Court File No. 01-CV-208141

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

THE COUNCIL OF CANADIANS, and DALE CLARK, DEBORAH BOURQUE, and GEORGE KUEHNBAUM on their own behalf and on behalf of all members of the CANADIAN UNION OF POSTAL WORKERS, and BRUCE PORTER and SARAH SHARPE, on their own behalf and on behalf of all members of the CHARTER COMMITTEE ON POVERTY ISSUES

Applicants

- and –

HER MAJESTY IN RIGHT OF CANADA, AS REPRESENTED BY THE ATTORNEY GENERAL OF CANADA

Respondents

AFFIDAVIT OF MANFRED BIENEFELD

I, Manfred Bienefeld, of the City of Ottawa, HEREBY AFFIRM that:

1. I received my Ph.D from the London School of Economics in 1969, and since 1986 have served as a Professor in the School of Public Administration at Carleton University. I have written and published extensively on the subjects relating to the international economy, particularly as these affect economic and social development in poorer nations. As such I have knowledge of the matters to which I hereinafter depose. A copy of my Curriculum Vitae is attached as Exhibit "A" to this Affidavit.

2. I have reviewed the affidavit of Denyse Vigors MacKenzie and have been asked to comment on certain claims relating to the risks and benefits of Canadian international trade policy as they relate to foreign investment.

3. To begin with, it is remarkable, given the subject matter of this litigation, that no argument or evidence is presented by Ms. MacKenzie to support the notion that the investor-state suit provisions of NAFTA are needed to achieve Canadian domestic or international policy objectives, including those related to trade. In fact, the failure of the CUSFTA and current WTO agreements to include analogous provisions demonstrates that robust international trade agreements can be established without the inclusion of such elements. Apparently, Canada was of the same view in putting forward NAFTA investment rules that did not allow for such unilateral and private rights of enforcement.

4. Moreover, as pointed out by Professor Somarajah, and since borne out by the virtual collapse of efforts to expand investment disciplines within the WTO, efforts to establish such disciplines as features of multilateral trade regimes have either foundered or been soundly rejected.

   Affidavit of Professor Somarajah, sworn April 28, 2003, paras. 96-102.

5. Rather Ms. MacKenzie's evidence speaks to more general points, which are at best only tangentially related to the question of investor-state litigation, namely that a) foreign direct investment necessarily and significantly benefits both recipient and capital exporting nations; and b) that international investment treaties are an important means of fostering FDI. I shall deal with these explicit and implicit claims in turn.

The Role of FDI in Achieving Canadian Policy Goals

6. In describing the link between trade and investment, Ms. MacKenzie states that "Canadian Policy is based on the recognition that FDI benefits both recipient and

capital exporting countries". As evidence to explain or support this core tenet of Canadian international trade policy her affidavit attaches a speech given by Minister Pettigrew to the Conference Board of Canada in 2002, and a report prepared by the Canadian Chamber of Commerce in partnership with Industry Canada (the "CCC report").

7. Mr. Pettigrew's remarks offer a number of declaratory statements about the putative benefits of FDI, but he does not present nor does he point to empirical evidence to support these statements. Rather, his remarks simply indicate that Canadian policy with respect to foreign investment fundamentally reflects the neo-liberal economic policy agenda[1] that gained its ascendancy in the 1980s, despite the virtual absence of systematic or persuasive empirical or historical supporting evidence, as explained by a paper I have written titled, "Structural Adjustment: Debt Collection Device or Development Policy?" which is attached as Exhibit "B" to this affidavit.

8. In fact, according to a recent report published by the World Bank, there is a real possibility that FDI can have a net negative impact, especially when it displaces domestic investment, appropriates domestic R&D capabilities, or "distorts" subsequent national policy discussion because it comes to have a disproportionate voice in the policy process. Moreover, a recent empirical study by UNCTAD confirms that such fears are not unwarranted since it shows that the only countries that have been able to derive significant, demonstrable benefits from FDI in recent decades have been relatively more interventionist Asian countries that have not only been selective in their efforts to attract FDI, but also very active in ensuring that the activities of foreign investors are consistent with nationally defined objectives and priorities. While this evidence is not conclusive, it is certainly incompatible with policies based on the assumption that such flows will always yield large, and critically important, net benefits. Copies of the World

[1] For present purposes I use the term neo-liberal to describe a set of economic policies which promote free markets with a bare minimum of state regulation, a reduction of government spending on social services, the privatization of public assets and resources, de-regulated international finance, and free trade.

Bank and UNCTAD reports referred to are attached as Exhibits "C" and "D" respectively, to this affidavit.

9. At present, the weight of the available evidence suggests that policies seeking to attract FDI indiscriminately within an effectively non-reviewable neo-liberal policy framework are always risky and often detrimental. And this is why Canadian government policies have long recognised the need to regulate foreign investment in the public interest.

10. The latent conflict between FDI and domestic policy goals is implicitly highlighted by the long list of so-called public policy "impediments to FDI" that are identified in the CCC report. As Ms. MacKenzie notes, in this report the Canadian Chamber of Commerce, which describes itself as "as an ardent supporter of trade and investment liberalization," advocates the dismantling of most such restrictions on investment, including many that are currently maintained by OECD countries, including Canada. It is undoubtedly significant that so many countries with such widely differing political heritages, came, over time, to the conclusion that such policies, in one form or another, provided the necessary framework for both federal and/or provincial governments to promote and protect provincial and national economic and social policy goals. And although such policies have undoubtedly been misused on occasion, there is no serious evidence to support their effective elimination.

11. It is important to understand that the real question is not whether FDI is a good thing or a bad thing. Rather, in this case, the question is whether it is defensible to assume that the effects of FDI will always be positive, let alone significantly positive, for the recipient society. The answer to that question is clearly "no", since there can be no doubt that the net impact of FDI depends on a number of constantly changing circumstances. That is why policies dealing with the attraction or regulation of FDI should always remain subject to review by national policy makers, or courts, a requirement that is incompatible with international

investment treaties that are specifically designed to limit such domestic policy flexibility, particularly when such constraints on *public* policy may be enforced privately.

International Investment Treaties and FDI

12. Even putting aside the question of whether it is sound policy to indiscriminately embrace both inward and outward FDI flows, and to remove key decisions regarding their operations from national jurisdiction, I do not find in the evidence introduced by Canada any substantive support for the claim that binding international investment rules are important for attracting foreign investment to this country, or for protecting the interests of Canadian investors abroad. There is certainly no evidence to support the notion that such investment, once received, serves the public interest or promotes the welfare of Canadians as it is defined in this country.

13. Both the history of FDI flows into Canada, and the simple fact that China, and several other Asian countries with relatively interventionist governments, have received a large and growing share of the world's FDI in recent years, calls into question the claim that international investment treaties are "necessary" to secure high levels of FDI flows.

14. The weakness of the evidence supporting the claim that bi-lateral investment treaties (BITs) are of material importance, either for attracting FDI, or for growth and development, is clearly summarised by the World Bank study previously noted, which describes the disconnect between FDI and BITs such as those negotiated by Canada, as follows:

> *Clearly, a BIT is not a necessary condition to receive FDI. There are many source-host pairs with substantial FDI that do not have a BIT. Japan, the second largest source of FDI has only concluded 4 BITs. The US does not have a BIT with China, its largest developing country destination. Brazil, one of the top receivers of FDI has not ratified a single BIT. In addition, there are also numerous examples of countries that have*

concluded many BITs and yet have received only moderate inflows. Sub-Saharan Africa, for instance, has had difficulties in attracting FDI, though it has tried to improve the environment for FDI by entering into various agreements to protect the interests of investors. There are also examples such as Cuba, where it does not have a BIT with either Canada or Mexico, its two biggest foreign investors. On the contrary, almost 60% of the countries it does have a BIT with actually have no foreign investment in Cuba. (Perez-Lopez et.al.) [2]

15. Furthermore, the same patterns broadly hold true for Canada. Thus the overwhelming majority of Canadian direct investment abroad (CDIA) is destined to the United States and Europe. Although FDI flows between Canada and the United States have increased rapidly in both directions in recent years (at least until the sharp reversals of 2003), there is currently no evidence to suggest that NAFTA investment rules have played a role in promoting such investment, and this assessment is consistent with the fact that flows to and from the EU have also risen during this period even though Canada has no similar investment agreements with the EU. Nor does Canada have such agreements with the most important FDI destination countries in the developing world, including Brazil and China.[3]

16. Furthermore, as discussed by the World Bank report noted above, the correlation between BITs and FDI has rarely been examined, but on the few occasions when it has been [UNCTAD 1998], no significant correlations were found. Thus the authors of the report Commissioned by World Bank conclude that :

    Analysing twenty years of bilateral FDI flows from the OECD to developing countries finds little evidence that BITs have stimulated additional investment.[4]

17. It is indicative of the lack of balance in Canadian trade policy that Ms. MacKenzie's evidence offers no acknowledgement that the establishment of binding international investment rules that can be privately enforced is associated

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[2] Exhibit "C" p. 9.
[3] Statscan, "The Daily", Tuesday, May 18, 2004, "Foreign direct investment", pp 1-4)
[4] Exhibit C, p. 22.

with a risk of significant adverse impacts. Thus her affidavit makes no reference to the authoritative studies such as those by the World Bank and UNCTAD referred to above, nor does it address, or discuss, the considerable risks and potential impacts associated with international investment agreements, which as identified in the report include:

- that, as recent high profile legal cases demonstrate, the rights given to foreign investors may expose public authorities to potentially large scale liabilities and curtail the feasibility of potential reform options;

- that the strength of the rights entrenched by such agreements may entail disincentives for potential domestic investors; or may provide foreign investors with levels of insurance well beyond those enjoyed by domestic investors or required to foster FDI with potentially far-reaching consequences for the future policy choices available to host governments; and/or

- that as the potential for legal recourse under international investment agreements becomes more widely known, the importance of such agreements in selecting a location may become more important over time, potentially leading to problems of moral hazard and adverse selection. [5]

18. More broadly, similar concerns have been raised about the socio-economic impact of the market-oriented neo-liberal policies that provide the framework, and the *rationale,* for the proliferation of BITs. In fact, the structural adjustment policies that have been aggressively promoted by the World Bank and the IMF since 1980 have generally sought to impose policies that echo, or duplicate, the constraints contained in bilateral and/or international trade and investment agreements. Here too the evidence shows that the impact of these broader neo-liberal policies can

[5] Exhibit "C", pp. abstract, 3 and 7.

often have detrimental, and sometimes disastrous, effects as described in my paper (Exhibit "B").

19. The essential conclusion of my work is that it is crucial for sovereign states to retain the ability to manage FDI related policies pragmatically, and in the national interest. This same conclusion has been reached by numerous leading authorities, including Yilman Akyüz in an UNCTAD Discussion Paper on financial liberalization:

> *government intervention in finance has often been misguided ... the appropriate response should be to reform the government and rationalize intervention rather than throw in the towel and simply 'unleash market forces' ... Success .. depends on ensuring reciprocity between support and performance; use of controls, regulations and subsidies for the intended purposes; and readiness to revise them as necessary.*[6]

20. Similarly, Dani Rodrik, of Columbia University, concludes his 1999 book on the new global economy and developing countries, as follows:

> *The evidence from the experience of the last two decades is quite clear: the countries that have grown most rapidly since the mid-1970s are those that have invested a high share of GDP and maintained macroeconomic stability. The relationship between growth rates and indicators of [economic' openness – levels of tariff and non-tariff barriers or controls on capital flows – is weak at best.* [7]
>
> *The countries that fell apart did so because their social and political institutions were inadequate to bring about the bargains required for macro-economic adjustment – they were societies with weak institutions of conflict management ... [because] ... adjusting to changing circumstances, and to external shocks in particular, requires the presence of institutions that can mediate distributional conflicts in society. In the absence of such institutions, the policy adjustments needed to re-establish macro-economic balance are delayed ... Societies with deeper cleavages (along ethnic, income, or regional lines) are particularly susceptible to policy paralysis of this sort, making institutions of conflict management all the more important.*[8]

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[6] Yilman Akyüz ; *Financial Liberalisation: The Key Issues* [UNCTAD DP 56, March 1993, UNCTAD: Geneva].

[7] Rodrik, Dani (1999) The New Global Economy and Developing Countries: Making Openness Work, Washington D.C.: ODC – Policy Essay No. 24 , at p. 2.

[8] Idem, p. 17.

Conclusion

21. While the federal government is certainly entitled to adopt an agenda of international trade and investment liberalization, good public policy development requires that government policies be defensible and based on the best available evidence. This is especially true in cases where policies significantly infringe or constrain the policy and legislative options of the country's sovereign institutions, as in this instance. Indeed, given the dearth of empirical evidence to support, and the substantial evidence to refute, the broad propositions on the basis of which Canada has made binding international commitments under several BIT agreements, and NAFTA's Chapter 11, it is fair to suggest that these policies were fundamentally based on ideology, rather than on persuasive evidence.

22. For these reasons, in my opinion Canada's commitments to such international investment agreements, particularly in light of the fact that they may be privately enforced, can neither be justified on the grounds that their effects are beneficial, nor on the grounds that they are an important means of fostering FDI. In fact, these commitments diminish the policy and regulatory prerogatives of governments while exposing Canada and the taxpaying citizenry to open-ended liabilities and risks, all in return for highly uncertain, hypothetical benefits.

23. I make this affidavit in support of an application and for no other or improper purpose.

AFFIRMED before me at the City of Ottawa, in the Province of Ontario, this 30th day of August, 2004.	))))))))	
A commissioner for taking affidavits, etc.		MANFRED BIENEFELD

EXHIBIT A

DEPARTMENT: School of Public Policy and Administration **July 2004**

a) **NAME: BIENEFELD, Manfred**, full professor, tenured, member Graduate Faculty

b) **DEGREES:**

B.A., (Hons.), University of Toronto, 1964

Ph.D., University of London, London School of Economics, 1969

c) **EMPLOYMENT HISTORY:**

Academic Appointments:

1986-	Professor, School of Public Administration, Carleton University
1972-86	Research Fellow, Institute of Development Studies; University of Sussex, UK
1969-72	Research Fellow, Economic Research Bureau; University of Dar es Salaam

Other:

1966-68	Teaching Assistant in Economics; London School of Economics, University of London, UK

d) **HONOURS:**

1978-86	Governor: Institute of Development Studies (Sussex: UK)

e) **SCHOLARLY OR PROFESSIONAL ACTIVITIES:**

i) Editorial Responsibilities:

1987-2002	Member, Studies in Political Economy Editorial Board

ii) Other Professional Activities:

December 2003	Joint organizer (with Professor Antonio Iglesias and Orlando Gutierrez, University of Havana) of an International Conference on "Public Administration for the 21st Century: Research and Human Resource Development Challenges", University of Havana and Carleton University, Havana.
April 2003	Joint organizer (with Professor Orlando Gutierrez, University of Havana) of Research Workshop on "The Social Impact of the Reforms", University of Havana, Havana.

February 2003	Joint organizer (with Professor Antonio Iglesias, University of Havana) of a seminar on "The Challenge of Teaching Public Administration," University of Oriente, Santiago de Cuba, Cuba, and Granma University, Baymo.
February 2002	Joint organizer (with Professor Antonio Iglesias, University of Havana) of conference on "Democratising Cuba's Policy Process," University of Havana, Havana.
August 2001	Invited participant in seminar to review interim results of CIDA funded project on "Women and Labour Market Reform in Russia," Kstovo, Russia.
April 2001	Invited for one week to the Wissenschaftskolleg zu Berlin (Institute for Advanced Study) to discuss issues related to the globalization of finance with scholars in residence, WIKO, Berlin, Germany.
February 2001	Joint organizer (with Professor Cristina Diaz, University of Havana) of Workshop on "Local Government Involvement in Environment Policy," University of Havana, Havana.
February 2001	Joint organizer (with Professor Antonio Iglesias, University of Havana) of Workshop on "Labour Market Policies in a Globalising World," University of Havana, Havana.
August and December 2000	Prepared and delivered one-week course, "Understanding Economic Policy Making," (last week of 4 week course on "Macroeconomics for Policy Management") Ministry of Finance, Hanoi, Vietnam (part of the Vietnam-Canada Financial Management Project implemented by Pricewaterhouse Cooper).
October 2000	Member of delegation including researchers from the Centre for Labour Market Studies and officials of FITU (Russia's largest trade union federation) to present proposals for gender sensitive labour market policies to Russia's Tripartite Commission, Moscow. (I was apparently the first 'foreigner' to make a direct presentation to this Commission.)
April 2000	Invited participant in Centre for Labour Market Studies conference on "Women and Labour Markets Reform in Russia," Otradnoye, Russia.
March-April 2000	Invited to work on a report on "Structural Adjustment and its Impact on the Labour Force: Lessons from our Case Studies."
February 2000	Taught two-week course on "The Changing Role of the State in a Globalising Economy," in the Masters degree program in Economics at the University of Havana.
February 2000	Prepared and delivered Graduate Course, "Globalisation and the Challenge of Development," Institute of International Economics, University of Havana, Havana, Cuba.

January 2000	Prepared and delivered one-week course, "Understanding Economic Policy Making," (first week of 4 week course on "Macroeconomics for Policy Management") Ministry of Finance, Hanoi, Vietnam (part of the Vietnam-Canada Financial Management Project implemented by Pricewaterhouse Cooper).
1999-	Founding member and member of the Executive Committee of the Progressive Economics Forum of Canada.
1999-	Senior member of a research team studying Gender aspects of the Russian Labour Market, jointly with a team from the Russian Academy of Sciences. CIDA funded, with support from HRDC.
1999-2000	Consultant to Price Waterhouse Coopers, mainly teaching officials of Vietnam's Ministry of Finance as part of the CIDA funded Vietnam-Canada Financial Management Project: March 1999; July-August 1999; January 2000; April/May 2000.
November 1999	Invited by the Central Bank of Thailand to lead a discussion of the role of capital controls in a modern, open economy.
May 1999	Gave evidence to the House of Commons Finance Committee Hearings on Productivity, Parliament Hill.
1997-2000	Canadian coordinator of the Public Administration component of the CIDA-Carleton Cuba project, collaborating with the University of Havana as it develops a graduate teaching program in Public Administration.
1998	Member of the University Senate and Chair of the Senate's Financial Review Committee.
1998	Invited by the Humanities and Social Science Federation of Canada to give a lecture on "Finance, Globalisation and Bank Mergers" as part of its Breakfast on Parliament Hill program. This was just the tenth such lecture since the program was initiated in 1994 to foster a broader understanding of the role of social sciences and humanities research in the development of public policy.
November 1998	"Enfoques teoreticos de las politicas economicas internacionales a finales de siglo," public lecture in the Auditorio de ADIDA, organized by local trade unions and the MOIR.
1997	Visiting Scholar at the Research Center on Development and International Relations, Aalborg University, Aalborg, Denmark.
August 1997	"Privatizing Telecommunications and the Public Interest,, Public lecture, Cartagena, Colombia.

1985-2004	Invited to give lectures or seminars at: University of Toronto; McGill University (Montreal); Queen's University (Kingston); University of Regina; University of Manitoba (Winnipeg); Lakehead University (Sudbury); Simon Fraser University (Burnaby B.C.); St. Mary's University (Halifax); York University (Toronto); University of Ottawa; Cornell University (Ithaca, NY); UCLA (Los Angeles); Brown University (Providence R.I.); University of Sussex (UK); INTECH: UN University (Maastricht); WIDER - World Institute for Development and Economic Research (Helsinki); OECD Development Centre (Paris); ILO (Geneva); University of the West Indies (Trinidad & Tobago); Javeriana University (Bogota); University de Antioquia (Medellin, Col); University de Manizales (Colombia); AVANCSO (Guatemala City); Universidad de Habana (Cuba); Universidad de Piñar del Rio (Cuba); University of Colima (Mexico); Sophia University (Tokyo); University of the Philippines (Manila); Chulalongkorn University (Bangkok); Institute for Research and Planning in Development (Tehran); National Defence College (Kingston); Universidad de Oriente (Santiago de Cuba); Universidad Granma (Bayamo, Cuba); London School of Economics (London); Wirtschaftskolleg zu Berlin (WIKO, Berlin); Institute of Development Studies (University of Sussex, England); Harbin Institute of Technology (Harbin, China); Jiao Tong University (Shanghai); City University of Hong Kong (Hong Kong). Also invited to speak by: Harvard Business School Alumni Association (Toronto); Government agencies in Canada, Great Britain, Holland, Guyana, Costa Rica, Cuba, Fiji, Thailand, Vietnam and Guangdong (China); and a variety of trade union and popular organisations in Canada, Colombia, Thailand and Mexico.

iii) Papers Presented:

February 2004	"Economic Globalisation and the 'New Imperialism'." Paper presented to the VIth International Conference on Globalisation and Development, Havana.
December 2003	"Labour Market Reform and Human Resource Development." Paper presented to International Conference on "Public Administration for the 21st Century: Research and Human Resource Development Challenges", University of Havana and Carleton University, Havana.
May 2003	"Socialist Dreams in a Neoliberal World." Paper presented at International Marxist Conference, "Karl Marx and the Challenges of the 21st Century," Havana.
April 2003	"Jobs, Incentives, Rights and Rewards: International Debates about the Trade Off between Efficiency and Labour Rights." Paper presented to Research Workshop on "The Social Impact of the Reforms," University of Havana, Havana.

February 2003	"Public Administration Reform: Recent International Trends." Paper presented to seminar on "The Challenge of Teaching Public Administration," University of Oriente, Santiago de Cuba and Granma University, Bayamo.
February 2003	"The Challenge of Development in a Unipolar World." Paper presented to the Vth International Conference on Globalisation and Development, Havana.
December 2002	"Aftermath of the Asian Crisis: The Latin Americanisation of Asia." Paper presented at an International Conference on Governance in Asia, GARC (Governance in Asia Research Centre), City University of Hong Kong, Hong Kong.
September 2002	"Enhancing Socio-economic Security within an Economic Model based on Fear and Insecurity." Paper presented to 9th International Congress of BIEN (Basic Income European Network), Geneva.
February 2002	"The Washington Consensus and the Restructuring of the State: Have we learned from History?" Paper presented to conference on "Democratising Cuba's Policy Process," University of Havana, Havana.
February 2002	"Why the Latin Americanisation of Asia is Bad News for Labour." Paper presented to the IVth International Conference on Globalisation and Development, Havana.
November 2001	"Restructuring Cuba's Public Sector: An International Perspective." Paper given to the VIth International Congress of CLAD (Centro Latinoamericano de Administracion para el Desarrollo) on State and Administrative Reform, Buenos Aires.
June 2001	"Cuba's International Integration: Risks and Opportunities." Paper presented to the Xth Comgress of the International Federation of Latin American and Caribbean Studies (FIEALC), Moscow.
June 2001	"The Russian Reforms and their Impact on Labour: A Transition to What?" Joint paper (with Tantyana Chetvernina and Liana Lakunina of CLMS, Moscow) to Conference on "The Two Faces of the New Work Order," Centre for Research and Work on Society, York University, Toronto.
May 2001	"The end of the Asian Miracle: A Prelude to Latin Americanization." Paper presented at the 17th Annual Conference of the Canadian Association for the Study of International Development, Laval University, Quebec City.
February 2001	"The Impact of Globalization on Local Government Participation in Environment Policy." Paper presented at Workshop on "Local Government Involvement in Environment Policy", University of Havana, Havana.

February 2001	"Competing Labour Market Models in a Globalising World." Paper presented at Workshop on "Labour Market Policies in a Globalising World," University of Havana, Havana.
February 2001	"The State and Civil Society: the Political Economy of the 'New Social Policy'." Paper presented to 3rd International Conference on Globalization and Development, Havana, Cuba.
December 2000	"The Implications of Global Financial Integration for Development." Public Lecture, Faculty of Management, Harbin Institute of Technology, Harbin, China.
December 2000	"The Misuse of Economics in Policy Making." Public Seminar, Postgraduate School of the Chinese Academy of Social Sciences, Beijing, China.
December 2000	"The Implications of Global Financial Integration." Public Seminar, World Institute of Economics and Politics, Chinese Academy of Social Sciences, Beijing, China.
August 2000	"Does Thailand need capital controls to forestall future financial crises?" Public Seminar, Chulalongkorn University, Bangkok, Thailand (sponsored jointly by the University's Political Economy Centre and by Focus on the Global South).
March 2000	"The State of the State." Address to the 2000 National Foreign Policy Conference on This Way to the Global Village organized by the Canadian Institute of International Affairs, Sheraton Centre, Toronto.
February 2000	"Public Administration and the Changing Role of the State." Public Seminar, Faculty of Economics, University of Pinar del Rio, Cuba.
February 2000	"Building State Capacity for a Globalising World." Seminar sponsored by the Department of Economics, University of Piñar del Rio, Piñar del Rio, Cuba.
November 1999	'The Next Asian Crisis." Public lecture sponsored by the Centre for Social Studies and Focus on the Global South, Chulalongkorn University, Bangkok, Thailand.
October 1999	'The Asian Crisis and the Death of the 'Asian Model'." Paper presented to the Graduate program of the Institute of Development Studies, St. Mary's University, Halifax.
June 1999	"Asia's Financial Crisis: The End of an Era." Paper presented to the Third Annual Asian Development Research Forum, sponsored by I.D.R.C. and held in Seoul, Korea.
April 1999	"Public Policy and the Declining Sovereignty of Nation States." Paper presented to a workshop on Teaching Public Administration University of Havana.

March 1999	"Can Global Finance be Regulated?" Paper presented to a conference on Economic Sovereignty in a Globalising World: Creating People Centered Economics for the 21st Century organised by Focus on the Global South, Bangkok.
March 1999	"Financial Management in the Shadows of the Crisis." Paper presented to the Ministry of Finance, Democratic Republic of Vietnam.
January 1999	"The Political Economy of Financial Bubbles: Why we never seem to learn." Paper presented to a conference on The Asian Crisis and Beyond: Prospects for the 21st Century, Carleton University.
January 1999	"El Estado y la sociedad civil. La economia politica de las nueva politica social." Paper presented to El Encuentro Internacional de Economistas on Globalizacion y Problemas del Desarrollo, Palacio de Convenciones, Havana, Cuba.
November 1998	"Studying the International Economy: Issues and Methods." Three day seminar given to the Department of Economics, University of Antioquia, Medellin, Colombia.
November 1998	'The Asian Crisis and the Future of Global Capitalism." Paper presented to a conference on Global Village or Global Pillage, Parkland Institute, Edmonton, Alberta.
November 1998	"Globalisation, Nation States and the Scope for Collective Action." Presented at a conference on The Politics of Globalisation, Cornell University, Ithaca, NY.
November 1998	"Asia Crisis or Global Crisis?" Seminar given at the Norman Paterson School of International Affairs, Carleton University.
September 1998	"Governments and the Liberalization of Financial Services: An International Perspective." Paper presented to a conference on Liberalization, Financial Services, and Government, Department of Economics, Laurentian University, Sudbury.
August 1998	'The Globalization of Markets, the Free Trade Agreement and the Canadian Economy." Address to the International Seminar in Canadian Studies organized by the International Council for Canadian Studies, University of Ottawa.
May 1998	"Political Economy and the Future of the Left." 3rd Annual Great Lakes Graduate Conference in Political Economy, York University, Toronto.
March 1998	"Setting the stage: Global scenarios for Labour Migration." Workshop on Labour Migration and Workers' Rights in the FTAA, FOCAL, Ottawa.

March 1998	"International Agencies, U.S. Hegemony and the Asian Crisis." Centre for Social Theory and Comparative History's Winter-Spring 1998 Colloquium Series on New International Institutions: By, and for, the U.S.? UCLA, Los Angeles.
January 1998	"Development Theory and the Lessons of the Asian Crisis." Public Lecture, University of Havana, Havana, Cuba.
January 1998	"Rethinking Canadian Economic Policy in the Shadow of the Asian Crisis." Economists' Round-Table on the Alternative Budget 1988, Ottawa.
August 1997	"Privatisation and Neoliberal Adjustment from a Global Perspective." Public Lecture, Technical University of Cartagena, Cartagena, Colombia.
June 1997	"Reading the Entrails of the 1997 World Development Report: Is the World Bank Really Changing Course?" Annual CASID Conference, Learned Societies Meetings, Memorial University, St. John's, Newfoundland.
May 1997	"Globalization and Social Change: Drowning in the Icy Waters of Commercial Calculation." Conference on Globalization and Social Change, Research Centre on Development and International Relations, Aalborg University, Denmark.
December 1997	"Understanding the Link between Financial Markets and 'the Real World'." Lecture to Political Science Association of Canada, Ottawa.
November 1997	"The Meaning of the Asian Crisis: Temporary Inconvenience, or Dire Warning?" Address to the Commonwealth High Commissioners, Ottawa.
September 1997	"Understanding the International Agency Enthusiasm for 'The Right to Development'." Workshop on The Right to Development, Inter-Church Coalition on Africa, Toronto.

iv) Scholarly Work in Progress:

Working on a paper dealing with the World Bank's most recent shift to a more poverty focused approach to adjustment in the developing world. A draft is being reworked, together with two former Carleton graduate students, one a graduate of the School's MA program.

Working on a paper dealing with "Promoting Green Industry: Some Lessons from Ontario's Experience in the early Nineties" to be presented to a conference in Istanbul dealing with sustainable development and organized by the Wharton School of Finance as part of the UN 'Global Compact' initiative.

Working on a paper dealing with the gender and poverty impact of Russia's labour market reforms over the past 15 years, working with Russian scholars from Moscow's Centre for Labour Market Studies.

Working on a paper dealing with the concept of a "Basic Citizen's Income" - and within that, with the question of the criteria by which to determine whether such incomes should be provided 'in kind' or in a monetary form.

Working on a book length manuscript dealing with the post-war evolution of "Development Theory" and the impact on the developing world of the neoliberal revolution that came to such prominence by the end of the seventies.

v) Administrative Responsibilities:

Departmental:

1986 - Graduate Supervisor, M.A. in Public Administration (Development Concentration)

Faculty:

University:

2003 - Member, Board of Governors

1999-2004 Member, CUASA Steering Committee

f) GRADUATE SUPERVISIONS:

Direct Supervisions:
Completed: 3 MA, 8 PhD
In progress: 0 MA, 1 PhD

Ph.D. Completed:

Basma Abdelghafar, "Implications of the WTO-TRIPS Agreement from a National Innovation Systems Perspective: The Pharmaceutical Industry in Egypt," September 1998 - January 2003

Ph.D. In progress:

Arslan Dorman, "Towards a Critical Explanation of Turkey's 1994 Financial Crisis," September 1998 -

Committee Membership:
Completed: 2 MA, 3 PhD
In progress: 0 MA, 5 PhD

M.A. Completed:

Sabrina Alton, "Understanding Government Procurement Liberalization in Canada and its Implications for the Federal Procurement Process," Institute of Political Economy, September 2002 - December 2003

David Tiley, Passed With Distinction "Post-Fordist `Ideal Type'? - The Labour Process in the Japanese Manufacturing Sector, 1967-1990," Institute of Political Economy, September 1994 - May 1997

Ph.D. Completed:

Michael Orsini, "Blood, Blame, and Belonging: HIV, Hepatitis C, and the Emergence of 'Tainted-blood Activism' in Canada, 1985-2000," September 1998 - December 2001

Luc Juillet, "Aboriginal Rights and the Migratory Birds Convention: Domestic Institutions, Non-State Actors and International Environmental Governance," September 1995 - September 2000

Brent Herbert-Copley, "Innovation, Regulation and Environmental Management in the Chilean and Canadian Pulp and Paper Industries," Department of Political Science, September 1993 – December 1998

Ph.D. In progress:

Saule Bakenova, "Canada Water Export Policy: The Dynamics of Agenda-Setting," January 1999 -

Marie Blythe, "Making new citizens: education policy in the first postwar decades," May 1999 -

Elizabeth Dandy, "Rescaling housing policy: Toronto/Ontario/ Canada," May 1998 -

Mustafa Bayirbag, "Regional development in Turkey: Gazantiep in S-E Anatolia," September 2001 –

Abdulghany Mohamed, "Canada's Policy on Financial System Consolidation: A Political Economy of Public Policy Transformation in an Era of Globalization," September 1998 -

g) GRADUATE COURSES: *

1997-98	Public Administration 50.501 International Policy Framework (x2)
1997-98	Public Administration 50.588 Structural Adjustment Policy
1997-98	Public Administration 50.609 Economics of Public Policy II
1998-99	Public Administration 50.501 International Policy Framework
1998-99	Public Administration 50.588 Structural Adjustment Policy
1998-99	Public Administration 50.609 Economics of Public Policy II
1999-2000	Public Administration 50.501 International Policy Framework
1999-2000	Public Administration 50.588 Structural Adjustment Policy
1999-2000	Public Administration 50.609 Economics of Public Policy II
2000-01	Public Administration 50.501 International Policy Framework
2000-01	Public Administration 50.588 Structural Adjustment Policy (x2)
2000-01	Public Administration 50.609 Economics of Public Policy II
2001-02	Public Administration 50.501 International Policy Framework
2001-02	Public Administration 50.588 Structural Adjustment Policy
2001-02	Public Administration 50.609 Economics of Public Policy II

2002-03	PADM 5001 International Policy Framework
2002-03	PADM.6009 Economics of Public Policy II
2003-04	PADM 5001 International Policy Framework (x2)
2003-04	PADM 5808 Structural Adjustment Policy
2003-04	Public Administration 50.573Z: Policy Seminar (Cuba)
2003-04	PADM 6106 Public Policy Analysis

* Carleton University changed its course numbering system as of May 2003. For example Public Administration 50.500 became PADM 5000.

h) EXTERNAL RESEARCH FUNDING:

Year	Source	Type*	Amt/yr	Purpose**
2002-03	CIDA	G	$153,590	Head, Public Administration component of CIDA-Carleton Cuba Project (Extension)
1998-2002	CIDA	G	$19,210	Head, Public Administration component of CIDA-Carleton Cuba Project
2002	Asian Development Bank	O	$10,000	To contribute to a Leadership Training Program on Economic Reform in Vietnam.
1999-2001	CIDA	G	$125,000	Carleton Coordinator for the teaching component of the Canada-Vietnam Financial Management Project
2000-03	CIDA	G	$12,000	Project on "Women and Russian Labour Market Reforms."
2000	ILO Geneva	O	$10,000	Report on "Structural Adjustment and its Impact on the Labour Force: Lessons from our Case Studies."

*Type: C-Granting Councils; G-Government; F-Foundations; O-Other
** Purpose: research, travel, publication, etc.

i) PUBLICATIONS:

1. **Life-time summary:**

- Books authored/co-authored 1
- Books edited 2
- Chapters in books 31
- Papers in <u>refereed</u> journals 21
- Papers in refereed conference proceedings 0
- Technical reports 14

Chapters in books 31
- Papers in refereed journals 21
- Papers in refereed conference proceedings 0
- Technical reports 14
Chapters in books 31
- Papers in refereed journals 21
- Papers in refereed conference proceedings 0
- Technical reports 14

- Abstracts and/or papers read 30
- Others 1

2. **Details:**

Books authored:

Books edited:

Chapters in Books:

1. "The Russian Reforms and their Impact on Labour: A Transition to What?" (with T. Chetvernina and L. Lakunina), in Jim Stanford and Leah Vosko (eds) Challenging the Market -- The Struggle to Regulate Work and Income, (McGill-Queen's Publishers, forthcoming 2004).
2. "Development Theory: A New Hegemonic Ideology?" in A.B. Bakan and E. MacDonald (eds) Critical Political Studies: Debates and Dialogues from the Left, McGill-Queen's University Press, Kingston, 2002, pp. 208-31.
3. "Can Finance be Controlled?" in Walden Bello, Nicola Bullard and Kamal Malhotra (eds.) Global Finance: New Thinking on Regulating Speculative Capital Markets, Zed Books, 2000, pp. 114-22.
4. "Globalization and Social Change: Drowning in the Icy Waters of Commercial Calculation," in J.D. Schmidt and J. Hersh (eds.) Globalization and Social Change, (Routledge, 2000), pp. 46-66.
5. "North American Regionalism from a Canadian Perspective," in B. Hettne, A. Inotai, and O. Sunkel (eds) National Perspectives on the New Regionalism in the North, (WIDER (Helsinki), Macmillan: London, 1999), pp. 195-238.
6. "La Economia Politica de la 'Nueva Politica Social'," in Maria Cristina Rojas de Ferro and Adriana Delgado Gutierrez (eds.) Politica Social: Desafios y Utopias. Proceeding of an International Conference on Nuevas Tendencias en Politica Social, Pontificia Universidad Javeriana, Bogota, Colombia, 1997, pp. 89-126.

Papers in Refereed Journals:

1. "Structural Adjustment: Debt Collection Device or Development Policy?" Review (Fernand Braudel Centre), Vol. XXIII, 4:533-82, 2000.

Papers in Refereed Conference Proceedings:

Others:

Papers in non-refereed journals:

1. "Enhancing Socio-economic Security within an Economic Model based on 'Fear and Insecurity'," Socialist Studies Bulletin, 68:5-22, Autumn 2002.

Working Paper:

1. 'The State and Civil Society: The Political Economy of the 'New Social Policy'," Development Research Series: Working Paper No.60 (ISSN 0904-8154), December 1997, Research Center on Development and International Relations, Aalborg University, Denmark.

SIGNATURE

DATE

EXHIBIT B

This is Exhibit "B" referred to in the affidavit of ...[illegible] BIENERZO... sworn before me, this 30TH day of [illegible] 20..07

A COMMISSIONER, ETC.

FERNAND BRAUDEL CENTER

A Journal of the Fernand Braudel Center
for the Study of Economies, Historical Systems, and Civilizations

On Editorial Policy

Review is committed to the pursuit of a perspective which recognizes the primacy of analyses of economies over long historical time and large space, the holism of the socio-historical process, and the transitory (heuristic) nature of theories.

On Publication Policy

We invite contributions of articles that fall within the general perspective, very loosely defined, of the journal, or articles that are specifically critical of the perspective.

There is no limit of size. We prefer articles that discuss the concrete world but welcome also attempts at conceptual re-definition. We will not exclude articles that are highly technical nor articles that are essays. Our central criterion is that an article seems in our judgment to grapple seriously with the intellectual issues it confronts, and that it confronts serious intellectual issues.

We will publish articles primarily in English, but we will be willing to publish articles in other scholarly languages. We will, from time to time, translate into English an article already published in another language. We will even be willing, from time to time, to republish an article that first appeared in English, if we believe that the readership of our journal and that of the original locus of publication are highly unlikely to overlap.

The editors deem it their function to judge the general worth of an article and not to argue substantively with the author about its contents. If the editors dissent strongly, they will print their dissents publicly rather than quarrel privately.

We are a scholarly journal but one we hope will be of interest, and more importantly of use, to persons and movements in the real and thankfully everchanging world.

In short, we reject some of the fetishes of academic reviews, but lay claim to sharing the central traditions of world scholarship. Though we are published in the United States, we hope to make our journal a forum that will reflect the true diversity of contemporary world scholarship.

The Editors

Structural Adjustment

Debt Collection Device or Development Policy?*

Manfred Bienefeld

Economies must constantly adjust to changing circumstances and, as the world-economy has become more volatile and more integrated, economies have had to become continually more flexible and responsive. Unfortunately, many developing countries were unable to meet this growing challenge during the 1970's and many borrowed heavily abroad or squeezed their export sectors to avert an economic or political collapse. This worsened imbalances in trade, production, and finance and these eventually became unsupportable when commercial bank lending abruptly ended in the early 1980's. When several large debtors were forced into virtual bankruptcy, the world suddenly discovered the debt crisis.

The International Financial Institutions (IFIs) were now called upon to restore order and to save the global financial system from collapse. They did so by mobilizing emergency credits to allow countries to meet their most pressing obligations, and by making receipt of those credits conditional on the implementation of policies designed to enhance economic flexibility. The aim was to assist countries in eliminating chronic balance of payments problems, often dominated by a heavy debt service charges. The primary focus of these structural adjustment policies was therefore on increasing debt service capacities through export expansion and import compression. Debt service obligations had to be given priority because sub-

* A draft of this article was written for a series of lectures on "Structural Adjustment: Past, Present and Future" given at Sophia Univ., Tokyo on Nov. 24, 25, 1993. At that time this article appeared as a Discussion Paper in the *Sophia Univ.: ADMP Series No. 5* (Tokyo: Sophia Univ.: Administration and Management Program). Subsequent events have only reinforced my central message, as the Epilogue explains.

stantial debt relief was not forthcoming and because the reestablishment of credit worthiness and of access to international capital markets was assumed to be prerequisite for a return to development and growth.

The neoliberal policies to help countries achieve this transformation were designed to allocate resources in accordance with global market signals. Prices, exchange rates, and factor incomes were to be allowed to move to equilibrium levels so that markets would clear and allocative efficiency would be maximized. Resources would be allocated in accordance with the global distribution of income and property rights, including those of the owners of the Third World's debt. Countries with high debt service burdens, low productivity, surplus labor, and weak technological capabilities could only hope they would reach equilibrium before the real price of labor had fallen below the subsistence minimum. In such a world, market forces would help governments achieve a reduction in domestic claims on resources (or "absorption") so as to create an export surplus to fight the balance of payments deficit. In this way, these policies were to increase debt service capacities and help governments achieve the painful adjustments demanded by the new facts of economic life.

This was the primary aim of structural adjustment policies, although the pain inflicted by expenditure reduction policies was to be moderated by means of expenditure switching policies designed to shift resources into the production of tradeable goods or services where they would either earn or save foreign exchange. This was to be primarily achieved by the deregulation of prices, especially those of foreign exchange and of labor, although explicit export promotion policies might also be used. The ideal scenario was termed the pure absorption case. In it total output did not decline because the necessary resource switching occurred instantaneously. Even in that case, however, domestic absorption (consumption plus investment) would still have to be restrained since the external deficit required a higher proportion of that output to be exported, but the pain would not be intensified by a simultaneous decline in total output. Unfortunately, in the real world, where resource switching is not instantaneous, a fall in output was likely.

The final feature of structural adjustment was the provision of additional loans designed to prevent that fall in output, since true adjustment would be difficult to achieve within a declining economy. However, these loans were generally provided at commercial rates of interest, so they entailed considerable risk. Unless the country achieved growth rates in excess of the very high real interest rates of the day, structural adjustment lending would actually worsen the country's debt problem even as it was increasing its debt service capacity.

The debt service objectives of these policies were both clearly defined and substantially achieved, producing large and sustained net resource transfers from many developing countries to the developed world. Indeed these objectives were fulfilled to such a degree that in the mid 1980's it was possible to say that "Bank profits have grown steadily during the debt crisis, according to a report by the Joint Economic Committee of Congress." Unfortunately, the news for the debtors was not so good since growth had not lived up to expectations. Thus, the same study noted that "the Administration's whole approach to the debt crisis has kept the banks solvent but it has sunk the debtor nations further in debt" (*The Wall Street Journal*: Dec. 31, 1986).

Naturally these neoliberal policies were not advocated as debt collection devices, but as policies to restore development. It was claimed that they would rectify the previous policy errors that were said to have led so many developing economies into crisis; that they would promote development by maximizing allocative efficiency and welfare; and that they would restore credit worthiness and growth, without damaging long-term development prospects or inflicting unacceptable welfare losses by stimulating a major supply response. But these claims were not well supported by history, by theory, or by empirical evidence. They were mere ideological assertions and they demanded acceptance of much short-term pain, in return for purely hypothetical, uncertain, and often implausible long-term gains.

The ideological nature of these policy prescriptions is apparent from the sweeping assertions made on their behalf by the IFIs; assertions that are quite incompatible with other claims that these are pragmatic policies tailored to specific circumstances. In truth, what pragmatism there is relates to the detailed phasing and timing of the policy's implementation, not the choice of policy or even direction. The policy itself is not negotiable and is espoused with an almost religious fervor that leaves little room for discussion. In the words of Michael Camdessus, managing director of the International Monetary Fund (IMF):

TWO PAGES ARE MISSING

are made, their costs will have to be allocated between debtors and creditors. Within countries, banking and securities regulations, together with bankruptcy laws, perform this function in a variety of ways, reflecting the balance of political forces within society. But in the international system the virtually complete absence of such an agreed upon legal framework created a situation in which might was right. Hence, powerful creditors were able to force weak debtors to carry virtually the entire burden of the costs of past mistakes. They did so by insisting on "full repayment" as a precondition for any short term assistance from the international community.

The injustice of this solution was magnified by the fact that the lenders had actually been heavily implicated in pushing the lending of the 1970's well beyond the limits of reasonable prudence. This is clearly acknowledged by the World Bank. Its 1985 *World Development Report* accepts that this lending spree occurred largely because the investment climate within the OECD was so poor, and that banks had used their leverage to pressure distressed borrowers into providing extensive public guarantees for loans whose commercial viability they claimed to have assessed, whereas, in fact, once these guarantees were in place "bankers paid less attention to the viability of the particular projects they financed" (World Bank, 1985: 114). Years later, after incalculable damage had been done to the developing world, the World Bank's 1989 *World Development Report* casually accepted that, in retrospect, the lending spree of the 1970's should be seen as *prima facie* "evidence that even competitive financial markets can make mistakes" (World Bank, 1989b: 4). But if that is so, then the costs of those mistakes should surely have been distributed much more evenly between debtors and creditors. Indeed a strong case can be made that the creditors bore a far greater responsibility, since they were thought to have much greater technical expertise in assessing commercial risks, and since they were thought to be risking "their own money" in these ventures. It is not easy for decision makers in poor developing countries, desperate for resources, to resist the temptation of accepting funds that are offered under such conditions.

In short, even public officials acting purely in the public interest, as they perceived it, would have had great difficulty justifying their refusal to accept such financial resources. The obvious short-term benefits of such inflows—the euphoria that thrives in such speculative periods, the arrogant and myopic confidence that emanates

from the ubiquitous financial experts who are also getting rich in t
process—together these would always threaten to overwhelm a
prudent officials seeking to limit their government's exposure t
risk. In fact, such people will tend to be replaced by those who ar
only too willing to play the game, to mouth the speculator's plati
tudes and promises and to denounce as 'backward looking' thos
who fail to understand that the old rules no longer apply in "the ne
economy." But the truth is that water still runs downhill; and spec
lative bubbles still burst—and always will.

Of course, the fact that the individuals promoting profligacy an
risk taking themselves often become fabulously rich in the proces
certainly does not diminish their arrogance, their confidence, c
their ability to influence the policy process. Especially since they ar
the preferred allies of the lenders who are falling all over themselv
to cash in on the good times, knowing full well that these must com
to an end one day. And so, in most cases, this alliance of risk take
will carry the day, will amass great wealth in the process, and wi
then use that power to ensure that the rest of society bears most
the cost of the ensuing collapse. In fact, such people may suff
some pretty spectacular paper losses, but they rarely share in the re
pain that is inflicted on their societies by the eventual adjustme
programs. Indeed, insofar as they have been able to accumula
large hard currency balances abroad, their power over local r
sources and labor will tend to multiply with the inevitable devalu
tion of the local currency. One might regard this as a particula
virulent example of the "moral hazard problem" that bankers oft
like to talk about.

On balance then, it was undoubtedly unethical to demand f
debt repayment from the governments of poor developing countri
when this particular speculative bubble burst. But that was the ba
premise of the structural adjustment program implemented in t
early 1980's.

Apart from being unethical, these policies were also not likely
be efficient in the long-term because, in many cases, such high lev
of debt repayment were sure to undermine long term developm
prospects or social or political stability. To obscure this possibili
the IFIs have produced a constant stream of optimistic scenar
which have been used to suggest that in most cases debts could
repaid without such dire consequences. In fact these projecti
have so consistently erred on the side of excess optimism that c

must surely consider the possibility that they were produced because they were needed to justify the demand for full debt repayment (see Bienefeld, 1988 for an elaboration of this argument).

THE APPEAL TO HISTORY

The Search for Historical Precedents

Broadly speaking, neoliberal policy prescriptions cannot be based on the historical record. History provides very few examples of countries that have used such policies to become competitive high-wage economies capable of supporting widely dispersed welfare benefits for a large population. In every case where such development was achieved in the presence of one or more technologically more advanced economies, extensive and nationally focused state intervention in the economy has played a major role.[1] Indeed, the historical record suggests that the ability to implement such policies coherently and effectively is a necessary condition for success and this is as true of the early industrial countries (see Gerschenkron, 1962; Senghaas, 1985), as it is of the larger East Asian Newly Industrializing Countries (NICs) (see Amsden, 1989; Bienefeld, 1988; Wade, 1990; World Bank, 1992). In virtually every instance development has been associated with strong and active states using protection, industrial promotion, financial regulation, and agricultural policies to create a coherent national economy capable of responding both to external challenges and to domestic social and political priorities.

The absence of suitable historical models was part of the reason why neoliberals placed such heavy emphasis on the experience of the NICs in the 1970's. Having argued that their success was due to their willingness to allow market forces to determine patterns of resource allocation, they proceeded to use their experience in countless policy documents to suggest that liberalization, deregulation, and privatiza-

[1] Some have argued that tariffs in the early industrial countries were lower than those in many developing countries in the 1960's and 1970's. But this ignores the fact that, in the nineteenth century, natural protection in the form of shipping and transport costs was astronomically high by today's standards. And, when this is taken into account, those early levels of protection will turn out to be extremely high for many products.

tion was a proven recipe for development. In fact they were said to "have provided an impressive empirical validation of the theoretical case against protection and for the view that ... free trade remains the best policy for developing (and developed) countries" (Lall, 1983: 11). What is more, this myth has persisted, with some minor adjustments, even after most of the early NICs had became economic disasters in the early 1980's, and even though all of the larger NICs that have remained successful turned out to be highly interventionist states.

Many of the early NICs suffered major reversals in the 1980's as they saw years of development suddenly reversed, real wages and domestic incomes decimated, infrastructure undermined, and investments turned to scrap. In many the rapid growth of the 1970's was now seen to have been purchased at a very high price, leaving a legacy of heavy debts, weak industrial and technological capabilities, deeply divided societies, and relatively powerless governments. These were heavy burdens with which to meet the challenges posed by the difficult, volatile, and hostile world-economy of the 1980's. Unable to deal with these problems on their own, most were eventually forced to seek help from the IFIs, but this was given only in return for their acceptance of one of those "comprehensive stabilization-cum-liberalization programs" that was far more radical than anything tried in the industrial countries. While the widespread acceptance of these policies may appear to validate them, it is important to remember that these were highly constrained choices and that there are always small but powerful minorities in every country that stand to gain from them.

In any event, this was a very different picture from that envisaged by those who had touted the NICs as neoliberal models in the 1970's. They had projected the early success of these countries bravely into the future, spoke of the end of the Third World, and expected these policies to be enthusiastically embraced as people saw their benefits. They did not envisage them being adopted reluctantly, under duress, and as the lesser of many evils. But faith in neoliberal policies was easily maintained despite these setbacks, which could be readily accepted as short-term pain for long-term gain especially by people not feeling the pain. In any case, no matter how bad things became, one could always believe they would have been much worse with any other policies, and/or that those implemen[ting] them were incompetent, corrupt, or both.

A somewhat bigger problem was posed by the discovery that the successful, large East Asian NICs had actually been managed by highly interventionist and nationalist states that had intervened extensively, and in very discretionary ways, in industry, technology, agriculture, trade, and finance. In the face of overwhelming evidence this reality was grudgingly acknowledged, but neoliberal defenders of the faith developed three lines of argument to defend their position. They claimed that these states had intervened only in market-friendly ways; that the intervention, though extensive, had had no significant effect; or that growth would have been even higher without that intervention. None of these arguments would persuade anyone not already committed to this position.

The argument that these states only intervened in market-friendly ways is no more than a tautology if these "market-friendly ways" are not identified *ex ante*, but only *ex post*, after they have proven their success. On the other hand, insofar as it is possible to identify opportunities for intervention that eventually yield market compatible, efficient outcomes, then this validates the interventionist case. Indeed, that is all that is being said. Intervention is virtually always designed to enable producers within an economy to become competitive in more attractive or rewarding activities--i.e., to shape dynamic comparative advantage. It is therefore meant to be market-friendly.

The claim that documented, extensive state intervention may have had no significant impact should serve as a reminder that in the social sciences no argument can ever be totally compelling, since the data is relatively soft and there is no opportunity to conduct controlled experiments. People are, thus, always free to reject any proposition they do not wish to accept. However, those who make this claim must admit to a double standard in that the degree of proof required for propositions that support the neoliberal claim is dramatically different for those that do not. Ironically, it will be shown later that the neoliberal case is actually based on very little evidence.

Finally, the assertion that these economies would have grown even faster without intervention merely reveals a willingness to discard the evidence in favor of a predetermined theoretically derived conclusion. This argument is especially dubious when it comes from people who earlier accepted the now discredited evidence of the neoliberal NICs as the empirical validation of their position. The bottom line is that the only genuinely successful developing countries (larger than a city-state) have been extremely interventionist over long periods of time. While this does not prove the necessi state intervention, let alone the desirability of any kind of in tion, it should, at least, dispose of the neoliberal claim th removal or the minimization of such intervention is the most in tant requirement for successful development.

Focusing on Process: The State as Scapegoat

Apart from the myth of the neoliberal NICs, the most w used justification for neoliberal policy prescriptions is the claim the development crisis of the 1970's was primarily due to exce state intervention. This argument contends that the "dirigiste ma" (see Lall, 1983) that dominated the early postwar years duced enormous inefficiency, corruption, and waste, because and short-sighted urban elites used government policies to ex peasantries, to squander resources on urban consumption an pursue inherently inefficient import substitution strategies. process eventually ground to a halt when the economies colla strangled by chronic balance of payments deficits and weighed d by hopelessly inefficient manufacturing sectors, an alienated uncooperative agriculture, and deeply divided social and poli structures. This story was readily accepted and quickly becam new received wisdom in leading policy circles.

The story was accepted because it provided a convenient sc goat, namely misguided and corrupt Third World governm because the unrestricted application of market principles to world served the interests of those who already controlled dispr tionate amounts of power, finance, markets, knowledge, and nology; because it contained a significant grain of truth, in that n Third World governments were undoubtedly corrupt and ine tive; and because it was remarkably vague, and therefore diffic refute.

In fact, state intervention, as such, was almost certainly no most important reason for the crisis that befell so many develo countries in the 1970's. It is more likely that the main problem a lack of effective, coherent, nationally focused, and democrati controlled state intervention; or the widespread adoption of and shallow development strategies trading short-term gain for l term risk; or the existence of an international system that allo the industrial world to use its economic and political power to the costs of some major global contradictions onto the sagging shoulders of the developing world. But one can readily understand why those in the centers of power would be much more comfortable with an explanation that blamed the victims for their own misfortune.

Although the mainstream's story accepts that global economic changes played a significant contributory role in bringing so many developing countries to their knees, it emphatically identifies faulty domestic policies as the primary problem. This is important because it is only if excessive state intervention is the primary problem, that neoliberal policy prescriptions can be presented as the primary solution. Indeed neoliberalism follows logically from such an analysis since it is really a crusade against market distortions, and especially those stemming from public sector activities. It claims to remove those evil distortions, restrict or eliminate the urban exploitation of agriculture, do away with those costly import substitution strategies, and reduce the chronic balance of payments deficits, while maximizing allocative efficiency and welfare. Unfortunately it will do all of these things only in theory. In practice, when introduced into distressed economies with many markets in massive, structural disequilibrium, it is more likely to lead to chronic instability, increased social and economic polarization, capital flight, and the impoverishment of large parts of the population.

The trouble with this argument is that it offers an unrealistic solution to the wrong problem. To gain a better understanding of the problem, it is necessary to look again at the context within which those Third World governments held and exercized their power, and at the process through which so many countries pursuing diverse policies came to find themselves in an impossible economic position by the early 1980's. This yields a very different alternative explanation. This begins by suggesting that the central problem was the rapid and foolhardy manner in which most developing countries had been integrated into a dangerously unstable and hostile international economy. Strongly encouraged and supported by the industrial world and the IFIs, most had adopted simplistic import substitution strategies which attached little importance to national control of industry, technology, or the policy process. They had relied heavily on foreign loans and had believed those who ridiculed fears that the terms of trade were likely to turn against primary producers at some stage. Unfortunately, just when their exposure to the risks inherent

in this strategy had risen to very high levels, dramatic shifts in global economy effectively undercut the economic, social, and p ical viability of economies they had built.

The mainstream account is thus not entirely wrong, it is me tendentious and incomplete. Elitist, corrupt, and incompetent ernments did frequently mismanage economies, but they did nc so independently, or solely at the behest of their urban coaliti They did so within an international context that strongly encoura them to adopt the very import substitution strategies for which are now so heavily criticized; that often supported unrepresenta and corrupt governments, so long as they were prepared to ac those policies; and that sanctioned those who sought to mar more carefully their economy's insertion into the global econo

The short-comings of government policies thus appear in a light. The much-maligned import substitution policies are no lo simply expressions of misguided and perverse nationalism, purs regardless of market forces. They are recognized as being the m stream policies that were preferred, and even demanded, by ma forces as they then were. After all, this was a time when multinat als invested in Third World manufacturing primarily in orde obtain preferred access to local markets and, in doing so, the variably demanded and obtained trade protection, through ta and quotas, or protection from domestic competition, through dustrial licensing schemes. These distortions were therefore expression of market forces as they impinged on developing co tries seeking to attract foreign investment to promote developm

The mainstream economists of the day never tired of refu and denouncing "woolly headed" dependency theorists who garded this kind of import substitution by invitation as dange and undesirable, because it produced inflexible, import-inten structures of production, limited the transfer of technological managerial capacities, encouraged import-intensive consump patterns and created dualistic social and political structures. T also dismissed the fear that the terms of trade were likely to t against primary exporters if they were forced to try to exp foreign exchange by increasing their exports into these sluggish unstable markets, with their low income elasticities of demand. A turned out, it was when all of those fears proved to be only to founded, that large parts of the developing world suddenly ... themselves in a deep and intractable crisis.

When heavy debts, high real interest rates, and the global slowdown in growth were combined with a sudden and protracted decline in their terms of trade, many developing countries found themselves in a hopeless position. The economic structures they had built over more than twenty years were suddenly paralyzed by foreign exchange shortages that strangled production, reduced capacity utilization, decimated productivity, destroyed the economic viability of infrastructure investments, reduced capital maintenance, and undermined investor confidence. At the same time, the capacity of their states to govern, to enforce vital regulations, and to guide the development effort was crippled as endemic shortages spawned parallel markets; falling revenues and salaries fueled cynicism and administrative decay in their public services; and both encouraged corruption and a growing contempt for the law.

This nightmare scenario was encountered by many developing countries just when they had invested heavily in infrastructural projects with long gestation periods and in import substitution programs still in the early import-intensive phase and not yet able to deliver significant benefits; and just when they had contracted heavy foreign exchange liabilities by relying on foreign capital to maximize short-run growth. For many there was simply no way out, without massive outside help, but that help was available only on condition that they throw all caution to the wind by adopting even more risky and dangerous policies under these difficult circumstances.

Not all countries were in the same position, and not all countries were treated in the same way. The impact of the global changes depended primarily on a country's indebtedness, its technological and administrative strength, and its immediate access to markets and investment flows. The countries of Asia, and especially those of East and Southeast Asia, fared so well because they entered the 1980's with relatively low debt burdens, had relatively strong and coherent states, and enjoyed preferred access to the massive investment flows emanating from Japan and the major East Asian NICs. In sharp contrast, and despite their relatively high levels of development, Latin America's highly indebted and highly polarized societies were hit hard by the crisis, suffering large reductions in real wages, in per capita income, and in the quality of life. Although a few have arrested or even reversed those declines in recent years, almost none have fully recovered the losses incurred in the interim. Africa was hardest hit, as a heavy debt burden was imposed on weak and fragile

economies, heavily dependent on primary commodity exports. Wi a few notable exceptions, like Botswana, Cameroon, and Gabon, i has seen living standards plummet in the course of the 1980's an there is, as yet, little sign of a significant revival.

Governments caught in such a situation have few options. Face with economic disaster they must attempt to keep inherited econom ic structures from complete collapse either by borrowing abroad o by squeezing agriculture (or other export sectors) in the desperat hope that they can hang on until the global situation returns t "normal." Under such conditions it makes little sense to condem them for exploiting agriculture, for excessive borrowing, or fo corruption or administrative laxity, without acknowledging these desperate constraints. It makes even less sense to imply that their performance under these conditions reflects the typical standard of public sector performance. And it makes no sense at all to tell such governments to liberalize trade, finance, and investment in order to produce large efficiency gains. It is like telling a disabled person trying to escape a forest fire to throw away the crutches because muscles must be exercized if one's running speed is to improve.

Such advice is not only untenable in purely economic terms, it also ignores the fact that the need for government to protect and to represent the public interest is never greater than in periods of crisis, when shortages and economic insecurity may threaten the social fabric. Even under more normal circumstances governments in poor societies facing a volatile and hostile global economy must play a central role in creating effective political and institutional structures capable of harnessing society's resources for national development. The fact that this has often been done badly in the past, merely demands more effort to strengthen their ability to carry out these tasks, and more care to ensure that they are not exposing themselves to situations that will exceed their "capacity to adjust." These tasks go far beyond the simple need to promote economic efficiency. In fact, efficiency is ultimately impossible without a degree of social harmony and cohesion, political stability, and responsible environmental management. And these things are impossible without forging a strong national identity, ensuring a significant degree of sovereignty and building a high level of trust and respect for the country's institutions.

Such objectives are not served by the narrow, ahistorical policy prescriptions of neoliberalism. Indeed, they become virtually unattainable in a neoliberal world where sovereign governments are reduced to enforcing the logic of a global market almost irrespective of the wishes or priorities of their people; where the activist state is constantly portrayed as a source of inefficiency and distortion; where bureaucrats are endlessly described as corrupt, lazy, and self-serving, and contrasted with entrepreneurs who are pictured as brave risk takers, largely responsible for innovation and wealth creation; where government attempts to control illegal markets have to contend with IFIs calling for the "decriminalization of parallel markets"; and where the imposition of capital controls to foster the development of national capital markets is ruled out by the alleged inevitability of international financial deregulation.

This looking glass world reflects the individualistic ideologies of the rich and powerful, who want nothing more than to see every global citizen face-to-face with a global market in which they wield power over assets, over effective demand, over knowledge and technology, and over the rules of the game. They want nothing less than to see the emergence of cohesive societies that are intent on pulling together in order to strengthen their collective position in that global market, and in order to create a domestic world in which the demand for efficiency can be balanced against other objectives like social stability, environmental protection, or personal economic security, according to priorities established through a meaningful political process.

For those who wish to pursue development thus defined, the state is not the main problem and the mainstream's account of the developing world's experience over the past 40 years certainly does not succeed in establishing that claim. In fact, history (and sensible theory) will tell us that an activist, national state remains an essential instrument for building stable and prosperous societies in the developing world. Moreover, if the international system continues to attack genuine national development efforts on the grounds that they have become redundant, then the dream of human, and of humane, development will continue to be foreclosed to most people in the developing world. But so too will the dream of a prosperous and stable future for those of us in the developed world.

This section has shown that the neoliberal case cannot be based on the historical record. And it cannot be justified on the grounds that government intervention has been the main reason for the crisis that befell so many developing countries in the 1980's. Indeed, a

more plausible explanation of that crisis sees the main proble deriving from the fact that many developing countries were integ into the global economy in a manner, and to a degree, that exce their capacity to adjust. From this perspective, the neoliberal po are not only not the solution, they intensify the problem.

Let us now consider the efforts to validate neoliberal p prescriptions by means of detailed, rigorous, and scientific evid

MARSHALLING THE EMPIRICAL EVIDENCE FOR NEOLIBERALISM

Efforts to establish neoliberal claims on a more rigorous, s tific basis have had no more success than those seeking to mak case on the basis of historical precedents or on the basis of v allegations about government failures. Indeed, these efforts produced results that either lend little support to those claim that reveal a frequent tendency to manipulate data and langua a desperate effort to rescue the cherished conclusions. A revi these efforts can only lead to the same conclusion as that reach Paul Krugman after reviewing the empirical evidence underpir the claims made on behalf of deregulated financial and foreig change markets.

> At this point belief in the efficiency of the foreign exchar market is a matter of pure faith; *there is not a shred of posi evidence that the market is efficient*, and ... similar results obt for other asset markets ... that is, both the bond market a the stock market.... The bottom line is that there is no *posi* evidence in favor of efficient markets, and if anything a p sumption from the data that (these) markets are not eff ent.... The important conclusion ... is that we are freed fr Friedman's ... argument ... that an efficient market could : exhibit destabilizing speculation.... *Now we know that in fact evidence supports this hypothesis–that it is one maintained purely faith* (Krugmann, 1989: 65–66, emphasis added).

Defining the Essence of the NICs

The history of attempts to provide a more scientific bas claim that the NICs were neoliberal success stories reveals progression from careful research yielding precise and properly qualified conclusions, to broad ideological assertions falsely said to be derivable from that same research. This issue became topical with the 1970 publication of Little, Scitovsky, and Scott's *Industry and Trade in Some Developing Countries*, which offered a thoroughly neoliberal explanation of NIC successes. This work was enthusiastically received in many quarters and instrumental in opening up an important debate. The evidence presented by the study led to strongly neoclassical conclusions because it was interpreted from a neoclassical perspective. The evidence does not speak for itself.

The problems that may arise in this process are revealed in a separate paper by I. M. D. Little, seeking to explain Taiwan's remarkable economic success. Little lists many aspects of that economy's growth which confirm his neoclassical expectations, but he either ignores or dismisses those that do not. Thus, there is no mention of the fact that Taiwan's public sector accounted for a higher proportion of GDP than those of India or Tanzania, or that Taiwan's import licensing system was highly discretionary and closely linked to a strong industrial policy. When contrary features are noted, as in the case of Taiwan's highly regulated and administered financial system, they are simply dismissed on the tautological grounds that such a highly regulated and inefficient system could not have contributed to its success (Little, 1979). Given such procedures, the evidence becomes the prisoner of the analyst's predetermined conclusions.

The most important contribution to the NIC debate came from a large research project undertaken in the U.S. under the auspices of the National Bureau of Economic Research (NBER) under the direction of Professors Bhagwati and Krueger (see Bhagwati & Krueger, 1973). This extensive project ultimately concluded that "neutral exchange rate regimes," which neither discriminate for or against exports, are most conducive to development and growth. This conclusion was carefully stated and accompanied by a reminder that such exchange rate neutrality had been successfully achieved and maintained by some highly interventionist Far Eastern NICs (see Bienefeld, 1988 for a fuller discussion).

But these careful research results were slowly turned into broad ideological assertions about the desirability of neoliberal policy prescriptions. The process begins when the NBER study's conclusion in favor of "neutral exchange rate regimes" is interpreted as implying that market forces should be allowed to determine patterns of

resource allocation. From a neoclassical perspective this is an
step, since it "explains" why countries pursuing such exchange
policies would be likely to do better.[2] However, it once again se
as a reminder that, although such interpretations are perfectly le
mate, their plausibility rests more on the plausibility of the the
than on the actual evidence. The evidence as such does not te
story. But in this way the experience of the admittedly intervent
ist Far Eastern NICs could be transformed into a story to supp
neoliberal prescriptions.

Of course, it would have been equally legitimate, and ma
more plausible, to conclude that this evidence demonstrated the
portance of maintaining a relatively stable exchange rate at a le
compatible with a healthy balance of payments, and of provic
broadly neutral incentives for exports and for domestically orien
production. One might then have noted how few countries
managed to do this successfully and pointed out that those who l
been most successful had been strong and coherent states, capa
of using a wide range of policy instruments for the purpose. Mo
over, their longer term ability to sustain this balance was cle
linked to their ability to shape the economy's dynamic compara
advantage by using a wide range of discretionary instruments
promote the development of strategically important parts of
economy. The broad neutrality of the exchange rate may have b
useful in allowing them to use product and sector specific tariffs
subsidies more effectively for targeting purposes. After all, the sa
study shows South Korea's effective rates of protection ranging fr
31 to 119% in 1968, and from -38 to 135% in 1978 (World Ba
1987: 89). The same evidence could therefore tell a very differ
story.

The debate became even less disciplined and rigorous whe
shifted to broad assertions about the superiority of Export Pro
tion (EP) over Import Substitution (IS). A case in point is a 1
paper by Bhagwati, in which he concludes that "I fail to find comp
ling reasons for thinking that the orthodoxy among econom
should revert to the IS strategy" (Bhagwati, 1986: 102). However,
does so while acknowledging that most successful EP strategies w

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[2] Of course, it is also true that Anne Krueger had elsewhere explained that the between neoclassical trade theory and either growth or efficiency, was a very tenuous (see Krueger, 1980).

based on previous IS policies which implies, of course, that EP and IS are not mutually exclusive alternatives between which one must choose (see Bienefeld, 1988, for a fuller discussion). The problem is that, if this is so, then it makes no sense to assert the superiority of EP over IS! In fact, the only sensible question that remains is, and has always been: What combination of IS and EP is appropriate to a country's specific level of development and circumstances? The answer to that question could never take the form of a single global policy prescription, neoliberal or otherwise.

The Evidence on "Outward Orientation"

Major methodological problems arise whenever attempts are made to compare the performance of various groups of countries said to share some complex, common feature like being a NIC, or an "adjustment lending country," or a country with a "strong outward orientation." These common characteristics are generally so complex and ill-defined that it is all but impossible to give them analytical meaning. And then the categories are usually so loosely defined that it is rarely clear to which groups any one country should belong. This makes the composition of the groups highly discretionary and raises the risk that this composition might be influenced by the expected or desired results. This impression must be carefully avoided, especially when the institution undertaking the study is known to be strongly committed to certain outcomes, either ideologically or by virtue of its advice. The fact that most such studies do not provide sufficient information to allow that exercise of discretion to be scrutinized is thus unfortunate since it merely raises possibly unwarranted suspicions (see World Bank, 1987; 1988).

A clear case in point is the 1987 *World Development Report's* attempt to compare the performance of four groups of countries, ranging from "strongly outward oriented" to "strongly inward oriented." The results of this exercise were widely cited as confirming the validity of the World Bank's standard policy prescriptions. The study concluded that "the economic performance of the outward-oriented economies has been broadly superior to that of the inward-oriented countries in almost all respects" (World Bank, 1987: 85). However, the methodology and the procedures used by this study raise many awkward questions and render the results effectively meaningless.

The biggest problem revolves around the definition and the composition of the categories. Clearly any meaning that might be attached to the results depends on the rigor and precision of these definitions, but they are neither rigorous nor precise. Each category is defined according to a large number of variables, with no indication of how these are weighted, quantified, or summed, and often with little indication of how they are even defined. Thus in one category, we have countries whose "use of direct controls and licensing arrangements is limited," while in another it is "extensive," but we do not know what this means, or how one classifies a country with limited controls "on average," but extensive and very effective ones in certain key areas of the economy.

Some of the problems this may cause are illustrated when one looks at the composition of the "strongly outward oriented" category, which is defined as including countries in which "trade controls are either nonexistent or very low" and in which "there is little or no use of direct controls and licensing arrangements" (World Bank, 1987: 82). This definition is clearly intended to approximate the World Bank's orthodox policy prescriptions since these results are cited in support of those policies throughout the report. Only four countries are included in this category and these happen to be the four Far Eastern NICs (South Korea, Taiwan, Singapore, Hong Kong). Given the well-known success of these countries, this obviously ensures that this category will perform best. Much therefore rests on the rigor with which this selection was made, but this is left largely unexplained.

In any event, one is hard-pressed to reconcile the mountain of evidence that has accumulated about South Korea, with the idea that it belongs in a category of countries in which there is "little or no use of direct controls" and in which "trade controls are either nonexistent or very low." Even the Bank itself has acknowledged in one of its official reports that the policies pursued by South Korea and Japan were clearly different from those it advocates since there "the state played lead roles in targeting, establishing and protecting key industries" (World Bank/UNDP, 1989a: 187).

Not surprisingly, this "strongly outward oriented" category clearly performed best. However, between the moderately inward and moderately outward groups there was little to choose, the former performing somewhat better in the period 1963–73, the latter between 1973 and 1985. The strongly inward group lagged behind on performed "better" in 54% of cases but, despite claims to the contrary, this cannot be treated as a statistically, or analytically, significant observation given the generality of these comparisons, the complexity of the characteristics shared by the countries in each category, the variance in the data, and the extensive overlap in the categories.

In its more detailed discussions the study shows that even the purely economic effects of these policies were profoundly disappointing in most of the AL countries. Thus, it concludes that "the hoped-for switching and growth-augmenting effects of adjustment lending *is (sic) not apparent* in the low income AL countries" (World Bank, 1988: 24, emphasis added); while in the highly indebted ones, a small increase in growth rates was accompanied by "a sharp fall in average investment/GDP ratios" and "although NAL (Non-Adjustment Lending) countries halved their budget deficits, AL recipients doubled theirs" (World Bank, 1988: 24). Together these two groups include a majority of the AL countries.

What the study actually shows is that only high-middle income countries exporting manufactured goods on a significant scale clearly benefitted from these policies. This is just what a good structuralist economist would have expected, since these are countries that may be strong and resilient enough to respond constructively to a sudden intensification of competitive pressure. However, even for them, the long-term significance of the short-term gains documented in this study will depend on whether a strong national institutional, technological, and managerial base was being created in the process. This is the lesson of the larger East Asian NICs, which distinguished themselves most clearly from most of the other NICs by their willingness to invest heavily in the development of national firms and technological capabilities, even though they incurred obvious short-term costs by restricting the role of direct foreign investment and investing in their own national manufacturing enterprises. It was this feature of their experience which has ultimately made it possible for them to remain competitive even as real wages continued to rise through the 1980's.

The characteristic nationalism of the most successful NICs must therefore be taken into account in evaluating the World Bank's one clearly positive finding, namely that the high-middle income AL countries were clearly able to benefit from its adjustment policies. Even this one success lends only qualified support to its adjustment

Indeed, it appears that such evidence was nonexistent at that tim
What is more surprising is that the IFIs themselves frequently a
knowledged this in their more technical studies, and in certain candi
moments in the heat of a debate. More surprisingly, the lack of en
pirical evidence extended even to the claims made on behalf of th
individual policy instruments that make up the adjustment package

In 1987, at a Carleton University workshop, a senior professiona
dealing with privatization in the World Bank,[4] stated in discussio
that "it is true that the empirical evidence for privatization is virtuall
non existent," but then went on to assure the audience that "wor
was being initiated to solve this problem" (Nellis, 1987). Given tha
the World Bank was already embarked on its privatization crusade
this was not actually very reassuring news. Moreover, the remark wa
also wrong, since there was lots of empirical evidence pertaining t
privatization, but it did not support the claims being made on it
behalf. In fact in 1980, Professor Baumol had summarized a majo
international conference that had evaluated the available evidence
on this subject, by noting that the case for the superiority of private
enterprise was generally strong with reference to profit oriented,
small scale activities. However,

> The case of large enterprises is quite different. Here the efficiency advantage of private enterprise, apparently, often disappears. One can easily find cases in which a public firm seems much more efficient than its private counterpart, as well as cases where the reverse is true. Thus, where large industry is concerned one must be pragmatic and be prepared to act differently from case to case in choosing between public and private ownership (Baumol, 1980: 301).

ensure that governments adopted "sound economic policies" as defined by the IFIs. This represented a far-reaching infringement of their sovereignty which was justified on the spurious grounds that the IFIs had shown "objectively, as a matter of scientific fact, that these policies served the national interest of the recipient countries." Significantly, an internal assessment of policy lending that was commissioned by the Bank, had defined it rather more tellingly as a process of giving loans "large enough to win access to the most senior policy makers" (Berg & Batchelder, 1985: 11). Much earlier, when this new approach was first being introduced, one of the World Bank's most senior officials had reminded its critics that "the business of the Fund and the Bank involves matters of high economic policy. They should not just become two more financial institutions" (Lar
Mills, 1981: 17).

[4] John Nellis, who is also the author of a number of World Bank studies on privatization.

The evidence on many of the other policy instruments that comprise the adjustment package was summarized in a 1985 study commissioned by the IMF to assess the effect of its adjustment policies on growth (Khan & Knight, 1985). Despite the fact that complex neoliberal policy packages made up of these instruments had been imposed on prospective borrowers for several years, there appears to have been little or no empirical support even for the individual instruments. In the words of this study: "the effects of fiscal deficits on growth turn out to be difficult to establish empirically" (Khan & Knight, 1985: 12); "attempts to eliminate distortions ... can cause unemployment and ... may even reduce welfare" (1985: 13); "despite the amount of research expended ... it is still uncertain whether an increase in interest rates will, on balance, raise the savings rate" (1985: 14); "the growth effects of exchange rate changes depend crucially on such issues as the extent and duration of the real exchange rate change, the structure of production, and the response of trade flows to relative price changes" (1985: 17). Ironically, the only relationship that was supported by the evidence was that between investment and growth; ironic because the most consistently reported outcome of those adjustment programs eventually turned out to be a decline in the investment ratio (World Bank, 1988; 1992; Corbo & Fischer, 1992; Dornbusch, 1990).

Given that the evidence supporting individual policy instruments was so weak, it comes as no surprise that this same study should declare evidence pertaining to the adjustment packages as a whole to be nonexistent. What may be a little surprising to some is that this study also suggested that, due to inherent methodological problems, such support might never be forthcoming. In view of these methodological difficulties it noted that

> it is easy to see why no empirical studies are available that undertake relevant comparisons between Fund programs and alternative programs. Consequently there is no obvious way of determining whether or not Fund programs are too harsh.... Little empirical evidence exists on the long-run effects of Fund programs, and none at all on the effects of various combinations of stabilization policies on economic development (Khan & Knight, 1985: 7).

There is no doubt that the neoliberal policy prescriptions that have been so widely and militantly imposed on developing countries

around the world were not based on the historical record or or persuasive empirical evidence. This means they could only have beer derived from pure theory, but even this turns out to be impossible.

SEEKING SALVATION IN THEORY

The Unreality of Theory

In theory anything is possible. This means that purely theoretical assertions cannot be taken seriously until they have received some significant historical and empirical support. However, the neoliberal prescriptions for development have been taken very seriously despite the evident lack of such support. How are we to explain this?

Some might suggest that these theoretical arguments are so clear that one should accept their logic, in spite of the weakness of available evidence. However, this is simply not the case. Indeed, the neoliberal policy prescriptions cannot be legitimately derived from neoclassical theory at all. In the words of one leading neoclassical theorist "these advocates say much more than even the pure theory allows them to say, and infinitely more than the applicability of that theory permits" (Hahn, 1982: 20).

There are simply too many inherent and inevitable imperfections in the real world for perfect competition to be taken as a reasonable approximation of that world. Information is not and will never be freely and instantaneously available, especially since its appropriation and protection is an endemic feature of competitive markets; the future is inherently uncertain and there is no market determined way of allocating the resulting privileges and risks; people's preferences are neither stable nor consistent, and they cannot be considered independently of market driven efforts to shape them; increasing returns to scale and learning effects are widespread. The list could go on. These are not minor blemishes that one could safely ignore. Taken together they imply that competitive markets will often be unstable, inefficient, and inequitable under real world circumstances. And this is particularly true under the sorts of conditions likely to exist in developing countries forced to turn to multilateral institutions for help.

The possibility that economic liberalization could be dangerously destabilizing has been frequently noted by critics (Rodrik, 1990;

Taylor, 1993; Bienefeld, 1988) and has also been acknowledged by the IFIs, which have a disturbing habit of noting the dangers inherent in these unproven and risky policies, while continuing to impose them on their clients. One IMF technical paper spends 45 pages setting out the theoretical foundations of its orthodox adjustment policies and then remarks, on the very last page, that these policies may not be appropriate in cases where "a large external debt creates special problems." In such cases, it says, "further study" is needed to determine "the proper mix of policies" because the orthodox package may well trigger a vicious cycle involving

> increased capital flight, which puts pressure both on the domestic currency (to depreciate further) and on domestic interest rates (to stem capital flight). Higher inflation also tends to raise nominal interest rates. These secondary effects on the exchange rate and the interest rates tend to lead to a further deterioration in the fiscal situation (IMF, 1987: 45).

The incredulous reader is left to reflect on the fact that these "special conditions" are precisely those under which these policies are most often and most vigorously applied. Moreover, this danger does not only arise when heavy debts pose "special problems," but also when a relatively weak technological base, a weak administrative and institutional structure, a volatile international market, or an unstable social or political situation pose "special problems." In fact, these are not "special problems," they are the normal problems confronting countries implementing these policies. The special cases are those that do not suffer chronically from these problems, such as some of the high-middle income countries that responded so much better to the adjustment policies.

A 1985 World Bank report noted this general problem when it lamented the fact that "borrowers and lenders often fail to take account of the institutional, social, and political rigidities that restrict a country's capacity to adjust" (World Bank, 1985: 2). And on another occasion, the World Bank deplored the first ten years of its own adjustment policy advice as having been based on an unwarranted application of "text-book economics" to the real world (World Bank, 1988: 66). Such statements read as if these institutions regard themselves as external observers with no responsibility for these events; or as if they believe that by acknowledging such problems they can deflect criticism, and then carry on as before.

Were they to take the above remarks seriously they would ha to abandon the endless repetition of their neoliberal prescriptio and return to a more nuanced, more serious, and more uncerta policy process in which politics, history, culture, institutions, ar power were once again taken seriously. For them, the trouble is th it would then no longer be possible to assert the claims of the glob market place as overriding priorities, leaving all other objectives demands as dependent variables to be adjusted around these facts economic life.

The Theory of the Second Best

Even if one were to ignore the unreality of the assumptions c which neoclassical theory rests, neoliberal policy prescriptions st could not be legitimately derived from that theory. This is becau the "theory of the second best" has long ago established that neocla sical theory is unable to predict how the removal of a few mark imperfections, from a world with many imperfections, will affe total efficiency or welfare. This contradicts the claims made o behalf of the neoliberal policy prescriptions and makes it clear th those propositions cannot be derived from this theory. Attempts b some proponents to evade this conclusion and to rescue the case fc the neoliberal policies by claiming that government failure is almo always worse than market failure (see Lall, 1983; and Helm, 198 cannot be taken seriously. Although such claims do serve as a r minder that market failure does not justify any form of state inte vention, they ultimately turn out to be nothing more than vagu ideological assertions based on "faith." And the only way to tra scend this low level of debate is to study and to analyze the historic record, to identify and to understand instances of successful stat intervention, and to use this knowledge when formulating economi policy.

Ideology and Alternative Theory

The largely ideological nature of neoliberal assertions is empha sized when leading exponents announce that their attachment to thi position is not based on evidence and could not be undermin any new evidence that might emerge. Thus, a 1988 IMF study exam ining the impact of structural adjustment policies on human welfar concludes that, due to methodological problems, its estimates of their short-term impact have to be "primarily based on deductive reasoning and not on the evidence itself." In estimating their long-term impact it has chosen to proceed on "the axiomatic assumption that the impact of structural adjustment on welfare is subject to a J-curve effect" (Heller et al., 1988: 10). Since axiomatic assumptions are made a priori, this decision makes the empirical evidence irrelevant.

Amid all of this confusion and dissimulation the sad fact remains that there are perfectly legitimate and consistent theoretical perspectives that are more easily reconciled with the evidence and that were more accurate in anticipating the actual evolution of the global economy over the past twenty years. Moreover, such alternative perspectives can even be derived from the neoclassical framework, as well as from various political economy traditions.

The neoclassical version of a more defensible theory emerges as soon as one takes culture, institutions, and market power seriously; accepts the importance of externalities, learning effects and dynamic comparative advantage; and understands that development, and even efficiency, have to be constructed so that their attainment is understood to require stable societies, steered by legitimate governments, and sharing objectives and principles reconcilable with peoples' aspirations for a gentle, peaceful, and prosperous existence. This is a more defensible and more realistic universal human objective than the alleged profit-maximizing behavior of economic man.

Since the earlier development debates concerned themselves with such issues, they were necessarily wide-ranging and inconclusive. No analysis that takes the complexity of the real world seriously could (or should!) ever attain the fatal rigor or the terrifying uniformity of policy prescriptions derived from the application of "textbook economics" to the real world.

The focus of those earlier debates turned out to be the nation-state, since it provides a vehicle that might allow political and economic objectives to be reconciled, or that might allow development to be defined and pursued in a politically and socially responsible manner. Differences over this question became more sharply focused in the 1970's as efforts to reconcile national social, economic, and political processes came into conflict with internationally driven economic trends. To resolve this conflict one either had to take the national question more seriously or abandon it entirely, in favor of

some version of internationalization, or more accurately, globa-
tion.

The neoliberals clearly chose the globalization option and th
assertions became more militant as it became clear that a grow
number of developing countries were taking the move toward
more nationalist option seriously in the 1970's. The threat was r
by an ideological offensive that dismissed such concerns, and est
lished the neoliberal orthodoxy as the received wisdom; and b
"real" offensive that consisted of excessive lending ("the mistake
in the 1970's, followed by the debt crisis, which has provided the I
with a degree of leverage that has allowed them to accelerate t
process of globalization to a previously unimaginable degree. At t
same time, nationally-focused development efforts that refused to
integrated into that process were brought to heel via sanctions or
necessary, via brutal subversion by armed "freedom fighters" such
the CONTRA in Nicaragua, RENAMO in Mozambique, UNITA
Angola, and the Mujahiddin in Afghanistan.

Theoretically there were a number of alternatives to the ne
liberal resolution of the crisis that erupted when the global chang
of the 1970's exposed the rickety foundations of the previo
orthodoxy, namely the "import substitution by invitation" model
development. The foundations for such alternative responses h
been long established both in the nationalist theories of Friedri
List (List, 1904; Senghaas, 1985), in radical dependency theory (s
Bienefeld, 1980; 1981a), and in the formulations of some of t
more farsighted development economists (Seers, 1983).

Mainstream debate alleges that events have discredited su
theories. However, nothing could be further from the truth. Indee
these theories were far more prescient and accurate in their view
how global development processes would evolve. The main concer
at the center of dependency theory have been borne out by t
events of the last twenty years. While the counterarguments of the
mainstream rivals have been revealed as naive and optimistic,
though they appear careful and measured compared to the ne
liberal claims about impending supply side miracles.

Looking at the world from a dependency perspective in tl
1970's one could anticipate the early demise of the dreams attache
to the "basic needs" policies of those years (Bienefeld, 1978); tl
debt crisis, and the associated reversals in human welfare (Bienefel
1981b); and the sudden and dramatic collapse of so many of tl

early NICs, as well as the more lasting success of those East Asian NICs that had built more solid foundations for national development (Bienefeld, 1986). One could see these possibilities because of the importance attached to the national institutional, technological, and financial foundations of a country's growth; the tendency of markets, and especially of deregulated financial markets, to fuel instability and the creation of excess capacities; and the tendency for competitive pressures to override all other policy considerations once the facts of economic life are shaped in a certain way. Most importantly, however, these developments could be anticipated by anyone who recognized both the importance, and the difficulty, of implementing effective national development strategies in an increasingly volatile global economy.

This brings this part of the argument to a close. It has been shown that the neoliberal orthodoxy that has dominated the development debate for the past two decades cannot be based on the historical record, on the empirical evidence, or even on neoclassical theory; that it displaced a far richer, more nuanced, and more serious debate, whose recovery must be still be our first priority; and that the new orthodoxy consists primarily of ideological assertions whose roots must be sought in the interests that they serve.

LOOKING TO THE FUTURE

The main short-term interests served by the neoliberal orthodoxy were those of the creditors holding the Third World's debt at the end of the 1970's. Certainly the clearest and most certain impact of these policies was to increase debt servicing capacities, although at a great cost to human welfare, to future development prospects, and to social and political stability. These interests alone may explain why these policies received such massive support in the immediate aftermath of the debt crisis, despite their lack of empirical or theoretical support. However, to understand their longer term support one needs to look more deeply into the global structures of ownership and power that are strengthened by the creation of a neoliberal world. The central, defining characteristic of that world is an almost unlimited preference for private ownership and an intense hostility to public ownership and control of resources, or to public sector efforts to require economic processes to accommodate themselves

to socially or politically defined objectives. Such a world constitut
a perfect environment for the expansion and exercise of corpora
power; it is these interests that are likely to be the central forc
behind the crusade for structural adjustment.

This article will conclude by reflecting on the role played by fou
current developments in the creation of a global, corporate, an
depoliticized world. These are: the transformation of General Agre
ment on Trade and Tariffs (GATT) from a passive organization, e
forcing trade rules representing a lowest common denominat
agreeable to its sovereign members, into an aggressive and proacti
institution rolling back the limits of national sovereignty; the increa
ing concern with the strengthening and expansion of intellectu
property rights; the increasing pressure being exerted on the fe
remaining nationally coherent economies to dismantle the found
tions of their past success; and the world's increasingly evident i
ability to deal with, or to rectify, the chaos that has so frequentl
resulted when social and political coherence has been stretche
beyond its breaking point, or when the IFIs have once again failed t
consider the limits of a country's capacity to adjust.

Taken together these four developments show the world movin
rapidly towards a period of acute instability and confrontation. Th
corporate power that is currently being expanded and entrenched i
increasingly divorced from any social or political roots, and i
therefore also increasingly free of social, political, or ethical co
straints. The success of the current initiatives on GATT and o
intellectual property rights would strengthen that corporate powe
partly by further undermining the capacity of public institutions t
protect the public interest; and partly by allowing corporation
greater freedom to assert their increasing control of knowledge an
technology to extract economic rents and to create barriers fo
potential competitors.

The recent rush to patent partial results achieved in genetic re
search has already reduced collaboration among scientists and th
publication of certain scientific results to a trickle, even thoug
scientific progress will suffer. One can only imagine what will ha
pen if the ownership of ideas continues to become entrenched
These boundaries are constantly being extended. A recent dr
copyright law tabled by the Canadian government would
required a university professor to pay royalties to obtain permissio
to write an extended quotation on the blackboard. Such straws i

the wind indicate the danger that, as ideas and knowledge are ever more widely appropriated as property, free communication and the free exchange of ideas will be threatened from a new direction.

In the meantime, the extraction of rents based on the ownership of knowledge and technology is intensified even from countries still struggling to deal with the debt crisis of the 1970's. Nor are such matters left to negotiations between firms and the regulatory authorities of the jurisdiction in question, as might once have been considered appropriate. Now the U.S. government feels free to threaten Argentina with trade sanctions unless it agrees to adopt new legislation to extend the period of patent protection granted to pharmaceuticals. This additional burden now has to be borne by Argentina, a country that has just gone through ten years of hell and is still threatened with social and economic collapse. This incident may turn out to be the tip of a large, costly, and ugly iceberg.

The third development concerns the pressure being put on all countries that insist on retaining a clearly national development perspective. These range from Japan, through South Korea and Europe, to Cuba. That some of these countries are, in fact, economically the most successful in the world presents us with the absurd spectacle of a chronically unsuccessful country (both socially and economically) imposing its policies on far more successful ones, allegedly in the interests of their own efficiency and welfare. Fortunately, Japan, South Korea, and Europe are all putting up a certain amount of resistance to this process in the context of the Uruguay Round discussions as they realize just how sharply these proposals would ultimately constrain their sovereignty.

One interesting dimension of this process has been Japan's recent resistance to the continued imposition of the neoliberal orthodoxy on the developing world. This is a welcome development because it may hasten the day when these policies are finally abandoned in favor of others that aim at the creation (or rather the recreation) of sovereign nation-states, linked together by reasonable and flexible rules that reduce the scope for conflict but confer enough sovereignty on each state to allow it to manage its national markets in the public interest. It is also a dangerous development, however, since the current hegemonic power may be tempted to use its economic, political, and, military power to override or sanction such objections.

Japan's challenge to the structural adjustment orthodoxy wa clearly articulated in a 1991 Overseas Economic Cooperation Fun (OECF) discussion paper, entitled "Issues Related to the Worl Bank's Approach to Structural Adjustment: Proposal from a Majo Partner" (Government of Japan, 1991). This suggested that "there i still much room for improvement in structural adjustment lendin as far as its content and the ways of implementation are concerned and then reminded the Bank that "when we make up an economi reform program, various factors other than efficiency must also b taken into account"; and also that "efficiency must be considere from a long-term viewpoint." It then drew attention to four ex tremely important issues by posing four specific and self-explanator sets of rhetorical questions.

> [If] the impetus for sustained growth can [not] be created by structural adjustment alone, isn't it necessary to introduce some additional measures for investment promotion?
>
> If imports are liberalized too quickly, is it possible to develop industries which will play leading roles in the next stage of economic development? If not, isn't it necessary to protect domestic industry to some extent for a certain period of time in order to allow a viable export industry to develop?
>
> Isn't it indispensable to have development finance institutions lending with subsidized interest rates, under some circumstances, in order to maximize social welfare?
>
> Is the privatization program taking into consideration other important aspects than economic efficiency? (Government of Japan, 1991: 4).

The paper concluded that in the 1980's "economic theory as well as economic policy were heavily oriented toward the pursuit of efficiency.... What is now needed is a policy well balanced between efficiency and fairness, in order to improve the welfare of the entire society" (Government of Japan, 1991: 17). One can only agree, although it is a wish not easily fulfilled.

The main reason for optimism on this front may be the fact that social and political stability, prosperity, and the wide diffusion of welfare benefits that most people in the industrial countries had come to take for granted 30 years after the Second World War, are increasingly threatened by these same global developments. Especially in countries like the U.S. and the U.K., where this process has been allowed to go furthest, social conditions have deteriorated, poverty and crime have exploded, and economic insecurity has become a cancerous growth undermining families, communities, and civil society. Eventually these trends will provide the political impetus for change, but the opposition will be formidable and we can only hope that the resulting political forces can be channelled into a constructive, welfare oriented nationalism, instead of an aggressive and militaristic one.

The fourth and last global development reinforces the point that the political forces released when societies lose their internal cohesion are not easily contained or channelled. From Liberia to Yugoslavia, from Georgia to Afghanistan, from Haiti to Somalia, from Russia to Ethiopia the world is full of reminders that such cohesion is not easily restored, no matter how many cruise missiles or food aid trucks one may have at the ready. It therefore behooves us to pay close attention before such ruptures occur and to do everything in our power to avoid them. By the same token, those who have deliberately brought about such ruptures in order to force societies like Nicaragua, Cuba, Afghanistan, or Guatemala to adopt different domestic development policies, would be held severely accountable in a perfect world.

That such brutal, subversive initiatives are often ostensibly undertaken to protect someone's definition of "human rights" only compounds the problem. It is one more example of the spread of Orwellian doublespeak in a world in which the objectives of too many policies have to be masked by misleading labels and supported by analyses that use empirical evidence only when it can be made to appear compatible with ideologically predetermined policy choices. And any objective account of "the story of structural adjustment" must conclude that it is another example of this process at work. There was little empirical evidence to support the extravagant claims made on behalf of these policies when they were first imposed. In fact, the claim that these policies were known to be a reliable basis for stable, equitable, and sustainable development, was almost entirely spurious; and the suggestion that this knowledge was robust and secure enough to justify the imposition of these policies on weak and distressed developing economies, is simply absurd. Moreover, the subsequent attempts to justify these policies ex post have been

revealed as exercises in which predetermined conclusions were repeatedly drawn in spite of the evidence; and in which evidence wa selectively, and often dishonestly, used. Only in an Orwellian worl could structural adjustment be presented as a "development policy. In reality it was, and it is, a debt collection device and a mechanisr for extending the reach of the competitive market into the farthe corners of the earth.

EPILOGUE

Since the first draft of this article was written in 1993, its basi themes have been powerfully illustrated. On one hand, the drive t build and to institutionalize a global, neoliberal capitalism has acce erated and deepened with the establishment of the World Trad Organization (WTO) and the signing of dramatic and far-reachin global agreements on telecommunications and finance. This ha been accompanied by the continuing marginalization of the U.N. i the face of the aggressive unilateralism of the "only remaining supe power"; a steady erosion of the scope for meaningful citizenship i harmonious, diverse, secular national communities; and an explosiv growth of economic and financial instability, together with a resu gence of deeply divisive ethnic and religious identities, and th fascist responses that are their natural counterpart.

Against this background, it has become easier to appreciate th strategic role that structural adjustment played in making the worl safe for finance; in bringing the developing world into line an thereby helping to lay the foundations for a more monolithic, mor integrated, more global—and ultimately more distant and undemc cratic—capitalism. And, over time, it has also become easier to se the yawning gap between the claims made on behalf of the neo liberal policy regime, and its actual outcomes. Of course, given th preceding analysis, it should come as no surprise that this has ha little impact on the IFIs' commitment to neoliberalism. In fact, th Asian crisis of 1997–98, which engulfed the very countries that ha long been dishonestly held up as models of successful neolibera development, has only served to accelerate the neoliberal project b giving the IFIs the leverage to overcome the long-standing r tanc of the most successful countries of the region.

In order to justify their continued adherence to the neoliberal agenda despite these major embarrassments, the IFIs simply had to rewrite history one more time.[5] Thus in the wake of the Asian crisis, the very same countries that had so long been (wrongly) extolled as models of neoliberal success, suddenly became cesspools of statist meddling, misallocating resources on a massive scale because crony capitalism is incompatible with economic rationality or efficiency. Naturally this analysis easily led to the conclusion that to overcome their serious and deep-seated problems, these countries needed to adopt neoliberal policies that they had actually never had. Hence, their financial systems, which had financed the most dramatic economic transformation in history largely out of domestic savings and with no serious financial crisis in over 30 years, had to be radically deregulated; and their domestic markets had to be freed from all manner of state intervention.

This sophistry is, for the moment, still carrying the day. This should serve as a graphic reminder that it is power, not reason, that prevails in such matters in the short run. Whether reason can alter this balance of power in the longer run is an open question, and a challenge to those who have taken the trouble to examine the

[5] They had done this many times before, with no visible signs of embarrassment. Thus when the oil crisis destroyed the viability of import substitution policies in many developing countries, the IFIs simply ignored the fact that this had long been their basic policy approach, and blamed those who had implemented these policies with their help. The same modernizing elites with whom they had worked so closely were suddenly reclassified. They were now portrayed as venal, self-interested, and corrupt nationalists and, as such, they became convenient scapegoats. And the same thing happened when the debt crisis overturned so many optimistic calculations in the early 1980's. Now those who had believed the IFIs when they extolled the virtues of foreign finance as a basis for development, were quickly transformed into profligate, corrupt borrowers who misused the funds entrusted to them. The fact that the IFIs had celebrated and encouraged this entire speculative process was conveniently forgotten, or downplayed. Also forgotten was the fact that critics of this process who had warned of an impending debt crisis in the 1970's, were often told by the IFIs that such concerns were misguided, if not perverse, since debt was not necessarily a problem in a growing economy, especially when the lenders were sophisticated financial institutions who could be trusted to assess the commercial and economic viability of the projects that they were financing. All of this was conveniently forgotten once the debt crisis had erupted. Not missing a beat, the IFIs immediately began to pontificate about the need to be prudent in managing a country's foreign exchange exposure. They even had the chutzpah to offer their services as alleged experts in this field even though as late as 1981, the World Bank's *World Development Report* had blithely declared that the debt exposure of the developing world was not a serious problem and that there was almost certainly room for even larger financial flows

evidence. It is encouraging that the groundswell of opposition t these policies has now grown to the point where those in power fe mildly threatened, and annoyed, by these developments. And it i also encouraging that some very influential, and sometimes rathe unexpected voices, have recently been added to the ranks of thos who share my main conclusions. Admittedly these are small beginnings, but it is from acorns that mighty oak trees grow. In conclusio I will simply quote some of these more recent dissident voices sinc they reinforce the main arguments of this article, and reflect th growing divergence between fact and fiction in the debate abou neoliberal adjustment.

Paul Krugman, in an article written in the wake of the Mexica Peso crisis, suggests that "the Mexican crisis marks the beginning o the deflation of the Washington consensus" (Krugman, 1995: 31) which he defines simply as "the belief that Victorian virtue in economic policy—free markets and sound money—is the key to economic development" (Krugman, 1995: 29). But then he adds:

> Something like that crisis was an accident waiting to happen because the stunning initial success of the Washington consensus was based not on solid achievements, but on excessively optimistic expectations.... Indeed, the ... consensus may usefully be thought of as a sort of speculative bubble—one that involved not only the usual economic process by which excessive market optimism can be a temporarily self-fulfilling prophecy, but a more subtle political process through which the common beliefs of policy-makers and investors proved mutually reinforcing (Krugman, 1995: 30).

And in each of the main policy areas, Krugman shows that even by 1995, the evidence in support of neoliberal claims is extremely weak—or worse. Thus:

> the empirical evidence for huge gains from market policies is, at best, fuzzy.... A survey by UCLA's Sebastian Edwards concluded that studies which purport to show that countries with liberal trade regimes systematically grow more rapidly than those with closed markets "have been plagued by empirical and conceptual shortcomings [that have] resulted, in many cases, in unconvincing results whose fragility has been exposed by subsequent work" (Krugman, 1995: 33, citing Edwards, 1993)

> All this . . . does mean that the widespread belief that moving to free trade and free markets will produce a dramatic acceleration in a developing county's growth represents a leap of faith, rather than a conclusion based on hard evidence.

> What about the other half of the Washington consensus, the belief in the importance of sound money? Here the case is even weaker (Krugman, 1995: 33).

The same conclusion was reached by Dani Rodrik in 1999. Indeed, John Sewell, President of the [U.S.] Overseas Development Council, summarizes the argument effectively in the foreword:

> He [Rodrik] argues that there is no evidence to back the claims of many that integration into the global economy *in and of itself* will improve economic performance. Indeed, according to Rodrik's analysis, there is no convincing evidence that openness, in the sense of low barriers to trade and capital flows systematically produces [economic growth]. In practice the links between openness and economic growth tend to be weak; and to be contingent on the presence of complementary policies and institutions (Rodrik, 1999: viii).

Of course, Rodrik is not a new arrival among the critics of neoliberal adjustment. He has been a consistent and articulate critic from an early date and this recent book merely consolidates and develops the insights contained in his earlier work, some of which was cited in the preceding discussion. However, this cannot be said of Salinas de Gortari, the former Mexican president, who was well known as an enthusiastic proponent of neoliberalism, and who steered his country in that direction during his term of office. And yet he too has become a fierce critic in light of the accumulating negative evidence embodied in the recurring endemic financial crises. Thus he now believes that:

> The essential meaning of the [world financial] crisis is that in an age of financial volatility, scarcity, and skepticism, most countries will have to walk on their own legs more than their governments and their elites had wanted or expected. . . . Although the paper is adamant that the solution to these problems does not lie in a return to "protectionism and populism," it is equally convinced that the neoliberal policy package

> does not hold out any hope of genuine, sustained develop[ment since "the neoliberal version of the market economy ma[y] favor the interests of big international businesses and [their transactions . . . [but it] suits almost no one else" (Salinas d[e] Gortari & Unger, 1999: 14, 19).

The same conclusion was reached by UNCTAD's 1999 *Trade [and] Development Report*. After a painstaking review of the available [evi]dence, this report uses surprisingly strong language to declare neoliberal promises "empty."

> In recent years developing countries have striven hard, an[d] often at considerable cost, to integrate more closely into th[e] world economy. But, in the face of deep-seated imbalance[s] ineconomic power and systemic biases in the internation[al] trading and financial system, their expectations of the gai[n] from such integration in terms of faster growth, greater em[]ployment opportunities and reduced levels of poverty hav[e] been disappointed. . . . By contrast, the downside risks hav[e] proven far greater than was generally expected (UNCTA[D,] 1999: 9).

> [F]ew attempts have been made to examine what rapid integ[ra]tion has actually meant for developing countries. The analys[is] in this *Report* shows that the empirical record has been at od[ds] with the promises (UNCTAD, 1999: 10).

> Liberalization of capital flows, often prompted by the need [to] finance growing external deficits, has actually made matte[rs] worse. It has led to currency appreciation and instability, ther[e]by undermining trade performance (UNCTAD, 1999: 13).

But the most striking recent addition to the ranks of the criti[cs of] neoliberal adjustment has been Joseph Stiglitz, who was force[d (or] persuaded?) to resign from his post as Chief Economist of the W[orld] Bank at the end of 1999 because of his increasingly outspoken [dis]agreement with the World Bank's version of the "received wisd[om"] about growth and development. Many of Stiglitz's critical co[nclu]sions about the neoliberal policy regime echo and reinforce central arguments developed in this article.

The main point is that neither economic theory, n[or] empi[rical] evidence can support the broad generalizations that provide foundations of the neoliberal Washington Consensus. Public sector deficits are not necessarily bad, nor are current account deficits; trade liberalization is not necessarily good; and government is not necessarily worse than the market. In fact, in every one of these cases, optimal policy choices will depend on a wide range of social, political, cultural, and institutional circumstances; will be subject to high levels of uncertainty and risk; and will differ for different segments of society. And that is why those choices must be made through domestic political processes that reflect society's values, preferences, and priorities. And why it would be indefensible for international agencies to play such an active, partisan role in that process, if their real objective was to facilitate self-directed human and social development and if they were really honest about the limits of their, and our, knowledge.

In January 1998 Stiglitz used the Annual WIDER Lecture[6] as a platform from which to call for a post-Washington consensus that would transcend the severe limitations of the prevailing Washington consensus, whose main policy prescriptions were all based on dubious theory and weak evidence. Thus, "the heart of the current problem in most cases is not that government has done too much, but that it has done too little" (Stiglitz, 1998a: 2,3);

> The focus on inflation ... has led to macroeconomic policies which may not be the most conducive to long-term economic growth, and has detracted attention from other major sources of macro-instability ... the focus on freeing up markets, in the case of financial market liberalization, may actually have had perverse effects, contributing to macro-instability ... [and] ... the focus on trade liberalization, deregulation, and privatization ignored other important ingredients required to make an effective market economy (Stiglitz, 1998a: 5).

The real problem was that the "success as an intellectual doctrine of the Washington Consensus rested on its simplicity ... [so that] its policy recommendations could be administered by economists using little more than simple accounting frameworks ... look at a few economic indicators ... and form a picture of the economy and a set

[6] This refers to the United Nations University's World Institute for Development Economics Research in Helsinki, Finland. The lecture was delivered on Jan. 7, 1998.

of recommendations." (Stiglitz, 1998: 5). Unfortunately this was never likely to be a good basis from which to address the true complexities and the difficult trade-offs that lie at the heart of the development policy process. Indeed, once these complexities are honestly acknowledged, the economist's task is reduced to one of "describing alternative consequences of different policies;" while it turns out that "the political process may actually have an important say in the choices of economic direction. *Economic policy may not be just a matter for technical experts!*" (Stiglitz, 1998a: 6, emphasis added).

A few months later, in an address to the World Bank's 10th Annual Bank Conference on Development Economics, Stiglitz went further to emphasize the dangers that arise when international experts become policy protagonists in client countries.

> It is not uncommon to find ... that a researcher of libertarian leanings will uncover evidence that large governments are bad for growth. As long as there is uncertainty, and there will always be uncertainty, it will be impossible to fully separate values from purely scientific discussions. Once we accept this conclusion, we realize that in giving advice we are not just purveying economic science. This requires us to think seriously about how we give advice and what incentives shape the advice we give (Stiglitz, 1998b: 3).
>
> The recognition of this uncertainty counsels humility, especially when those supposedly with scientific knowledge apply their imperfect knowledge to real world situations affecting millions of individuals (Stiglitz, 1998b: 4).
>
> This is particularly true when there is uncertainty about the consequences of various policies. Advisers, of course, have a responsibility to make sure that the alternative outcomes–and the probabilities associated with them–are understood as precisely as possible. But the ways in which risks are weighted and balanced becomes a political decision for many to participate in. No outsider can, or should, impose his or her risk preferences on those who must live with the consequences (1998b: 20).
>
> If the advice of outsiders is to be taken seriously, it must be based on reasoned argument–on science, on evidence, with a full recognition of the limitations and uncertainties that are

associated with scientific evidence, not the confidence so typically associated with ideology (1998b: 27).

And, judged by these standards, the World Bank's orthodox adjustment policies do not fare well. In too many cases their policy prescriptions have been strongly advocated even when the evidence supporting them was weak, or even contrary. And this discrepancy may be most glaring in the case of financial liberalization. As Stiglitz notes:

> The ideological basis for liberalization of financial markets is a simple one, and could be stated as: "Free and competitive markets are the basis of a capitalist economy, and have delivered enormous fruits to those that have adopted them. There should be no more question about the virtues of liberalization of financial markets than about liberalization of trade or any other market within the economy." ... Unfortunately, the *scientific foundations* for this *ideological* position are not very sound (1998b: 15, 16).

In fact, both theory and evidence strongly support the proposition "that at least one of the consequences of capital account liberalization is to increase the risk facing an economy," so that the question of "whether the gains are worth the risks will presumably depend on the circumstances of the country" (Stiglitz, 1998b: 18). In other words, there is no scientific basis for the neoliberal claim that capital account liberalization is an important, let alone an essential, condition for successful development.

This conclusion is further reinforced by Jagdish Bhagwati, a highly respected development economist and a strong supporter of free trade, who surprised many people when, in the wake of the Asian financial crisis of 1997–98 he spoke critically about the pernicious influence of a "Wall Street-Treasury complex" on the development debate. When asked to elaborate, he explained that he was referring to

> a "networking ethos"—not a conspiracy, for sure— ... based on an intimate to-and-fro movement of elites between Washington ... and Wall Street. These people talk to one another all the time [and] widely share the view that global financial capitalism is both inevitable and hugely desirable, and until now were almost unanimously of the view that capital ...

> convertibility was just like free trade: a foolish view that has been ... blown apart by the current crisis (Bhagwati, 1998: 14).

But in the inner circles of the IMF and the World Bank, the Asian crisis has not altered the course that they have set for the developing world—and for the world as a whole. And this is not really surprising once one understands that the neoliberal policy regime that they espouse was never based on strong, or secure theory or evidence. To be sure there have been some cosmetic changes. The Bank has stepped up its poverty rhetoric and the IMF has acknowledged the obvious fact that the promotion of neoliberalism must ultimately take account of political and social realities. But neither the direction, nor the thrust of their policies has changed, as explained by Michel Camdessus, the IMF's Managing Director, speaking to the Pacific Basin Economic Council in May, 1999 (Camdessus, 1999: 4). In answer to a question seeking to know whether there should be "a formalized institutional approach to capital account liberalization," he said:

> It was here in Hong Kong, at the IMF Annual Meetings in 1997, that the international community, through a statement of the Interim Committee, declared that "[it] is time to add a new chapter to the Bretton Woods agreement." The Fund's Executive Board was invited to propose an amendment to the Fund's Articles of Agreement that would make the liberalization of capital movements one of the purposes of the Fund, and extend, as needed, the Fund's jurisdiction through the establishment of carefully-defined and consistently applied obligations regarding the "liberalization of such movements." It is significant that this statement was made after the crisis had begun to emerge and it is even more striking that, as the full scale of the crisis became evident, how few countries reversed direction. Although it was understandable that the crisis made the international community think twice before proceeding, I believe it is now time for momentum to be reestablished (Camdessus 1999: 4).

Since this article has suggested that the IMF's enthus[iasm] for capital account liberalization—and for neoliberal reform, more generally—was never based on strong theoretical or empirical foundanot do much to change that institution's mind. In fact, the crisis quickly turned into an opportunity to intensify financial liberalization and neoliberal reform since it dramatically enhanced its leverage in Asia, where many very successful economies had long been relatively immune to its advice.

These recent events merely confirm the earlier conclusions of this article. The neoliberal policy regime was never based on sound theory or on strong empirical evidence. The claim that these policies were needed to promote development, or to enhance human welfare, was always largely spurious and it has remained so. Now, as before, this policy process is largely driven by ideology and interests, and those interests have become stronger in the course of the neoliberal reforms.

In a recent paper Stiglitz drives home this point as he discusses the policy debate that erupted in the wake of the Asian crisis. After being highly critical of the speed and the cynicism with which many of the same international financial institutions that had so recently extolled the virtues of the East Asian tigers, now sought to suggest that the crisis was merely the inevitable result of their "crony capitalism,"[7] he goes on to ask:

> Were some of the IMF's harsh criticisms of East Asia intended to detract attention away from the agency's own culpability? Most importantly, did America—and the IMF—push policies because we, or they, believed the policies would help East Asia or because we believed they would benefit financial interests in the United States and the advanced industrial world? And, if we believed our policies were helping East Asia, where was the evidence? As a participant in these debates, I got to see the evidence. There was none (Stiglitz 2000: xx).

The challenge with which this leaves us is a political one, not an analytical one. Analytically it should now be possible to suggest that all reasonable and well-informed people should agree that the neoliberal reforms of the past quarter century were fundamentally misguided and ideologically driven; that they were never based on strong theory or evidence; and that they were so persistently pursued in spite of the virtual absence of supporting evidence, because they served the interests of capital, and especially of financial capital. We might call this the post-Seattle consensus.

[7] As Stiglitz rightly points out elsewhere, this brazen rewriting of history is not very persuasive since it leaves the problem of explaining why these same states had been so phenomenally successful over the previous 35 years (1998b: 10–14).

From this it follows that the struggle to reverse these trends is primarily a political one, for change will come only if political opposition to these policies can be mobilized and sustained at both a national, and an international, level. The irony is that despite all the talk about progress and the "information explosion" and the "knowledge society," we enter the twenty-first century facing much the same problems as those faced by our forefathers as they entered the twentieth.

Then, as now, the struggle was to find a way of harnessing the enormous productive and technological potential of market relations, so that these could be made to serve human and social needs and priorities; so that their tendencies to instability and inequality could be contained; so that the pressure to reduce people and nature to mere commodities could be curbed. Then as now, this task was widely deemed impossible. And then as now, there were legitimate fears that attempts to solve this problem through collective political action might lead to a totalitarianism that would bring few benefits along with enormous costs. And then as now, we cannot be certain of what is possible; or even of what is desirable, because the future is uncertain, and so are the consequences of our actions, however good our intentions.

But this does not mean that we have learned nothing. In fact, there are many things we should have learned from this past century. We should have learned that the fear of possible totalitarian nightmares is well-founded; and so is the fear that the competitive market can yield a nightmare of instability, inequality, and conflict, if it is not adequately embedded within a social and political framework that is capable of managing it in the public interest. But we should also have learned that when, as in the quarter century after the Second World War, the balance of forces between capital and labor is rather more equal, it is in fact possible to manage market forces in the public interest, to a significant degree.

Whether it will be possible to find a new solution to this old problem, is a question that cannot be answered *ex ante*. The obstacles are certainly formidable, but so are the costs of failure—or of apathy. And even the longest journey must begin with a single step.

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EXHIBIT C

Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite

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Abstract: Toted as an important commitment device that attracts foreign investors, the number of bilateral investment treaties (BITs) ratified by developing countries has grown dramatically. This paper tests empirically whether BITs have actually had an important role in increasing the FDI flows to signatory countries. While half of OECD FDI into developing countries by 2000 was covered by a BIT, this increase is accounted for by additional country pairs entering into agreements rather than signatory hosts gaining significant additional FDI. The results also indicate that such treaties act more as complements than as substitutes for good institutional quality and local property rights, the rational often cited by developing countries for ratifying BITs. The relevance of these findings is heightened not only by the proliferation of such treaties, but by recent high profile legal cases that demonstrate that the rights given to foreign investors not only exceed those enjoyed by domestic investors, but expose policy makers to potentially large scale liabilities and curtail the feasibility of different reform options. Formalizing relationships and protecting against dynamic inconsistency problems are still important, but the results should caution policy makers to look closely at the terms of agreements.

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"Even some of NAFTA's strongest supporters say that clever and creative lawyers in all three countries are rapidly expanding the anti-expropriation clause in unanticipated ways."
Business Week: April 1, 2002. "The Highest Court You've Never Heard Of"

A Canadian trade lawyer gave the following assessment to Parliament regarding NAFTA's Chapter 11: "They could be putting liquid plutonium in children's food. If you ban it and the company making it is an American company, you have to pay compensation."
Bill Moyers in "Trading Democracy", PBS, Feb. 5, 2002.

"Essentially, we've now seen a shift of the use of investment agreements as a shield to using them as a sword against government activity."
Howard Mann, a lawyer with the International Institute for Sustainable Development, interview with Bill Moyers on "Trading Democracy" for PBS, Feb. 5, 2002.)

"NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides."
Robert Azinian, Kenneth Davitian and Ellen Baca v. The United Mexican States, Award, November 1, 1999, para. 83.

"In these early days of NAFTA arbitration the scope and meaning of the various provisions of Chapter 11 is a matter both of uncertainty and of legitimate public interest."
Mondev International Lt. v. United States of America, Award, October 11, 2002, para. 159.

As FDI has surged dramatically over the last two decades, more developing countries are competing to host these multinationals. In addition to negotiating firm-specific deals through tax incentives, subsidies etc., countries have increasingly turned to signing bilateral investment treaties (BITs) as a way to entice foreign investors to their shores. Recent years have witnessed an explosion of such treaties. BITs are heralded by their proponents as an important means of attracting new foreign direct investment (FDI). Yet there has been little examination of whether these instruments actual affect the allocation of foreign investment. There has also been remarkably little attention paid to the implications of the strength of the rights bestowed to the investor and obligations assumed by the host country. Recent claims brought under such treaties are only now bringing to light the potential magnitude of the obligations assumed by the host countries.[1] The potential prospect of large stake litigation makes it all the more important to assess the benefits of entering such agreements. This paper provides an empirical investigation of whether the benefits are being realized, whether a BIT can substitute for weak domestic property rights and whether ratifying it results in a significant increase in FDI.

A BIT could help attract investment by serving as a commitment device. It is hypothesized that countries with weak domestic property rights can increase their attractiveness as a potential host by explicitly committing themselves to honoring the property rights of foreign investors. In particular, a BIT could be a commitment device to overcome dynamic inconsistency problems. Hosts would have an incentive to make those promises necessary to bring investors in, but once the sunk costs are made, the host then has the incentive to deliver only to the level that will keep the investor from leaving[2]. The presence of the BIT, with its dispute resolution mechanisms and provisions for compensation in the case of expropriation, guard against host country actions that would adversely impact the profitability of the investment.

The importance of property rights, and the quality of domestic institutions more broadly, have been recognized in studies on growth and investment (see Kaufmann, Kraay, Loido-Zobiton (1999); Acemoglu, Johnson, and Robinson (2001); Stein and Daude (2001),

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[1] In CME Ltd. v. Czech Republic, an award of $350 million was handed down; an amount that will stand as Czech Republic's appeal of the award was rejected by the Swedish Court of Appeal in May 2003. A claim for $450,000 in the case of The Loewen Group v. The United States of America was just dismissed on jurisdictional grounds after the Loewen Group was acquired by a US interest after bankruptcy proceedings – and after over four years in the arbitration process and a long, public debate on the merits of the case. Another high profile case arising under NAFTA is still pending, with claimants seeking $950 million in the case of Methanex v. The United States. Of course, even if the tribunals find in favor of the claimants, the size of the award will not necessarily be at the level the claimants seek, but clearly the sums involved are substantial. Non-fiduciary costs can also be substantial; for example, if certain proposals for reform are abandoned for fear of legal action. For more information on recent high profile cases, please see the appendix.

[2] With the proliferation of BITs, another motivation for signing the treaty is the fear they the potential host will not be competitive as a location if they do not also offer similar protections.

Dollar and Kraay (2002); Rodrik, Subramanian, and Trebbi (2002); Hallward-Driemeier (2002)). Investors care about the likelihood that they will be able to earn - and control - a return on their investment. The existing studies have tested for the effect of property rights using differences across countries at a given period in time. The measurement of the quality of property rights (or institutions) are based on qualitative assessments and do not vary too much over time. Turning the focus to BITs has some advantages to these earlier approaches. First, the effect of ratifying of a BIT provides a more specific test of the importance of property rights per se. Second, it also relies on changes over time rather than variations in the cross-section. Using time-series variation regarding a distinct change in the property rights of a group of investors provides a more direct test of whether this significantly affects investment.

While it should be recognized that a BIT could be an important commitment device, the nature of the commitment can vary enormously depending on the terms of the BIT. Too much attention has been placed on whether or not a BIT exists than on the strength of the property rights actually being enshrined in these agreements. To date there is no discussion in the economic literature of whether the strength of the rights enshrined in a BIT would provide adverse incentives to potential investors or provide insurance well beyond what domestic investors enjoy or that foreign investors would require to enter – with consequences that could potentially have enormous impact on the feasible policy choices available to host governments. Such concerns have begun to be debated within legal circles[3], largely stemming from recent arbitration decisions and new cases of how rights in

[3] The issue is gaining some attention among legal scholars, but with the focus on the US and Canada; eg. NAFTA's regulatory takings is analyzed relative to the property rights protected in the Fifth Amendment of the U.S. Constitution, see Vicky Been (NYU Law Review, forthcoming).

BITs are being exercised against the US and Canada.[4] This paper uses these cases to help motivate the issue more broadly and takes the perspective of developing countries that represent the vast majority of host signatories of BITs.

What is a BIT?

BITs vary across countries, but they generally share similar features of defining foreign investment and laying out various principles regarding treatment, transfer of funds, expropriation and mechanisms for dispute settlements. As the central piece of a BIT is the assurance it gives investors regarding their property rights, it is important to look more closely at what these rights are. Examining the language and growing legal caseload, it is clear not only do foreign investors secure additional property rights, but that the rights could be more substantial than many had anticipated.

One common clause included in many BITs gives the investor the right to sue the host government if actions undertaken by the government are deemed to substantially expropriate the business of the firm. Two points should be highlighted. The first is that this right of an individual investor to sue the government is in itself an expansion of investor rights. In most cases, the government can claim sovereign immunity, leaving little recourse in the legal system. The remaining alternative is to seek the assistance of the

[4] The most high profile examples involve disputes between the signatories of NAFTA. While NAFTA is not strictly a bilateral treaty, its Chapter 11 has language common to many BITs and highlights a number of relevant issues that apply more broadly to BITs' signatories. Some of the cases under consideration demonstrate some of the unintended consequences of language commonly found in BITs that raises the distinct possibility that BITs can constrain policy choices on a broad set of issues from health to the environment and open governments to substantial liabilities. For a brief description of some of the recent cases, please see the Appendix.

It should also be noted that some of the current cases that are grabbing media attention (e.g. Methanex's suit against the US for $970 million due to California's ban of MTBE) have not been settled. It is possible that as more cases are decided the prospect of expansive regulatory takings claims will not upheld. However, that such a case is in arbitration indicates that large suits that could limit feasible policy choices are at least a distinct possibility.

investors' own home government in gaining diplomatic protection. This may not be granted and makes the entire process a political one. Instead, with the investment treaty, the host government consents to a standing offer to arbitrate disputes covered by the treaty.

The second point is the definition of what is deemed expropriation. BITs outline those terms under which expropriation could be deemed lawful and compensation would be due. The exact wording of such clauses varies by signatory countries, but there is broad agreement on the thrust of the terms. Property can only be legally expropriated if it is for a public purpose; is done in a non-discriminatory way; compensation is paid; and the expropriation is done in accordance with due process of law. Of these conditions, the one with the largest consequences is the compensation clause. That there be some requirement for compensation is not controversial. What can be are the terms of the compensation. Standards include "prompt, adequate and effective" or "payment of full value" or "just compensation". This has been interpreted to mean the market value of the investment immediately prior to the expropriation being made public. Some statements are explicit (e.g. "the purpose of which shall be to place the investor in the same financial position as that in which the investor would have been if the expropriation or nationalization had not taken place." China-Sweden BIT) while others leave the terms rather vague, creating challenges for courts and policy makers as they try to assess the impact of the BIT.

The nationalizations that peaked in the 1970s provided many clear-cut cases of expropriation. Of greater concern more recently are "indirect expropriations," "creeping" expropriation or "regulatory takings" and whether they amount to a taking requiring compensation. These newer provisions on expropriation typically apply to actions by a country that "substantially impair the value of an investment." There is no requirement that it be an isolated event or even that the country try to take ownership of the investment. Many BITs expressly state that expropriations include measures "tantamount" or "equivalent" to expropriation, or actions that would substantially impair the value of the investment.[5]

Rather than bringing the case in local courts (the quality and speed of which the foreign investors may not like) or seeking diplomatic protection, BITs usually specify dispute resolution mechanisms. One of the more popular options is to submit to binding arbitration through the ICSID (International Centre for Settlement of Investment Disputes), an affiliate agency of the World Bank. Two others for are the International Chamber of Commerce and UNICTRAL (United Nations Commission on International Trade Law). In these arbitration proceedings, three arbiters are selected – generally with each party selecting one and the forum selecting the third. These proceedings are not bound by precedents, are not necessarily obliged to be open to the public[6], or to publish final decisions. The decisions have only limited avenues for appeal and cannot be amended by the domestic legal system or supreme court. The nature of the dispute resolution procedures can provide a great deal of leeway in how cases will be decided – with critics pointing out the danger that they could encourage investors to pursue their case even if the merits are not all that strong.

While expropriation cases have arisen from BITs over time, the caseload has been relatively small. In the last few years the numbers have jumped substantially. Having settled about 60 cases in four decades, ICSID now has over 40 cases currently pending.

[5] E.g. BIT between Japan and Egypt, Article V: "expropriation, nationalization, restriction or any other measures, the effects of which would be tantamount to expropriation, nationalization or restriction." France and Pakistan, Article 5: "measures of expropriation, nationalization or any other measures the effect of which would be direct or indirect dispossession" of an investment. See UNCTAD 1998, Chapter III for more detailed discussion of the provisions included in BITs.

[6] Some countries do make documents available to the public. For example, the United States' Freedom of Information Act mandates that documents be made available. However, this is not necessarily so for all countries.

The increase in cases is partly a function of the increased number of BITs, and may also be a function of the publicity generated by cases brought under NAFTA's Chapter 11.

Critics worry that MNCs will use the provisions on regulatory takings and compensation as insurance against many risks the firms would otherwise have assumed themselves as part of the normal process of establishing and running a business. The terms of the treaty can be seen as giving them essentially a property right in those regulations that affect their profitability remaining as they are – and that if that gamble turns out to be wrong, that they could be entitled to earn those profits anyway.[7] How broadly the regulatory takings provision will be applied is still not determined, but the language of the treaty still offers greater property protection than is enjoyed by domestic investors. (Been 2003).

As the potential for legal recourse under BITs becomes more widely known, the importance of BITs in selecting a location may become more important, and could lead to problems of moral hazard and adverse selection. If investors believe there is a chance for successful litigation against the host government and that they are then protected from substantial amounts of risk, firms may work less hard to make their firm a success or may be attracted to locations where their legal case could be made most strongly rather than for economic reasons. Those firms most likely to enter could be those most keen to pursue all legal recourses should the opportunity arise. Such cases may be rare, but the size of the

[7] In addition to the size of the awards and the constraints placed on policymakers, some American critics are concerned that Chapter Eleven is causing an "end run" around the constitution and are decidedly anti-democratic – the terms and consequences of Chapter Eleven were never publicized or debated prior to signing; that there is no room for public comment or even public scrutiny of the arbitration procedures; and limited mechanisms for appeal. Bill Moyers ran a special on PBS entitled "Trading Democracy" (Feb. 5, 2002), calling Chapter 11 the "Trojan horse of NAFTA" and "the system of secret tribunals "a private court for capital"". A similar theme was sounded by Business Week in "The Highest Court You've Never Heard Of" (Business Week: April 1, 2002); that decisions with widespread impact are and will be made by arbitration panels behind closed doors with no public accountability or recourse to the court system.

claims in existing cases is large enough that negotiators should be careful in defining the terms surrounding expropriation and compensation clauses in future BITs or such agreements as the proposed expanded Free Trade Area of the Americas.

The Azinian case provides an interesting example. On the one hand, the decision explicitly warns against the treaty being seen as a recourse against any poor outcome.

> A foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority and may suffer a breach by that authority, and *still not be in a position to state a claim under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints...NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing it is terms so provides.(Azinian and others v. The United Mexican States, Award, November 1,1999, para. 83)

On the other hand, given the facts of the case (some claims are dismissed as "preposterous", p. 7), that the claimants even brought the case illustrates that they felt the treaty did give them a real possibility for relief.

It should be noted that the rights secured in a BIT are reciprocal; investors from country A investing in B are the same as those given to investors from country B investing in country A. However, in practice there is usually tremendous asymmetry as almost all the FDI flows covered by BITs are in fact in one direction.[8] It is precisely those cases where FDI flows in substantial amounts in both directions that countries have balked at ratifying BITs. It is striking that there is a dearth of such agreements between rich OECD countries. Rich OECD countries do participate in BITs, but almost exclusively with developing countries. It could be that in such a case there is not seen to be a need for a BIT to stimulate investment as it is already substantial. Or, while OECD governments are keen to

[8] There are at least two cases, of the 120, filed before ICSID where the plaintiff is a developing country and the defendant a developed country.

secure such rights for their companies overseas, they balk at granting such rights to MNCs within their own borders.

Trends in BITs

The first BIT was ratified in 1959. Since then, the number of BITs has increased steadily through the 1980s. In the 1990s, the number boomed. In 1990 there were 470 treaties, by 2000 there were close to 2000 BITs (see figure 1). Almost all the earlier treaties were ratified between rich OECD countries and developing countries (see figure 2). With the fall of the Berlin Wall and the new former-Soviet republics, many East European countries ratified treaties – with the OECD and with developing countries. The biggest rise more recently is the signing of BITs between developing countries.

By 2000, half of all FDI flows from the OECD to developing countries were covered by a BIT. What is being tested in this paper is whether this increase is simply due to the increased country coverage – or whether FDI flows are diverted to destinations covered by investment treaties. Clearly, a BIT is not a necessary condition to receive FDI. There are many source-host pairs with substantial FDI that do not have a BIT. Japan, the second largest source of FDI has only concluded 4 BITs. The US does not have a BIT with China, its largest developing country destination. Brazil, one of the top receivers of FDI has not ratified a single BIT. In addition, there are also numerous examples of countries that have concluded many BITs and yet have received only moderate inflows. Sub-Saharan Africa, for instance, has had difficulties in attracting FDI, though it has tried to improve the environment for FDI by entering into various agreements to protect the interests of investors. There are also examples such as Cuba, where it does not have a BIT with either

Canada or Mexico, its two biggest foreign investors. On the contrary, almost 60% of the countries it does have a BIT with actually have no foreign investment in Cuba. (Perez-Lopez et.al.)

Other studies

There is a growing literature on the importance of institutions and property rights. Most has been focused on the effects on long run growth rather than on FDI. (Knack and Keefer (1995), Acemoglu, Johnson, and Robinson (2001); Dollar and Kraay (2002); Rodrik, Subramanian, and Trebbi (2002)). Daude and Stein (1995) do look at the effect of institutions on FDI in a cross-section of both developed and developing countries, finding a large effect of institutions in attracting FDI. Hallward-Driemeier (2002) looks at the effect of institutions on the allocation of FDI among developing countries using panel data and finds a weaker effect. These studies use broad measures of property rights, using either ICRG rankings or the Kaufmann, Kraay, Zoido-Lobaton (KKZ) indicator. The advantage of this study is to look at clear cases where property rights are explicitly strengthened to determine their importance.

There are a couple of papers that have looked at other bilateral arrangements and their implications for FDI. Blonigen and Davies (2000) look at the role of tax treaties. Here there is a larger literature. They find that contrary to expectations, tax treaties can discourage FDI, arguing that they can be used as devices to reduce tax evasion and not just tools to simplify tax filings and avoid double taxation. Yeyati, Stein and Daude (2002) look at the role of regional integration and the location of FDI, testing whether greater access to larger markets attracts FDI. While they are almost exclusively looking at intra-OECD FDI flows, they find an important effect of trade agreements and FDI.

The role of BITs has received some discussion in law journals. There the focus has again been on the issue of providing a commitment device to overcome the dynamic inconsistency problem (Vandevelde 1998) or the strategic concerns potential signatories face as other countries also consider signing such agreements (Guzman 1998). The question of whether the treaties actually do affect investment is not addressed.

Within the economic literature, BITs have generated very little attention. UNCTAD (1998) sponsored one of the few analyses. It studied the impact of 200 BITs on bilateral FDI data, examining years prior to and after their conclusion. It found a weak correlation between the signing of BITs and changes in FDI flows, but used minimal control variables in generating this result and did not control for the strong upward trend in FDI over time. Their cross-section analysis of 133 host countries in 1995 concluded that BITs do not play a primary role in increasing FDI, and that a larger number of BITs ratified by a host country would not necessarily bring higher inflows. While this cross sectional result is interesting, the more rigorous test is to examine the impact of an investment treaty over time. This study looks at a panel dataset of biliateral FDI flows, augments the control variables included and addresses a number of econometric issues not examined in UNCTAD's earlier work.

Data

This paper focuses on the importance of BITs for FDI outflows from OECD countries to developing country hosts. This is because almost all but the most recent BITs are ratified between OECD countries and developing countries. Also, the vast majority of FDI inflows into developing countries originate from OECD countries. As the rational for a host to ratify a BITs is most applicable for developing countries where property rights are generally weaker than in OECD countries, this focus facilitates the testing of the hypothesis that the strengthening of property rights significantly affects FDI flows.

The paper uses bilateral FDI outflows from 20 OECD countries to 31 developing countries[9]. It covers the years of 1980 to 2000, capturing the surge in the number of BITs ratified. The OECD is the source of over 85 percent of FDI flows to developing countries, so this paper covers the vast majority of FDI to developing countries and to FDI covered by BITs.

With the increase in the number of BITs, the share of FDI to developing countries that is now covered by a treaty has grown tremendously. In 1980, the share of FDI under a treaty was less than 5%, while by 2000, it had grown to about 50% (see figure 4). However, this increase in FDI by countries with a BIT is largely explained by compositional shifts; as more country pairs ratify treaties, the amount of FDI flows covered increases. What remains to be seen is if the flow between host-source pairs changes significantly with the ratifying of a treaty.

In addition to information on the date of ratification of BITs[10], the regressions control for the size of the source country, the size of the host country, the GDP per capita of the host country, the host country's macroeconomic stability (proxied by its inflation rate),

[9] Eight other OECD countries, particularly those that more recently joined the OECD, do not report their FDI outflows and so are not included.
[10] UNCTAD publishes both the date of signing of BITs and the date it was ratified. The distinction is important as the treaty only goes into effect once it is ratified – and there are several cases where 'signed' treaties have never been ratified (e.g. Brazil has signed 13 BITs, but not ratified a single one). The paper uses the date of ratification of the BIT in all the empirical work.

its openness to trade (trade over GDP) and the gap in average years of education between the source and host pairs. These data come from the World Bank's World Development Indicators, and the education variables from Barro and Lee. Different specifications were tested and these were the most consistent explanatory variables and are similar to those used in the location choice literature for MNCs. Recognizing that there could be other important time-invariant characteristics that are unobserved, the regressions are all run using fixed effects.[11]

Two dummy variables are also included. A dummy is included to capture the effects of the enormous political and economic changes in Eastern Europe and the former Soviet Union in the 1990s relative to the 1980s. A number of these countries ratified BITs in the early 1990s, so the lack of a dummy could bias upwards the importance of the BIT that rightly was due to the regime shifts. Another dummy is added for the ratifying of NAFTA. NAFTA is not strictly a bilateral investment treaty, but it shares similar language and so is included in the measure of investment treaties. However, unlike a BIT, the treaty was largely a trade agreement, one that made Mexico a more attractive destination for investment as an export platform to the US and Canada. Again, not controlling for the broader economic change would bias upwards the importance of a BIT that is really due to changes in trade policy.

[11] To check for robustness, the regressions were also run using host and source dummies and including host-source pair information on distance, colonial ties, shared language etc. These geographic and political variables were strongly significant. The rest of the results were not significantly different from the fixed effects estimator and so both sets are not reported here.

Hypotheses

The importance of ratifying a BIT is tested for in a number of ways. What is of interest is the change in property rights introduced with the BIT. Thus, the tests rely on the variation over time rather than across countries. Including source-host pair fixed effects not only controls for other unobserved characteristics that could affect bilateral investment flows, it means that the significance of the BIT is only identified on changes over time.[12] First, a dummy is included in a panel regression that takes the value of 1 once a BIT has been ratified between a pair of source-host countries. The significance of the coefficient on this variable is then be a test of the importance of the treaty.[13]

Related, is a test looking at the time horizon over which a BIT might attract additional FDI. One possibility is that there would be a window after the ratifying when FDI might increase. Some investors might delay their investment prior to the ratification, so that there would be short spike with the ratification. Or, the publicity of the treaty could spark additional investment in the immediate period after the ratification. Dummy variables capturing the three years post ratification is included to test for the importance of a window. A related test is looking at a reduced sample of those countries that did ratify treaties during the sample period and comparing the average FDI in the 3 year period after a ratification with the average FDI inflow in the 3 year period prior to the treaty. A third

[12] The regressions were also run using separate source and host country fixed effects and including various source-host controls such as distance, common language, common border, and colonial links. The results are qualitatively the same.

[13] This paper does treat all BITs equally, when in fact there are some differences between them. The general point that BITs strengthen property rights holds across all of them. It is possible that there would be more of an effect if one looked only at those treaties with the strongest investor protections. Given this would require reading and devising an index measure of several hundred BITs, it is beyond the scope of this paper. However, if BITs are acting as a substitute for property rights, one would expect that the stronger clauses would be included in treaties with countries that have lower domestic property rights. That there is no evidence that these countries receive additional FDI after signing a BIT would indicate that the effort to classify individual BIT terms is unlikely to be fruitful.

approach is to include a series of dummies, for the year of ratification, and each of the 5 years prior to ratification and post ratification to see if there are consistent patterns across country pairs. Including dummies on the years leading up to the ratification would also test for whether treaties came after increases in FDI. The results to all three tests are consistent, so only the third extension is reported.

The hypotheses are tested using both the level of FDI received, and the amount of FDI normalized by the host country's GDP. While the overall patterns would be expected to be similar, a few differences should be noted. It is well known that FDI to developing countries is concentrated in a few markets. However, these markets are large. If instead one looks at FDI/GDP, the ratios demonstrate much less variance than the levels. Also, the top recipients of levels of GDP are not among the top receivers once one looks at the ratio. In fact, a number of small countries have a higher ratio. Particularly as investment can be lumpy, a few large investment projects can represent a significant portion of a small economy.

One difficulty with these approaches is that FDI level rose substantially during this period. So dummies that are 1s for the later period will be significant in part due to the trend in FDI. Adding a trend term can capture this. But another test is also developed.

Regressing the level of FDI and the ratio of FDI to GDP address whether BITs increase the amount of FDI. A related question is whether BITs simply shift the destinations of the FDI among developing countries. To address this question, the amount of FDI a host receives is normalized by the total amount of FDI outflows from that source. Thus, the share of source X's FDI to host Y is the dependent variable. The question is then whether the host receives a large share of X's FDI with the conclusion of an investment treaty.

BITs are often justified by the developing country as a signal that they will protect the property rights of the foreign investor, thereby strengthening their investment climate. However, the credibility of this signal will be affected by the degree of corruption and the quality of the legal system of the host country. The existence of a BIT is thus interacted with the quality of the legal system and the extent of corruption to see if BITs' signal is only valuable within a country with a certain level of overall property rights.

Econometric Concerns:

It is possible that there is reverse causation: that the existence of extensive FDI flows means the source country has a larger incentive to conclude a BIT with the host country. Thus it is possible that FDI flows increase in the period prior to or concurrent with the ratifying of a BIT. This would imply there is a positive feedback from FDI to the probability that a BIT is ratified. On the other hand, it is also possible that hosts that do not receive much FDI would be interested to sign as a way of increasing FDI – if this is correct, one would expect a negative feedback from FDI to the presence of a BIT. Which story dominates is an empirical question.

This potential endogeneity of a BIT is addressed with the use of instrumental variables. The instrument used is the number of other BITs a host has entered into with countries other than the source country being considered. The willingness of a host to ratify a BIT, as measured by the number of outside BITs, should be correlated with the probability it signs with this particular host country, but shouldn't affect the amount of FDI that particular source country would send. Thus, when US investors are considering investing in India, their decision would not be affected by whether India has ratified treaties with the UK or France. However, that India has entered other treaties would be expected to influence their willingness to enter such a treaty with the US.[14]

One of the shortcomings of the data is that a great number of cells are left blank. The data comes from the source country, but they do not necessarily report all the FDI to each of the host countries. Thus, it is difficult to know if the blank represents a zero and simply a non-reported number. What is clear, however, is that the true value of the blank cells is less than the values that are reported. To deal with this issue, regressions are reported only using the data that is published. In addition, a number of rules were used to fill-in in blanks with 0s. Regressions were run using the different rules for missing values. The results remained consistent, so what is also reported is the more expansive inclusion of zeros. Blanks were filled in a) only for years after a source began reporting (i.e. some don't until 1985); and b) if at least five other values are reported for that source for that year (i.e. The UK did not report any amounts in 1984, so none of these values were filled in as 0s). Following these rules result in almost a doubling of the sample. It should be noted that a

[14] It is possible that a US MNC with a French subsidiary could invest in India via its French subsidiary rather than directly from the parent company so as to have the Indian plant covered by a BIT. The widespread use of such a practice would undermine the validity of the instrument. However, this possibility is one that is safeguarded against in most BITs. Not wanting to extend rights to investors that have only weak or tenuous links to the treaty partners, standards of nationality are spelled out in the treaties. These include "substantial ownership", "ability to exercise decisive control", "principle place of business" in addition to the location of incorporation. (UNCTAD, pp.39-41) Furthermore, as a practical matter, if there were such flows they would be expected to bolster a finding that BITs attract FDI (which we don't find in the data) and the actual correlation between FDI flows and the number of treaties the host has signed with other countries is 0.03 -- whereas if the diversion of funds through third countries were common, the presence of additional alternative channels would then be expected to be negatively associated with FDI flows.

number of source-host pairs only have 0s (e.g. New Zealand – Czech Republic, Portugal-Thailand etc.) and some of these pairs have BITs, although others do not.[15]

Results:

Column (1) reports the findings using the level of FDI for all the reported bilateral pairs using a fixed effects estimator to control for time invariant host, source and host-source effects. Column (2) repeats the regression, using the augmented series that fills in missing amounts with zeros as discussed above. Including the additional zeros nearly doubles the sample size, has little impact on the qualitative results while increasing the significance of the findings.

The effect of the control variables are robust and of the expected sign. The larger the source country and the large the host country, the larger the FDI flow. Flows are also higher to richer host countries. Macroeconomic instability discourages FDI. A host's trade openness could be ambiguous if source countries are looking to jump tariffs. The negative finding would be consistent with that, but a more plausible explanation is that trade to GDP ratios are often higher for small countries so that this measure is likely further evidence that larger FDI flows go to larger countries. The NAFTA dummy is large and significant, capturing the increase in FDI to Mexico with the implementation of this free trade deal. This is one of the few strong pieces of evidence that an investment treaty could stimulate investment – but, as it is tied to a trade agreement with the world's largest market, it is hard to disentangle which effect really dominates.

[15] Another way to deal with the cutoff is to treat the sample as a truncated one; to replace the 0 and negative observations with the lowest positive value in the dataset and estimate the regressions with a Tobit specification. The drawback with this approach is that fixed effects cannot be incorporated, nor can instruments. And the information on known negative flows is lost. It turns out that there are a significant number of negative flows between pairs with a treaty and that losing this information influences the results.

The coefficient on the BIT treaty is negative and not significant. Breaking down the effect of a BIT over the years preceding and following the ratification of a treaty (column 3) illustrates that there is little positive association for a 10 year window. Only in year 5 after the ratification is there a positive (and extremely weak) association.

Controlling for the possible endogeneity of the decision to enter a BIT, columns 4 and 5 present the results from the IV estimation. The instrument is the number of BITs the host has entered into with other countries, a number positively correlated with the probability it enters a BIT with the source, but should not be affecting the amount of FDI received from that source country. The results lead to a significant negative finding on the impact of ratifying a BIT. Assuming the instrument is valid, this implies there would otherwise be a positive feedback from larger investment flows encouraging the ratification of a BIT. Including the 'missing 0s' still leads to a negative finding of a BIT, with the coefficient falling corroborating the inference of the positive feedback in the non-IV regressions.

The same set of regressions was repeated, this time looking at the ratio of FDI to host GDP (see Table 2). This normalization, however, leads to somewhat different interpretations. While larger countries get more FDI in absolute numbers, the ratio of FDI to GDP is highest for smaller countries. Now, the size of the source country is not significant and the size of the host is negative. Controlling for size, richer hosts do receive more however. In these regressions the impact of a BIT is totally insignificant, even when instrumented for. Looking at the window around the ratification, there is weak evidence that the ratio of FDI/GDP rises – or at least loses the negative values pre the date of ratification.

A final set of regressions looks at the FDI going to a particular host country as a share of the total FDI the source country sends. The results are reported in Table 3. Larger host countries do not necessarily get a larger share, although more developed ones do. Here one gets the one significant positive result that a BIT could increase FDI (column 2). However, the result seems to come from the period 5 or more years after ratifying the treaty. And, instrumenting for the ratification of the treaty reverses the sign on this coefficient.

While these findings suggest that BITs do not serve to attract additional FDI, it is possible that this is due to its being obscured by other changes that are occurring between the two signatories over time. Such changes could include: lowering trade barriers, increased knowledge of conducting business in the host country, following customers abroad etc. However, these changes would likely work to increase the likelihood of investing overseas, so if the BIT variable is capturing some these effects, one would expect it to bias up the coefficient. One possible change that could work in the other direction is the ratification of a tax treaty. Blonigen and Davis (2002) find that the signing of a tax treaty could reduce FDI and if a tax treaty is entered into at the same time as BIT, this could weaken the observed effect of the BIT. However their result stems from intra-OECD FDI flows; it is not clear whether there result would extend to OECD FDI into developing countries, particularly when so many now enjoy various degrees of tax holidays. Nor is there much evidence that tax treaties and BITs are entered to at the same time.

Table 4 – 6 report the results from testing the hypothesis that the quality of domestic institutions may be important in determining the effectiveness of a BIT in attracting FDI. One possibility is that it will be more effective in weak institutional settings, acting as a

substitute for a strong domestic protection of property rights. On the other hand, it may be that a certain level of institutional capacity is needed before the BIT is seen as credible. A positive interaction term on institutional quality and the ratification of a BIT would favor the latter interpretation. The results show either no effect, or a positive interaction. Table 4, columns 1, 2, and 3 report the results from the KKZ measure of the rule of law using the level of FDI, its share in GDP and the share of the source country's FDI the host receives. The effect is insignificant for the level of FDI and the share of the source country's FDI. However, it is significantly positive for the ratio of FDI to GDP. To test for the importance of institutions more broadly, other KKZ governance measures were used. Table 4 also reports the results for corruption and Table 5 for regulatory quality and government effectiveness. These measures also provide evidence of a positive interaction; that a BIT complements rather than substitutes for strong domestic institutions. In addition, for the interaction to offset the negative impact of the BIT, the quality of institutions would have to strong – for example, at the level of Chile. Table 6 repeats the regressions using the ICRG measures of law and order and corruption. These measures include time variation in the quality of institutions. With country dummies included, it captures the effect of changes in institutional quality. For the ICRG measures, the interaction term is again strongly positive and significant. Thus, the evidence suggests that BITs are more, rather than less, effective in settings of higher institutional quality and where institutions are already being strengthened. This undermines a central rational for some of the less developed countries that enter into these agreements hoping to bypass the need to strengthen property rights and institutions more generally. Put differently, if host countries are committed to trying to attract more FDI, BITs have not provided a short-cut from the need to implement broader reforms of domestic institutions.

Conclusion

Recent and pending cases of international investment disputes covered by investment treaties have raised concerns of the potential costs to host governments – both in terms of the size of potential awards and in the possible reduction of viable choices open to policy makers due to their adverse effects on foreign investors. Critics speculate that these cases will serve to encourage firms to look for ways to exploit the terms of the treaty as a lucrative way of doing business, seeking compensation for risks that they had not previously expected to be protected from. Given the increasing concern about the potential and often unanticipated costs of BITs, it is all the more important to examine whether BITs are delivering their expected benefits. If so, policy makers have the task of weighing the benefits and potential costs against in other. However, if there is little apparent benefit, the case to ratify new agreements – at least under terms that are extremely favorable to the investor – is harder to make. It is not that formalization of relations and treaties that protect against dynamic inconsistency problems should not be encouraged, just that the terms of these agreements and the strength of the rights given to investors should be scrutinized.

Analyzing twenty years of bilateral FDI flows from the OECD to developing countries finds little evidence that BITs have stimulated additional investment. Those countries with weak domestic institutions, including protection of property, have not gotten significant additional benefits; a BIT has not acted as a substitute for broader domestic reform. Rather, those countries that are reforming and already have reasonably strong domestic institutions are most likely to gain from ratifying a treaty. That BITs act as more of a complement than a substitute for domestic institutions means that those that are benefiting from them are arguably the least in need of a BIT to signal the quality of their property rights.

It is possible that in a few years a different result will emerge. The publicity surrounding the investor protection cases being brought under NAFTA's Chapter 11 and the cases being brought against Argentina as it dissolved its currency board, may make potential investors more aware of the potential gains they would have under a BIT and insist on such terms. On the other, policymakers may take greater care to refine the expropriation and compensation clauses to ensure the worst fears of the critics are not realized, bringing closer together the relative costs and benefits of BITs.

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APPENDIX
Recent cases on compensation of expropriation, highlighting regulatory takings

Most of the recent publicized cases have arisen under NAFTA's Chapter 11. While not strictly a bilateral agreement, the terms are the same as those used in many BITs. And the cases below illustrate the types of obligations other signatory host countries could face. While cases like these have been brought by OECD multinationals in developing countries before, these are some of the first cases where MNCs have sued rich OECD host governments. The outcomes add insight into why OECD governments have refused to enter into other agreements that would give such rights to foreign companies operating in their borders, at the same time as wanting such rights for their own MNCs overseas. It should be noted that these cases have not all been settled and the prospect of expansive regulatory takings claims may not be upheld. Even so, the size of the suits and the potential constraints on policy choices should give host country signatories pause over the precise nature of the terms they agree to.

Concerned about the possible health risks associated with a gasoline additive, MMT, Canada considered banning it (it was already effectively banned in the US). Ethyl Corporation, an American company and the sole supplier of MMT in Canada, filed the first Chapter Eleven case. After instating a ban, Canada's parliament then reversed course, lifting the ban and paying Ethyl $13 million for damages incurred during the time the ban was in place. Avoiding the $200 million suit was not the only consideration, but it was widely discussed in the deliberations of the issue.

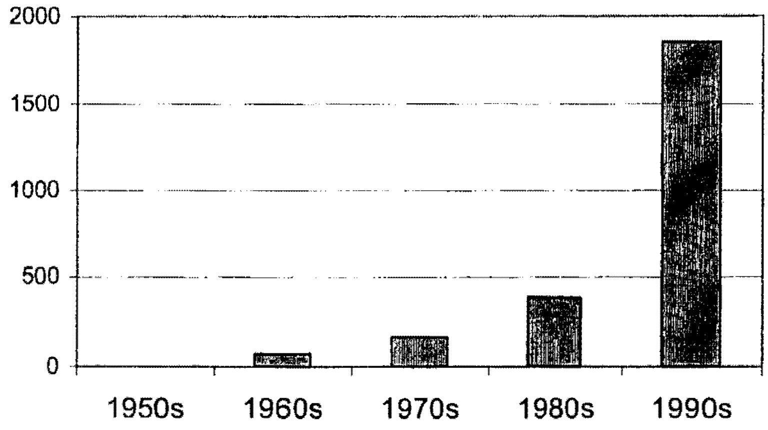
The threat of another lawsuit also served to thwart a proposed health reform bill in Canada. Canada was proposing to increase the warnings on cigarette packaging. RJReyolds and other tobacco firms threatened a lawsuit and the reform measure was dropped. Since the signing of NAFTA, only two new environmental regulations have been considered in Canada – and both have been challenged under Chapter Eleven.

In the US, there is a case pending that will be extremely influential in determining the scope of such claims. The case regards another gasoline additive, MTBE. Originally hailed as a means of improving air quality by enabling gas to burn more cleanly, it has since been discovered to have tainted the water supply and has been linked to cancer in laboratory animals. California decided in 1999 to ban the additive. Its maker, Methanex, a Canadian corporation is suing for $970 million in lost profits.

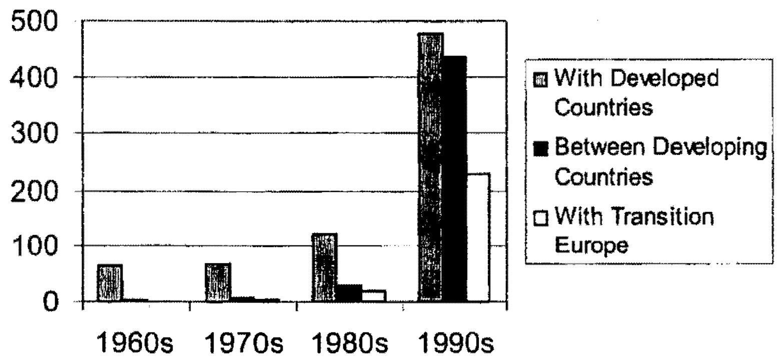
Another high profile case was just resolved. The case involved the Loewen Group, a Canadian funerary home company. A Mississippi competitor had successfully brought Loewen Group to court on antitrust violations. Loewen group settled the case, agreeing to pay $150 million. Four years later, it sued the US government claiming that it had been denied due process in the Mississippi courts (part of their claim is based on instructions and comments made to the jury that were characterized as anti-foreign and racially biased.) – and is sought close to $500 million in compensation. The case was registered four years ago and was just dismissed on jurisdictional grounds as the Loewen group had been bought by a US interest.

Another case that generated a lot of attention in the press is that of Metalclad, a US waste disposal company that attempted to set up facilities in Mexico. Despite federal government assurances, local officials denied a building permit due to failures to clean up waste that was entering the water table and due to intense protest from local residents. Metalclad sued and was awarded $16 million – a sum that had been reduced from the original amount sought due to the determination that expected profits would not have been that high.

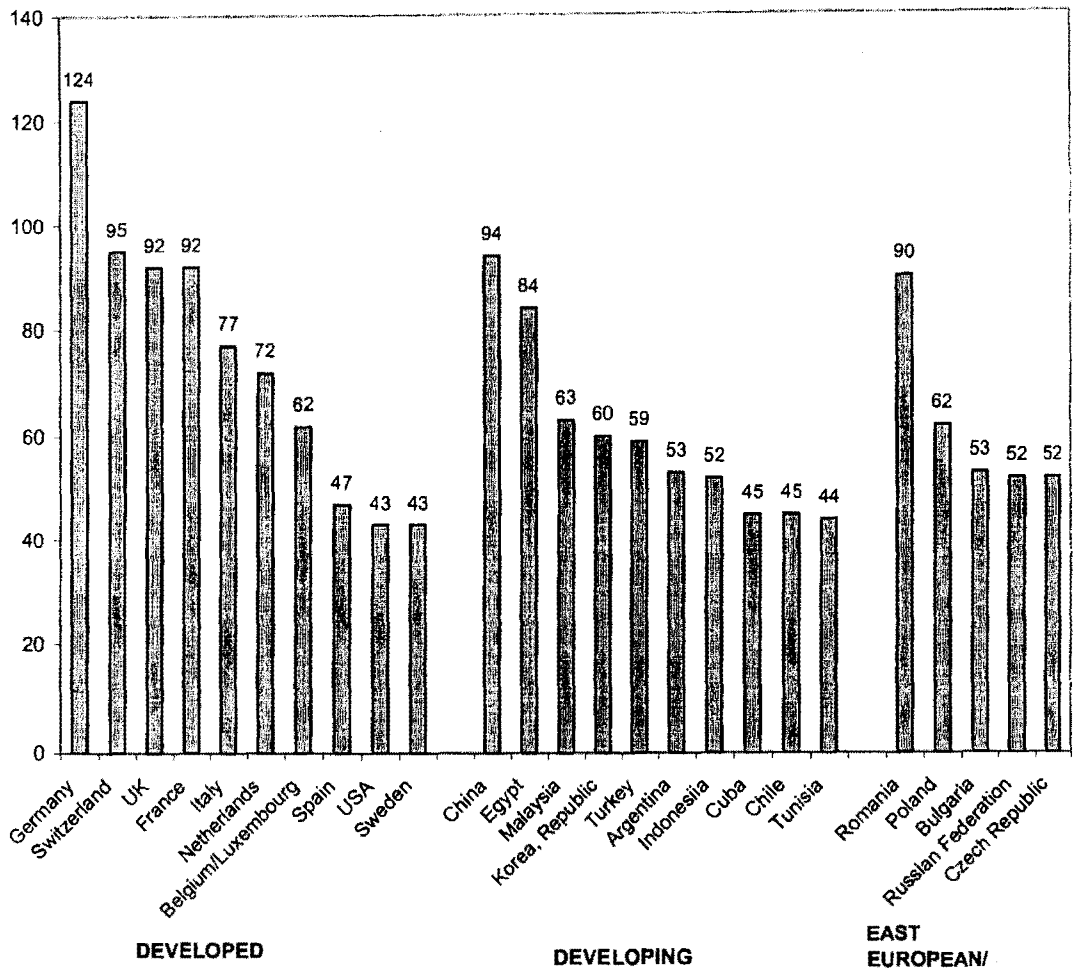
Surge in the number of BITs



BITs concluded by developing countries



Top 25 countries in terms of the number of BITs concluded, 1 January 2000



Share of OECD-Developing Country pairs with a BIT and the share of OECD FDI they cover

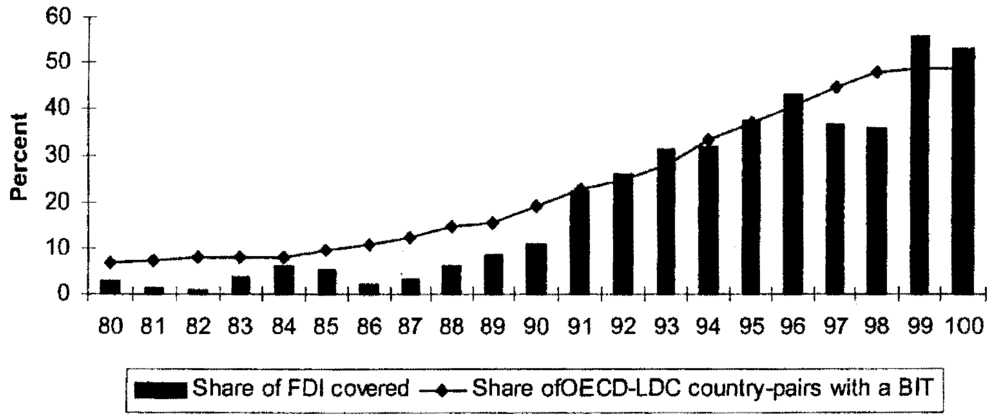


Table 1: Levels of FDI Flows

	(1) FDI Flow	(2) FDI Flow w/0s	(3) FDI Flow w/0s	(4) IV FDI flows	(5) IV FDI Flow w/0s
Source GDP	0.176	0.163	0.163	0.170	0.151
	(13.79)**	(23.34)**	(23.27)**	(12.74)**	(18.10)**
Host GDP	0.092	0.078	0.072	0.090	0.158
	(4.37)**	(7.50)**	(6.94)**	(4.19)**	(8.71)**
Host GDPPC	12.274	11.499	11.772	12.864	29.747
	(1.80)+	(3.83)**	(3.93)**	(1.86)+	(6.39)**
Host infltn	-6.193	-3.188	-3.271	-6.979	-6.813
	(3.90)**	(3.74)**	(3.81)**	(4.16)**	(5.85)**
Host tr/GDP	-136.290	-46.329	-51.882	-166.602	-35.077
	(2.55)*	(1.81)+	(2.01)*	(2.91)**	(1.18)
Skill gap	11.703	7.634	7.928	16.159	25.171
	(0.91)	(1.25)	(1.30)	(1.21)	(3.28)**
E.Europe90s	-10.440	6.742	-7.186	22.878	182.407
	(0.27)	(0.35)	(0.37)	(0.51)	(4.88)**
NAFTA	256.311	196.005	198.304	227.505	97.975
	(5.24)**	(6.84)**	(6.94)**	(4.33)**	(2.64)**
BIT treaty	-11.360	-11.615		-207.520	-101.320
	(0.51)	(0.98)		(1.67)+	(1.90)**
Yr Ratify -5			-14.641		
			(0.67)		
Yr Ratify -4			-13.718		
			(0.65)		
Yr Ratify -3			-16.360		
			(0.80)		
Yr Ratify -2			-25.177		
			(1.26)		
Yr Ratify -1			-37.388		
			(1.91)+		
Year Ratify			-40.503		
			(2.11)*		
Yr Ratify +1			-54.577		
			(2.86)**		
Yr Ratify +2			-31.512		
			(1.65)		
Yr Ratify +3			-17.467		
			(0.86)		
Yr Ratify +4			-4.025		
			(0.19)		
Yr Ratify +5			2.760		
			(0.12)		
Constant	-162.401	-110.477	-106.870	-193.177	-229.021
	(1.83)+	(3.41)**	(3.30)**	(2.72)**	(6.04)**
No. Obs.	4261	8153	8153	4261	8153
No. pairs	434	537	537	434	537
R-squared	0.16	0.13	0.13		
Wald Chi2				1390.30	1803.93
Prob > Chi2				0.00	0.00

Absolute value of t-statistics in parentheses
+ significant at 10%; * significant at 5%; ** significant at 1%
Source-host country pairs included; year dummies not reported.

Table 2: Ratio of FDI/GDP

	(1) Ratio	(2) Ratio w/0s	(3) Ratio w/0s	(4) IV Ratio	(5) IV Ratio w/0s
Source GDP	0.030	0.029	0.032	0.024	0.033
	(0.71)	(1.52)	(1.66)+	(0.32)	(1.64)
Host GDP	-0.229	-0.121	-0.127	-0.220	-0.147
	(2.74)**	(3.17)**	(3.35)**	(1.84)+	(2.61)**
Host GDPPC	0.184	0.101	0.106	0.176	0.131
	(2.25)*	(2.78)**	(2.94)**	(1.57)	(2.19)*
Host infltn	-0.000	-0.000	-0.000	-0.000	-0.000
	(0.63)	(0.90)	(1.00)	(0.52)	(1.08)
Host tr/GDP	-0.011	0.002	-0.001	-0.010	0.003
	(0.51)	(0.17)	(0.09)	(0.41)	(0.25)
Skill gap	-0.007	-0.003	-0.003	-0.007	-0.003
	(1.43)	(1.40)	(1.36)	(1.42)	(1.30)
E.Europe90s	0.020	0.015	0.010	0.019	0.018
	(1.05)	(1.50)	(0.93)	(0.99)	(1.62)
NAFTA	0.007	0.009	0.009	0.009	0.006
	(0.40)	(0.81)	(0.77)	(0.38)	(0.45)
BIT treaty	0.004	0.003		0.013	-0.020
	(0.42)	(0.67)		(0.14)	(0.53)
Yr Ratify -5			-0.013		
			(1.54)		
Yr Ratify -4			-0.014		
			(1.76)+		
Yr Ratify -3			-0.015		
			(1.95)+		
Yr Ratify -2			-0.014		
			(1.77)+		
Yr Ratify -1			-0.018		
			(2.37)*		
Year Ratify			-0.019		
			(2.56)*		
Yr Ratify +1			-0.023		
			(3.09)**		
Yr Ratify +2			-0.011		
			(1.55)		
Yr Ratify +3			-0.010		
			(1.30)		
Yr Ratify +4			-0.004		
			(0.47)		
Yr Ratify +5			-0.004		
			(0.44)		
Constant	0.879	0.241	0.240	0.915	0.253
	(1.45)	(0.88)	(0.87)	(1.29)	(0.92)
No. Obs.	4261	8153	8153	4261	8153
No. pairs	434	537	537	434	537
R-squared	0.05	0.03	0.03		
Wald Chi2				705.78	707.2
Prob > Chi2				0.00	0.00

Absolute value of t-statistics in parentheses
+ significant at 10%; * significant at 5%; ** significant at 1%
Source-host country pairs included; year dummies not reported.

Table 3: Share of Source Countries' FDI Sent to Host

	(1) Share sent	(2) Share w/0s	(3) Share w/0s	(4) IV Share sent	(5) IV Share w/0s
Source GDP	-0.007	0.007	0.007	0.032	0.012
	(0.80)	(1.89)+	(1.86)+	(1.88)+	(2.81)**
Host GDP	-0.025	-0.016	-0.017	-0.079	-0.047
	(1.53)	(2.03)*	(2.21)*	(2.90)**	(3.90)**
Host GDPPC	0.025	0.016	0.017	0.074	0.051
	(1.52)	(2.15)*	(2.35)*	(2.85)**	(4.04)**
Host infltn	-0.001	-0.000	-0.000	-0.001	-0.000
	(5.39)**	(4.52)**	(4.45)**	(5.42)**	(5.47)**
Host tr/GDP	-0.007	-0.006	-0.006	-0.014	-0.005
	(1.74)+	(2.97)**	(2.93)**	(2.61)**	(2.33)*
Skill gap	-0.002	-0.000	-0.000	-0.002	0.000
	(1.57)	(0.38)	(0.32)	(1.52)	(0.14)
E.Europe90s	-0.001	-0.001	-0.002	0.002	0.001
	(0.33)	(0.60)	(0.78)	(0.42)	(0.61)
NAFTA	0.001	0.001	0.001	-0.008	-0.003
	(0.22)	(0.54)	(0.47)	(1.53)	(1.14)
BIT treaty	0.002	0.002		-0.057	-0.026
	(1.43)	(2.05)*		(2.63)**	(3.28)**
Yr Ratify -5			-0.002		
			(0.93)		
Yr Ratify -4			-0.002		
			(1.07)		
Yr Ratify -3			-0.002		
			(1.16)		
Yr Ratify -2			-0.003		
			(1.88)+		
Yr Ratify -1			-0.002		
			(1.27)		
Year Ratify			0.000		
			(0.03)		
Yr Ratify +1			0.001		
			(0.61)		
Yr Ratify +2			0.000		
			(0.22)		
Yr Ratify +3			0.001		
			(0.34)		
Yr Ratify +4			0.001		
			(0.35)		
Yr Ratify +5			0.003		
			(1.73)+		
Constant	0.219	-0.026	-0.021	-0.011	-0.012
	(1.81)+	(0.47)	(0.38)	(0.07)	(0.20)
No. Obs.	4261	8153	8153	4261	8153
No. pairs	434	537	537	434	537
R-squared	0.03	0.02	0.02		
Wald Chi2				461.21	522.77
Prob > Chi2				0.00	0.00

Absolute value of t-statistics in parentheses
+ significant at 10%; * significant at 5%; ** significant at 1%
Source-host country pairs included; year dummies not reported.

Table 4. Interaction of BIT and the Rule of Law and Corruption (KKZ)

	(1) Level of FDI	(2) FDI/GDP	(3) Share of source FDI	(4) Level of FDI	(5) FDI/GDP	(6) Share of source FDI
Source GDP	0.160	0.033	0.009	0.163	0.036	0.009
	(22.49)**	(1.71)+	(2.22)*	(22.85)**	(1.85)+	(2.28)*
Host GDP	0.091	-0.097	-0.022	0.094	-0.110	-0.022
	(7.05)**	(2.20)*	(2.48)*	(7.39)**	(2.48)*	(2.45)*
Host GDPPC	19.309	0.069	0.023	10.956	0.081	0.022
	(4.48)**	(1.57)	(2.56)*	(2.89)**	(1.81)+	(2.48)*
Host Inflation	-3.760	-0.000	-0.000	-3.969	-0.001	-0.000
	(4.06)**	(1.18)	(4.88)**	(4.31)**	(1.46)	(4.99)**
Host Trade/GDP	-44.104	0.001	-0.006	-46.566	-0.000	-0.006
	(1.70)+	(0.08)	(2.86)**	(1.81)+	(0.05)	(2.93)**
Skill gap	13.487	-0.004	-0.000	8.328	-0.004	-0.000
	(2.08)*	(1.65)+	(0.32)	(1.31)	(1.84)+	(0.44)
NAFTA	174.251	0.012	0.000	182.449	0.011	0.000
	(5.81)**	(0.99)	(0.12)	(6.09)**	(0.92)	(0.16)
E.Europe 90s	52.865	0.008	-0.001	17.397	-0.003	-0.002
	(2.11)*	(0.77)	(0.47)	(0.67)	(0.32)	(1.01)
BIT	-124.365	-0.000	-0.005	-85.700	0.028	-0.003
	(2.34)*	(0.00)	(1.27)	(1.60)	(1.34)	(0.60)
BIT*Rule of Law	-78.310	0.070	0.004			
	(0.57)	(4.44)**	(1.27)			
BIT*Corruption				85.330	0.097	0.008
				(1.90)+	(6.45)**	(2.68)**
Constant	-190.700	0.171	-0.027	-141.770	0.197	-0.027
	(5.38)**	(0.62)	(0.48)	(4.27)**	(0.71)	(0.48)
Observations	8153	8153	8153	8153	8153	8153
Number of source partner pairs	537	537	537	537	537	537
Wald Chi2	1792.97	727.19	574.3	1809.56	745.98	579.96
Prob > Chi2	0.00	0.00	0.00	0.00	0.00	0.00

Absolute value of z-statistics in parentheses
+ significant at 10%; * significant at 5%; ** significant at 1%
Country pair fixed effects included; year dummies not reported.

Table 5. Interaction of BIT and Regulatory Quality and Government Effectiveness (KKZ)

	(1) Level of FDI	(2) FDI/GDP	(3) Share of source FDI	(4) Level of FDI	(5) FDI/GDP	(6) Share of source FDI
Source GDP	0.162	0.030	0.008	0.162	0.035	0.009
	(22.76)**	(1.56)	(2.09)*	(22.79)**	(1.80)+	(2.17)*
Host GDP	0.102	-0.087	-0.022	0.092	-0.112	-0.022
	(6.68)**	(1.96)*	(2.42)*	(7.34)**	(2.50)*	(2.40)*
Host GDPPC	11.034	0.068	0.023	11.694	0.078	0.022
	(2.99)**	(1.53)	(2.52)*	(3.03)**	(1.73)+	(2.44)*
Host Inflation	-4.070	-0.000	-0.000	-3.876	-0.000	-0.000
	(4.28)**	(1.24)	(4.59)**	(4.23)**	(0.98)	(4.74)**
Host Trade/GDP	-40.660	0.001	-0.006	-46.230	0.000	-0.006
	(1.57)	(0.10)	(2.86)**	(1.79)+	(0.00)	(2.90)**
Skill gap	6.794	-0.004	-0.000	8.491	-0.005	-0.000
	(1.04)	(1.81)+	(0.28)	(1.32)	(2.19)*	(0.46)
NAFTA	178.727	0.011	0.000	179.302	0.009	0.000
	(5.93)**	(0.91)	(0.16)	(5.98)**	(0.76)	(0.14)
E.Europe 90s	16.032	0.008	-0.001	30.390	0.005	-0.001
	(0.63)	(0.80)	(0.36)	(1.23)	(0.45)	(0.58)
BIT	-136.134	-0.004	-0.004	-110.332	0.016	-0.003
	(2.19)*	(0.20)	(0.81)	(2.08)*	(0.77)	(0.77)
BIT*Regulatory Quality	114.636	0.064	0.000			
	(1.69)+	(3.18)**	(0.08)			
BIT*Government Effectiveness				59.957	0.089	0.004
				(1.40)	(6.12)**	(1.48)
Constant	-140.031	0.105	-0.024	-144.729	0.255	-0.023
	(4.18)**	(0.38)	(0.43)	(4.26)**	(0.92)	(0.41)
Observations	8153	8153	8153	8153	8153	8153
Number of source_partner	537	537	537	537	537	537
Wald Chi2	1808.41	719.73	573.26	1806.33	745.19	575.87
Prob > Chi2	0.00	0.00	0.00	0.00	0.00	0.00

Absolute value of z-statistics in parentheses
+ significant at 10%; * significant at 5%; ** significant at 1%
Country pair fixed effects included; year dummies not reported.

Table 6: Interaction with Law and Order and Corruption (ICRG)

	(1) Level FDI	(2) FDI/GDP	(3) Share of Source FDI	(4) Level FDI	(5) FDI/GDP	(6) Share of Source FDI
Source GDP	0.180	0.006	0.014	0.183	0.007	0.013
	(19.46)**	(0.28)	(3.23)**	(19.55)**	(0.33)	(2.97)**
Host GDP	0.082	-0.065	-0.027	0.089	-0.069	-0.023
	(5.92)**	(1.30)	(2.46)*	(6.09)**	(1.38)	(2.07)*
Host GDPPC	7.656	0.051	0.028	6.537	0.055	0.027
	(1.70)+	(1.07)	(2.57)*	(1.45)	(1.14)	(2.43)*
Host Inflation	-6.116	-0.001	-0.001	-5.962	-0.001	-0.001
	(5.09)**	(1.82)+	(6.68)**	(4.88)**	(1.71)+	(6.16)**
Host Trade/GDP	-70.514	-0.011	-0.006	-41.056	-0.013	-0.005
	(2.23)*	(0.87)	(2.47)*	(1.28)	(1.04)	(2.13)*
Skill gap	5.609	-0.001	0.000	10.019	-0.002	0.001
	(0.79)	(0.28)	(0.06)	(1.39)	(0.60)	(1.54)
NAFTA	122.192	0.017	-0.003	175.104	0.010	0.000
	(3.77)**	(1.42)	(1.27)	(5.41)**	(0.82)	(0.19)
E.Europe 90s	-38.596	0.018	-0.005	-41.788	0.017	-0.004
	(1.31)	(1.59)	(1.96)+	(1.43)	(1.47)	(1.69)+
BIT	-17.413	-0.032	-0.023	-251.702	-0.020	-0.032
	(0.13)	(2.52)*	(2.27)*	(2.63)**	(1.67)+	(4.42)**
Rule of Law	-43.280	-0.011	-0.003			
	(4.94)**	(3.39)**	(5.22)**			
BIT*Rule of Law	9.980	0.005	0.004			
	(0.41)	(0.59)	(2.04)*			
Corruption				-41.640	-0.012	-0.004
				(4.35)**	(3.35)**	(5.62)**
BIT*Corruption				89.531	0.032	0.008
				(3.76)**	(3.67)**	(5.01)**
Constant	7.859	0.348	-0.070	-10.741	0.206	-0.087
	(0.15)	(1.06)	(1.10)	(0.25)	(0.63)	(1.37)
Observations	6952	6952	6952	6952	6952	6952
Number of source_partner	537	537	537	537	537	537
Wald Chi2	1609.87	671.76	615.24	1543.19	662.68	598.91
Prob > Chi2	0.00	0.00	0.00	0.00	0.00	0.00

Absolute value of z-statistics in parentheses
+ significant at 10%; * significant at 5%; ** significant at 1%
Country pair fixed effects included; year dummies not reported.

EXHIBIT D

FOREIGN INVESTMENT IN DEVELOPING COUNTRIES
Does it Crowd in Domestic Investment?

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CONTENTS

Chapter **Page**

INTRODUCTION 1

I. THE ISSUES 2

II. A THEORETICAL MODEL OF INVESTMENT WITH FDI 6

III. TESTING FOR CROWDING IN OR CROWDING OUT 9

IV. CONCLUSIONS 14

REFERENCES 16

FOREIGN INVESTMENT IN DEVELOPING COUNTRIES

Does it Crowd in Domestic Investment?

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This paper assesses the extent to which foreign direct investment in developing countries crowds in or crowds out domestic investment. We develop a theoretical model of investment that includes an FDI variable and we proceed to test it with panel data for the period 1970–1996 and the two subperiods 1976–1985 and 1986–1996. The model is run for three developing regions (Africa, Asia and Latin America). One version of the model allows us to distinguish crowding in and crowding out effects for individual countries within each region. The results indicate that in Asia – but less so in Africa – there has been strong crowding in of domestic investment by FDI; by contrast, strong crowding out has been the norm in Latin America. The conclusion we reach is that the effects of FDI on domestic investment are by no means always favourable and that simplistic policies toward FDI are unlikely to be optimal.

Introduction

Foreign direct investment (FDI) is prized by developing countries for the bundle of assets that multinational enterprises (MNEs) deploy with their investments. Most of these assets are intangible in nature and are particularly scarce in developing countries. They include technology, management skills, channels for marketing products internationally, product design, quality characteristics, brand names, etc. In evaluating the impact of FDI on development, however, a key question is whether MNEs crowd in domestic investments (as, for example, when their presence stimulates new downstream or upstream investments that would not have taken place in their absence), or whether they have the opposite effect of displacing domestic producers or pre-empting their investment opportunities.

This is a rather important issue. In recent theoretical and empirical work, investment has been identified as a key variable determining economic growth. Thus, if FDI crowds out domestic investment or fails to contribute to capital formation, there would be good reasons to question its benefits for recipient developing countries. Moreover, given the scarcity of domestic entrepreneurship and the need to nurture existing entrepreneurial talent, a finding that MNEs displace domestic firms would also cast doubts on the favourable development effects of FDI. These are all the more important questions when one considers that FDI is far from being a marginal magnitude. As can be seen in table1, FDI, as a share of total gross fixed capital formation is a significant and growing magnitude in developing countries. In fact, FDI is a much larger proportion of investment in developing than in developed countries.

This paper addresses the question of whether FDI causes crowding in (CI) or crowding out (CO) of domestic investment. Chapter I lays out the issues involved. In chapter II we propose a theoretical model for investment in developing countries that includes an FDI variable. Chapter III presents the results of econometric tests of the model for Africa, Asia and Latin America, using panel data for 1970–1996. The main conclusions of the paper are given in chapter IV.

Table 1
Developed and developing countries:
FDI inflows as a percentage of gross fixed capital formation
(Percentage)

Region	*1986–1991*	*1992–1996*
Developed countries	3.5	3.2
Developing countries	3.4	6.8
Africa	3.9	7.2
Asia	2.8	6.0
Latin America	5.3	9.5
Central and Eastern Europe	0.1	6.2

Source: UNCTAD, *World Investment Report*, various issues.

I. THE ISSUES

Investment by MNEs contributes directly to overall investment, because it is part of it. Indeed, domestic investment (I_d) plus investments undertaken by MNEs (I_f) ought to add up to total gross investment (I).

$$I \equiv I_d + I_f$$

I_f is usually thought of as FDI. This formulation is, of course, an over-simplification, since FDI is not equivalent to new investments by foreign firms. FDI is a financial balance-of-payments concept; on the other hand, investment is a real national accounts variable. Much FDI never becomes investment in the real sense: mergers and acquisitions (M&As) are mere transfers of ownership of existing assets from domestic to foreign firms. In some countries investments by MNEs could exceed FDI. This is the case of investments financed through borrowings on domestic capital markets. This phenomenon is more widespread in developed than in developing countries. In the latter, borrowing costs on domestic financial markets are normally much higher than on international markets, and this usually discourages domestic borrowings by MNEs.

A crucial question as regards the development impact of FDI is the extent to which it affects investment by domestic firms (I_d). If it has no effect whatsoever, any increase in FDI ought to be reflected in a dollar-for-dollar increase in total investment. If FDI *crowds out* investment by domestic firms, the increase in I ought to be *smaller* than the increase in FDI. Finally, if there is *crowding in*, I ought to increase by *more* than the increase in FDI.

The assessment of the effects of FDI on domestic and total investment is far from being a trivial matter. Little can be said on an a priori basis. The effects of FDI on investment may well vary from country to country, depending on domestic policy, the kinds of FDI that a country receives, and the strength of domestic enterprises.

It is possible, however, to specify conditions that are favourable to CI. In developing country settings, foreign investments that introduce goods and services that are new to the domestic economy, be they for the export or domestic market, are more likely to have favourable effects on capital formation than foreign investments in areas where there already exist domestic producers. In the former case, the effects on capital formation will be positive because domestic producers do not have the knowledge required to undertake these activities and, therefore, foreign investors do not displace domestic investors.

This is precisely the spirit of Romer's (1993) important paper on the contribution of FDI to development. Romer uses an endogenous growth model, whose driving force is the introduction of new goods to the economy. This is where FDI comes in: as one of the major agents for introducing new goods (together with the technologies and human capital that accompany such goods) into economies that do not have the know-how or human resources to produce them.

If FDI enters the economy in sectors where there are competing domestic firms (or firms already producing for export markets), the very act of foreign investment may take away investment opportunities that were open to domestic entrepreneurs prior to the foreign investments. In other words, such FDI is likely to reduce domestic investments that would have been undertaken, if not immediately at least in the future, by domestic producers.[1] The contribution to total capital formation of such FDI is likely to be less than the FDI flow itself.

---

[1] Of course, such foreign investments may be desirable for other reasons, such as introducing competition into stagnant or backward sectors. However, what we are concerned about here is the impact on domestic investment and entrepreneurship. Given the enormous superiority of MNEs over domestic firms in most developing countries, the competition is likely to be one-sided.

This leads to a hypothesis linking the contribution of FDI to capital formation to the sector of the economy to which it goes. When the sectoral distribution of FDI is substantially different from the distribution of the existing capital stock or of production, the contribution of FDI to capital formation will be more positive than when the distribution of FDI follows roughly the existing sectoral distribution of the capital stock. In other words, *the relationship between FDI and domestic investment is likely to be complementary when investment is in an undeveloped sector of the economy* (owing to technological factors or to the lack of knowledge of foreign markets). On the other hand, FDI is more likely to substitute for domestic investment when it takes place in sectors where there exist plenty of domestic firms. The same may occur where domestic firms already have access to the technology that the MNE brings into the country.

One can, of course, argue in favour of exactly the opposite hypothesis. For instance, MNE investments in new activities may pre-empt investments by domestic firms that, with proper government nurturing, could be in a position to enter the sector. This was the rationale for limiting investments in certain high technology sectors in the Republic of Korea and Taiwan Province of China. The bet in these cases was that domestic firms could in fact emerge, and it paid off (see Amsden, 1989; Wade, 1990). However, in most other cases in the developing world the appearance of domestic producers in a new sector is unlikely or might take too long. Policies to foster entrepreneurship in new sectors can be very costly to the economy as a whole, if these sectors have technological requirements that run too far ahead of domestic capabilities. Besides, there are very few countries where governments can be as effective in nurturing technologically advanced domestic firms as were the governments of the Republic of Korea or Taiwan Province of China in the heyday of their industrialization drive. Examples of botched and costly intervention in favour of domestic firms in high-technology sectors abound in the developing world. One of the most disastrous was the Brazilian "informatics policy" of the early 1980s, which involved severe restrictions on FDI in information technology sectors. These restrictions led to very little domestic investment, and the firms that were created were highly inefficient. The policy was abandoned well before the programme was due to expire.

Also, it could be argued that the entry of an MNE into a sector where there exist several domestic firms may lead to investments by incumbent domestic firms in order to become more competitive. However, given the vast technological superiority of MNEs, their investments are more likely to displace domestic firms, and even cause their bankruptcy, than to induce domestic firms to invest.

Even where FDI does not displace domestic investment, foreign investments may not stimulate new downstream or upstream production and, therefore, may fail to exert strong CI effects on domestic investment. *Thus, the existence of backward or forward linkages from the establishment of foreign investors is a key consideration for determining the total impact of FDI on capital formation.* It should be stressed, though, that linkages are a necessary but not sufficient factor for CI. In cases where foreign firms simply displace existing ones, the existence of linkages cannot prevent CO.

One may also hypothesize that the impact on investment is greater when FDI takes the form of a greenfield investment than when it is an M&A. This is ultimately an empirical matter. In a recent study on the impact of FDI on development in Latin America, sample surveys of MNE affiliates in Argentina and Chile revealed that, for the firms interviewed, the purchase of existing assets was a small component of the total investment. Post-purchase investments very often included modernization and rationalization of operations, and, above all, investments in technology (see Agosin, 1996; Riveros et al., 1996; Chudnovsky et al., 1996). These investments were particularly large in the privatizations of telecommunications and public utilities in Argentina in the early 1990s. Most of the acquisitions in Argentina and Chile during this period were made with the intention of running the firms so acquired and bringing them up to date technologically.

But M&As may not lead to any increase in the physical capital of a host country. In some cases, the acquisition of a domestic firm is almost akin to a portfolio investment, with the MNE doing nothing to improve the operation of the domestic company. This was the case of several acquisitions in Latin America in the 1990s, as those economies became desirable destinations of portfolio investments. Very recently, there have been a large number of such cases of FDI, all with doubtful impacts on capital formation. Many of the acquired companies are not in need of modernizing, since they operate with state-of-the-art technology. Nor is it likely that their purchase by a foreign company will be followed up by sequential investment that the acquired firms would not have made themselves. In such cases, the act of FDI is not investment in the national accounts sense, and it does not lead to investments later on.

In fact, large M&As, like large portfolio inflows, may have adverse macroeconomic externalities on the most interesting types of investments. When they are of a size that can no longer be considered marginal, M&As tend to appreciate the exchange rate and discourage investment for export markets (and, indeed, for the production of importables as well). In small countries, these investments constitute the engine of growth of the economy.

It is interesting that M&As are prohibited in some of the most successful newly industrialized countries. Taiwan Province of China restricts foreign ownership of the equity of domestic companies in two ways. A single foreign person or entity can own no more than 15 per cent of a domestic company, and all foreigners together are not allowed to own more than 30 per cent in the equity of a domestic company. Until the recent financial crisis, the Republic of Korea maintained similar restrictions. In order to assist in the restructuring of industry and to attract FDI, these restrictions have been dropped (Agosin, 1999a).

It is often argued that an acquisition will lead to capital formation indirectly, when those who have been bought out invest in new sectors of the economy. But the effect is likely to be weak, if it occurs at all. Most acquired firms are joint stock companies, and the shares purchased through a buy-out are tendered by stockholders, who are more likely to use the proceeds to purchase other financial assets (at home or even abroad) than to make real investments. Thus, the relationship between acquisitions of domestic firms by MNEs and real investment may be very tenuous indeed.

There are other macroeconomic externalities of MNE activities that could lead to CO. By raising domestic interest rates, the borrowing by MNEs on domestic financial markets may displace investment by domestic firms. Such borrowings may also worsen foreign exchange problems during times of balance-of-payments crisis, as borrowing in domestic currency can be converted to foreign exchange and easily remitted abroad by companies operating in global markets and having global financial connections.

To what extent this takes place in actual fact is an empirical question, and undoubtedly the situation will vary from country to country. But it may be critical in small countries negotiating with large firms. For example, in its foreign investment regulations, Chile, which has very liberal policies with regard to FDI, has retained the right to limit the access of foreign companies to the domestic banking system, if national conditions so warrant. The provision has never been invoked, but its very existence is a reminder that, for a small country, borrowing on domestic markets by MNE affiliates may, under certain circumstances, be problematic.

II. A THEORETICAL MODEL OF INVESTMENT WITH FDI

What, then, is the empirical evidence on CI or CO? In order to answer this question, we develop a model of investment in developing countries that introduces explicitly an FDI variable. The analysis of the effects of FDI on investment takes off from the (already stated) identity stating that total investment is the sum of domestic investment and real investment undertaken by MNEs:

$$I_t \equiv I_{d,t} + I_{f,t} \tag{1}$$

Investments by MNEs can be thought of as being a function of FDI (F). The resources that cross the exchanges as FDI are often not used at once to finance real investment. There is a lag between FDI and I_f. Therefore I_f will depend not only on contemporaneous FDI but also on its lagged values:

$$I_{f,t} = \psi_0 F_t + \psi_1 F_{t-1} + \psi_2 F_{t-2} \tag{2}$$

From the point of view of the recipient country, FDI can be considered to be an exogenous variable (because it depends on variables that relate to conditions in the world economy, MNE strategies, etc.).[2]

On the other hand, domestic investment needs to be specifically modelled. There is a large literature on investment in developing countries (Rama, 1993), and the candidates for inclusion as explanatory variables are therefore numerous. Here we take the view that investment is essentially a stock adjustment variable responding to the difference between the desired and actual capital stock. Investment adjusts partially to this difference because firms face liquidity constraints to investment and because the adjustment takes time. The basic model is the following:

$$I_{d,t} = \lambda \left(K^{*}_{d,t} - K_{d,t}\right) \tag{3}$$

where K^{*}_{d} represents the capital stock desired by domestic firms, and $\lambda < 1$.

In our model, the desired level of the capital stock depends positively on expected growth (G^{e}) on the difference (y) between actual output (Y) and full-capacity output (Y_{n}). This model is obviously a version of the neoclassical investment model, best exemplified by Hall and Jorgensen (1967). The missing variable is the user cost of capital. Most empirically estimated models of investment in developing countries have not found that interest rates or other proxies for the user cost of capital are significant in explaining variations in investment rates. This may be because investment is liquidity constrained. Therefore, we do not include interest rates as explanatory variables in our investment model, which is the following:

$$K^{*}_{d,t} = \phi_0 + \phi_1 G^{e}_{t} + \phi_2 y_t \tag{4}$$

where

$$\phi_1, \phi_2 > 0$$

Consider next the law of motion of the capital stock:

$$K_{d,t} = (1-d)K_{d,t-1} + I_{d,t-1} \tag{5}$$

where d is the annual depreciation rate.

---

2 Below we offer a formal test of the exogeneity of FDI with regard to the variables that enter into the function explaining domestic investment.

Combining (3) through (5):

$$I_{d,t} = \phi_0' + \phi_1' G^e + \phi_2' y + \lambda I_{d,t-1} + \lambda' I_{d,t-2} \tag{6}$$

where

$$\phi_0' = \phi_0 + \lambda^2 (1-d)^2 K_{d,t-2}$$

$$\phi_1' = \lambda \phi_1$$

$$\phi_2' = \lambda \phi_2$$

$$\lambda' = \lambda^2 (1-d)$$

We are now in a position to introduce equation (2) for investment by MNEs and to convert our model for domestic investment into one for total investment. Replacing (6) and (2) into (1) and collecting terms:

$$I_t = \phi_0' + \phi_1' G_t^e + \phi_2' y_t + \psi_0 F_t + \psi_1' F_{t-1} + \psi_2' F_{t-1} + \lambda I_{t-1} + \lambda' I_{t-2} \tag{7}$$

where:

$$\psi_1' = \psi_1 - \lambda$$

$$\psi_2' = [\psi_2 - \lambda^2 (1-d)]$$

All that remains to be done to have a model that can be estimated is to specify a process of expectations formation for the growth rate. If expectations are rational, expected growth should not deviate systematically from actual growth. In this case, $G_t^e = G_t$. The alternative is adaptive expectations:

$$G_t^e = \eta_1 G_{t-1} + \eta_2 G_{t-2} \tag{8}$$

III. TESTING FOR CROWDING IN OR CROWDING OUT

A version of the model with adaptive expectations[3] with respect to the growth rate was estimated for a panel of data for 32 countries (12 in Africa, eight in Asia, and 12 in Latin America) over the period 1970–1996. The model was tested in two versions. One (shown here) has the growth rate as the only explanatory variable of domestic investment. The second incorporates a proxy for the gap between actual and full-capacity output (where the latter was estimated with a Hodrick-Prescott filter). Since the results of both versions were practically identical, we show the results obtained with the more parsimonious version.

The investment equations for each of the three individual regions were of the following form:

$$I_{i,t} = \alpha_i + \beta_1 F_{i,t} + \beta_2 F_{i,t-1} + \beta_3 F_{i,t-2} + \beta_4 I_{i,t-1} + \beta_5 I_{i,t-2} + \beta_6 G_{i,t-1} + \beta_7 G_{i,t-2} + \varepsilon_{i,t} \quad (9)$$

where I = investment-GDP ratio; F = FDI/GDP ratio; G = growth of GDP; the α's are fixed country effects; and ε is a serially uncorrelated random error.

The equation used to determine the specific effect of FDI on investment in each country is an adaptation of (4), which considers the possibility that within each region the β's associated with FDI can vary from country to country:

$$I_{i,t} = \alpha_i + \beta_{1,i} F_{i,t} + \beta_{2,i} F_{i,t-1} + \beta_{3,i} F_{i,t-2} + \beta_4 I_{i,t-1} + \beta_5 I_{i,t-2} + \beta_6 G_{i,t-1} + \beta_7 G_{i,t-2} + \varepsilon'_{i,t} \quad (10)$$

The data were drawn from IMF, *International Financial Statistics* and World Bank, *World Development Indicators*. All series are in 1987 prices. For all the estimations of the investment function, the method employed was that of Pooled Estimations of Seemingly Unrelated Regressions (SUR).

Note that we shall be testing for long-term CI or CO. For this the relevant coefficient is:

$$\beta_{LT} = \frac{\sum_{j=1}^{3} \beta_j}{1 - \sum_{j=4}^{5} \beta_j}$$

[3] Econometrically, the adaptive expectations alternative worked better than the rational expectations hypothesis.

The criteria used to determine CO/CI is the value and significance of β_{LT}. There are three possibilities:

(i) With a Wald test it is not possible to reject the hypothesis that $\beta_{LT} = 1$. This means that in the long run an increase in FDI of one dollar (or, more precisely, of one percentage point of GDP) becomes one dollar of additional total investment (or investment amounting to one percentage point of GDP).

(ii) Consider now the case in which the null $\beta_{LT} = 1$ is rejected and $\beta_{LT} > 1$. This is evidence of CI: in the long run, one additional dollar of FDI becomes more than one additional dollar of total investment.

(iii) If the null $\beta_{LT} = 1$ is rejected and $\beta_{LT} < 1$, there is long-run CO: one additional dollar of FDI leads to less than a one-dollar increase in total investment. In other words, there is displacement of domestic investment by FDI.

How to interpret a result in which $\beta_{LT} \neq 1$? If the equality holds, investment by MNEs simply adds one-to-one to investment by domestic firms, and there are no macroeconomic externalities stemming from FDI. If the long-term effect of FDI is to produce CI, long-term macroeconomic externalities are positive. And evidence for CO implies that FDI has negative long-term externalities on investment.

The regression equations for the three regions are shown in table 2, and the CO/CI regional results are summarized in table 3. CO/CI effects for shorter periods of time (1976–1985 and 1986–1996) is also presented in table 3. Our equations explain a high percentage of the variation in regional investment, and all coefficients are reasonable and statistically significant.[4]

For the period 1970–1996 as a whole there is CO in Latin America and CI in Asia. In Africa, FDI increases investment one-for-one (N-effects). Interestingly, only in Asia is there evidence of strong CI (a positive macroeconomic externality). This is precisely the region where aggregate investment, by both MNEs and domestic firms, has been strongest.

The results obtained with this exercise are quite different from those of Borensztein, De Gregorio and Lee (1998). These authors find CI for developing countries as a whole, but the significance of the CI coefficient is not robust to changes in model specification. The problem with their results is that they are based on an ad hoc econometric model and do not represent estimations derived from an investment function. What they do, in fact, is use a standard growth equation *à la* Barro (1991) and substitute the FDI/GDP ratio for the growth rate of per capita GDP. The results reported here also have the advantage of attempting to disaggregate, as between regions and individual countries.

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[4] We are aware that the use on the right hand side of lags of the dependent variable introduces inconsistency in the estimates of the parameters. However, the inconsistency is unlikely to vitiate the results, since it is inversely proportional to the number of observations (in this case 27).

Table 2
Investment equations for three regions, using data for 1970–1996
(Estimation by SUR with country fixed effects; dependent variable: total investment, I)

Variable	*Africa*	*Asia*	*Latin America*
F	0.076 (2.10)[a]	1.113 (5.23)[b]	-0.151 (-2.64)[b]
F(-1)	0.089 (2.50)[a]	-0.120 (-0.36)	0.032 (0.46)
F(-2)	0.234 (6.54)[b]	-0.319 (-1.50)	0.063 (0.93)
G(-1)	0.126 (6.34)[b]	0.233 (6.07)[b]	0.130 (5.58)[b]
G(-2)	0.074 (3.66)[b]	0.141 (3.20)[b]	-0.004 (0.17)
I(-1)	0.467 (8.05)[b]	0.673 (9.09)[b]	0.700 (11.53)[b]
I(-2)	0.086 (1.74)	0.078 (1.12)	-0.098 (-1.97)[a]
Adjusted R-square	0.816	0.909	0.786

Note: Figures in parenthesis are *t*-ratios; country fixed effects are omitted.
a Significantly different from zero at the 5 per cent level.
b Significantly different from zero at the 1 per cent level.

Table 3
Developing regions: effects of FDI on investment

Region	*Long-term coefficient linking FDI and I*	*Long-term effect*
1970–1996		
Africa	0.89	N[a]
Asia	2.71	CI
Latin America	-0.14	CO
1976–1985		
Africa	2.19	CI
Asia	5.56	CI
Latin America	-1.22	CO
1986–1996		
Africa	1.30	CI
Asia	2.91	CI
Latin America	0.04	CO

a Parameter not significantly different from one (Wald test).

If the sample period is subdivided into two shorter periods representative of the last two decades (1976–1985 and 1986–1996), the results are basically unchanged, although Africa now appears with CI effects in both subperiods. The results for Asia and Latin America are the same for the shorter subperiods as for the sample as a whole.

For the period as whole, the classification of individual countries into the three categories is shown in table 4.[5] In Africa cases of CO are almost balanced by cases of CI; in Latin America there are no cases of CI, only cases of CO and of N-effects. By contrast, in Asia there are no countries exhibiting CO. In three countries (Republic of Korea, Pakistan and Thailand), FDI crowds in domestic investment; in five others, it has N-effects.

Table 4
Effects of FDI on investment in individual developing countries, 1970–1996

Crowding in	*Neutral effect*	*Crowding out*
Africa (3)	***Africa (5)***	***Africa (4)***
Côte d'Ivoire	Gabon	Central African Republic
Ghana	Kenya	Nigeria
Senegal	Morocco	Sierra Leone
	Niger	Zimbabwe
	Tunisia	
Asia (3)	***Asia (5)***	
Korea, Republic of	China	
Pakistan	Indonesia	
Thailand	Malaysia	
	Philippines	
	Sri Lanka	
	Latin America (7)	***Latin America (5)***
	Argentina	Bolivia
	Brazil	Chile
	Colombia	Dominican Republic
	Costa Rica	Guatemala
	Ecuador	Jamaica
	Mexico	
	Peru	

[5] It should be obvious that the analysis for individual countries cannot be undertaken for decade-long periods, since the data are too scant to allow for coefficient estimation.

As already noted, the analysis carried out here is crucially dependent on FDI being exogenous to the variables determining investment (here, the growth rate of GDP with one- and two-year lags). In order to test for the exogeneity of FDI, panel regressions were run for the three regions, with FDI as the dependent variable and the growth rate with one- and two-year lags as the explanatory variables. The two equations estimated were as follows:

$$F_{i,t} = \delta_i + \gamma_1 G_{i,t-1} + \gamma_2 G_{i,t-2} + u_{i,t} \tag{11}$$

$$F_{i,t} = \delta_i' + \gamma_1' G_{i,t-1} + \gamma_2' G_{i,t-2} + \gamma_3' F_{i,t-1} + \gamma_4' F_{i,t-2} + u_{i,t}' \tag{12}$$

These two models were estimated with data for 1970–1996 using SUR with fixed effects. The results, reported in table 5, leave little doubt that the variables explaining domestic investment (past growth) do not explain FDI. Therefore, one is justified in including FDI as an exogenous variable in the equations for total investment.

Table 5
Panel estimations with FDI as a dependent variable
and growth lagged once and twice as explanatory variables
(Probabilities associated with the estimated coefficients and adjusted R squares)

	P-values of coefficients in equation (11)	*P-values of coefficients in equation (12)*
Africa		
G(-1)	0.0504	0.4249
G(-2)	0.1336	0.1568
Adjusted R^2	0.097	0.041
Asia		
G(-1)	0.0198[a]	0.4984
G(-2)	0.9959	0.6484
Adjusted R^2	0.082	0.880
Latin America		
G(-1)	0.7184	0.4984
G(-2)	0.0620	0.6484
Adjusted R^2	0.082	0.560

a Significantly different from zero at the 5 per cent level.

The estimated coefficients of $G_{i,t-1}$ and $G_{i,t-2}$ are not significant, with one exception. In Asia, the estimate of γ_1 in equation (11) is significantly different from zero. In equation (12), when the lagged values of FDI are introduced into the model, the coefficient becomes insignificant. Since the preferred model is equation (12), problems of endogeneity between the variable explaining domestic investment (lagged growth) and FDI can be discarded for all three regions. Adjusted R squares of most estimated equations are low. In the two cases where adjusted R squares are high (estimates of equation (12) for Asia and Latin America), their level can be attributed solely to the effect of lagged FDI.

IV. CONCLUSIONS

The econometric exercises conducted here suggest that, over a long period of time (1970–1996), CI has been strong in Asia, and CO has been the norm in Latin America. In Africa, FDI has increased overall investment one-to-one. If the two subperiods 1976–1985 and 1986–1996 are taken separately, the results vary only for Africa, which appears as having CI rather than N-effects.

Results for individual countries (for the 1970–1996 period as a whole) are also interesting. CO is the norm in Latin America, CI in Asia, and African countries appear almost in balance as regards both CO and CI.

The main conclusion that emerges from this analysis is that the positive impacts of FDI on domestic investment are not assured. In some cases, total investment may increase much less than FDI, or may even fail to rise when a country experiences an increase in FDI. Therefore, the assumption that underpins policy toward FDI in most developing countries – that FDI is always good for a country's development and that a liberal policy toward MNEs is sufficient to ensure positive effects – fails to be upheld by the data. A recent piece of research by one of the authors of this paper reveals that the most far-reaching liberalizations of FDI regimes in the 1990s took place in Latin America, and that FDI regimes in Asia have remained the least liberal in the developing world (Agosin, 1999b).[6] Several Asian countries still practice screening of investment applications and grant differential incentives to different firms. As already noted, some types of investment have remained prohibited for most of the period under review. Nonetheless, it is in these countries that there is strongest evidence of CI. In Latin America, on the other hand, these practices have been eliminated in most countries. Nonetheless, liberalization does not appear to have led to CI.

While we are unable to test for what types of policies will maximize the contribution of FDI to total investment, the analysis does suggest that there is considerable scope for active policies that discriminate in favour of foreign investments that have positive effects on total investment. What these policies might be is beyond the scope of this paper. Some countries have been successful in adopting

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[6] Of course, we are dealing with matters of degree. Investment regimes have become pretty liberal throughout the developing world as a consequence of a profound reassessment of the benefits and costs of FDI.

screening policies to ensure that FDI does not displace domestic firms, or that MNEs contribute new technologies or introduce new products to the country's export basket (some Asian countries that appear to have CI effects – the Republic of Korea and Thailand – come to mind).[7] But most developing countries do not have the administrative capabilities to implement effective screening policies, and their attempts to do so often wind up scaring off MNEs altogether. An alternative might be to adopt a fairly liberal regime, and then go after specific companies that fit in well with the process of progressing up the "quality ladder" (to use the expression of Grossman and Helpman, 1992, chaps. 4 and 7).

CI in Asia may also be associated with high overall investment rates. Where investment is strong, investments by MNEs may elicit positive investment responses in the domestic economy through backward or forward linkages. CI may also take place in countries with low domestic investment rates (such as those in Africa), where MNEs invest in sectors that domestic investors are unable to enter, because of technological or capital requirements that domestic firms cannot meet.

Latin America is the great disappointment. One reason for CO in that region is that overall investment has been much weaker in Latin American than in Asia. It could also be that Latin American countries have been much less choosy about FDI than Asian countries, either in the sense of prior screening or attempting to attract desirable firms.

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[7] Information on the investment policies of individual countries can be obtained from the trade policy reviews conducted by the World Trade Organization (WTO). For the Republic of Korea and Thailand, see GATT (1991a and 1991b). The IMF's *Yearbook on Exchange Restrictions* also carries information on investment regimes.

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