharma Profit (\$ Million)	Pharma Sales (\$ Million)	Pharma Operational Profit Margin
1	<i>Pfizer</i>	1	12,920.0	28,288.0	45.7
2	<i>Merck &amp; Co</i>	3	10,213.6	21,631.0	47.2
3	<i>GlaxoSmithKline</i>	2	7,598.2	26,979.0	28.2
4	<i>Johnson &amp; Johnson</i>	5	5,787.0	17,151.0	33.7
5	<i>AstraZeneca</i>	4	4,006.0	17,841.0	22.5
6	<i>Novartis</i>	9	3,857.3	13,497.4	28.6
7	<i>Wyeth</i>	11	3,505.5	12,386.6	28.3
8	<i>Aventis</i>	7	2,969.6	15,705.4	18.9
9	<i>Abbott</i>	13	2,739.0	9,304.0	29.4
10	<i>Takeda</i>	15	2,446.6	6,838.3	35.8
	<b>Group Subtotal</b>		<b>56,042.9</b>	<b>169,621.8</b>	
	<b>Group Average</b>				<b>31.8</b>
	<b>As % of grand total</b>		<b>77.8</b>	<b>56.9</b>	

Source: Scrip Reports 2003, *Scrip's 2003 Pharmaceutical Company League Tables*

According to the Pharmaceutical Executive Report, published in May of 2003, the top 10 positions in the global pharmaceutical industry for 2002 were as follows:

**Table 4: Top 10 Pharmaceutical Company Positions for 2002**

	Company	2002 Global Sales	Change from 2001	2002 R&D Spend	Headquarters
1	<i>Pfizer</i>	\$ 28.28 billion	+12 %	\$ 5.17 billion	New York, NY, USA
2	<i>GlaxoSmithKline</i>	\$ 28.20 billion	+ 8 %	\$ 4.29 billion	London, England, UK
3	<i>Merck</i>	\$ 21.63 billion	+ 1 %	\$ 2.67 billion	Whitehouse Station, NJ, USA
4	<i>AstraZeneca</i>	\$ 17.84 billion	+ 9 %	\$ 3.06 billion	London, England, UK
5	<i>Aventis</i>	\$ 17.25 billion	+ 11%	\$3.67 billion	Strasbourg, France
6	<i>Johnson &amp; Johnson</i>	\$ 17.2 billion	+ 15.5 %	\$ 2.7 billion	New Brunswick, NJ, USA
7	<i>Novartis</i>	\$ 15.36 billion	+ 4 %	\$ 2.6 billion	Basel, Switzerland
8	<i>Bristol-Myers Squibb</i>	\$ 14.7 billion	- 2 %	\$ 2.2 billion	New York, NY, USA

9	<i>Pharmacia</i>	\$ 12.03 billion	+ 1 %	\$ 2.32 billion	Peapack, NJ, USA
10	<i>Wyeth</i>	\$ 11.7 billion	+ 7 %	\$ 2.08 billion	Madison, NJ, USA

Source: Pharmaceutical Executive 2003, *Fourth Annual Top 50 Pharmaceuticals*

Top global pharmaceutical positions have generally been shared among a handful of pharmaceutical giants from year to year. A recent wave of mergers has further solidified the preponderance of large pharmaceutical companies and has intensified the concentration at this level of industry, a concept termed the “cartelization” of the pharmaceutical industry (Joseph 2003). For example, the merger of *Glaxo Wellcome* and *SmithKline Beecham* in December of 2000 created one of the largest and most powerful pharmaceutical companies in the world, the United Kingdom’s *GlaxoSmithKline*. *Pfizer* of the United States acquired its global leadership position after its merger with *Warner-Lambert* in July of 2000. The global presence and activity of these colossal multinationals has earned them enormous financial power. According to 2001 statistics compiled by Oxfam, based on the United Nations’ *Human Development Report* for 2000, the largest five drug companies in the world in 2001 taken collectively had “a market capitalization greater than the economies of Mexico or India, and twice the gross national product (GNP) of sub-Saharan Africa” (Oxfam 2001, 11).

Along with being hierarchical, the global pharmaceutical market is also highly competitive. Upon expiry of patents, former patented products become subject to intense competition. Furthermore, the vast majority of pharmaceutical companies in the world produce some sort of generic medicines or other substitute products under their own brand names (Maskus 2000b, 52 & 53). Thus, beneath the top level of major pharmaceutical companies are thousands of highly competitive and market-aggressive pharmaceutical firms with international and multinational presence.

Another characteristic of the pharmaceutical industry is that it is highly dependent on patent protection to sustain its R&D activities, thus investments in research and development follow market incentives very closely (Barnard 2002, 165; Maskus 2000b, 53). Strong patent protection is vital for supporting biomedical research, and the existence of patents ensures the patent-holder a long-term profit. Research and development activities, however, are very costly; those contemplating the possibility of investing into the research and development of a new drug need the financial incentive of returns that are higher than average after-tax R&D costs. Patents provide entrepreneurs with enough financial incentives to justify their investment and development risks - patent rights award developers with a 20-year period of market monopoly during which innovators can set prices, sometimes as high as the market can bear, by ways of recouping their high R&D costs.

In a 1994 study, economists from Duke University concluded that only three out of every ten new pharmaceutical products introduced in the market from 1980 to 1984 had returns higher than average after-tax R&D costs (PhRMA 2001, 1). Apart from the high risk and low probability rate of success for new drugs, food and drug authorities closely investigate chemical compounds for safety, effectiveness and patentability. Another reason for high R&D costs is the long approval process for pharmaceutical products – it takes an average of 12 to 15 years in the U.S. for a product to go through pre-clinical research, clinical trials, regulatory marketing approval and finally product launch (Maskus 2000b, 53; PhRMA 2001, 1). Even given the successful completion of this last stage, the Pharmaceutical Research and Manufacturers Association (PhRMA) estimated in 2001 that only 30 % of new drugs entering the market are

profitable (PhRMA 2001, 1; Resnik 2001, 27). It was also estimated that in 1999 an average of \$500 US million was required to introduce a new medicine on the market (Condon 2002, 99; Maskus 2000b, 53; PhRMA 2001, 1). Another statistic provided by the pharmaceutical industry in the U.S. is that the research-based pharmaceutical sector spends on average 13 to 20 % of sales on R&D, compared to less than 4 % for the U.S. industry overall (Danzon 2001, 5; Maskus 2000b, 53; PhRMA 2001, 1 & 2).

Over the past 30 years, the amount of money as percentage of sales allocated to research in the pharmaceutical industry has increased significantly, from 11.4% in 1970 to 18.5% in 2001 (PhRMA 2001, 1). Thus, the industry's rationale for exclusionary rights under TRIPS is that patents allow firms to recoup their large R&D costs, and that in the absence of IP protection, benefits from research and innovation would decrease. Sharma, however, brings up the question of "whether the small markets typical of many developing countries are sufficiently large for the absence of IP protection to affect the supply of pharmaceutical R&D" (Sharma 1997, 72). Because developing countries jointly represent only 10 to 15 percent of global pharmaceutical consumption, many argue that developing countries do not comprise large enough markets by themselves, so that the additional costs to consumers in the developing world for IP protection becomes a welfare loss that is not recouped through increased R&D benefits (Schulz 2000; Sharma 1997, 71-72).

As Patricia Danzon of the Wharton School of Business explains however, pharmaceutical R&D is a fixed, globally joint cost – a cost that is largely independent of the number of patients or number of countries that would ultimately use the drug. As she maintains, R&D costs cannot be simply attributed to specific countries, despite the fact that 90% of global pharmaceutical R&D costs are used for the development of drugs largely targeting problems affecting 10% of the global population living in developed countries, such as baldness, obesity and depression (Pecoul 2001; Thomas 2002, 259). When a chemical compound is developed through R&D activities to serve the demands of affluent countries, no incremental R&D expense is needed for the use of that same drug in low-income countries (Danzon 2001, 5). Moreover, global joint R&D costs are largely sunk by the time the product is offered on the market and figure in the final negotiated price. Thus, large R&D costs inevitably complicate pricing strategies; yet, the pharmaceutical industry argues, patents allow innovator firms to recoup the hefty R&D expenses as a way of preserving incentives for future research and development. As such, patents reward patentees for their inventions and are necessary for further technological development. The pharmaceutical industry further argues that the lack of investment in diseases plaguing the developing world is precisely due to the lack of patent protection in those countries.

PhRMA claims that its members are losing sales of approximating \$30 US million annually as a result of patent violations (Condon 2002; PhRMA 2001). Pharmaceutical companies maintain that patent infringers, such as generic manufacturers, merely copy the patentee's invention and have no need to recoup R&D costs. They only incur production and distribution costs. This enables them to undercut the patentees' prices and still make a considerable profit. They further argue that compulsory licensing may offer cheaper prices for life-essential drugs to needy people in the short run, but at the risk of undermining incentives to develop new medicines in the long run (Danzon 2001, 19; Lanjouw 2001; Lanjouw 2003). A report by the *Pharmaceutical Research and Manufacturers Association* (PhRMA) also found that a growing generic presence would harm consumers by reducing innovation leading to new pharmaceutical products; it revealed that the net consumer gain from accelerated generic entry

into the prescription drug market was \$1 US, whereas the consumer loss from reduced pharmaceutical innovation was \$3 US (PhRMA 2002, 1).

### **Counter-Arguments to Pharmaceutical Claims**

As Joseph argues, however, there is evidence to believe that pharmaceutical corporations often overestimate their R&D costs. In developed countries, much of the research activities and clinical trials that contribute to the development of new drugs are actually done as a public expense in government and university laboratories, with significant public resources invested in safety tests (Joseph 2003, 433; Passarelli 2002, 41). Furthermore, many maintain that the argument of patents having an effect in promoting R&D and innovation has been established but not quite proven (Joseph 2003; Schulz 2000, 150). As Joseph indicates, the introduction of patent laws in Italy, which began in 1978, has reportedly not lead to a significant increase in R&D expenditures or drug innovations by Italian pharmaceutical firms; instead, there has been a sharp decline in Italy's pharmaceutical exports, which had been largely dependent on generic copies (Joseph 2003, 434). Moreover, around 80% of the R&D expenditures of the world's major pharmaceutical companies is dedicated to the creation of the so-called "me-too" or "copycat" drugs, which are pharmaceutical products that are novel enough to gain patent protection, yet add little therapeutic value to existing medications (Joseph 2003, 434; Resnik 2001, 27-28 ). Finally, the world's major pharmaceutical companies, what Joseph terms "Big Pharma," generally tend to spend two to three times more on their marketing expenditures than on research and development. Therefore, the disproportionately high non-R&D expenditures of "Big Pharma" indicate that large pharmaceutical multinational companies "can afford to trim" their high prices without negatively interfering with research and development budgets (Joseph 2003, 432).

On the other hand, even though patents are the most direct cause of price increases, they are not the only obstacle to access to affordable medicines in the developing world. Kobori even goes as far as questioning whether patent protection in accordance with TRIPS is the single most powerful barrier to affordable medicines – he examines a survey of 53 African countries for 15 ARV drugs conducted by the Center for International Development. It revealed that only a few African countries had patents on ARVs and of those that did, only three types of ARVs had been patented. However, countries with no patents did not have a better access to the ARVs. As the author argues, "if the enforcement of patents were depriving Africans of access to ARVs, countries with no patents should have better access" (Kobori 2002, 13). This same survey has also been used by PhRMA in its justification for IP protection (PhRMA 2003).

### **Compulsory Licenses and Trade Sanctions in the Developing World**

Compulsory licenses enable local generic pharmaceutical manufacturers to produce chemically equivalent, lower-cost versions of on-patent medicines. Developing countries, insisting on the compulsory licensing flexibilities of TRIPS as a source for cheaper generic drugs, have been instrumental in positioning the issue at the center of the TRIPS debate, resulting in the current post-August 30, 2003 TRIPS regime. It waives the domestic-market exclusivity provision of compulsory licensing under Article 31 (f) and currently allows any WTO to import and export medicines made under compulsory licenses in matters of public health emergencies. Moreover, WTO members are free to determine for themselves what constitutes a situation of public health emergency.

**Compulsory licenses.** Despite the legal flexibilities that TRIPS now provides concerning compulsory licensing and parallel importing of medicines in times of public health emergencies, pharmaceutical companies have bitterly contested the right of developing countries to avail themselves of these recognized legal measures. The pharmaceutical industry's predominant fear is that "systematic recourse to compulsory licensing would be detrimental to the patent system" (Van Eeckhaute 2002, 15). The companies have argued that the compulsory licensing flexibility poses the risk of being abused and applied in circumstances far beyond the norms where it is justified. They claim that the cost advantage of compulsory licenses may be used by nations for their own economic benefit, rather than being aimed at alleviating serious threats to public health. Furthermore, pharmaceutical companies fear the so-called "cross-country leakages", or spillovers, where cheaper medicines designated for developing-country markets find themselves exported to affluent nations. As Danzon and Lanjouw explain, the world pharmaceutical market consists of two distinct disease markets – one for pharmaceuticals such as antibiotics and HIV/AIDS medications that target diseases of global scope, and one for diseases prevalent in the developing world, such as malaria and tuberculosis (Danzon 2001; Lanjouw 2001; Lanjouw 2003). Danzon argues however, that the risk of spillovers of cheaply priced drugs earmarked for developing-country markets, such as HIV/AIDS treatments, undermines pharmaceutical companies' incentives to provide cheaper drugs in the first place. Because of cross-market leakages, the higher prices in their developed-world markets would be sacrificed as a source of funds needed to recoup the companies' global joint R&D expenses (Danzon 2001). Compulsory licensing therefore is still a major contentious topic for developing nations and pharmaceutical giants, even despite the most recent amendments of TRIPS designed to balance economic interests and social welfare.

**Trade Sanctions.** The evolution of TRIPS has apparently addressed some of the most pertinent issues for developing countries. However, the principle problem of access to affordable life-saving medicines in the developing world still exists. The problem is not necessarily imbedded in the provisions of TRIPS, but rather in how they are implemented in practice. The pharmaceutical industry as a whole is a powerful lobbying force that often has influence on trade policy (James 1999; Thomas 2002). Between 1997 and 1999, members of PhRMA spent \$236 US million lobbying Congress (Oxfam 2001, 6). In the United States, "Section 301" became part of national trade legislation after intense lobbying on the part of pharmaceutical companies. "Section 301" vested the United States Trade Representative (USTR) to the WTO, headed by Robert Zoelick, with the power to monitor the relevant trade laws of foreign countries and place trade sanctions and diplomatic pressures against nations which do not provide potential US investors with adequate IPR protection. These bilateral pressures on the part of powerful nations, being themselves influenced by the demands of powerful lobbies, is considered inconsistent with WTO norms, especially in the developing world. As Dommen further points out, the WTO was set up as a multilateral institution precisely in order to provide a "rules-based system" that would protect its members from these kinds of unilateral pressures (Dommen 2002, 28 & 29). Examples of such trade or diplomatic pressures abound:

**India.** India has been consistently targeted by PhRMA, which regards the Indian generic drug industry as a major threat to its members' interests. Among PhRMA's members are such pharmaceutical giants as *Pfizer*, *GlaxoSmithKline* and *Merck*. India is one of the main sources of cheap generic drugs for markets in Africa and other low-income countries. Its government has

repeatedly been warned, however, that it faces trade sanction despite the fact that India has been consistent with global trade laws and has been legally availing itself of its full transition period until 2005, as ruled by the WTO. In August of 2000, *GlaxoSmithKline* threatened to take the Indian generic manufacturer *Cipla* to court. *Cipla* had been exporting a generic version of the ARV *duovir* to the small African nation of Ghana. *Duovir* was patented under *GlaxoSmithKline's* *combivir* brand name; a daily dose cost \$16 US. *Cipla* however offered its generic version for only \$1.74 US for a daily treatment. Although *GlaxoSmithKline's* suit was filed before the national law of Ghana recognized patents on pharmaceutical products and although *Cipla's* exportation of generics was consistent with its transition period rights granted by the WTO, *GlaxoSmithKline's* actions were successful in stopping *Cipla* from selling generic ARVs in Ghana (Condon 2002, 100 & 101; Oxfam 2001, 22 & 23; Thomas 2002, 258).

*GlaxoSmithKline's* actions against the Indian generic manufacturer *Cipla* facilitate the argument that even in a rules-based system, such as the framework of the WTO, intimidation and unilateral pressure are still employed by powerful actors in order to supercede the status quo of the global trade regime and ensure the protection of their own objectives. Despite the recent flexibilities and legal measures of TRIPS adopted on August 30, 2003, there is a risk that the “intimidation vs. rules” argument may still occasionally characterize the actions of any large and powerful pharmaceutical company.

**Brazil.** In June of 2000, the United States challenged Brazil's *Industrial Property Law of 1996* by making a complaint at the WTO. As discussed earlier, Brazil's *Industrial Property Law*, the nation's patent law, holds that in order for a patent to be issued and maintained, the patent-holder must make use of the technology in Brazil. American pharmaceutical companies claimed that this requirement violated TRIPS and lobbied the U.S. government to place Brazil under its “Section 301 Watch List” as a first step toward trade sanctions. The complaint against Brazil was a high-profile one, considering Brazil's unprecedented success in making generic versions of patented pharmaceutical products and selling them for fraction of the cost of the patented originals, and in its national HIV/AIDS treatment and prevention program. In July of 2001, the United States dropped the suit after public efforts on the part of health organizations and world leaders.

Since April 2002, 12 ARVs have been included in the World Health Organization's *Model List of Essential Drugs* (WHO 2002, 2). Seven of those are generically manufactured by Brazil for a fraction of the cost of the patented originals. PhRMA, however, has publicly attacked the parallel importation of generic ARVs, even though they are categorized by the World Health Organization as “essential” and permitted as parallel imports under TRIPS (Oxfam 2001, 24).

The example of Brazil, like India, demonstrates the coercive actions on the part of large pharmaceutical companies and their national governments against the legitimate use of TRIPS flexibilities. In the case of Brazil, the country has successfully used in the past the threat of placing patented medicines under compulsory licenses inside its territory as a negotiating tool in obtaining price cuts on essential medicines or voluntary licenses - so pharmaceutical giants' fears could, to some extent, be justified. Yet, unilateral diplomatic and trade sanctions levied against the nation with the highest established records of generic infrastructure and downward pressure on price of medicines in the world – for addressing a health issue of pandemic proportions such as HIV/AIDS - hardly seems a warranted recourse.

**South Africa.** South Africa has the largest population of people living with HIV/AIDS in the world - currently over four million adults and children live with HIV/AIDS (Barnard 2002, 160). In 1997, Section 15 of South Africa's *Medicines and Related Substances Control Act* was passed in order to deal with public health threats. It provided that the Minister of Health may protect public health in certain situations by allowing the importation of generic, low-cost medicines as a substitute to the higher-priced patented medicines already in use. In 1998, however, 39 prominent pharmaceutical companies mounted a lawsuit against South Africa's government after it made public the implementation of a law designed to facilitate the access to low-cost AIDS drugs to millions of South Africans. They claimed that Section 15 of South Africa's Medicines and Related Substances Control Act was in violation with South Africa's obligations under TRIPS, even though the transition period allowed to South Africa to fully conform to TRIPS was not until 2000.

At the time of the lawsuit, generic equivalents of patented products were being manufactured by countries such as India, Brazil and Thailand. Those drugs would have been made available in South Africa at significantly reduced prices. For example, *Pfizer*, which held the patent for the ARV *fluconazole*, sold its product in South Africa for \$9.34 US per dose in 1999. In that same year, the generic equivalent of the drug was sold by Thailand for only \$0.60 US per dose (Barnard 2002, 162-164). In 2001, the 39 pharmaceutical companies dropped the lawsuit after considerable negative publicity.

However, as demonstrated by the table below, the issue of access to affordable medicines may not solely be resolved through generic versions of pharmaceutical products alone. In 1997 in South Africa, even the price of *generic* antiretroviral therapy per patient per year, produced by the Indian generic manufacturer *Cipla*, exceeded South Africa's total per capita expenditure for health for that year by almost 600% (Barnard 2002, 163 & 168):

**Table 5: Price Per Patient Per Year for Triple ARV Therapy Compared to South African Resources**

USA and South Africa at patented drug prices	\$ 10,000
Brazil (under license, with threat of independent production of generic drugs)	\$ 4,000
Estimated cost at pharmaceutical manufacturers' price reductions offered in April 2000	\$ 3,000
Estimated cost at pharmaceutical manufacturers' price reductions offered in April 2001	\$ 1,000
<b>Estimated cost from CIPLA (Manufacturer of generic drugs in India)</b>	<b>\$ 600</b>
Per capita GNP, South Africa, 1997	\$ 3,210
<b>Per capita public expenditure for health, South Africa, 1997</b>	<b>\$ 105</b>
Per case public expenditure for AIDS, South Africa, 2000	\$ 10

Source: Barnard, 2002, 163 & 168

The United States has argued that TRIPS is the minimum standard acceptable for patent rights protection. In its bilateral dealings, the U.S. has put countries under diplomatic and trade pressure to change their patent and trade laws so that they provide for greater patent protection than what is mandated under TRIPS (Dommen 2002, 27-28; James 1999; Oxfam 2001, 6; Thomas 2002, 255). Some of the countries placed under U.S. trade sanctions include Thailand, Egypt, Jordan, Ecuador, Sri Lanka, and Dominican Republic.

### Pharmaceutical Industry Initiatives

Despite the controversial role and interests of the pharmaceutical industry however, it has addressed the issue of affordability of medicines in the developing world on a number of occasions. It has entered into partnerships with governments and non-governmental organizations in several initiatives to increase the supply of essential drugs and reduce their costs.

One such partnership is the joint United Nations Program on HIV/AIDS (UNAIDS) which established the “Accelerated Access to HIV/AIDS Care and Treatment” initiative. The initiative is a joint collaboration between UNAIDS, UNICEF, the World Health Organization, the World Bank and several of the world’s largest pharmaceutical companies such as *GlaxoSmithKline*, *Merck*, *Roche*, *Boehringer Ingelheim* and *Bristol-Myers Squibb* which joined the UN program in 2000. As part of the initiative, these companies have agreed to provide HIV/AIDS treatment medications in developing countries at prices 15 to 20% of those in the United States under a differential pricing system. Despite the program’s good start however, figures from UNAIDS show that by the year 2005, \$10.5 US billion would be needed for prevention, care and support programs in low and middle-income countries. The current budget of the initiative, although growing, is less than one fourth of this amount (Oxfam 2001, 30; Teixeira 2003, 85; WHO 2002, 7).

Pharmaceutical patent holders have also begun focusing particularly on Africa, as the region of the world most severely affected by the AIDS crisis. Botswana is the country with the highest rate of HIV infection in the world, at more than 35% of the adult population. In 2000, *Merck* and the Gates Foundation began donating \$50 US million each over a period of five years to the “Botswana Comprehensive HIV/AIDS Partnership” in a collaborative effort to improve health care infrastructure and access to HIV treatment in the country (Condon 2002, 99). Uganda, one of the most adversely affected nations, has concluded negotiations with *Merck*, *Bristol-Myers Squibb* and *GlaxoSmithKline* to purchase ARVs from them at significantly discounted prices. In December 2000, *Pfizer* agreed to donate the ARV *fluconazole* to the public health agencies in South Africa; *Boehringer Ingelheim* offered the ARV *nevirapine* for free, albeit exclusively for the prevention of mother-to-infant transmission of HIV (Barnard 2002, 165).

Another partnership between several of the world’s pharmaceutical giants and the World Health Organization called “The Roll-Back Malaria Initiative” was created alongside a program initiated to fight Tuberculosis. For more than a decade *Merck* has been providing free drugs for the treatment of river blindness and has committed its efforts until the disease is eliminated.

## CONCLUSION

Clearly, achieving a fine balance between patent protection and access to pharmaceutical products is a formidable task. Yet, as Schulz argues, patent rights on essential drugs are simply unjustified in critical and extreme situations concerning public health, such as the HIV/AIDS pandemic (Schulz 2000, 151). Many foresee that the solution to the difficult issue of IP protection and developing medicines for the developing world could best be addressed through reciprocity and cooperation between pharmaceutical companies and governments of developing nations, for the mutual benefit of both (Resnik 2001). Critical issues of public health should take precedence over harmonization of global trade regimes, and access to life-saving medicines in developing countries should be facilitated by further flexibilities in TRIPS, such as more inclusive “fast-track” procedures for granting compulsory licenses.

The World Health Organization (WHO), being a specialized agency of the United Nations (UN) with an international mandate to promote health and improve health services, should oversee these flexibilities and safeguard developing countries' rights to recognized legal measures within TRIPS and the WTO. Furthermore, the World Health Organization should adopt a more active approach toward forging partnerships on behalf of developing countries with global pharmaceutical companies, financial institutions, and international medical relief and humanitarian agencies in order to improve other factors that influence access to effective treatments in the developing world, such as distribution, available financing, and quality diagnosis. Governments in the developing world should also step up to the plate, establishing comprehensive measures to eliminate corrupt and profligate practices, so that adequate domestic health-care infrastructure is established. Domestic governments could also play a crucial role in enforcing laws and regulations that would prohibit cross-market leakages, so that drugs destined for developing-country markets do not find their way to the markets of affluent nations. The advent of the Internet has made such cross-country leakages more likely (Lanjouw 2001, 6). Yet, a system of specially color-coded or designed packages may be helpful in preventing illegal trafficking of pharmaceutical products (Danzon 2001; Lanjouw 2001).

Resnik argues that such a situation of mutual cooperation could be further reinforced when developing countries adhere to international agreements on intellectual property, such as TRIPS, to secure patents and ensure a stable business environment – by promoting the rule of law, free and open markets, reliable currencies and banking systems. On the other hand, pharmaceutical companies should involve themselves in research and development activities for developing drugs plaguing the developing world and offer discounts on prices for essential medicines (Resnik 2001). This manner of cooperation would be mutually supportive of both public health and intellectual property rights, without forgoing the benefits of developing new drugs. As Van Eeckhaute points out, “one should not forget that generic copies can only be made available to the extent that novel drugs have been developed and made public first” (Van Eeckhaute 2002, 13).

As Maskus explains, stronger IP implementation will invariably be very costly to the developing world - economic benefits of stronger IP rights are rather long-term and are only possible when accompanied by other growth-promoting factors (Maskus 2000a; Maskus 2000b). Due to costs and potential adverse effects, at least in the short run, the reluctance of developing economies to strengthen their patent laws is understandable. Yet, both the WTO and the WHO could work together to actualize the benefits of strong commitments to intellectual property rights for developing countries in a manner that is responsive to the realities and needs of the developing world, so that there are simultaneously adequate supplies of cheaper generic medicines and incentives for the creation of new drugs.

Making prices of medicines in the developing world commensurate with people's ability to pay is another crucial area of influence for the WHO. As Oxfam argues, prices of life-essential pharmaceutical products should be determined as part of an international system of equitable pricing that is transparent and fair, and that is concurrently established by the World Health Organization and the World Bank. Such a system would ensure that price differentials are based on the World Bank's Human Development Index and on a country's ability to pay (Oxfam 2001, 9).

Inadequate IP protection in developing countries provides a disincentive for pharmaceutical companies to develop novel medicines targeting diseases prevalent in the developing world, such as HIV/AIDS, malaria and tuberculosis. Yet, absence of strong

intellectual property regimes in developing nations facilitates their generic manufacturing industries, as in the case of India and Brazil, which have become effective and indispensable sources for cheaper medicines and which would otherwise have to wait until the duration of patents expires before any generic production could take place. On the other hand, the production of generic medicines in itself does not involve much novelty, since generic manufacturers generally employ the chemical research and technological innovations already developed by manufacturers of patented versions, thus availing themselves of the technology without having to invest in it. Thus, both the scientific and public welfare benefits of novel medicines and therapeutic treatments are forgone. Finding an answer to this complex relationship involves a balanced consideration of concerns on multiple levels, yet a solution to the difficult issue of intellectual property rights protection and access to affordable medicines in the developing world may best be addressed in a context that is mutually supportive of both pharmaceutical companies and governments of developing nations. As discussed, such a context would only be feasible if it provides for the conjunction of global institutions such as the WTO, the WHO and the World Bank. As such, it would simultaneously ensure the adequate supply of cheaper generic medicines and the incentives for pharmaceutical research and development, without forgoing the social benefit of novel drugs. In critical situations of health emergencies, however, like the looming HIV/AIDS pandemic, access to life-saving medicines should take precedence over all other considerations.

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## **THE TRIPS AGREEMENT AND ECONOMIC DEVELOPMENT: THE MISSING LINK\***

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*The negotiation of the TRIPS agreement, during the Uruguay Round, came as a need to achieve balance between corporate and private interest, and was accepted specifically by less developed countries as a trade off for promises of greater economic development. Nevertheless, a recurring concern for developing countries is the cost associated with protecting foreign innovation at the expense of economic development. The expected increase in technology transfer and the link of economic development as a result of implementing the TRIPS agreement is a source of sharp disagreement among scholars. This author argues that the evidence of benefits to less developed countries associated with this link is still incomplete. The global protection of intellectual property rights lacks balance and constitutes a net transfer for the interest of important corporate sectors in the developed countries, while largely unresponsive to the developmental needs of less developed countries. This paper explores the concept of intellectual property rights protection and its evolution. It focuses on the main economic developmental incentives incorporated for LDCs to sign the agreement: foreign direct investment as a technology transfer; with specific emphasis being placed on its causal relationship with the TRIPS agreement. It will then conclude by reevaluating the success of the TRIPS agreement implementation and proposals to increase and enforce such returns.*

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The evolution of the international trading system from the General Agreement on Tariffs and Trade (GATT) rounds to the World Trade Organization (WTO) has been portrayed as a process of negotiations that have progressively encompassed a number of trade issues in an effort to promote equitable trade with transparency, non-discrimination, development, and economic reform. Intellectual Property Rights has been one of such trade issues incorporated into the WTO through the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement. The agreement was set to provide basic protection including patents, copyright material, trademarks, and industrial design, but unknown to many; it also seeks a developmental agenda in the form of promoting the transfer of technology. Since the beginning of its implementation, it has created an onset of problems compromising less developed countries' developmental welfare at the expense of following TRIPS standards. Moreover, there are differing academic perspectives as to the effectiveness of the protection of intellectual property rights to promote FDI, and, in the long run, technological acquisition. The recent access to drugs conflict has taken center stage and transfer of technology has taken a back burner, but it is important that such initiative be implemented. This paper will trace the theory of intellectual property, its eventful emergence as a principle international issue, and thereby its adoption to the WTO. The structure and components of the TRIPS agreement will also be discussed, indicative of its distributive efforts and thereby passivity to promote a more developmental agenda. Of concern is how implementing the TRIPS agreement is obstructing the channels of transfer of technology; moreover, how institutionally

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the TRIPS agreement within WTO confines will substitute prohibited channels to promote the transfer of technology.

## **THE EVOLUTION OF INTELLECTUAL PROPERTY RIGHTS**

Property on its own is defined as something that is tangible; essentially an asset that has market value. Intellectual property is defined much the same. Hoekman and Kostecki, define Intellectual property as “information that has economic value when put into use in the marketplace” (Hoekman and Kostecki 274, 2001). To explain more thoroughly, unlike regular property, intellectual property is intangible, it is abstract. However, it can be called property in that such information is valuable in terms of who has access to it, thereby creating a market differentiator using scarcity. Access to such knowledge provides a tangible visible advantage over another. In terms of regular property, it is clearly visible who is the more advantageous: the person who owns the land or asset. Comparably, with regards to intellectual property, the more advantageous would be the individual with access to such information.

The definition of intellectual property protection is more extensive. Innately, intellectual property protection draws on two types of law: Common and Roman law. These two main schools of thought focus on terms of ownership in connection to what constitutes intellectual property, but differ in who owns such property and by what means. The first school of thought believes in private property ownership, emphasizing the Lockean view of private property. The second school of thought, public property ownership, expands on the Roman law code emphasizing public, communal and moral responsibility (May 2003). The conflict of interests regarding the access to intellectual property between less developed and developed countries can be explained by looking at this dualistic perception of intellectual property. Developed countries tend to take a more private property approach, which emphasizes market efficiency, while less developed countries tend to emphasize a public benefits theory for its emphasis on community ownership, a legal culture much embodied in such countries.

### **Private Property Ownership**

The definition of intellectual property, in terms of private rewards is based on providing an incentive to maintain technological innovation that being private property ownership. Private ownership allows the owner to have complete market control over such knowledge. The original investment would be regained by profits through the sale of a good or by way of royalties that others pay to rent the use of such knowledge. Private rewards then, are the increasing development of technology due to ample incentive to innovate, and the economic gains by creators. This school of thought, therefore, emphasizes strict intellectual property rights protection, which precludes the greatest amount of investment return. In terms of private rewards, this comprehensive protection of intellectual property is justified because it protects the investment of the creator. If there is no protection of intellectual property, inventors will feel discouraged to create because the costs, in terms of time, labor, and material investment, will not be redeemable. Private ownership allows the creator to regain his investment and profit from the surplus.

There are many complexities regarding private ownership, which arise in a market economy. The first is that complete control of such knowledge allows for the monopolization of a niche on the market. This factor conflicts with one of the basic justifications for privatizing, the

idea of increasing technological development. It is arguable that if there is no competition to the control of an owner on such intellectual property, there will be slower development as the creator will be less likely to improve his innovation. This can be explained more easily in a market scenario where there is product (A) that is comparably the same in function and technology to product (B). Both products have cost the same to create and to purchase. The question is how product does (A) or product (B) for that matter, incite the public to prefer its product. The answer lies in improvements of product (A) in order to create a market differentiation to the product (B), and vice versa. Therefore, competition helps to induce innovative development by creating competitive innovation where creators use innovation to maximize their market share, this being the key element for antitrust law: multifirm competition (Okediji 2003, 927).

Additionally, if there is complete and infinite control of such knowledge, not only will it create a monopolistic environment, but it will also make such knowledge extremely hard to obtain and build upon. This completely underscores competition because it marginalizes the ability for competition to arise in the first place. Take for instance product (A), where the creator has sole private and indefinite ownership to the innovative production and use. If the creator chooses not to disclose that information, or rent that knowledge, product (A), which may be a necessity or improvement upon society, can only be acquired through the product (A) vendor. It is unlikely that product (B) will be able to compete for market share because no one else will know how such product can be made and used; there will be no creation of product (B), unless through extensive and costly alternative methods like reverse engineering.

The second complexity involved is that private rewards ideology denotes each type of intellectual property equal protection under the law. Clearly, there are many different types of intellectual property: patents, copyrights, trademarks, to name a few. The conflict that arises from assigning equal protection to different types of intellectual property is that it may protect marginal innovation, that is to say, minor improvements on common or known knowledge. This allows for basically anything that is an improvement on the preceding creation to be protected and conferred equal protection. This type of protection, arguably, would lead to the reduction of access to innovative information and thereby the reduction of incremental innovative development. This can be explained through a hypothetical scenario as well, where you have product (A) and another person uses such product and improves it. Under this perspective of equal protection of intellectual property, that improvement on product (A) would be considered a new intellectual property, or product (B). As a result, anything that marginally delineates a new innovation is protected, thereby exacerbating the market with new innovation. Anyone wanting to use such basic knowledge would have to pay royalties in order to gain access; this, of course, reduces access to even the slightest increase and possibly most common knowledge.

### **Public Property Ownership**

These complexities in terms of access to innovation are what public ownership of intellectual property ideology considers. Public benefit theory believes in the concept of knowledge of commons. Christopher May, from the University of West England, describes this concept as a pool where knowledge resides before it is patented and protected (May 2003, 13). This abstract pool of knowledge is accessible to the public and is pertinent to the development of a society. When a person creates or discovers something, he/she has hypothetically taken from that pool of knowledge. Public benefit theory believes that the person who is responsible for such creation or discovery should be compensated, via terms of limited private ownership;

nevertheless, the use and sale of such knowledge should never interfere with public necessity and should be returned to the knowledge of commons thereafter the investment has been regained.

This theory diverges from private rewards in that protection of intellectual property should not be indefinite and bestowed equally to all types of innovative property. It justifies this in terms of access and moral responsibility to the public. As previously explained, it argues that extensive protection of an intellectual property can lead to monopolistic tendencies, reducing access, and thereby competitive innovation. Furthermore, such monopolistic practices can exclude important technology from the public, such as a drug formula to cure a prevalent disease. Hypothetically, if product (A) is important for the welfare of the community, but the only way to access such product is through the vendor, then those who do not meet the economic requirements to access product (A) are worse off. As Robert L. Jr. Ostergard from the University of New York at Binghamton, notes in his article on human rights and intellectual property:

Locke's theory of property also contains two limitations on the acquisition of property. The first is on the amount of property that can be appropriated: 'enough and as good left in common for others.' In other words, so long as others are not made worse off by the acquisition, there is no limit on the amount that may be appropriated.... If the purpose of IPR is simply to protect an idea, this has been achieved; however, nothing is said about the rights of other people to use this information except under the monopoly conditions dictated by the owner. If the purpose of the monopoly right is to make people's lives better, then one must look at the effects that this right has on all people. If the substance is available only to a segment of the population that needs it, then the remaining population is 'worse off' relative to those to who the substance is available (Ostergard1999, 159- 161).

Considering Ostergards' two points, then the complete control of a product is impermissible. Locke argues that as long as there is accessibility to that product, and no one is worse off, private property control is limitless. However, in the scenario earlier described, access is not given to all because it is limited indefinitely to those who can purchase it, and those who cannot are made 'worse off.' In such scenarios, private control is not a good option. The public benefits theory believes in this path of logic that not all intellectual property should be given over for private protection and, if they are, it should be to a time limited enough for the creator to regain his investment and make a respectable profit. This is not to say, however that intellectual property should not be protected, nor is it to say that protection should be to acquire as much profit as possible. Rather it means to promote that the protection of any primary good cannot constitute the degradation of humanity.

Traditionally, the definition of intellectual property has employed the private rewards theory through a utilitarian model, finalized in the TRIPS agreement. Yet as Rochelle Cooper Dreyfuss from the University of New York Law School observes, the purpose of intellectual property law is to create rights to exclude not to exploit (2004). This analysis means that exclusion is a foundation characteristic of IPR law, yet when such exclusion provides the opportunity to exploit market domination; it is contradicting the legal purpose of IPRs. The TRIPS agreement by developed countries perspective has been implemented to protect the innovators' rights through exclusion, necessary for much industrial development. Less developed countries feel that the TRIPS agreement has not only excluded a product's ownership but also provided an avenue for exploitation by developed countries' MNCs using profit mechanisms at

the cost of key transfer of technology channels, such as imitative processes. Support for a more extensive public benefits TRIPS agenda is now being demanded by less developed countries. The dualistic notion of what constitutes as effective protection of intellectual property rights and its institutional implementation is at the heart of the debate. The theories of intellectual property protection facilitate the understanding of such discontent, and offers insight to the evolution of the TRIPS agreement, economic development, and why such division over implementation of critical components as technology diffusion, is still to be resolved.

### **Intellectual Property Rights in Trade: Why are Intellectual Property Rights Important?**

At the core of the Bretton Woods system was the common goal by a number of countries, headed by the United States and Britain, to liberalize world trade. Since Bretton Woods to the current Globalization period, the idea of comparative advantage, in an international market system, has expanded to all facets of industry. Intellectual Property has been one of key types of regimes that have developed from increase trade flows and the need to seek a comparative advantage.

The protection of intellectual properties is key to many international trade industries such as the semiconductor, pharmaceutical, software, telecommunications, and entertainment industries, to name a few. Even in terms of trademarks, intellectual property rights are a key issue in protecting such important industries that depend on quality identification. For trade in 2002 - 2003 the WTO reported:

The faster growing sectors [were] industrial products (i.e. “manufactures”) on the goods side (rising from 50.2% of world exports in 1985 to 58.2% in 2002), and a category of services that include [d] computer and information services, financial services, insurance, telecommunications, and personal, cultural and recreational services (the report calls these “other” services, i.e. not transport or travel) — up from 6.3% of world exports in 1985 to 9.4% in 2002 (WTO, 2004)

The significant increase in trade by these industries shows, however, intellectual property products and transactions have increased in density across various subjects of trade. Not only in terms of transactions is intellectual property such an important share in trade, but also in the production process of industries. As Carlos A Braga, Carsten Fink, and Claudia Sepulveda from the Information Program in the World Bank explain in their article,

The increase in the number of domestic grants may also reflect changes in the behavior of firms regarding their propensity to apply for patent protection. The increase in R&D costs of certain industries, as well as the shortening of the life cycle of new products, has created additional incentives for companies to use IPRs as a competitive weapon (Braga, Fink, and Sepulveda 2000, 23).

The shelf life of such products produced utilizing intellectual property knowledge, is decreasing by each new level of competitive innovation introduced into the industry. Each time there is a new technological development, in such as in the creation and selling of cellular phones the telecommunications industry, it outdates all other cellular products that cannot compete. The importance of patents to such industries is crucial in slowing down the innovation curve and

improving the ability to compete. This is done by reducing and protecting access to technology and the copying of such that would otherwise help to displace or reduce such product's market share. Multinational corporations, specifically those affected by the lack of such protection, have used the vulnerable quality inherent to intellectual property as rationalization for a more internationally extensive regime. Therefore, the immensity of the subject matter has throughout history necessitated the participation of a wider scope of global actors.

### **History: Preceding Intellectual Property Rights Regimes**

Traditionally, before the 20<sup>th</sup> century, intellectual property protection was domestically confined. The first international policy framework to extend patent protection was the Paris Convention for the Protection of Industrial Property in 1867. It was ratified in 1884, but, during the post World War II, it grew in prominence due to the increase of state membership. Previously, a company or such like entity that wished to protect its intellectual property across international borders had to file for a patent in each country, at roughly the same time, as the national patent application. This made international business extremely difficult to develop, and for industries inalienably vulnerable to piracy. The Paris Convention initiated the intellectual property legal regime by conferring two key principles to the international protection of patents: national treatment and right of priority (WIPO 2004, 5).

National treatment, allowed the international patent holder to be treated fairly. It reduced the use of asymmetric policies that previously had enabled domestic parties to file for a patent on said innovation, before the foreign creator. Right of priority took this rule one-step further and used the original national patent claim as the priority date for patent application in other countries, provided that it was filed within a limited amount of time. The Berne Convention for the Protection of Literary and Artistic Works of 1886 treaty also helped to develop international IPR protection; with subsequent revisions made until the late part of the 20<sup>th</sup> century. This Convention protected copyrighted material, and was similar to the Paris Convention because it instituted national treatment in terms of copyrighted material. The convention extended right to priority, however, by conferring such rights internationally without the prerequisite of formal registration in the domestic and or foreign state (WIPO 2004, 26).

Both conferences were fundamental to the initiative process to shift intellectual property protection to a multilateral setting. Nevertheless, they still fell short of the needed prescribed protection solicited by major industry leaders. "As Sam Ricketson notes: 'Although the network of bilateral copyright arrangements...was extensive, the protection this offered to authors in countries other than their own was far from comprehensive or systematic'" (May 2003, 6). This, of course, is the problem with the intrinsic soft legal nature of treaties: only those who signed onto the treaty have to abide by said standards.

Since these two major treaties, there have been subsequent international regulations, which culminated in the formation of the World Intellectual Property Organization (WIPO) in the 1960s. The WIPO has since moved as an adjunct section of the United Nations and helps to promote international awareness and protection of intellectual property by organizing and harmonizing the diversity of treaties for member states. Its function is one of guidance for LDCs in particular, and improvement of development of international intellectual property protection by facilitating treaty ratification and compliance. As Christopher May establishes in his article on intellectual property that WIPO is not up to par with DCs needs in terms of enforcement (May 2003, 6). As reiterated by MNCs and DCs there were three major deficiencies in its framework:

First, it gave incredible discretion to its members on how to implement such network of treaties through its domestic legal regimes. This, of course, was inconsistent in that DCs generally tended to have a stricter adherence to such standards compared to the flexible or non-complying standards of LDCs in particular. Second, as a result of such inconsistency, there were many complaints brought by state members about noncompliance, but WIPO lacked such means to resolve disputes. Thirdly, if there was a clear violation of a treaty, since the leadership was collective, it lacked the hierarchical leverage to oblige members to conform to treaty standards. In other words, there was no clear path of enforcement. This lack of enforcement led many DCs, specifically the United States, to look for alternative methods: unilateral or bilateral sanctions.

During the 1970's, the period of Interdependence, the United States trade policy shifted to a protectionist model that pursued a strategic trade foreign policy to open up foreign markets. This was done by increasing competitive advantage in its domestic industry sectors and reducing access to the American market through unilateral sanctions to pressure countries with understood distorted trade practices that hurt American industry and its ability to remain competitive. The Trade Act of 1974, amended in 1979 and 1984, further assisted this change in foreign policy by giving the president full power to negotiate trade agreements. This extension of authority translated in the use of unilateral means to "remedy unreasonable discriminatory trade practices against the US" (Puckett 1996, 675).

In terms of the international protection of intellectual property, it allowed the United States Treasury Representative (USTR) the ability to investigate countries with irregular injurious trade practices, such as noncompliance with WIPO agreements, and follow through on providing a solution for compliance usually taking a non-tariff or tariff direction, via the President's approval. This methodology was one of original instrumental processes that influenced the evolution and eventual creation of the TRIPS agreement; it was the beginning of connecting trade policy to intellectual property rights. As Laurence R. Helfer from the University of Chicago School of Law inquisitively explains, "The government increased protection standards by linking intellectual property to trade in a series of bilateral consultations with developing countries in the 1980s" (Helfer 2004, 21-22). This connection made intellectual property more enforceable and an important commodity in the international market.

The United States congress also passed the Omnibus Trade and Competitiveness Act of 1988, which further enhanced this trade policy process by transferring direct trade negotiation powers to the USTR. It instituted the extension of section 301 of the Trade Act of 1974, to include a specific section regarding the liberalization of foreign markets for intellectual property, *Special 301*. This list, still part of contentious international dialogue concerning US foreign policy, selects countries based on their "egregious practices of denying adequate and effective protection of intellectual property rights" (Puckett 1996, 680). The inclusion of a state in this list initiates an investigation and follows through with bilateral or unilateral negotiations that concludes in trade sanctions, unless successful. A good example of one of the original *Special 301* induced sanctions involved Brazil, where the US eventually imposed a 100% *ad valorem* duty on Brazilian goods, specifically on drugs (Puckett 1996, 686). Since then, Brazil and others have slowly but inevitably increased their protection and administrative process to required standards. A direct result of such flexible use of sanctions not only put the EU on the defensive, but was also perceived, by many states, as domestically intrusive and discriminatory (Hoekman and Kosteci 2001, 279). Although taking such consequential empirical measures against less developed countries was effective, it reduced the soft power legitimacy of the United States and

triggered disputes in the GATT rounds from Tokyo to its eventful transition to the World Trade Organization.

The use of such hostile foreign trade policy by the United States further pushed adoption for an international intellectual property rights regime. Even if unilateral or bilateral sanctions were effective means of coercing intellectual property rights protection, they lacked international credibility. The use of the GATT to liberalize other trade barriers during the 1980s prompted many corporate leaders and interest groups to pressure their government officials to extend the domestic foreign policy connection with trade and intellectual property rights to such multilateral forum thereby increasing legitimacy. “They foresaw considerable advantages from shifting negotiations into the [GATT]” (Helfer 2004, 18).

The purpose of establishing the GATT rounds as an international trade regime, during the post WWII era, was to maximize economic growth by liberalizing trade in terms of David Ricardo’s framework of comparative advantage. The GATT was different from prior schemes promoting trade liberalization in that it focused on implementing a trade system using cooperative policy. Furthermore, unlike previous treaties or unilateral and bilateral agreements, it had a far-reaching scope enforceable through the Dispute Settlement Body (DSB). Nevertheless, this enforcement capability was used discreetly to not interfere in a states’ sovereign right over its domestic policy. This was especially true in the case of the United States and the European Union, then the European Commission, the major proponents and an active decision making force in the GATT rounds. It was the EU and the U.S. that clearly delineated limitations of power of the GATT on sovereign power, and thereby promoted domestically favorable trade policies utilizing two key principles: reciprocity and non-discrimination. Such means of implementing foundational principles showed the contradicting nature of “[DCs] who consistently created rules that affronted the principles upon which they purported to establish in the GATT” (Anonymous 1995, 1723). This imbalance of power was evident throughout the subsequent rounds, which tended to undermine if not completely “exclude less developed countries’ from international governance of trade” (Spero and Hart 2003, 235). GATT policies generally resulted in significant domestic benefits for developed countries, at the expense of less developed countries.

Regardless if the GATT’s trade policies favorable to developed countries’ domestic interests, the corporate sector and developing countries themselves pressed for a more extensive and permanent intellectual property international organization. The supportive industries varied in scope, but coincidentally, the majority was involved in commerce sectors vulnerable to underdeveloped, non-enforceable, and or nonexistent foreign intellectual property rights frameworks. These corporate leaders lobbied for government policy to stop the pervasive use and advancement of imitative processes affecting economic sectors like the petrochemical, pharmaceutical, semiconductor industries among others, by increasing product vulnerability and directly reducing its competitive advantage (Hoekman and Kosteci 2001, 277). Furthermore, they argued that the GATT had failed to address such pressing and important issues for developed countries prior to the Uruguay Round. . The GATT rounds had not provided the necessary human resource and structure to move trade agenda items quickly and efficiently. A clear example was the outstanding issue of intellectual property rights protection and its marginalization to a periphery concern on several occasions: “Informal negotiations in Tokyo Round and limited scope in the 1947 GATT intellectual property rights provisions”(Hoekman and Kosteci 2001, 282). As a result, the United States, primarily, led the campaign to formalize the GATT system and include intellectual property rights.

## **THE TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS AGREEMENT**

The Uruguay Round, met under pressing circumstances. Both DCs and LDCs had unsettled issues to negotiate in the new round, which created barriers that prevented them from cooperating with each other's interests. LDCs had been hurt by the swift decrease of their agricultural exports due to the increase of subsidies on such DCs' industries, thereby reducing their access to developed countries' markets. Access to foreign markets was believed to be key to further their economic development. Developed countries, comparatively, had new issues to consider. Sluggish commodity exports had underscored unequivocal trade flows due to necessary environmental or competitive statutes, which were imposed on trade, yet these provisions were nonexistent in relation to LDCs exports. This legal difference further accommodated developed countries belief that the lack of protection of intellectual property rights by LDCs had translated into non-tariff barriers on their exports, reducing their success of entering foreign markets (Spero and Hart 2003, 102). Simultaneously, the industrial community had been lobbying the United States government as well as the EU, for a more cohesive and enforceable international intellectual property rights regime due to the growing and pervasive use of technology to produce pirated and or illegal imitations of goods. Pressure from many directions to harmonize legal protection of competition in terms of international trade thus shifted the trade agenda for developed countries in the GATT.

Less developed countries wanted to continue negotiations on unresolved issues from previous rounds and saw the aggregation of new trade subjects as deterrent to their trade policy plight, but DCs rejected such claims. LDCs faced either accommodating to a new agenda, or losing the ability to negotiate on their necessary trade policy. Consequently, DCs exerted their leverage over negotiations and introduced two important issues: the need to formalize the GATT to a more binding and permanent multilateral body, the WTO, and the need to facilitate trade in service and commodity sectors by implementing the TRIPS agreement. The restructuring of the GATT, was argued as a means to improve member compliance, reintroduce objectivity in the negotiating, and dispute process by including checks and balances in the DSB. Furthermore, the formalization of the GATT would benefit the international protection of intellectual property rights in trade, the second issue, because it provided for more linear and extensive enforcement mechanisms.

### **Components of the TRIPS Agreement**

The TRIPS agreement first acknowledges the dualistic nature of intellectual property rights, evident in its preamble, and defines a clear understanding of its objectives as being in terms of both private and corporate interests. Its utilitarian model foresees the junction of such differing intellectual practices to provide for all involved parties (Maskus 2000, 473). Furthermore, unlike previous intellectual property rights regimes, the TRIPS agreement's scope of protection reaches across international borders, utilizing the WTO's multilateral base to execute minimum standards for various forms of intellectual material as described in the agreement. The TRIPS agreement also requires that all member countries "establish minimum standards of protection for all substantive areas of intellectual property law" (Corbett 2001, 1089). This provision refers to two types of laws or legal issues. First, TRIPS protects reiterated international intellectual property standards, such as the Paris and Berne Conventions. Secondly, it acknowledges stipulating new standards of intellectual property law, and existing ambiguities

within the agreement itself (Weeraworawit 1996, 1). The agreement also implements the principle of national treatment to prohibit the use of discriminatory domestic policies against foreign-based entities compared to national entities. It then also requires the implementation most-favored-nation-treatment MFN.

As to the intellectual property regime, the TRIPS agreement specifically names the entities, methods, and process of enforcement, to be executed domestically by the member state. This means that the TRIPS agreement calls for the specific change of criminal prosecution at a civic level an unprecedented reach into domestic legal policy by a multilateral agreement. It then defines and explains the process of judicial review in motion, prescribing the use of a public trial and of fines or incarceration as legitimate means of penalty, provided they are fair and equitable to the degree of the crime. The agreement then extends such measures to protect intellectual property minimum standards at member's borders.

In terms of its public policy, the articles are less assertive and ambiguous (Chisanga, 2001). Specifically pertinent to economic development is the issue regarding Article 66.2. This article requires developed countries to facilitate technology diffusion by providing incentives for its corporate sector. Although, the article is an enforceable component, there are no specifics as to deadline or means of complying with said provision (Chisanga, 2001, 2). All other provisions are acknowledgements by the TRIPS agreement of the need for protection and enforcement of minimum standards and such compliance's ability to be conducive to social and economic development, but they do not explicitly include language that would presuppose action or enforcement.

The agreement is more specific in many other areas, but the presently referred articles affect developed and less developed countries trade relations significantly within the base of competitive law. In terms of its goals to provide protection and developmental policy, the articles are specific and enforceable on the private property agenda, but neglect enforceable processes and guidelines to meet the public agenda. Of importance also is the conflictive nature of the agendas in terms of promoting technology transfer. The enforcement of intellectual property standards clearly prohibits imitative processes, popular historical channels of technology diffusion, which then conflicts with promoting the economic development agenda. Further, the agreement is non-explicit in providing for alternative methods to substitute the lack of historically constant channels of technology acquisition. This description of the articles and their WTO implementation, in terms of promoting the developmental agenda, is purposeful in defining that there is a clear imbalance of interest and action by member countries.

### **The Bargaining Process**

This brief summary of important provisions of the TRIPS agreement helps one to understand the complexity that less developed member countries contemplate when deciding to agree to such document. Although the agreement is written simply and cleanly to facilitate understanding and clarity, the legal implications of complying with all requirements, especially as a member country lacking domestic intellectual property legal precedence is daunting. Analyzed from a more political perspective, the TRIPS agreement has extensive reach. In terms of a member's domestic policy, the agreement encroaches on a country's autonomy and more importantly gives preference to its international agenda at the cost of its domestic welfare.

The focus of this section is to describe the bargaining circumstances that induced LDCs to agree to the TRIPS agreement. Traditionally, group dynamics and game theory have played a

significant role in trade negotiations and its outcomes; the Uruguay Round was no exception. The Uruguay round, like previous trade negotiations, was also characterized by North and South politics. Negotiations were highly restrictive and intensive and countries primarily operated within pre-existing coalitions.

There were two major coalitions, “The Quad,” and the informal less developed country coalition. The four major developed countries formed “The Quad,” which met privately numerous times to settle disputes and negotiations among each other and to agree on a trade stance regarding any specific issue usually in opposition to less developed countries’ stance. This form of cohesive negotiation helped to settle internal differences among developed country members and thus prevented disagreements and confusion that would have otherwise jeopardized the negotiation process. In contrast however, less developed countries suffered from leadership vacuums, changing loyalties, and although many LDCs had the same common goal, they lacked internal consensus and solidarity, thereby facilitating developed countries’ efforts in deceiving a less developing country’s secretary to meet alone and pressure him to agree to the TRIPS agreement (Drahos 2003, 90).

The level of necessity for trade concessions by LDCs also helped to aggravate the lose-lose negotiating context. The United States and other developed countries did not need the multilateral negotiating regime to impose their terms of trade on less developed countries. Whereas less developed countries, especially at this time, when their main source of capital, raw product exports was decreasing, were subject to circumstantial “take it or leave it” negotiations (Tikku 1998, 90). The strategy that led many LDCs to adopt the TRIPS agreement was the “Carrot and Stick” model (May 2003, 7). The “stick” was the threat of bilateral sanctions by the USTR, and the “carrot” was the “Global Package,” also known as trade-offs, that promised many trade liberalizing policies, which would induce domestic economic development in return for signing the TRIPS agreement (Helfer 2004, 22-23).

The trade off bargaining process promised several actions and results to LDCs. The focus of the trade-offs themselves, concentrated on creating a more positive trade environment by reducing or stopping certain protective trade policies “to secure access to the markets of industrialized states” (Helfer 2004, 23). The first of such actions was “the promise by OECD countries to phase out the Multifibre Arrangement (MFA)” which had greatly depleted the export quotas of LDCs with extensive textile industries (Hoekman and Kostecki, 2001, 280). The second promise was the agreement by DCs to increase access to their agricultural markets. This was evident in the effective adoption of the Agreement On Agriculture (AOA) in the Uruguay round. Although subject to interpretation, it can be concluded, based on current and past trade policy, that these two promises were kept. Regardless of the subsidies and tariffs still imposed on agricultural or textile goods, there is academic consensus that overall access to these markets has empirically increased in comparison to the LDCs trade status at that time.

Another bargaining chip used by DCs was to include extensive transitional periods. This displayed understanding and compromise by DCs. However, to its true nature of being a trade-off is questionable. Transitional periods would have been needed regardless of trying to entice LDCs to adopt the agreement. The requirements on domestic law are very proactive and the agreement deals too much with a variety of legal cultures and resources, making harmonization into a similar legal culture in terms of intellectual property law, complex. Thus, even for developed countries, time was allotted to make the necessary changes to comply with the agreement. It was logical for less developed countries, having little or no precedence of such legal standards, to be given transitional periods. Obviously visible by way of schedules of

implementation and even an extension system on certain issues of intellectual property law, this promise was kept.

The next part of the trade-offs is the focal point of current academic debate on the success of implementing the TRIPS agreement. The promise of economic development and technology transfer was not only expressed verbally in the Uruguay negotiations as means of exchange for approval of the TRIPS agreement but also written into the agreement itself as part of the overall vision for responsible protection of intellectual property rights. The preamble states as follows: “Recognizing that intellectual property rights are private rights; Recognizing the underlying public policy objectives of national systems for the protection of intellectual property, including developmental and technological objectives” (World Trade Organization 1994, 320; hereafter TRIPS). Thus, this display of certainty in promoting economic development provided LDCs with arguable means for believing the claims by DCs. LDCs were given to believe that protection and enforcement of the TRIPS agreement would thereby increase economic development, through the dissemination of technology and by way of some institutional channel of technology diffusion. Edward Chisanga, the Zambian Representative to the WTO and WIPO, explains this acquiescence as being shortsighted, saying, “LDCs did not see the [irony] of this [agreement] due to the fact that most formal technology is developed and owned in the North (Chisanga 2001, 2). This commentary does not seek to generalize on the passivity of each member. There were some states that still disapproved of the agreement. Nevertheless, DCs took active measures and threatened developing countries with unilateral sanctions. Another incentive to adopt such agreement: unilateral sanctions are prohibited under the new agreements, and disputes are solved under the auspices of the DSB (Corbett 2001, 1093). The United States further linked its General System of Preferences (GSP) program of 1984, from which many DCs benefited, to the adoption of the agreement, proving to be a successful means at coercion (Drahos 2003, 82).

Seen as a complete package, these trades-offs, although specific to the needs of the LDCs by providing access, development, and security, were asymmetrical. Many of the trade-offs were promises that had no contractual or causal certainty. Moreover, some were not even benefits (transitional periods) but essential to the smooth implementation of such an extensive and harmonizing undertaking. On April 15, 1994, the “Final Act” of the Uruguay round was approved, executing the adoption of the Agreement on Trade Related Aspects of Intellectual Property Rights, by way of the new World Trade Organization. Transitional terms aside, the implementation process had begun. Although, developed countries and less developed countries had agreed to the same written agreement, both left Marrakesh with two different expectations of the course of implementation and its results.

**Problems from the Beginning.** From the date of inception, all countries had one year to implement certain legal provisions, thereby preventing regression by countries in terms of intellectual property rights. The first of said provisions was to either update or create laws that would allow the country to comply with the protection of intellectual property rights. This, of course, included the minimum standards provision, a mailbox system allowing a place for storing filings for patents and exclusive rights given to pending patent product, and to ensure some type of protection meanwhile the intellectual property rights regime is in its preliminary stages. (Corbett, 2001, 1091-1092). However, just the implementation of these legal provisions proved a formidable task. Many countries have little if no personnel and financial resources to create or update their intellectual property regimes. In addition, some countries have industries, such as India’s pharmaceutical sector, that rely on a relaxed set of intellectual property right laws (Tikku

1998, 92-95). The implementation process then became a very resource needing and domestic welfare debased process.

### **The TRIPS Agreement: Defining Characteristics and Member Expectations**

This implementation process has redefined the TRIPS agreement to LDCs in more realistic terms. The complexity of the implementation process has proven to be unexpected and more time, resource, and energy consuming than believed. The realization of considering the true trade components involved when adopting this agreement had been delayed as a result of a misconception by both parties of the focus of the agreement with respect to one another. Even when the bargain process was underway, DCs and LDCs had emphasized different components of implementing the TRIPS agreement. Whereas DCs had concentrated on the acquisition of an intellectual property rights law regime as the reward itself, LDCs had focused on the outcomes of the process: the promises.

There are two key TRIPS agreement principles being: comprehensive, and reciprocal. Both countries differed in the definitions as they apply to the agreement, and the type of implementation processes needed to fulfill them. This section will look at these two principles in light of the point of divergence for developed countries and less developed countries, comparing both to understand the dissatisfaction in both camps, and to assess the differences of their legal cultures at play in the implementation process. These differences have an important consequence on the actions and focus that the TRIPS agreement should take.

**Comprehensive.** One of the most important principles that distinguish the TRIPS agreement from previous intellectual property regimes is its comprehensiveness. The TRIPS agreement covers all types of intellectual property, with a few exceptions, and encompasses all major intellectual property treaties prior to other regimes. In terms of how developed and less developed countries view this principle, this definition is misperceived. Developing countries, especially the United States, see this principle as all inclusive, and equivocal. In fact, this feature is further interpreted by developed countries to apply “[as laying] a foundation for convergence toward higher standards of protection on a global scale” (Braga, Fink, and Sepulveda, 1999, 1). This can be further interpreted as an agreement applicable to all types of societies and legal cultures. In essence, that is what the TRIPS agreement does. It takes the essential forms of protection of intellectual property rights and applies them to each member’s legal regime. This, of course, is logical in that since the TRIPS agreement is focused on facilitating trade exceptions among what intellectual property to protect, and who can or cannot protect, would maintain the same disconnected protection of intellectual property rights. Instead, for the better of the whole, rather than make exceptions from one legal culture to another it has converged into a global standard of protection, essentially an all-encompassing “umbrella” (Helfer 2004, 13-14; Bryan, 1994, 44).

However, less developed countries define this term very differently. Unlike the developed countries, they see this agreement as being comprehensive in contributing to different goals. This stems from the goals expressed in the agreement itself:

The protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge

and in a manner conducive to social and economic welfare, and to a balance of rights and obligations (TRIPS, 1994, 323).

The agreement applies the protection of intellectual property in many aspects, for private and public means. By this meaning, it is logical that there are exceptions to the equal and extensive protection of intellectual property rights all the time because these patents have many different applications when promoting different outcomes. In essence, the main point of divergence is that developed countries see the provisions of the TRIPS agreement as definitive and uncompromising whereas less developed countries see the provisions as proof for exceptions and selectiveness.

**Reciprocity.** Reciprocity is another principle utilized by the TRIPS agreement to balance the needs of intellectual property rights protection by the private and corporate sectors. Bagwell and Staiger define reciprocity as “[referring] broadly to the ideal of mutual changes in trade policy which bring about changes in the volume of each country’s imports that are of equal value to changes in the volume of its exports” (Bagwell and Staiger, 2003, 57). In other words, countries must concede to gain. It is not a zero-sum situation but rather a compromise built on the knowledge that each actor needs the other. However, in terms of the principle’s implementation by both developed and less developed countries, there is a misconception of what each country must do to make such compromise succeed.

The mutual agreement made by developed and less developed countries was the implementation of the TRIPS agreement. It was the promise of technological acquisition that convinced less developed countries to concede to developed countries’ insistence on adopting the TRIPS measures. The main trade-off, the promise worth the complex process of adopting a differing legal culture and enforcing it, was the security of technology. This means that developed countries did not see the transfer of technology as a bi-product of intellectual property protection, but rather as a guaranteed outcome. Edward Chisanga, head of Permanent Mission of Zambia to the UN explains this concept when commenting on Article 66.2, the provision on transfer of technology: “Article 66.2 could be interpreted to imply that implementation of TRIPS by LDCs would actually depend on developed countries’ implementation of Article 66.2” (Chisanga 2001, 5).

Comparatively, developed countries explain this mutual understanding to implement the TRIPS agreement, as its own reward. This position is better understood in terms of how they view the transfer of technology as a market based process. They claim that strong enforceable intellectual property rights regime results in many positive aspects, transfer of technology being one of them. As interpreted by developed countries, TRIPS is the protection that allows for pockets of innovation to happen by decreasing access. It is also the protection that attracts FDI because it decreases the risk on an investment venture (Maskus 2001). Looking at these differing points of view, it is easy to understand the discontent by LDCs with DCs for not following through on its promise for transferring technology because they believed transfer of technology would be implemented through more institutional means. As Keith Maskus explains, “Developing countries are frustrated with absence of effort by rich nations to transfer more technology. The commitment to make such transfers, though exhortatory, was nonetheless a promise that was written into the agreement itself” (Maskus 2000, 239). This view is even more enforced, by the strong legal binding that Article 66.2 of the TRIPS agreement provides to LDCs. This culminated in LDCs efforts in 2001 that pushed the TRIPS council to create an

annual review of developed countries and the incentives given to the corporate sector to transfer technology. Nevertheless, the fruit of the institutions implementation is a highly debatable issue in a reciprocal interpretation: to what extent is institutional transfer of technology being enforced by the WTO onto developed country members and are the benefits empirically visible?

The intrinsic nature of intellectual property rights to protect both private ownership and promote public rewards makes the implementation process hard to interpret objectively. Both protection ideologies are important; they provide harmonization of interests to the intellectual property regime. Furthermore, the implementation process has turned out to be a more difficult task than was expected. Nevertheless, developed countries should not remain ambivalent to the implementation process just because they “met the minimum standards set by TRIPS” (Hoekman and Kosteci, 2001, 284). It is true that developed countries have had to alter little, if not any of their legal regimes, to comply with the TRIPS agreement, but what of the promises made by them to less developed countries?

## **TRANSFER OF TECHNOLOGY**

This section will consider the legality and legitimacy of channels for transfer of technology. This account of the means of technology acquisition will provide an understanding of the causality of patent protection to the diffusion of technology, of importance to less developed countries, as it was a promised outcome of the implementation of the TRIPS agreement. First, it will briefly explain the different channels and factors that enable transfer of technology. Second, it will consider the historical usage of such channels by current developed countries. Foreign Direct Investment has been characteristically adopted as the effective channel for transfer of technology, by developed countries. Of much concern to this paper is to understand whether that market means of transfer of technology is significantly induced by the protection of intellectual property in less developed countries. The third section will look to find factual evidence to corroborate such causality. This section will then conclude with the outcomes of such inventories and the difficulties currently plaguing less developed countries.

### **Channels for Acquisition of Technology**

Transfer of technology is obviously very important to any state wanting to improve its economic development because it denotes the ability to produce higher commodity goods. Several means of appropriation of knowledge confer different rewards in terms of ingenuity and competitiveness. “At its most basic level, it means the successful learning of information and the know-how to use it by one party from another party” (Maskus 2000, 136). Emphasis is placed on the knowledge acquired and the know-how aspect to the transferability of technology. It is the difference between having information and applying it. This difference plays a more important role later in terms of imitative processes.

**Legitimacy vs. Legality.** The idea of intellectual property rights is to protect knowledge in order to protect the investment of the creator, and to maintain enough access to benefit the public. This, in turn, plays out in transfer of technology by creating channels of legitimate or illegitimate means (Maskus 2000, 136). When knowledge is protected, the acquisition of it through compensatory methods is considered legitimate. The creator, or the one holding the rights, can verify an entity’s use of his knowledge because he either licensed it, currently this is

through arm's length investment and shared it to improve his industry in other regions-FDI, or sold it across borders-trade in goods. Through any of these channels, the creator/owner of the knowledge is being compensated, with either royalties, share in profits, or revenue, from sharing his goods. Illegitimate channels provide technology diffusion without having to provide reparations. These channels include pure imitation and reverse engineering (The legality of such processes is verified using the TRIPS agreement as a standard of law. Reverse engineering is not discussed in the TRIPS agreement, so it is unsafe to give it a legal status). Imitative channels of transferability are currently the target of the TRIPS agreement and much of the motivation behind its entrance into the WTO.

In many instances, imitation processes and reverse engineering have been easier approaches to obtain information, predominantly because they require little if no input from the creator/owner. As earlier mentioned, the owner of a technological good has incredible power and can wield it to promote or deny access to such commodities. Through these processes, however, Imitation is easily marketable but the know-how aspect is slow or lacking, hindering the ability to apply the production process to formulate new technology quickly (Maskus 2000, 137). Imitation processes do have many proven benefits evident by the widespread use of such channels in many transition economies. Furthermore, the imitation process can only produce exact replicas of the product, which are subject to legalities protecting the owner's right. However, imitative references are important in that they set the base for future innovative industries and a growing skillful workforce. Reverse engineering improves on imitation. In the disassembling process, one gains the inputs and production dynamics that provide the ability not just to replicate but also to improve or to create a substantially different but comparable product. Reverse engineering, however, is costly and labor-intensive factors that affect the ability to "discern its know-how" (Samuelson and Scotchmer 2002, 1587-1588).

### **Historical Methods of Transfer of Technology**

It is the belief of developed countries that the protection of intellectual property will lead to the acquisition of technology. Yet history records reveal that comparatively developed countries themselves have not followed this mode of acquisition.

Ha-Joon Chang, Assistant Director of Development Studies at University of Cambridge, in one of his latest articles, details a series of historic examples that emphasize the duplicity of the policy initiatives by developed countries. First as claimed, it is true that some technological knowledge did transfer through legitimate processes and there were some legal enterprises to prevent patent theft through legal means during the 18<sup>th</sup> through 19<sup>th</sup> century. A good example of this is Britain, who at the time being the world technological power, pushed the protective initiatives that regulated immigration and the movement of machinery controls (Chang 2001, 288-289). This was done to prevent the gradual flow of knowledge that was being used effectively by other countries and to maintain its competitive status. As Chang explains, "Very often, it should be noted, acquisition of advanced technology was organized through 'illegitimate' means" (Chang 2001, 289). Chang then describes many instances of illegitimate uses of technology acquisition such as espionage and forgery, to which there was sometimes a link with state sponsorship. Finally, he describes how patent laws began to pass in developed countries around the late 18<sup>th</sup>. However, Chang compares current policies and concludes:

All these IPR regimes were highly ‘deficient by the standards of our time. Patent systems lacked disclosure requirements, incurred very high costs in filing and processing patent applications and afforded inadequate protection to the patentee...and most relevant, these laws accorded only very inadequate protection of the IPR of foreign citizens (Chang 2001, 290)

This information is of considerable weight because it suggests that the legal culture, or lack thereof, does not conclusively promote the use of illegal actions by a country. Rather, it can be deduced from such examples that all countries, developed or less developed, suffer from the same need to acquire technology capabilities and will do so regardless of the legality of means employed due the primacy of need. Even the United States, one of the strongest developed countries to support adoption of the TRIPS agreement, did not adopt a patent agreement itself (Berne Convention) early in its developmental stages of production because it would have prevented the support of its domestic industry of publishing (Chang 2001, 306). On such evidence, it is therefore illogical to demand that countries take an alternative route of improving their technological capability.

In terms of more recent circumstances the experience of the newly industrialized countries (NICs) also provide proof of the importance of imitative processes (this includes reverse engineering) to improve the acquisition of technology. A key example of this policy is South Korea, which, during its early stages of industrialization, used duplicative methods to accumulate sufficient technological capability (Dutifield 2004, 54). Brazil also, having one of the largest inflows of FDI as a less developed country (Sayal 2004, 61), until recently, has passed laws that restrict the production of such products, and has in its development stages had a strong imitative and generic industry.

All these historical circumstances help to aid the case that popular traditional methods of technological transfer to further economic development are dissimilar to what developed countries define and require through the TRIPS agreement as suitable means of increasing levels of technological capability. Instead, developed countries argue for the protection of intellectual property rights as a definitive propellant of increase inflow of FDI. So then, such direct cause and effect argument follows with the question, does intellectual property protection induce the increase inflow of FDI?

### **A Channel and Market Method of Technology Transfer: FDI**

This section will look at the causality of intellectual property rights in terms of market means of transfer of technology. It will then look briefly at three different studies: Kumar, Maskus, and Sayal, which analyze the impact of intellectual property rights protection as a major determinant for investing in a country and summarize their findings, specifically of how protection of IPRs determines the increase of FDI.

For this paper, market means of transfer of technology will be defined as transfer of technology without proactive measures to provide intentional incentive such as programs or policy structures to make the diffusion of technology likely. The market feature being transfer of technology through FDI, specifically research and development (R&D). R&D is the technology spillover investment that allows for research and development to be conducted via the foreign affiliate to the host country. Nagesh Kumar writes, “In view of considerable spillovers of R&D activity, its internationalization is seen to be contributing to technological capability in host

countries” (Kumar, 1995, 2). Therefore, considering this information, the FDI critical for less developed countries is the R&D, although other types of FDI are also important for their business and structure knowledge acquisition. Furthermore, the information regarding FDI, in the following sections, explains and reiterates that there is still insufficient evidence to confirm that protection of IPRs is a significant variable that contributes to the transfer of technology for LDCs, acquired by R&D through FDI.

### **FDI: Features and Determinants**

It is difficult to assess the level of causality that intellectual property rights have on increasing levels of FDI for LDCs. Even if the protection of IPRs is a formidable consideration, it is one determinant among many that influences a multinational corporation (MNC) to invest in a foreign country (Braga, Fink, and Sepulveda 1999, 32). Two factors at play when considering R&D explain the push for an international location and the determinants that help to decide what host country is likely to receive FDI.

**Internalization Factors.** In terms of R&D investment, there are the location aspects that engage in the process when considering internalization. The first, is that R&D is more likely to be conducted at the home. This is due to the immensity of the technology spillovers that comes with such endeavors. Daniel F. Burton, Erich Bloch, and Mark Mahaney explain this in terms of American MNCs, “MNCs keep their highest-wages jobs and their critical R&D activities here at home” (Burton, Bloch, Mahaney 1994, 34). Secondly, FDI distribution tends to be uneven across countries. As Prabuddha Sanyal explains, “The international distribution of R&D activities of MNEs is highly uneven, depending on other things, the nature of foreign direct investment (FDI) received by the country and the resources and environment prevailing in the country for undertaking technological activities” (Sanyal 2004, 59). Thirdly, the R&D investment activity when internationalized tends to be located in developed countries. This can be attributed to many factors that come together in developed countries, including economies of scale, technological capabilities and agglomeration effects.

**Determinants of Host Countries.** Determinants of FDI can be grouped into four types: Market seeking, Resource-asset seeking, Efficiency seeking, and Policy Frameworks (Mallampally and Sauvart 1999, 5). In terms of the Market seeking determinants, it is the size of the market, the economies of scale, and the country specific adaptations that are favorable to investment opportunities. In terms specifically for R&D, investors are more likely to set up R&D units with larger markets because they have better opportunities of regaining that investment compared to small economies of scale (Kumar 1995, 9). Resource-asset determinants are usually specific to the location such as raw materials or also the level of technology innovation that country provides, skilled labor, communication, etc. Efficiency seeking determinants are usually local specific too, but it allows the MNC the ability to produce through cost efficient means. These determinants usually consist of the “resources and assets determinants, as specified earlier, but adjusted for labor productivity” (Mallampally and Sauvart 1999, 6). The last is the policy-seeking group of determinants, which places a focus on the policy infrastructures of a country. It is usually concerned with a country’s economic policies such as whether they are open or closed in terms of trade, its government or market policies in terms of intellectual property protection, standards of treatment regarding foreign affiliates, and its affiliation to global agreements.

As is evident, the protection of intellectual property rights is one of many factors involved in the decision-making by MNCs to invest in an individual country. Yet the list of such variables does not take into account the differences within each group of determinants, and is only a list of the host specific determinants. There are also determinants based on the type of industry, which ascertain what host specific factors are more suitable for their production needs and how they will invest (Maskus 1998, 120).

All these factors help to construct an accurate image of the decision making process that MNCs rely on to decide the most suitable location for FDI, and in particular, R&D. These factors also explain why developed countries are still a small percentage of destination countries for R&D. Regardless of the several policies (TRIPS) or improvements being implemented to increase their FDI potential, many of these less developed countries lack economies of scale, good and viable infrastructure, and a skillful workforce. Furthermore, as Nora Kahn concludes, “While achieving compliance with TRIPS may well improve openness, risk, rule of law, and perhaps costs, a country’s market size, infrastructure, and degree of industrialization will remain unchanged. Without strength in these base factors, implementation of intellectual property protection will not increase the inflow of FDI” (Kahn 2002, 3) It is irrational to believe that a less developed country with a small economy of scale, skilled labor force, and technological capability will automatically improve its investment potential just by implementing the TRIPS agreement. Foreign affiliate’s assets may be protected by TRIPS, but they will have to invest a considerable sum to make up for the lack of other important variables.

### **Implications of IPRs on FDI (Literature)**

Various studies have been made about the determinants on R&D investment. However, this section will only focus on the conclusions drawn by these three studies on the importance that protection of IPRs plays in attracting FDI.

**Kumar (1995).** The study of Nagesh Kumar in 1995 looked at the importance of factors that determine overseas R&D. It grouped factors into three groups: extent and nature of FDI, host country resources, and policy regimes. Its conclusions compared the overall determinants of internationalized R&D between developed and less developed countries. It found ironically, that the protection of intellectual properties proved a more important determinant for investment in a developed country than to a less developed country. Kumar, explained this by considering the distinct types of R&D activity: “A strong positive influence in the case of industrialized countries and an insignificantly negative influence for developing countries may in fact be reflecting the different nature of R&D activity performed by MNE affiliates in the two groups of countries” (Kumar 1995, 17). He attributes this difference in R&D activity to the fact that in developing countries foreign affiliate productivity must be adapted to fit local production. As a result “R&D in developing countries is more local production oriented than that conducted in industrialized countries, and hence not so sensitive to the level of intellectual property protection” (Kumar 1995, 18). In comparison, in developed countries, intellectual property protection is significant due to the high level and critical quality of the R&D.

**Maskus (1998).** The study by Maskus in 1998 focused primarily on identifying to what extent stronger IPRs induced the increase of FDI flows into LDCs. Maskus makes two important conclusions. In terms of the implementation of vertical vs. horizontal FDI, IPRs does play a

significant determinant to horizontal investment because the production is high quality, as compared to vertical FDI. Moreover, horizontal FDI tends to be full-scale production, which contains more critical components that must be protected. It also explains that, in a less developed economy, the type of FDI attracted is of low knowledge input industries; however, as the level of production increases, horizontal FDI starts to displace vertical FDI and that is when IPRs starts to take on a more important investment determinant role. He explains, as in previous studies, that there are many other determinants based on host locality that come into play:

Moreover, it must be emphasized that strong IPRs alone do not sufficiently generate strong incentives for firms to invest in a country. If that were the case, recent FDI flows to developing economies would have gone largely to sub-Saharan Africa and Eastern Europe. In contrast, China, Brazil, and other high-growth, large-market developing economies with weak IPRs would have attracted less FDI. (Maskus 1998, 129-130).

Maskus' study of FDI determinants further serves to generate some answers about the causality of economic development. If the TRIPS agreement promotes the idea of protection of intellectual property as the stepping-stone for economic development, then how is it that the success stories of LDCs show a differing economic growth pattern? Maskus explains saying:

In the early stages of their industrial growth, developing countries have an interest in limited protection, because they want to be able to freely imitate imported technologies. As they develop, however, they should become increasingly interested in tightening IPRs, both in order to attract the most advanced technologies and to encourage their own innovation. This prediction is confirmed by the varying degrees of patent protection across countries according to the level of economic development. (Maskus 1998, 135).

These findings are important because although his study points to the importance of IPRs on FDI, it also explains that it is not an economic factor of development. Rather as a country's economy develops, so too, shall the importance of developing its IPR regime increase, not conversely. His research also helps to understand more objectively the implementation of a stronger intellectual property protection regime is important. Nevertheless, this is preferable at later level of economic development and not at the beginning or when development is still fragile.

**Sayal (2004).** The study by Sayal in 2004 is the most recent study that focuses on how IPRs affects an increase in FDI, specifically in terms of R&D. This is a test analogous to the Kumar tests, and its conclusions fall in the same category:

The strength of patent protection in developing economies does not appear to be of any significance for R&D investments by US multinationals. From the analysis, the type of R&D that is undertaken in developing economies is not at all sensitive to the relative strength of patent protection offered by them (Sayal, 2004, 72).

Furthermore, the author concludes its study with prescribing different proactive measures to improve R&D investment by MNC's that shed light on the true motivating factors for improving potential FDI flows. Prabuddah Sayal explains that, in order for MNCs to even consider a

developing country for R&D research, “It is pertinent that these countries first create a technological infrastructure and augment its human capital formation before R&D investments by MNEs takes place (Sayal 2004, 73). Her policy recommendations suggest that other important determinants, those especially in the resource-seeking group that provide infrastructure and a strong production base, are preferable to increasing FDI flows.

These studies have an empirical foundation, and their conclusions suggest that strengthening of IPRs is not a formal significant determinant that generates the inflow of FDI, specifically R&D. As usual, studies should, regardless of their nature, be treated delicately for their dependence on statistics. In terms of their use in comparison to other studies, this article has also consulted the contending perspective set of authors. The most significant being the Mansfield studies (1979) and (1994), which generated survey data finding that IPRs was a significant factor for investing abroad for MNCs, specifically in its influence to different areas of industry, such as the petrochemical industry. These studies do concur with Maskus that more complex forms of R&D are dependent on stronger intellectual property rights protection. Although relevant and used by much of the scholarship because it signifies a different IPR role in inducing FDI, these studies were conducted on the onset and before the Uruguay round and need to be assessed in light of the more recent scholarship.

**Summary of Findings.** In conclusions of the data supplied by the authors regarding FDI, the importance of IPRs is relevant as the economic infrastructure consolidates and becomes more attractive to investment by more specific-industries. However, as explained by Maskus, the importance of IPRs should be reduced in the advent of the preliminary or still ungraduated developmental stages. Therefore, it is questionable that IPRs at the beginning and intermediate economic development stages, truly leads to technology transfer. According to Nagesh Kumar, a strong patent regime, at such low levels of development, might detract R&D into a country (Kumar 1995, 17). Furthermore, Sayal and Maskus focus on balance of production factors, and competitive policies, with respect to developing countries, to enable them to gain preliminary transfer of technology FDI. This refocus is reminiscent of the initiative by some developing countries like Brazil and India. It has been, until recently, on the onset of sanctions by developed country members’ pressure that they have increased their IPRs, whereas before they allowed patent flexibility in order to benefit from imitative processes. This was the case of India’s Patent Act 1970, or comparatively Brazil’s Patent Law of 1971. Both provided no patent protection for many types of products such as pharmaceuticals, foods, chemical substances, alloys, etc. India’s law, in particular, allowed segmented flexibility to imitate or engineer easily copyable products so as to “leapfrog” and focus on building productive potential (Tikku 1998, 92).

### **At A Disadvantage**

The outcomes of this analysis, specifically considering the promise of transfer of technology is key to offsetting the initial short-term implementation costs, is discouraging. Less developed countries cannot rely on FDI to “possibly” transfer technological capabilities. More so, their traditional means of technology acquisition using imitative processes have been taken away or obscured by the TRIPS agreement. They need institutional assurance that can provide, unquestionably, transfer of technology and thereby improve economic development.

**Article 66.2: Institutional Means of Transfer of Technology.** Article 66.2 provides for an assertive policy to help the inducement of investment via incentives provided by developed countries. The article is clear in stating one of the overlooked major goals of the agreement itself:

Developed country members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country members in order to enable them to create a sound and viable technological base (WTO 1994, 348).

Although potentially a powerful concession tool for LDCs, there has been an ineffective push to implement and enforce this article. During the Doha round in 2003, a group of 13 countries called the “Like Minded Group” (LGB) managed to employ this article into a binding set of policies (ICSTD 2001). The program, although a breakthrough in focusing on the developmental agenda of the TRIPS agreement, leaves too many allowances to the discretion of developed countries. The institution only inspects developed countries’ incentive policies annually. There still is no specificity on the subject of what effective incentive provisions are, and how they will be quantified. An example of how the issue of transfer of technology is not being addressed by this policy is the recent 2005 Report of Implementation of Article 66.2 by the United States. In the report, the United States describes many institutions’ current agendas that are in the process of providing aid for developmental initiatives in less developed countries such as USAID. The report fails to actually describe incentives to corporate sectors to transfer technology and the descriptions of such institutional initiatives such as USAID seem promising, but readers of the report will fail to know that such programs are being budget downsized. There is no description of factual, empirical data considering (1) the incentives themselves provided by the U.S. government nor (2) the outcomes of such incentives. It is not only the logistics of how the article will be implemented, but also affecting its success is the attitude by both perspective groups over the how much focus and energy should be spent on developing this agenda. Developed countries actions to focus on the implementation of the agreement have centered on corporate interest rather than the developmental initiative, and even less developed countries have had their own reservations to actively pursue Article 66.2 implementation. In two articles by The International Centre for Trade and Sustainable Development, there were instances where the LGB decided to either prioritize other implementation conflicts such as access to drugs over transfer of technology, or failed to provide for a component of the new program. The ICTSD described how still by 2001 “no LDCs had supplied a list of [technological] needs, as had been agreed at previous meetings [to the TRIPS Council]” (ICTSD 2000; 2001). It is imperative to improve on the institutional program accorded by the council in the Doha round. The majority of less developed countries lack many of the characteristics that improve FDI. Unlike Brazil, India, or the NICs, they cannot fully benefit from market-induced flows of technology. As the Article 66.2 program stands right now, this policy change will not be sufficient to increase corporate sector mobility to invest in less developed countries.

**Antitrust and Other Missing Provisions.** There also needs to be added anti-trust components to the TRIPS agreement to make reverse engineering a viable source of knowledge acquisition and improve the competitive component of less developed countries, a self-independent initiative (Okediji 2003; Samuelson and Scotchmer 2002, 1577). Competitive industries like generic pharmaceutical companies owned by less developed countries, are attempting to maintain market

existence in the wake of the TRIPS implementation. However, their instruments of competition and capital have been greatly reduced as a result on stringent anti-imitative process provisions and limits on compulsory licensing. These corporate competitors, whose existence will not only drive down the price of intellectual goods and improve acquisition of technology, would greatly benefit from more pro-competitive standards. Until this point, there have been no actions or responses regarding reverse engineering. Furthermore, less developed countries are currently undergoing many systemic and resource implementation costs with the hope of increasing their economic development by adopting the TRIPS agreement. They also face large rent transfers and royalty payments to the patent holder leaving the country as result of having to pay each time for the use of intellectual property that is primarily owned by developed countries' industries (Hoekman and Kostecky 2001, 298).

The TRIPS Agreement makes it difficult for LDCs to rationalize the agreement's implementation when consequently its provisions jeopardize the national welfare and development. Such disadvantageous circumstances are all reasons for less developed countries to take a more proactive stance in the WTO concerning TRIPS implementation.

### **MODES OF IMPLEMENTATION: IMPROVING BARGAINING AND TRIPS FLEXIBILITY**

There are still many unresolved issues related to the TRIPS agreement. Most Urgent is the need to use more flexible international and domestic implementation initiatives that provide for a clearer path of transfer of technology. The refocus and work on the developmental agenda of the TRIPS agreement can be acquired by increasing anti-trusts issues, appropriately implementing institutional facilitators for transfer of technology, and employing the flexibility provisions set for by Article 27.1 to create a viable and pro-competitive domestic IPRs regime.

There are two modes for implementing these initiatives. The first mode uses individual resources at a domestic level. The second mode employs a formal coalition in a multilateral setting to improve bargaining process. Versions of some of these tools have been previously employed by LDCs but have been ineffective. This paper recommends newer and improved tools for increasing international and domestic leverage proposed by two members of the academic intellectual property debate. This section will provide a description of the dynamics as well as benefits and detriments to using each mode. It will then conclude by providing the best possible options for furthering less developed countries' policy needs.

#### **'Intelligent Implementation' (Individual - Domestic Mode)**

The TRIPS agreement as has been stated before has a large scope with local prescribed requirements. The minimum standards are non-negotiable and must be domestically implemented as is. There is one article that academics refer to as the "flexibility clause" due to its leniency to allow countries' to define what constitutes as patentable. The Article 27.1 reads:

Subject to the provisions of paragraphs 2 and 3, patents shall be available for any inventions, whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are capable of industrial application (WTO 1994, 331).

Although seeming another stringent legal requirement, this article provides some room for maneuver for less developed countries. The terms “new, inventive-step, and industrial application,” provide definitions, which can be expanded or limited, based on the type of IPRs regime that is beneficial for a country’s policies. Depending on the level of privatization and competitiveness, as well as considering practices conducive to technological capability, a country can apply these terms either to ease patentability standards or restrict patentability. Lee Petherbridge, explains this concept saying:

By intelligently implementing and enforcing substantive intellectual property standards, particular developing countries can faithfully implement TRIPs and in so doing, utilize internal administrative and judicial policy to maximize their benefits (Petherbridge 2001, 1046-47).

This system works by employing these terms to provide boundaries for the processing or denying of patents, thereby allowing a country the ability to protect intellectual property substantively but also protect their domestic welfare by providing legal easement on limits for technology spillovers. To understand the consequence of these terms when applied at a domestic level, it is best to define their elasticity, broad vs. specific, and the results on patentability.

The first term “new” refers to literally the idea of an invention being new. However, it has greater depth when applied to a circumstance of a patent application for a device, formula, etc. that improves on a previous existing entity. This term is relatively very important for providing protection to endogenous items, specifically in terms of biodiversity. The methodology to apply this term and the others to broaden or narrow a patentability test is analogous to setting a bar. Regarding “new” if the bar is narrowed then the bar has been lowered, allowing for small subsequent changes on a product to be patentable, because they meet very minimum standards. However, if the term is broadened, then bar is moved higher, setting “new” standards high, so an innovation will have a harder time meeting all those requirements of newness (Petherbridge, 2001, 1049). The results of this broadening will thereby help to prevent restriction of technological knowledge that would otherwise be protected by patents. Allowing competitive industries to use such knowledge in a legal context to further their technological capabilities.

The term “industrial application” is similar to the term “useful” but in this context, it is not just referring to use because anything can be used. Rather it refers to literally an “industrial application” a utility definition much stronger and broader to cover. If a country decides to narrow the standards of utility requirement for a patent application, then the term “useful” can be substituted. For the terms “inventive-step” the common term in patentability standards is “non-obvious.” The benefits of this term its intrinsic ambiguity:

The purpose of the non-obvious requirement is to complement the novelty requirement. From a certain perspective, patentability is all about novelty. Non-obviousness, because of its conceptual nature, is very difficult to pin down, and thus, has considerable interpretative flexibility (Petherbridge 2001, 1053).

Using the bar analogy, by lowering the bar and setting the limits low, anything then can be “obvious,” If the more broader term labeled by the TRIPS agreement (“inventive-step”) is used, then the novelty must not just be obvious, but it must be a dynamic innovation, encompassing a

lot more requirements of utility. Therefore, in applicative terms, an industries technology that does not pass this standard is subject to legal use by other industries.

This is a rough sketch of how these terms can be applied, but it allows one the ability to see how such terms can be utilized to develop the administrative section of a country's IPRs domestic regime. Moreover, it seeks to prevent the misjudgment of less developed countries to replicate their IPRs regimes by American standards, the most private and extensive, and thereby fall at the mercy of any foreign entity that wishes to patent a substance that could consequently hurt their country's resources or restrict knowledge flows. Lee Petherbridge explains this practicality:

Developing countries intelligently implementing TRIPS may use the written description requirement to raise or lower the bar for patentability by require more or less description of the invention in the application. They might also use the written description requirement to narrow or enlarge the scope of protection, by just protecting only the disclose [information] (2001, 1056-1057).

It also allows for a more flexible use of knowledge that can be shared by domestic industries. If an intellectual good's partial or whole components are not patented, such knowledge can be shared to create new technology. Therefore, logically considering either broad or narrow patentability requirements, the obvious choice for less developed countries is to broaden these terms enough so that the standards are raised high enough to prevent everything to be patentable, and to restrict technology information, important for their domestic technological endeavors. If less developed country replicates the American system (narrow the standards), essentially it will reduce the amount of knowledge available for public means, a problem that restricts transfer and reduces access to knowledge.

### **A Formal Coalition (Multilateral Mode)**

The other option that countries have to obtain some concessions from developed countries regarding unresolved implementation issues is by using the WTO. However, considering the unsuccessful ability of the LDCs in the Uruguay round to avoid the passage of TRIPS agreement itself and difficulties during the Doha round to gain access to drugs that had been hampered as a result of the agreement, the coalition approach should be redesigned. The use of the WTO to gain concessions regarding unresolved or even future conflicts, should take a collective formal approach by less developed countries. However, this formal coalition should be constructed based on Dr. Peter Drahos' of the National Australian University system, for the primary reason that this method does not focus on majority, but rather in effective negotiating, a key component needed to operate in the WTO.

The formal coalition system identifies four major variables that prescribe success in bargaining: share of market power, commercial intelligence (networking), enrollment abilities (ability to enroll others to its side), and internal rules (rules for negotiating that prevent easy concession). Considering these factors, Drahos employs three rules to improve a less developed country coalition success.

The first step a coalition must take is determining its objective, meaning its goals for forming must be clear (Drahos 2003, 86). This is an important to step, if not the most critical. A clear and solid objective will prevent the coalition from breaking apart once pressure is applied.

A clear objective will also help to maintain the dynamics of the type group. Drahos identifies several types of LDC groups formed in past rounds: the G-77, The Cairns group, and the most recent being the Medicines Campaign (Drahos 2003, 90). These groups had different make-ups and served different purposes. The G-77 utilized the “strength in numbers” ideology; however, its downfall was eventually its largess amount of members with a broad objective (Drahos 2003, 87). A broad agenda is not always advantageous, rather it acts like a rubber band; the objective can keep expanding and expanding until it snaps. The group lost solidarity at the expense of generality. One way to solve this problem is “pragmatism.” As Drahos explains the Cairns group illustrated pragmatism during the Uruguay round. The group members, who although had a strong agriculture policy objective, were flexible in other subjects of negotiations, and did not let difference of alliances take away from the initiative (Drahos 2003, 88). A concise agenda, therefore, based more on the subject of the negotiation rather than on the membership loyalty, would reflect more convergence, and improve a groups bargaining process.

The second step, involves developing leadership. This is also a critical component, and unlike any other group formed by developing countries before. Drahos explains the importance of this component in terms of another coalition: “Some developing countries have to be prepared to take on a leadership role with a specific view toward acting as a counterweight to the Quad if the need arises” (Drahos 2003, 93). Although leadership by one or two countries (India and Brazil) or by four or five regional leaders (India, Brazil, Egypt, Nigeria, and China) would still be unequivocal, compared to the Quad; nevertheless, it is an improvement in more private negotiations. Not all members can be present in small decisive meetings, so leadership would help to make decisions clearer at such times.

The third step involves creating a monitoring and analytical component inside the coalition. This element will help to provide sub-leadership roles and promote accountability, a needed commodity, to strengthen the “glue”, and prevent self-serving or disloyal agendas. It will also aid in improving and strengthening arguments against TRIPS provisions as members will be able to spend more time and resources to collaborate in the information gathering and processing rather than when less developed countries were hampered with overwhelming duties that eventually led them to concede to self-detering policies. The circumstances were such that countries had to either choose between group loyalty and self-preservation. This duplicity did not imply betrayal but reflected the poor internal group structures’ inability to perform many demanding responsibilities multilaterally; weak delegation will concede easily. (Drahos 2003, 83). The coalition strategy will help, to gain concessions and provide a much harder more visible connectivity to break through for developed countries. It will also make objectives more legitimate, even create, and maintain more solid connections between group members because each member will concentrate on a more specific aspect and will need to build relationships.

## **Comparison**

Analyzing and comparing the two modes, they both have their benefits and drawbacks. Intelligent implementation, although important for promoting domestic administrative sovereignty, could threaten its state by incurring DSB pressure to reduce its “anti-national treatment” policies. This happened during the Medicines Campaign, where countries were essentially bargaining for permission to use provisions (compulsory licensing) that were granted under the TRIPS agreement. The probability of intelligent implementation of Article 27 or any other type of domestic solutions, being blocked by developed countries, is, therefore, credible.

Domestic actions necessitate first the use of multilateral means to gain legitimacy and support and thereby avoid disputes. The formal coalition approach is also not full proof. The Formal Coalition is going to take a more general approach at fulfilling member needs in order to provide consensus among the different member countries. As a result, a domestic approach is also needed to specifically meet domestic needs that would go unanswered given the more general international provisions. Considering these factors, therefore, this paper argues that a real improvement in bargaining process should harmonize both macro and micro methods into one mode of implementation compatible to each other's goals.

The formal coalition would negotiate to gain a clear statement by the TRIPS council to allow for "intelligent implementation" of Article 27 by less developed countries as a means to improve domestic channels of technology transfer. It would also seek to improve the institutional facilitator for transfer of technology at a multilateral setting, pushing for a more cohesive and enforceable Article 66.2 program. While the domestic approach would seek to provide for leniency in terms of technological spillovers in specific industries and dissuade abusive legal manipulation by large foreign MNCs on intellectual goods. The result would be a two-way implementation revision plan by less developed countries that would converge to take out loopholes and gaps and serve the same purpose: transfer of technology.

## CONCLUSION

The TRIPS agreement now protects intellectual property rights at an international level. It is an all comprehensive agreement that although means to harmonizes both philosophical ideologies of private and public, also is reduced in objectivity by the states that utilize its provisions to further their corporate sector well being. There were two agendas from the beginning of the passage of the agreement: to protect intellectual property to decrease trade barriers, and to promote economic development through the transfer of technology. There has been an imbalance focus and thereby success of the implementation of the first agenda goal but at the cost of neglecting the developmental agenda of the agreement. This asymmetry has led to a host of conflicts for less developed countries, specifically to the detriment of their economic development by way of reduction of access to technological capability. It is clear that intellectual property rights protection is not a predominant factor in improving the acquisition of technology for the majority of less developed countries to induce flows of FDI. The TRIPS implementation has indirectly slowed less developed countries' learning curve through the prohibition of imitative processes that have been historically popular reliable channels of technology diffusion. These circumstances have left less developed countries with empty promises of transfer of technology and no self-proactive methods to acquire it. Therefore, less developed countries should prepare for the next set of negotiations to more cohesively bargain their position of an enforceable and effective institutional channel of technology transfer and gain legal flexibility at home to allow for technology spillover using legal patent definitions. For it is imperative that an institutional channel of transfer of technology be effectively implemented. Without it, the trade-offs less developed countries agreed to will be no more than developmental decorations in the TRIPS agreement.

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