University of Michigan Law School
Program in Law and Economics Archive: 2003-2009

Year 2005 *Paper* 47

Globalization, Law & Development: Introduction and Overview

Michael S. Barr* Reuven S. Avi-Yonah†

*University of Michigan Law School, msbarr@umich.edu
†University of Michigan, aviyonah@umich.edu

This working paper is hosted by The Berkeley Electronic Press (bepress) and may not be commercially reproduced without the permission of the copyright holder.

http://law.bepress.com/umichlwps-olin/art47

Copyright ©2005 by the authors.

GLOBALIZATION, LAW & DEVELOPMENT: INTRODUCTION AND OVERVIEW

*Michael S. Barr**
*Reuven S. Avi-Yonah***

INTRODUCTION

The current period of globalization (defined loosely as increasing global economic integration), which began with the liberalization of exchange and capital controls and lowering of trade and investment barriers in the 1980s, is not the first time the world got economically smaller. The period from 1870 to the outbreak of World War I in 1914 was by some measures (such as the percentage of GNP in developed countries derived from overseas investment, and labor migration) marked by more extensive globalization than the post-1980 one. This earlier globalization came to a halt with the hostilities of World War I, followed by the high tariffs and limits on migration in the inter-war period.

Most observers would agree that globalization can in principle be a positive phenomenon and aid human development even if they disagree about the extent to which the current wave of globalization has in fact been helpful. A key issue in these debates is the extent to which globalization widens or narrows the gap between the developed nations and the developing world, or at least significantly improves the lot of the developing world even if it does not narrow the gap. To the extent globalization helps bring developing countries up to the standards of developed countries' life expectancy, health, education, and overall prosperity, most would agree that it should be viewed positively, and that a relapse to closed economies like the one that followed World War I should be avoided.

The debate has therefore focused primarily on how globalization can be managed in a way that helps development. In this debate, some have advocated maximum reliance on free markets, free trade, and *laissez faire* policies in the international arena,[1] while others have advocated adapting something akin to the "mixed economy" model that is already generally applied in the developed countries domestically to

* Assistant Professor of Law, the University of Michigan Law School. We would like to thank Virginia Gordan, Barbara Glispin, Kelly Janiga, and Kristen Roy for their help in organizing the conference, and Jon H. Kouba, University of Michigan Law School JD 1965, the Center for International and Comparative Law and the John M. Olin Center for Law & Economics of the University of Michigan Law School and the William Davidson Institute at the University of Michigan Business School for supporting the conference.

** Irwin I. Cohn Professor of Law, the University of Michigan Law School.

1. *See, e.g.*, T. N. Srinivasan's contribution in this issue.

bepress Legal Repository

Hosted by The Berkeley Electronic Press

international economics, resulting in a bigger role for national or transnational regulation of both trade and investment.[2]

The role of law in development has become a key focus of this debate in recent years. Yet stale discussion about the importance of law in development from a generation ago has largely given way to richly textured debates about what forms of what law, public administration, enforcement, and other institutions, developed where and by whom, might improve economic growth how, and for whom.

Following the collapse of the Soviet Union and the emergence of market economies in formerly communist countries, policy makers perceived the establishment of the "rule of law" in the domestic arena as a crucial and indispensable factor in promoting development.[3] It soon became apparent, however, that a simple focus on promulgating good formal rules, or launching "anti-corruption" campaigns, was not enough.

Moreover, following the conclusion of the Uruguay Round and the establishment of the WTO and its legalistic dispute resolution mechanism in the mid-90s, law makers realized that legal rules can indeed be crafted to govern some aspects of globalization. Those interested in the distributive aspects of globalization saw that these rules may be key to ensuring that globalization benefits the poor as well as the rich, thus preventing a 1920s-style backlash.[4] Others saw these rules as critical to keeping distributive issues away from trade, which they viewed as about increasing the size of economic pie, not divvying up its pieces.

The papers in this issue were written for a conference that we and our colleague Jan Svejnar convened at the University of Michigan Law School in April, 2004 to address some of these issues, which arguably are the most pressing problems facing the world in the 21st century. Moreover, the gap between developed and developing nations underlies a host of other global problems, such as fighting terrorism, managing immigration pressures, and protecting the environment.

The conference was designed to contribute to a debate renewed in the last several years on how best to promote development in an era of globalization. In some ways, the UN framed the current debate in 2000, by setting out a series of far-reaching and concrete "Millennium Development Goals," which aimed to significantly reduce global poverty by 2020. In other ways, the current debate has been framed by troubled trade talks. After a breakdown between rich and poor countries in Seattle, the latest global trade round was launched two years later in Doha by focusing

2. *See, e.g.*, Robert Kuttner's contribution in this issue.

3. *See* the contributions in this issue by Michael Trebilcock, Kevin Davis, and Katharina Pistor and their colleagues.

4. *See* the contributions in this issue by John Braithwaite and Carlos Correa.

bepress Legal Repository

http://law.bepress.com/umichlwps-olin/art47

explicitly on a new development agenda. These talks are threatened, however, both by a continued lack of market access for developing countries to some key sectors in industrial countries, such as agriculture, as evidenced by the failures of trade negotiations in Cancun in 2003, and an increasingly complex set of trade rules that many countries lack the legal and institutional competence to navigate.

We invited a number of experts from a variety of disciplines to discuss issues related to the links between globalization, development, and law. This issue is the result. Below, we summarize the articles and remarks published herein, and the offer some observations about areas of agreement and disagreement.

SUMMARY OF PROCEEDINGS

The proceedings opened with Robert Kuttner's keynote speech,[5] which argues in favor of applying a "mixed economy" model to international economics, rather than the current preference for *laissez faire* embodied in the Washington Consensus. Kuttner argues that it is incongruous to support a significant role for government regulation in domestic economies, as all developed countries do to some extent, while leaving international trade and investment unregulated. This situation is particularly paradoxical given that globalization itself creates greater links between domestic and international economies, and therefore it becomes harder to maintain the mixed economy domestically while leaving the international economy unregulated. For example, it has been argued that unfettered tax competition to attract investment in the international arena can potentially undermine the ability of both developed and developing countries to finance their domestic social safety net, at a time when the pressures of globalization on work and wages render a social safety net more necessary than ever.[6] According to Kuttner, the large question is how to move piecemeal towards global or transnational regulation.

The first panel session, moderated by Jan Svejnar, focused on "the purposes of development." Kamal Malhotra's piece argues that the purpose of development is "the achievement of the highest level of human development for every human being," and that human development should be defined broadly as "a process of enlarging choices." In his view, lots of economic growth is "voiceless, ruthless, rootless, and futureless." By contrast, in the human development paradigm, the ultimate

5. Not reproduced here.

6. For this debate, see the contributions of Rueven Avi-Yonah and Michael Littlewood in this issue.

bepress Legal Repository

Hosted by The Berkeley Electronic Press

objective of development is not to create more wealth or to achieve higher economic growth, but to enlarge this range of choices and the human capacity to live one's life. Albert Park and Linda Tesar commented by agreeing with Malhotra but pointing out that economic development is frequently a necessary precondition for other types of human development (the same point is made more extensively in T.N. Srinivasan's article, discussed below). Park emphasized the importance of new institutional economics to the discussion of how to achieve economic development, while Tesar highlighted the potential for foreign direct investment to provide net benefits to both developed and developing countries.

The second and third panels, moderated by Kenneth Dam and Robert Litan, focused on "the role of law and institutions in development." Jonathan Hiatt and Deborah Greenfield argue for the importance of core labor rights in world development. They claim that in order to persuade working people to assume the risk of the free market, the "new economy" needs to be managed in a way that lifts living standards around the world, rather than becoming a "race to the bottom" in environmental protection, consumer protections and labor standards. They call on the WTO and the International Labor Organization to commit to work together to ensure that free trade proceeds within a framework of respect for core labor standards, such as freedom of association, elimination of compulsory and child labor, and a ban on discrimination in employment. Hiatt and Greenfield cite the cases of bilateral U.S. agreements with Cambodia and Jordan as examples of successful incorporation of core labor standards into trade agreements.

David Kennedy's contribution[7] poses a challenge to the prevalent rhetoric that focuses on the importance of legal factors in development. Kennedy argues that this frequently serves as a way of avoiding a discussion of the political and distributive choices attending the development process by linking it to a supposedly "neutral" rule of law paradigm. In particular, Kennedy challenges the value of two common ideas of the "new" law and development movement; the importance of formalizing legal entitlements and of fighting corruption, which in both cases lead to enshrining a particular distributive outcome. Instead, Kennedy calls for viewing the legal regime as a site for contestation and experimentation by paying attention to the distributive and political results of different legal regimes.

Kerry Rittich's article, *The Future of Law and Development: Second Generation Reforms and the Incorporation of the 'Social'*, distinguishes current efforts to discuss development from earlier ones by the explicit

7. Not reproduced here.

bepress Legal Repository

http://law.bepress.com/umichlwps-olin/art47

attempt to incorporate social, structural, and human dimensions into the agenda of the international financial institutions. Rittich argues that we can learn a lot about the fate of this type of "second generation" reforms by examining how they are operationalized through legal rules and institutions. While the legal and institutional architecture of development does not appear to have substantially changed, the World Bank does attempt to incorporate social justice concerns such as human rights, gender equality and labor standards into the development agenda.

T. N. Srinivasan's article focuses on the political economy of ensuring both greater access to industrial country markets and a rule-based and transparent global system of trade and finance that guarantees such access. He argues that progress in this regard depends largely on domestic events in a few large industrialized countries, and that declarations such as the Millennium Development Goals or the "right to development" have only limited operational significance. Moreover, the potency of development assistance as a lever to bring about sustainable reforms in developing countries is overrated. Finally, Srinivasan argues that it is a mistake to ignore the tremendous variance across developing countries, especially because much of the needed changes in polity, society, and institutions to promote development are domestic and not external. It is possible, however, to make some valid generalizations, and one of them is that the legal system of a country has both an intrinsic value and an instrumental role in promoting (or retarding) development.

The wide ranging article by Michael Trebilcock and his colleagues responds to some of T.N. Srinivasan's challenges by addressing the political economy of rule of law reform in developing countries. Trebilcock et al. develop a "procedural conception" of the rule of law, thereby attempting to bypass the debates about whether the rule of law is based on instrumental or deontological normative theories. This procedural conception is based on six elements: the judiciary; access to justice; prosecutors; police and other law enforcement officials; the penal system; and tax administration. These elements are first analyzed generally and then applied to Latin American and central and Eastern European countries. The authors conclude that despite much effort, "the promise of rule of law reform is proving exceedingly difficult to fulfill." The problem resides not in technical impediments, but rather in social, cultural, and historical issues, and even more so in political economy factors. That is, elites block reform. The authors make a series of practical recommendations to enhance the likelihood of durable rule of law reforms, such as harnessing political pressure by certain domestic and foreign interest groups, and by foreign governments and international organizations.

bepress Legal Repository

Hosted by The Berkeley Electronic Press

Kevin Davis' piece complements the pessimistic analysis by Trebilcock et al. by asking: What does the rule of law variable measure? Davis argues that optimistic claims about the extent to which legal reforms can play a causal role in development by reference to country-wide statistical analyses are misguided because in many cases the variables that are used to measure characteristics of the legal system do not capture information about aspects of that system that are amenable to reform. For example, variables that measure legal heritage, respect for the rule of law, respect for property rights, and enforceability of contracts may measure both legal and non-legal aspects of a society; to the extent they measure legal institutions, they aggregate information about the characteristics of several types of institutions. Consequently, Davis argues that studies based upon these data can provide little or no guidance on the relationship between legal reforms and development.

Katharina Pistor and her colleagues present an empirical analysis of "legal institutions and international trade flows." In earlier work, they presented a model in which higher institutional quality gave rise to comparative advantage in complex goods production, while countries with weak legal institutions are typically "stuck" with exporting simple products. In this article, Pistor et al. extend the model to generate predictions about the effect of domestic institutions as well as trade barriers, export subsidies and import tariffs on trade flows. They find that countries with higher institutional quality experience greater trade flows, and that the quality of legal institutions is significantly more important for exporters than for importers. Moreover, the quality of legal institutions is of little importance for exporters of simple goods, but greatly important for exporters of complex goods. They develop a tentative explanation for these findings based on the relative ability of traders in different types of goods to opt out or contract around defective legal institutions.

On a more specific level, Katherine Terell examines the impact of minimum wage legislation in Costa Rica, which has both a "covered" sector (in which minimum wages apply) and an "uncovered" sector. She finds that legal minimum wages have a significant positive effect on wages of workers in the covered sector, but none in the uncovered sector; and that minimum wages have a negative impact on both employment and hours worked in the covered sector. Both effects are most significant in the lower half of the worker distribution.

Daniel Kaufmann delivered a keynote address[8] demonstrating through a wide range of empirical evidence that good governance matters to development. Key elements of governance include rule of law, honest government, efficiency of the regulatory regime, and democratic

8. Not reproduced here.

bepress Legal Repository

http://law.bepress.com/umichlwps-olin/art47

accountability. Kaufmann highlighted the difficulties of anti-corruption campaigns that fail to look at the myriad ways in which corruption is institutionalized in a society.

The fourth panel, moderated by Michael Barr, focused on "policy priorities for development." John Braithwaite's article *Methods of Power for Development: Weapons of the Weak, Weapons of the Strong* uses regulatory theory to explain how American power works in the world system by networking corporate and state power with power in civil society. Braithwaite argues that contrary to common perceptions, the United States is in fact reluctant to fire the big guns that underwrite its realist power; instead, it usually has its way through dialogue led by analytically sophisticated experts. This type of power can be used by developing countries as well, because they can sometimes enlist the corporations and NGOs of the rich nations to defect to their cause. For example, poor nations can threaten to use their big stick of refusing to repay large debts owed to the rich nations' banks. More broadly, developing countries can work together to display a responsive enforcement pyramid of networked governance to achieve the same kinds of power that usually accrue to developed ones.

Steven Radelet's article, *A Framework for Supporting Sustained Economic Development*, explores some of the similarities across low-income countries that have achieved success in economic development since 1960. Radelet identifies twenty-one countries that were relatively poor in 1960 and have recorded economic growth of at least 2.2% per person per year (the maximum forty year average of the United States ever recorded in its history), along with significant increases in life expectancy and declines in infant mortality and illiteracy. Four core elements stand out as being consistent across these countries: macroeconomic and political stability; significant investments in health and education; a reasonable environment for the private sector; and relatively strong governance. While these factors are primarily the responsibility of developing country governments, Radelet argues that the international community can help by increasing the quantity and quality of foreign assistance and granting greater access to markets in industrialized countries.

Lael Brainard's comments[9] focused on the extent to which U.S. policy interests drive aid. She noted that concerns over HIV/AIDs, security in the wake of September 11, and a desire for making aid conditional on policy reforms were paramount at present. She noted that both U.S. policy and that of the multilateral development banks employed inconsistent standards for conditionality.

9. Not reproduced here.

bepress Legal Repository

Hosted by The Berkeley Electronic Press

Michael Barr's article, *Microfinance and Financial Development*, asks to what extent can a focus on microfinance make it more likely that financial development can lead to poverty alleviation. Barr argues that focusing on microfinance might help for four reasons: First, microfinance institutions themselves might increasingly reach financial self-sustainability and attract private capital flows to their mission of poverty alleviation, although reaching financial self sustainability and scale has proved elusive for many microfinance institutions. Second, microfinance institutions might "grow up in the cracks between the cement blocks of bad government"; they could help grow domestic credit demand and alleviate poverty despite weak legal and political institutions and so might be a particularly appropriate target for donor support in such countries. Third, microfinance institutions can help bridge the gap between the formal (banking) sector and informal lending markets, helping to complete fragmented domestic markets. Fourth, microfinance could contribute to domestic demand for better governmental and market institutions, and focusing on the needs of a growing microfinance sector may lead domestic entities (including the government) to respond by strengthening the institutions needed for broad-based financial development, such as credit information clearinghouses.

The focus of the fifth panel, chaired by Rob Howse, was on the role of trade and foreign direct investment (FDI) in development. Carlos Correa examines investment protection in bilateral and free trade agreements and its implications for the granting of compulsory licenses. He argues that while developing countries have entered into a large number of bilateral investment treaties (BITs) and free trade agreements that provide for investment protection, there is no evidence indicating that the adoption of BITs has actually encouraged FDI flows to the signing developing countries. At the same time, the broad definition of protected "investment" in BITs to include intellectual property rights may undermine the rights secured by developing countries under the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) to grant compulsory licenses, as such licenses might constitute an expropriation entitling the holder of the patent to compensation under the BITs.

Kevin Hasset focuses on the role of FDI in development. He argues that there is a broad consensus that FDI is a key component of trade and exerts a positive impact on development, primarily in the form of increased wages for skilled workers, leading to an incentive for the developing countries to invest in human capital. Hasset further argues that tax rates have a significant correlation with FDI and that as the corporate tax rate of a country declines, both investment as a percentage of

bepress Legal Repository

http://law.bepress.com/umichlwps-olin/art47

GDP and real GDP per capita growth rate increase. Thus, developing countries should consider tax policy reforms to attract capital flows in their direction.[10]

Susan Esserman's comments[11] focused on the "impossibly high" expectations of developing countries for progress on development coming out of the Doha round of trade talks. She also discussed the role of the WTO Appellate Body in preserving political compromises that keep developing countries engaged in the world trading system.

The sixth and final panel, moderated by Reuven Avi-Yonah, focused on financing development. Abdel Hamid Bouab's comment, *The Monterrey Consensus: Achievements and Prospects*, summarizes the conclusions of the international conference on financing for development held in Monterrey, Mexico, in March, 2002. The Monterrey Consensus incorporated six elements of financing for development: mobilizing domestic financial resources; mobilizing international resources including FDI and other private flows; using international trade as an engine for development; increasing international financial and technical cooperation for development; reducing external debt; and enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development.

Anthony Clunies-Ross' article, *Development Finance: Beyond Budgetary ODA*, argues that budgetary appropriations by rich country governments are likely to prove inadequate to meet the estimated external finance needed for the achievement of the Millennium Development Goals. Clunies-Ross argues that the focus instead should be on those methods that currently present the softest targets on the ground and as to which there are no coherent and legitimate interests ranged against. The most promising candidates are various forms of international tax cooperation, the resumption of regular allocation by the IMF of Special Drawing Rights (SDRs), and the creation of an SDR denominated bond designed for preserving the assets of poor migrant workers and their families. In addition, Clunies-Ross suggests two ways of increasing the resources available to international organizations for use on behalf of the world community: recycling of SDRs that have no net value to the countries initially receiving them; and internationally coordinated taxes on world resources, activities, or externalities, such as a tax on currency transactions.

Reuven Avi-Yonah's article, *Bridging the North/South Divide: International Redistribution and Tax Competition*, argues that finding ways to

10. For other views on this issue see the articles by Avi-Yonah and Littlewood in this issue.

11. Not reproduced here.

bepress Legal Repository

Hosted by The Berkeley Electronic Press

help bridge the North/South divide in terms of life expectancy, health, and living conditions may be the most important task facing humanity at the beginning of the 21st century. The Millennium Development Goals adopted by the UN are a beginning step toward that goal, and require additional funding of about $50 billion per year (over existing aid). However, Avi-Yonah agrees with Clunies-Ross that under current conditions it seems extremely unlikely that democratic approval can be given in developed countries to such an increase in aid, and certainly not to the level of redistribution required to bridge the gaps. Nor are new methods of financing such as the Tobin Tax on currency transactions (favored by Clunies-Ross) likely to be enacted given the opposition in the developed world. In these circumstances, the best policy approach is for the developed countries to help developing countries help themselves. In order to do that, the developed countries need to restrict harmful tax competition among developing countries, and competition to attract flight capital from developing countries to developed countries.

Michael Littlewood's article, *Tax Competition: Harmful to Whom?*, takes the contrary position to Avi-Yonah's in the tax competition debate. Littlewood argues that the theory that tax competition by developing countries to attract FDI is harmful is unproven; that even if it is harmful, it does not follow that it would be desirable to stop it; and that, in any event, stopping it poses practical difficulties which have yet to be resolved.

CONCLUSIONS

These articles present a wide range of views on a broad range of topics related to globalization, development, and the law. It may be possible, however, to draw some tentative conclusions about areas of agreement and disagreement.

First, there is broad agreement that increasing development and reducing the gap between developed and developing countries is an important goal. Moreover, the economists (e.g., T.N. Srinivasan) tend to agree with the development experts (e.g., Malhotra) that development should be defined broadly to include more than increasing GDP, although there may be some disagreement about whether economic development is or is not a necessary precondition to other forms of development, and what consequences follow from the definition.

Second, there is broad agreement that globalization can in principle be helpful for development, as long as it is managed correctly, and that a retreat from globalization like that which occurred in the 1920s would be unfortunate. There is considerable disagreement, however, about what

bepress Legal Repository

http://law.bepress.com/umichlwps-olin/art47

needs to be done to ensure that globalization in fact helps development. On the one hand, economists like Srinivasan and Hassett argue that the problem is governmental rules like tariffs and taxes that hinder the free flow of trade and investment, which would most favor development. On the other hand, Kuttner, Hiatt, and Rittich argue that a "mixed economy" model incorporating domestic labor standards, consumer protections, and environmental protections should be developed for the global economy. Terrell's article complements this debate by showing both the pros and the cons of adopting a developed country idea like the minimum wage in a developing country context.

Third, there is a general consensus that legal institutions and good governance are important for both managing globalization and achieving development, and that these institutions go beyond "law" or "policy" to encompass the basic structures of society itself. Unfortunately, as Trebilcock, Pistor, Davis, and their colleagues all point out, such institutions may be difficult to change. Moreover, it is not at all clear that these institutions are responsive to change from external forces. One problem is that these institutions are intimately linked to particular distributive outcomes and therefore attempts to change them may run into significant political opposition, as Srinivasan argues. Radelet's article, however, is more optimistic in pointing out that several developing countries have succeeded in achieving high rates of growth over a long period by adopting good policies and sound governance. Moreover, Braithwaite's article makes it clear that in an interconnected world, developing countries can sometimes benefit from institutional links that were formed by developed countries. In addition, Barr shows that sometimes positive institutional growth can occur in developing countries in spite of the weakness of governmental frameworks.

Fourth, there is agreement that the current architecture of globalization can in some ways be improved if it is to work in the interests of development. Thus, Correa points to defects in the BIT network from a developing country perspective. Many discussants at the conference noted the problem of sovereign debt crises and the need for international mechanisms to help resolve these with greater success, with solutions ranging from market adoption of collective action clauses, to an international bankruptcy court, to "dollarization" as a way to minimize currency risk. Similarly, Rittich recommends incorporating broad development issues into the agenda of the global financial institutions.

Finally, there is a general consensus that more financial resources are needed for development, and that official development assistance increases are unlikely to be forthcoming in sufficient amounts, as argued by Bouab, Clunies-Ross, and Avi-Yonah. There is disagreement,

bepress Legal Repository

Hosted by The Berkeley Electronic Press

however, on a range of alternative measures that could be used for additional financing, such as the Tobin Tax (espoused by Clunies-Ross, while Avi-Yonah is skeptical), limits on tax competition to attract FDI (espoused by Avi-Yonah, while Littlewood is skeptical and Hassett opposed), or creative financing through the IMF.

We hope that the conference, and the papers in this issue, will contribute to the debate over how to best promote development in an age of globalization. In our personal view, both the advocates for globalization, and the protestors on the streets of Seattle, ought to share this goal. But how to get there is a rightly contested, and contestable, question.

bepress Legal Repository

http://law.bepress.com/umichlwps-olin/art47