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NOTES FROM THE EDITOR'S DESK

Dear Reader,

The 7th Issue of the *Asian Journal of Public Affairs* presents a range of policy articles for your potential interest.

The commentary in this issue – *Path to Sustainability: From Fair Trade to Fair Development*, focuses on one of the most dynamic and relevant arenas in recent times – social enterprise. Authored by Professor Durreen Shahnaz, the commentary focuses on the role that Fair Trade Organizations play in influencing the social canvass of Asia and the world. It also discusses the significance of critical developments in the field of Social Enterprise (SE) which include the rise of impact investors and the development of a Social Stock Exchange.

The article on *Indonesian Labour Migration* examines the issue of migrant labour from Indonesia in the light of the centuries old tradition of slavery in the Indian Ocean region. It studies the role of non-state actors and addresses the extremely challenging issue of equitable treatment of labour and protection of labour interests through its recommendations.

Food security is one of the most topical issues in the Asian region and a collaboration of sorts between the main players in this sector may not always be the best way forward. This is evident in the paper *'The Cartel of good Intentions? OREC and Food Security in Asia'*.

'US-Japan Missile Defence Cooperation: China's Reaction and Responses' examines the relationship between three powerful nations – the US, Japan and China. The analytical framework studies how the cooperation between Washington and Tokyo impacts policy making in China and addresses a very critical question – Is the rise of a new regional security order in the horizon?

It is argued that investment financed by foreign aid can actually break the 'vicious circle of poverty' that developing nations are caught in and provide a fillip to their growth. *'Is Untying of Aid the only Solution to the Problem of Tied Aid'* uses social cost to examine the issues associated with tied aid and provides innovative solutions for using tied aid to alleviate poverty in developing countries.

In addition to these articles, we have two interesting book reviews. While one focuses on counterinsurgency, the other provides an interesting take on the growing body of research which opposes neoclassical development economics as the guiding force for economic progress.

This note would not be complete without a heartfelt thank you to our contributing authors, for their support and cooperation; our faculty advisors, Prof. Charles Adams and Prof. Darryl Jarvis, and our administrators, Prof. Ora-Orn Poocharoen and Ms. Ruth Choe for their continued guidance and encouragement.

Yours Sincerely,

The AJPA Editorial Board
November 2010

PATH TO SUSTAINABILITY: FROM FAIR TRADE TO FAIR DEVELOPMENT

Durreen Shahnaz

As a Social Entrepreneur, I have been asked to share my thoughts on what role Fair Trade Organizations (FTOs) can play in changing and impacting the social and environmental canvass of Asia and the rest of the world. If we are going to talk about the role of FTO in social and environmental sphere, then we need to talk about the sustainability of FTO themselves in its own operations. In other words, before you go and expand your impact in a country or community we need to take a close look at the health of your organization and what you need to make yourself grow and thus expand your impact. Therefore, I will briefly discuss the sustainability of Social Enterprises (SEs) in Asia, to explore the role of FTOs in this movement.

Social Enterprises in Asia

As we are seeing every day, Asia is uniquely positioned to suffer the great global challenges of the 21st century. Containing 60% of the world's population, its dense populations are vulnerable to economic downturns, social upheaval and environmental degradation.

In response, Asia's SEs (defined as mission driven for-profit or market driven not for profit entities) sector has grown to be as vast and diverse as the individual countries and challenges it spans. Asia has become the incubator of some of the most innovative approaches to these challenges. Asia's SEs sector has grown to be as vast and diverse as the individual countries and challenges it spans. Existing SEs address food security, housing shortages, environmental degradation, failing health care and educational systems, and poor sanitation – within and beyond their respective national boundaries. In increasing numbers, SEs in both the for-profit and not-for-profit sectors are helping to achieve the region's socio-economic goals.

Professor Durreen Shahnaz is the Founder of Impact Investment Exchange and Impact Investment Shujog. She is also Adjunct Associate Professor at Lee Kuan Yew School of Public Policy at National University of Singapore.

However, a large volume of individual activity by itself is not enough. As the Monitor Group states in its recent report: “A great product idea married to a noble mission is rarely enough to make meaningful progress in the face of massive social challenges like improving the lives and livelihoods of billions worldwide living in impoverished conditions.”

This is particularly true in Asia, where there are countless innovative social enterprises making significant impact in their individual communities – but receiving little attention from Asian financial institutions. Investigations in Bangladesh, India, Thailand, and the Philippines, as well as in South Africa, Brazil, Kenya, and other countries, reveal no shortage of market-based approaches that *claim* to be profitable or financially self-sustaining. On closer inspection, however, many are struggling financially and at most serve a few thousand people – a drop in the ocean given the millions living in extreme poverty. Only a tiny fraction of market-based initiatives reach populations commensurate with the scale of the problems they aim to address.

While media frequently covers the achievements of successful and large SEs such as Grameen Bank or BRAC, these entities are the exception rather than the norm. Over the years, a small handful of very large SEs in Asia (of which Grameen Bank and BRAC are a part) were lucky to receive substantial government and donor support. Not all the SEs in Asia are in the same position. Unfortunately most of the SEs neither have the same unlimited access to capital nor have they attracted the same recognition for the impact of their work.

In the universe of Asian SEs, currently there is only a relatively small number of SEs who are able to raise capital in the open market and thus utilize the capital for growth. The remaining SEs need to make improvements in a wide variety of financial, social, sustainability and governance issues before they can raise and utilize capital effectively.

Fair Trade Organizations – the Initial SEs

The Fair Trade movement has its roots in the 1960s social political movement. This movement is in effect the initial torchbearer of the Social Enterprise movement, that brought to global attention the need and ability to marry best operational practices with trade activities.

When market-oriented approaches to social problems were first mooted, there was no capital available for SEs. Entrepreneurs (social or otherwise) either used their own funds or applied for bank loans (requiring collaterals) to start SEs or FTOs. The only other option (one that continues to play a large role) was to receive grants. Grants came from two main sources: foundations and religious

organizations. This was not a sustainable source of funding and this funding was limited to not-for-profit organizations.

Even with these limitations, the fair trade movement flourished. It created opportunities for the economically disadvantaged producers, built in transparency and accountability, paid a fair price, worked on capacity building of the producers, improved working conditions, took into account environmental issues in production practices and forbade child and forced labour.

This made significant contribution to developing second level organizations and increasing the opportunity for growth and product diversification. It also set the standards for such practices as improved food consumption, child mortality and schooling in the production areas and improved social wellbeing through education and skills training.

Fair trade as a movement has also experienced significant sales growth from 2004 to 2009 showing a four fold increase in certified sales to consumers from 832m Euros to 3,400m Euros. This is an average year on year growth of over 30 percent for five years running. Though these achievements are significant, a lot more could be done with proper support and access to capital.

Rise of Impact Investors

A silent movement has been taking shape in the investor community. Over the last five years or so, a group of investors (globally) have come together and are embracing the concept of investing their wealth for more than just financial return. They are interested in triple bottom line return – financial, social and environmental. The market for this group of investors is estimated to be USD \$500 billion. These Impact Investors initially were just focusing on the western market but now they are casting a global net to be involved with the best SEs who are changing the social and environmental landscape of the globe in a sustainable way.

Currently, for Impact Investors interested in Asian SEs, the potential field is vast but daunting. Each investor must carry out his or her own due diligence studies on each potential investee – a lengthy, labour-intensive, and inefficient process. Investors need credible external monitoring, commonly understood standards of quality, access to comparative data and rates of return, and an ability to invest in partnership with others. There is no transparent, accountable and efficient transactional platform that reliably facilitates investments that generate real financial and social returns yet. Further, there is no efficient method by which

investors can gauge whether simple injection of their capital will actually ensure sustainability of an enterprise. This need is exacerbated because most SEs have never raised capital from funding sources other than from donor agencies and thus lack the know-how or ability to make their enterprises market ready to raise commercial capital in a structured way from private or public sources.

In a recent round table of Socially Responsible fund managers in the UK, it was noted that SEs are missing out on millions of dollars because they do not have the proper structures in place to receive investment. According to meeting reports, fund managers wanted to put more money into high-impact investments, but were often unable to do so because potential investees lacked corporate governance and legal structures that facilitated investment, and effective mechanisms to measure the value they created. Even though social enterprises in the UK have gained momentum with the establishment of the UK Third Sector ministry, a ministry dedicated to building the social enterprise sector, these systemic challenges endure. Elsewhere in the world, and especially in Asia, where social enterprises are burgeoning without government support, the need for sector-wide capacity building is even more pronounced.

In order to capitalize on the growing interest and supply of impact investment capital, SEs urgently need to strengthen their operational, managerial, fiscal, and strategic processes – spanning the wide spectrum of internal financial systems, human resources, leadership, governance, social outcomes measurement and accountability, strategic planning, decision-making, and communications. The sector as a whole needs to adapt and apply contemporary private sector and organizational development practices to build up accountability, which will enable SEs to access these new funding sources and grow to scale.

Creating a Social Stock Exchange

Having created, run and sold oneNest, a SE connecting the artisans over the world to markets ensuring fair prices for their work, I was faced with the daunting task of raising funds for this venture. This struggle made me realize the need to connect social entrepreneurs to fund raising platforms. The opportunity for me to do something on a larger scale with more impact came to me when I moved to Asia and started teaching at the National University of Singapore. On the side, I also began writing about the need for a social capital market space. My words struck a cord with many and I received endorsement and support for my work initially from the Rockefeller Foundation and then the Singapore Government and Asian Development Bank.

There was a need to connect the growing number of Impact Investors to support the work of Social Enterprises and assist them in growing their impact. Thus, the

Impact Investment Exchange (IIX), a social stock exchange for SEs in Asia, was founded. I was audacious enough to think that we can make investors care about more than just a financial return for their investment. And we did. IIX has been receiving resounding support from the financial sector and the public in creating this exchange, which will in essence assist SEs to increase their social impact and in effect assist millions of women and disadvantaged across the globe.

IIX will be Asia's first social stock exchange, providing a trading platform and an efficient capital raising mechanism for Asian Social Enterprises (SEs), including both for-profit and not-for-profit entities with a social mission. IIX will connect these SEs with Impact Investors seeking to achieve both a social return and an economic return on their investment while providing capital to fund innovative social businesses.

As the building blocks of IIX were being put together, we quickly realized the need to get SEs ready for the investors. Thus, the sister entity of IIX called Impact Investment Shujog was created. Shujog is a Bengali word for opportunity. Shujog was created to give opportunity to the SEs to join the capital markets to raise capital.

Shujog fosters growth, maturity, innovation and market readiness in the SEs and impact investment sectors in Asia, which have the potential to address urgent social needs and environmental problems in the region. Through research, training, workshops, advocacy, strategic consulting and third party technical expertise, Shujog fosters the social enterprise ecosystem and provides SEs with the knowledge and systems required to raise commercial capital in order to magnify their social and environmental impact.

FTOs have an important role to play in continuing to bring about this positive social change to Asia and more importantly, it is about time capital markets worked with SEs and provided the capital to expand their work. Social Entrepreneurs have the power to change the world for the better – as a business owner; as a change maker; as one who influences government policy; as a leader and as an example. Entrepreneurship is the key to the future of Asia and we need to back the entities that support these entrepreneurs

INDONESIAN LABOUR MIGRATION: LINKING CONTEMPORARY EXPLOITATION WITH HISTORICAL TRENDS

Andrew S. Billo¹

Abstract

This article examines the contemporary exploitation of Indonesian labour migrants by drawing comparisons with the centuries-old institution of slavery¹ in the Indian Ocean region. Slavery, which represented the first form of international labour movement for purposes of filling work shortages, shares a number of commonalities with the recruitment and working conditions faced by Indonesian labour migrants today. In particular, the role of non-state actors, both historically and at present, was and is significant in facilitating international movements of labour, while the state's role has been mostly limited to maintenance of territorial boundaries. The article argues that because slavery was entrenched within Indonesian society and controlled by a variety of actors for centuries, eliminating the exploitation of labour migrants today is especially challenging. Systems of recruitment developed during the period of slavery are maintained and lead to the circumvention of official labour migration policies. Similarly, the degree to which modern day labour migrants face exploitation varies, making identification of exploitative situations challenging. For example, historically, some Indonesians were enslaved for only a brief period before being released to paid employment. Likewise, many labour migrants in contemporary Indonesia face debt-bondage situations akin to slavery, before having the opportunity to earn an income. To eliminate migrant exploitation, the article argues in favour of multilateral solutions that establish internationally agreed upon norms for their protection. While Indonesia's eventual ratification of international conventions for protecting migrant workers will be important for establishing its own obligations under international law, it will be without consequence if migrant-receiving states do not ratify accordingly. Thus, the article suggests the use of multilateral mechanisms for encouraging the adoption of labour migration standards that respect the rights of labour migrants.

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² The United Nations Slavery Convention defines "slavery" as "the status or condition of a person over whom any or all of the powers attaching to the right of ownership are exercised."

Introduction

The outflow of labour migrants from Indonesia is significant. International Labour Organisation (ILO) research indicates that 4.3 million labour migrants, out of Indonesia's total population of 227 million (World Bank 2010), were working overseas in 2009, with an additional 700,000 labour migrants leaving each year. (ILO 2010) Importantly, the ILO believes the actual number of Indonesians working overseas may be two to four times higher than the official estimates. Of the total number of labour migrants, women represent more than 75 percent. Remittances constitute an important part of the Indonesian economy: more than US\$ 6 billion were remitted to Indonesia in 2007 and the corresponding figure for 2008 was more than US\$ 8 billion. (Ibid)

While the government of Indonesia attempts to regulate international migration, mainly through licensing recruitment agencies and issuing passports, informal systems appear to dominate the labour recruitment process. The "patron-client" system³ is one such mechanism for facilitating international labour migration from Indonesia. (Scott 1972, 92)

However, because of the Indonesian government's failure to successfully offer protection to migrants, numerous organisations have raised concerns over the treatment of Indonesia's overseas workers, and the situation in which they are recruited, both in government and non-government channels. Reports indicate that in some instances, Indonesian labour migrants have found themselves working in slave-like conditions. (Human Rights Watch 2004; Amnesty International 2010)

Three main laws exist in Indonesia with the purpose of regulating labour migration. The first, Law Number 39/2004, addresses the placement and protection of migrant workers. The second and third, Presidential Instructions Numbers 6 and 81 of 2006, authorises the creation of a Government-organised labour recruitment agency, the Ministry of Manpower and Transmigration, which is now a national agency. While the Government's initiative to protect labour migrants is important, the ILO reports that labour migrants from Indonesia "...are exposed to institutionalised trafficking and forced labour practices throughout the entire migration cycle". (ILO 2010)

Therefore, to answer the question of why the contemporary Indonesian state has failed to develop policies that sufficiently regulate labour migration (to protect

³ Defined as "an informal cluster consisting of a power figure who is in a position to give security, inducements, or both, and his personal followers who, in return for such benefits, contribute their loyalty and personal assistance to the patron's designs." (Scott 1972, 92)

labour migrants), it is important to consider the historical institution of slavery in the Indian Ocean region, as it constituted the first form of organised migration for purposes of filling labour shortages in the region. The degree of freedom that slaves were permitted varied, as did the individuals and entities involved with recruitment: slaves, having been recruited by merchants, private companies, or other societal actors, worked to gather products, extract resources or operate merchant vessels, and were exploited in varying degrees via pre-capitalist social relationships. The state was mostly absent in controlling labour migration during the seventeenth and eighteenth centuries. (Goss and Lindquist 2000)

The increased territorial sovereignty of states in nineteenth and twentieth century Southeast Asia created tighter border restrictions and greater demand for labour, as workers were unable to flow freely between source and destination countries as had occurred in the past. (Ibid) These restrictions further necessitated the creation of informal networks for facilitating the trade of labour from one state to another. The degree to which labourers paid fees for this service varied, as did the degree to which labourers were obligated to work for employers at the destination. However, some research indicates that state policies designed to control migration were easily circumvented with the assistance of brokers and middlemen. (Spaan 1994; Sim and Wee 2009)

While slavery as a formal institution in Indonesia was abolished in the early nineteenth century, it continued to manifest itself in the period of indenture from approximately 1830s until 1940s. Moreover, many labour migrants today continue to work in exploitative situations no different, or worse, than those faced by many slaves. (Surtees 2003) In spite of the development of more formal guest worker programs in the second half of the twentieth century, the Indonesian state's control over the labour migration process continues to be limited, in part because of the value of remittances channelled back to the country from labour migrants working abroad. (Goss and Lindquist 2000) Increased state involvement would likely be in the form of increased regulation, thus complicating procedures for labour migrants. (Silvey 2004)

In order to understand the contemporary labour migration system in Indonesia, the article first addresses the historical roots of migration in the Indian Ocean region, commencing with slavery. The article argues that the legacy of slavery, and subsequently indentured work, is perpetuated in exploitative situations currently faced by labour migrants in Indonesia. Further, the paper goes on to argue that the informal networks which historically facilitated and condoned exploitation of migrant workers are maintained in contemporary Indonesian society. As a result of the dominance of informal networks, the Indonesian government has only been able to assert itself with limited authority in the labour migration process. Increasingly liberal governance and the development of

international human rights norms in the latter half of the twentieth century have outpaced attempts by the Indonesian state to protect labour migrants under international law. Perhaps to avoid criticism from the international community for its lack of action against what is an exploitative process, the Indonesian state appears to detach itself from the process altogether. The labour migration process is therefore controlled by private businesses and localised patron-client relationships at the village level, which fall beyond the scope of central government and international-community mandated legal obligations. Finally, the article concludes with suggestions as to how systems that perpetuated exploitative labour migration for centuries could now be eliminated through more effective governance, both in Indonesia, the ASEAN region, and globally.

Parallels between Past and Present

Slavery, as an institution, existed throughout the Indian Ocean region for centuries and operated within Indonesia until the end of Dutch occupation in 1940. (Boomgaard 2003) Slavery serves as the foundation for low-skilled, international labour migration: slaves were moved, traded, and controlled from East Africa to Southeast Asia to fill various labour needs. (Goss and Lindquist 2000) Limited literature exists with regard to the specific origins of the slave trade in Southeast Asia (Allen 2009), but it has been termed “the world’s oldest trade” in colonial literature on the Dutch East Indies. (Vink 2003) Slavery in the Indian Ocean region was an institution with a set of “special characteristics,” which included, “...property or chattel status and the ensuing potential of re-isolation, institutionalised coercion and systematic exploitation, outsider status or essential kinlessness defined as ‘social death,’ and lack of control over physical reproduction and sexuality...” (Ibid, 136)

The fact that slave trading in the Indian Ocean region has not received the same level of attention as its Atlantic Ocean counterpart has a bearing on the way we see exploitation of Indonesian labour migrants today. In the Indian Ocean region, the slave trade existed before European colonisers arrived, and continued after they left, whereas the Atlantic slave trade was an external institution imposed by European states in Africa. (Ibid) Ending the Atlantic Ocean slave trade, while challenging, was possible based on “a remarkable transformation in moral and political sensibilities” within European states. (Mason 2009, 810) British diplomats in particular worked with their counterparts in Europe to come to agreement regarding abolition, realising that “British abstention from the commerce would not help many Africans if other nations continued it”. (Ibid, 811) The Indian Ocean slave trade, however, was deeply entrenched in native societies, and as a consequence, in spite of efforts by the British in particular to end the trade in slaves globally, they were mostly powerless to do so in Asia.

Currently, the exploitation of labour migrants in the Indian Ocean region is difficult to combat because of the diversity and fragmentation of actors involved, from private entities to governments. Historically, the diversity of groups moving slaves in the Indian Ocean region meant that slavery was under-reported in official records. Colonising powers retained records in Europe, or in different commercial centres around the Indian Ocean region, but there was no central repository. The extent of the slave trade in the region was therefore comparatively less well known. (Vink 2003; Allen 2009) Allen (2009, 877) writes, “As those who study slavery in the Indian Ocean world know only too well, a major obstacle to reconstructing the history of the slave trading in this region is the relative dearth of archival materials...”

Unlike the Atlantic slave trade, which was controlled by European states, native populations for centuries controlled Indian Ocean slavery. Slavery in the Indian Ocean “focused on the household” and was considered “paternalistic” and therefore relatively benign. (Vink 2003) Slavery was described more as “coerced labour” and studies conducted by colonisers at the time, which focused on political economy, largely ignored Indian Ocean slavery, as it could not be quantified in financial terms. (Ibid) Exploitation found in contemporary labour migration in Indonesia could also be considered “benign” by those entities controlling the process: the paternalistic relationship between labour migrant and recruiter makes exploitation more challenging to pinpoint, as does the reliance of labour migrants on different actors responsible for facilitating their migration. Situations that may begin as exploitative (passports and salaries withheld) may eventually yield profit for the migrant as debt is paid off and the employer grants greater autonomy.

In considering different flows of labour migrants from Indonesia, the slave trade was also important in establishing bonds between different societies across the Indian Ocean region that remain today. (Vink 2003) cites four forces that created links across the region: Islam from the Middle East, Chinese civilisation and political power, nomads from Central Asia, and European expansion by sea. Again, the state was not the only force in establishing these links. As he writes, the “Dutch Indian Ocean slave trade precisely involved, among others, the movement of peoples, cultural diffusion, and economic exchange during the later stages of the Indian Ocean *ancien régime*”. (Ibid) *Batavia* (present day Jakarta, and formerly a Chinese colonial city) became a trade hub, to which the Dutch colonisers drew slaves from East Africa, South Asia, and Southeast Asia. In the late seventeenth century, slaves accounted for half of the city’s population. (Ibid) Therefore, in addition to networks being established by a variety of state and non-state actors, slaves themselves became an indispensable component of the Indonesian labour force.

The way in which slaves were controlled also has parallels with the control of labour migrants today. Southeast Asian legal codes generally “acknowledge five paths by which a person could enter a state of bondage: inheriting the bondage of one’s parents; sale into bondage by parents, husband, or oneself; capture in war or raids; judicial punishment (or inability to pay fines); and, most importantly, failure to meet debts”. (Ibid) The Dutch, upon colonisation, perpetuated slavery through their own Protestant beliefs, which argued slavery as preferable to execution of enemy soldiers, as well as ad-hoc arguments favouring the need to settle uncivilised peoples and the need to populate its colonies. (Ibid) The pressure on would-be migrants in contemporary Indonesian society is similar. Poor families see migration as a “survival strategy,” and in this instance, would-be migrants become vulnerable to exploitation and human trafficking. (Surtees 2003)

During the period of slavery, disasters often influenced one another in pairs. For example, a volcanic eruption would ruin a harvest and suffering from famine, Indonesians were then recruited as slaves. (Boomgaard 2003) Today, natural disasters also lead to increased vulnerability to exploitative labour. A cursory examination of the activities of most humanitarian agencies reveals a lengthy list of disasters that have inundated Indonesia’s sovereign territory in recent years. Recovering from such disasters is challenging and securing employment abroad may represent the only opportunity for wage labour.

The majority of slaves in the Indonesian archipelago during the nineteenth century served in a domestic capacity working for “company officials, burghers, and Asian subjects in areas under Dutch jurisdiction,” for example as cooks, maids, concubines, or musicians. (Vink 2003, 160) Some slaves worked in agriculture, while others were fishermen and sailors. Those that were criminals performed hard labour. (Boomgaard 2003) Women were more often employed as housemaids, while men were more often involved with fieldwork. (Vink 2003) Labour migration in contemporary Indonesia has conformed to the same gendered patterns of men performing “dirty and hard work” outside, and women being responsible for “light and modern” indoor work: “Engagement in agricultural labour is taboo for young, unmarried women...while factory work is now regarded as a key rite of passage. (Elmhirst 2007)

Slave rebellions seldom ever took place. However, slaves did show their unhappiness with their treatment through “everyday forms of resistance,” such as doing minimal work. (Vink 2003) On occasion, slaves would run away, but in general the power of slave owners was too great and ensured the absence of large-scale revolt. The way in which labour migrants in Indonesia are controlled is not dissimilar, as, for example, domestic workers have their movements

restricted from the time they enter training centres until the time they finish their employment contracts in the destination countries and return to Indonesia. (Rudnyckyj 2004) In spite of isolated incidents of migrant labourers fighting back against exploitation, the power of the actors controlling the contemporary labour migration system prevents large-scale uprisings.

A final notable comparison with regard to slavery and contemporary labour migration in Indonesia is that of open and closed systems of slavery. The “open system” was typically found in urban areas and allowed for a slave’s upward mobility. In the “closed system,” slaves were unable to emerge from their status because of the stigma attached to slavery. (Vink 2003) Both a closed and open system of work exist in current labour migration trends: some labour migrants, in an “open system,” effectively work under exploitative conditions, or at least conditions that violate internationally established human rights norms. (Amnesty International 2010; Surtees 2003) The salary they earn may be sufficient to create business or agricultural opportunities in Indonesia, or to send a sibling to school. (Silvey and Elmhirst 2003) Other labour migrants, in a “closed system,” may face outright enslavement, and the stigma associated with those conditions may make re-entering domestic labour markets nearly impossible without proper return and reintegration assistance. (United Nations Office on Drugs and Crime 2006)

Thus, exploitation, human trafficking, and indeed enslavement of labour migrants from Indonesia today (Amnesty International 2010; Surtees 2003) should not be viewed simply as a contemporary phenomenon but rather as a derivative of a system of slavery that is centuries old. One reason why the Indonesian state today has been ineffective in protecting labour migrants from entering exploitative situations comparable to the historic closed systems of slavery is in part because of the diverse set of actors that control the labour migration system. The fact that labour migration today is not managed by a single entity, and indeed is largely controlled by non-state actors, is the most important vestige of slavery.

From the Age of Indenture towards Contemporary Labour Migration

The industrial revolution in Europe during the nineteenth century increased the demand for natural resources from the Southeast Asian region. (Crump 2006) To meet these demands, labourers were moved around the region by merchants from 1830 until 1940, in what was known as the age of indenture. (Goss and Lindquist 2000)

It was in this period where British and German merchants recruited and transported indentured workers from densely populated subsistence economies

in South and Southeast Asia to meet the demands for labour supply in sugar plantations and mines in the Pacific islands. What was, "...common to all of the migration flows was the development of recruitment systems that incorporated existing social networks into new institutions, often promoted and regulated by governments." (Goss and Lindquist 2000, 391) Where previously government's role in controlling the slave trade was no more significant than other societal entities at best, a system of limited government control over existing networks of persons being traded across the region was developed. In spite of increased governmental recognition of human mobility, which resulted from an increased awareness of issues of territorial sovereignty, government remained only secondary to existing networks in promoting labour migration. In fact, attempts by the government of the Dutch East Indies at the time to increase regulation, further promoted a role of societal actors who became increasingly important in facilitated circumvention of government regulations. (Goss and Lindquist 2000)

During the period two systems of recruitment were developed in the Indian Ocean and East Asian regions which remain today - one in South Asia was known as *kangani*⁴ and the other system was that of the "credit-ticket," whereby migrant labourers, particularly from China, travelled independently having received travel loans from commercial lenders or kin. (Goss and Lindquist 2000) Both systems mirror the informal networks in contemporary labour migration trends existing beyond the scope of government today. In the case of *kangani*, labourers, rather than governments, fulfilled the role of recruiter, with support of their employers. In the case of credit-ticket, private business saw the value of exporting labour and the chance to profit, which was not capitalised upon by the state. The effectiveness of both systems of recruitment evidence how the state's intervention was not needed to further facilitate recruitment of indentured labourers, as is perpetuated in contemporary labour migration systems.

Government regulations with regard to migration were further circumvented in the annual migration of Muslim pilgrims for hajj, a movement that was restricted by Dutch colonisers in Indonesia in the mid-nineteenth century. At that time, pilgrims used brokers, often sheikhs, to facilitate their passage via Singapore, where the Dutch East Indies government lacked jurisdiction to regulate their travel. The brokers, or sheikhs, had often worked temporarily in Mecca and then returned to East Asia, and thus employed a similar tactic to *kangani* of recruiting other brokers within the ranks of hajj pilgrims. In some instances pilgrims would return from hajj in debt and in this case the pilgrim would be forced to work in Singapore or Malaysia as bonded labour. (Spaan 1994)

⁴ The *kangani* system established networks whereby migrant labourers were allowed to return home with the purpose of recruiting other labourers

While the state was limited or even absent in the recruitment of indentured workers and the development of systems that facilitated their migration (or afforded indentured workers protection), it did have an important role in creating the need for international labour migration altogether, "...which can only occur across international boundaries..." (Goss and Lindquist 2000, 400) That is, as states in Southeast Asia became increasingly nationalistic and defined by territorial boundaries during the twentieth century, the states unwittingly created a need for an organised process to navigate international travel. Where indentured workers were once easily recruited and transported between states without interference, governments' increasing scrutiny, both in sending and receiving territories, created a stronger market for service providers ready to step-in to fulfil a variety of roles in facilitating the international labour migration process. (Goss and Lindquist 2000)

After the 1940s, and the official abolition of slavery in the Indian Ocean region, guest worker or contract labour programs, both of which constitute the most common form of labour migration in Indonesia today, formally replaced indentured work. These programs developed as a result of economic inequalities, but also along racial, ethnic, religious, and cultural lines in the second half of the twentieth century, as well as for reasons resulting from increased state sovereignty as stated above. "Recruitment originally followed long-established social networks," with government participation only increasing upon the realisation of the potential for commercial gains, as well as to increase political control. (Goss and Lindquist 2000, 393) An example of how the government capitalises directly on the profits of returning labour migrants may be seen at the primary port of entry, Jakarta's Soekarno-Hatta International Airport. By processing labour migrants separately, "...they are forced to relinquish parts or all of their earnings to immigration officials..." (Surtees 2003, 101) In this way, officials circumvent the government's own legal framework.

In recent labour migration trends, 35 percent of Indonesian labour migrants end up in the Middle East. (Sim and Wee 2009) Both Saudi Arabia, the top destination for Indonesian labour migrants (Sukamdi 2008), and Indonesia have viewed labour migration through the lens of economic policy and promoting economic development in both countries. Since actively encouraging labour migration between Indonesia and Saudi Arabia in the 1980s, the Indonesian state benefited from lax enforcement with regard to the treatment of workers, as Saudi Arabia was willing to accept more workers, which in turn, meant a greater volume of funds remitted to Indonesia. (Silvey 2004)

Throughout the Gulf region, Asian labour migrants are known as "reliable and cheap and, unlike other Arab nationals who might invoke ethnicity to support demands for better treatment and are more likely to migrate with families, they

are clearly temporary aliens unlikely to challenge the authority and monopoly of wealth enjoyed by the ruling elites..." (Goss and Lindquist 2000, 393) In a similar way, during the period of indenture the recruitment of Javanese was preferred over Chinese or Indians because they were seen as more likely to accept the temporariness of their assignment. Today, Southeast Asian migrants are largely recruited to fulfil labour shortages in wealthier Arab states because they are perceived to be more deferential. (Ibid)

Similar conditions for labour migrants exist within migrant receiving states in East Asian, such as Malaysia, Singapore, Taiwan, Macau, and Hong Kong. (China) Deliberate, poor enforcement in some receiving states encourages migrants to overstay their visas in order to ensure the existence of a population to fulfil the needs of the low-wage sectors of the economy. (Ibid) In Malaysia, there are 563,000 Indonesian migrant labourers on legal contracts primarily operating in the construction, domestic, and plantation industries, while an additional 700,000 are thought to be in the country illegally. (Goss and Lindquist 2000; Sukamdi 2008) In spite of reported abuses of Indonesian migrants in Malaysia, enforcement of cross-border migration is challenging and there is little incentive for the Indonesian government to intervene at the risk of jeopardizing bilateral relations and billions of dollars in annual remittances.

The Dominance of Non-State Actors in Contemporary Labour Migration

Goss and Lindquist contend that globally, the role of the state in the labour migration process is to perpetuate dependency, as seen in the way the state extracts revenue through bureaucratic processes and creates expectations for employment outside of the homeland. (Goss and Lindquist 2000) This appears to be the case in Indonesia, where the process involves "numerous agents and institutions". (Goss and Lindquist 2000) Numerous labour migrants are able to navigate complex and costly migration processes only through the use of patron-client associations.

Patron-client associations, often discussed in the context of Southeast Asian political systems at-large, are also relevant to understanding relationships between the labourer (client) and recruiter (patron) in the migration process. Where some states, the Philippines for example, may offer support and training services to labour migrants in order to better prepare them for the migration process, the Indonesian state's de facto role with regard to labour migration is the maintenance of territorial boundaries and the creation of bureaucratic structures, which as discussed earlier, create a demand for agents that facilitate the flow of labour migrants into destination markets, as well as opportunities for

government officers to profit through corrupt practices. (Surtees 2003) It also creates a role for recruitment agencies, rather than government, in providing training. Training takes place in holding centres operated by the employment agencies, where migrants learn skills that will assist them in performing their work at the destination, but do not necessarily receive information vital for protecting their rights at the destination. Migrants may stay in these centres for several months, and while there, are typically not allowed to leave, except at established times. (Surtees 2003)

The Indonesian government's bureaucratic procedures, which in theory are meant to regularise the labour migration process, may actually complicate the process further to necessitate the role of brokers, or *calos*, to act as intermediaries between the patron and client. *Calos* are involved in almost every stage of the recruitment process and are typically known personally to the labour migrants themselves. Labour migrants borrow at high rates of interest to pay a fee to the *calo* for services rendered, the amount varying depending upon the preferred destination country. The *calo* then puts the prospective migrant in touch with employment agencies, some registered and some not, to formalise the recruitment. (Spaan 1994)

Within Southeast Asian patron-client relations, the client submits him or herself to servitude, with the expectation that the patron will provide support to the client in the event of hardship or exploitation. In the case of Indonesia, this patron is typically a respected community member, often a village head, religious leader, or businessman: "patron-client networks in some cases actually enable transnational economic relations in so far as they serve as a critical means through which rural Indonesian women gain access to a transnational domestic labour market". (Rudnyckj 2004)

Scott (1972) further describes the Southeast Asian "patron-client" model of association as a "dyadic relationship," whereby both patron and client benefit from protection, provided by the patron, and service, provided by the client. Scott agrees that the role of *calos* is a critical component in the labour migration process. The *calos*, in his role as intermediary, is not necessarily of a different status than either the patron or client. In this context, the *calos* "...does not himself control the thing being transferred". (Ibid, 95) This distinction is important in consideration of the networks involved in the recruitment of labour migrants, as the *calos* simply acts to bridge the desires of both parties. With that objective accomplished, and some personal benefit acquired as a result of the transaction, the welfare of the client may be of little concern. The patron, by virtue of not dealing directly with the client, also relinquishes responsibility in the event of exploitation. In the case of Indonesia, there may be several *calos* involved in the process, thereby further distancing patron and client from direct

contact, and absolving the patron of responsibility.

Scott maintains that informal power groups, not the state, create systems whereby loyalty is attained through offers of security. This structure is “useful in penetrating behind the often misleading formal arrangements in small local communities where interpersonal power relations are salient”. (Scott 1972) He writes that in the modern Southeast Asian state, these structures undermine state authority and are as important as national institutions themselves. In some instances the patron-client relationship exists within formal state institutions, although are well disguised in that circumstance. (Scott 1972) Trust is built with the informal system, rather than with government processes.

As in the case of many patron-client relationships in Indonesia, the distinction between “legal and illegal recruitment and deployment is blurred.” (Surtees 2003, 101) Surtees writes that even legally registered labour recruitment agencies use illegal practices, such as providing clients with false documents. She describes a common situation where Indonesian domestic workers travelling to Malaysia for several months, are unknowingly issued one-month visas, which they overstay, and then face deportation penalties when trying to leave. The migrant’s irregular status leaves her further vulnerable to exploitation, as she is unable to seek assistance from authorities due to her irregular status. (Ibid)

It is argued that the Indonesian state should do more to protect labour migrants through improved enforcement and regulation of migration procedures. In better regulating the migration process, particularly by ensuring accountability and transparency, instances of exploitation could be reduced and remittances could be better tracked, thus generating more regular and transparent sources of revenue for the state. It is likely that more transparent regulation does not occur because the market for generally low-skilled Indonesian migrant labour is elastic: enforcement of regulations would make Indonesian labour migrants more expensive as compared to regional competitors, and although stricter enforcement may result in wages for Indonesian labour migrants being higher, the total number of migrants recruited from Indonesia would be lower. (Abella 1984)

Thus, for the Indonesian state, there is little financial incentive to implement restrictive labour migration policies, and indeed, while better regulations would help ensure better working conditions for migrant labour, the state does not profit from increased restrictions. Furthermore, perhaps as a result of path dependency, it is difficult for the state to change the structure dominated by non-state actors, who derive their power from centuries-old practices.

Finally, in consideration of contemporary labour migration trends, the fact that

labour migrants themselves have devised ways to manipulate the system to their advantage should not be neglected. Most returned labour migrants in Indonesia report that in spite of harsh employment conditions, they would prefer to migrate again. (Rudnyckyj 2004) In order to do so, Indonesian labour migrants have sought “alternative routes to continuing with overseas employment after their contracts end”. (Sim and Wee 2009) Indonesian labour migrants see the Indonesian government, to the extent it is involved in the labour migration process, as an adversary, rather than as a provider, and thus circumvent the government’s regulations. The unofficial status of these workers may lead to increased vulnerability to exploitation.

Working towards the Equitable Treatment of Indonesia’s Labour Migrants

In light of frequently documented instances of Indonesian labour migrant exploitation, similar to the centuries-old institution of slavery and indentured work in the Indian Ocean region, what policies might be put forward to protect labour migrants’ rights? Because exploitative systems facilitating migration for the purposes of filling labour shortages are a deeply entrenched phenomenon in the region, they are challenging to alter. Still, change is possible, and the implementation of new laws governing labour migration in the last decade is a positive step. In order for those policies to be effective, further steps should be taken:

1. **Develop multilateral and regional agreements in cooperation with labour receiving states and neighbours**

When British diplomats moved to abolish the slave trade in the late eighteenth century, they recognised they would need to act multilaterally with the support of their Spanish, Portuguese, and French counterparts for the abolition to be effective. Similarly, migration policies are most effective when they are implemented in cooperation with several governments, rather than unilaterally or even bilaterally. If Indonesia demands that labour-receiving states uphold the rights of its labour migrants abroad, it runs the risk of losing its share in the labour export market to regional competitors in Southeast Asia such as Thailand, Vietnam, or Cambodia, all of which may be willing to export labour with fewer conditions.

In that regard, the Bali Process, which was setup by states in the Asia-Pacific region as a multilateral mechanism for combating irregular migration, could be expanded to protect the rights of migrants travelling via regular channels. In order for the Bali Process to be most effective, it would need to be legally binding, with participation of key migrant-

receiving states in the Gulf Region is particularly critical. In its current form, the Bali Process is a non-binding grouping and no Gulf States participate.

Alternatively, a regional, binding agreement between labour sending countries could be setup under the auspices of the Association of Southeast Asian Nations (ASEAN). As a result of the contributions of labour migrants from the Southeast Asian region being well recognised by receiving countries, ASEAN could leverage the value of those workers to collectively bargain for more adequate protections at the destination.

2. **Ratify the Convention on the Protection of the Rights of All Migrant Workers and Members of their Families**

Indonesia has stated publically that it intends to ratify the convention before 2011. (Rachman 2009) Currently Indonesia is a signatory to the convention, but ratification would hold the Indonesian state legally accountable for human rights abuses suffered by its migrant workers. The signing of the convention is indication that the Indonesian government is aware of the abuses suffered by its migrants and is concerned enough to take steps toward ensuring their legal protection.

Still, in order for ratification to occur, it is imperative that the Indonesian state first takes action to ensure the transparency of all stages of the labour migration process. Greater involvement on the part of the Ministry of Manpower and Transmigration to provide accurate information on the migration process to labour migrants would be helpful in establishing trust.

The migrant workers convention applies to all stages of the migration process, including departure and return. By taking responsibility for its own nationals through ratification of the convention, Indonesia would signal to receiving states, which rely on Indonesian labour migrants to support their economies, that it takes allegations of abuse and exploitation of Indonesian nationals seriously.

Still, as with the development of multilateral or regional agreements for the protection of migrant workers from Southeast Asia as a whole, ratification is unlikely to occur until Indonesia's regional neighbours also become party to the convention. More stringent recruitment standards for Indonesian labour migrants would likely mean higher costs, both for recruiters and employers in destination countries. Thus working

regionally and multilaterally to reach agreement with regard to standards on the export of migrant labour is likely an important first step to ratifying the Migrant Workers Convention.

3. **Hold private sector recruiters accountable and conduct mandatory pre-departure orientations (PDO)**

Given the importance of non-state actors in Indonesian labour migration processes, their adherence to national and international standards for the protection of labour migrants is imperative. The Indonesian state should take steps to ensure that the labour recruitment process is transparent, particularly the payment of recruitment fees. Recruitment fees should be set at a level that ensures significant debt is not accrued by migrants. Recruitment companies must be held accountable for exploitation, whether at the pre-departure stage, at the destination, or upon return. The Indonesian state should set up a transparent complaints procedure through which they may evaluate reported cases of abuse. Such a procedure would be in line with the recently established Corruption Eradication Commission, which is described as taking “a tough approach”. (Transparency International, 2009) Payments to migrants should be made transparently via electronic wire transfer to ensure wages meet minimum requirements established by law.

Related to the establishment of an effective complaints procedure, mandatory pre-departure orientation sessions for every migrant worker should be implemented by government to advise labour migrants of their rights and responsibilities. Such PDO training would need to take into account the specific needs of the target beneficiaries, in terms of prior education attained and literacy. The Philippines conducts mandatory PDO classes for all departing labour migrants and provides a useful model for Indonesia to adopt.

Such programmes would establish a level of comfort between migrants and the state authorities, thus building confidence in the state’s capacity to intervene in cases of misconduct or exploitation brought to its attention.

4. **View labour migration as a short-term, rather than long-term, development strategy**

By emphasizing labour migration, Indonesia risks becoming a MIRAB society “where *m*igration generates *r*emittances, and *a*id finances local *b*ureaucracy to provide most sources of income and employment”. (Goss and Lindquist 2000, 398) Remittances from labour migrants may benefit sending countries, but mostly in terms of individual households; the

extent of their contribution to a sending country's overall development is less clear. For example, in the Philippines, where remittances accounted on average for 5.3 percent of gross national product during the period of 1990 through 1999 (Quisumbing and McNiven 2010), the extent to which remittances have contributed to the country's overall development is unknown. What is known is that remittances create inequalities between households sending labour migrants abroad, and those that do not. (Semyonov and Gorodzeisky 2008) Those inequalities may lead individuals from poorer, non-migrant households to make risky migration decisions in order to compete with relatively wealthy migrant household neighbours.

Emphasising labour migration as a development strategy has further social consequences for sending communities, including gender imbalances and a drain of persons with technical expertise. In the Philippines, communities absorb additional costs of migration, including the psychological effects of a mother or father living abroad, supporting migrants in pursuing training and during periods of joblessness, and a loss of capacity to maintain traditional forms of employment such as agriculture. (Quisumbing and McNiven 2010) There is also an overreliance on the strength of receiving-country economies to support foreign migrants.

Conclusion

The historical origins of the slave trade in the Indian Ocean region have directly influenced the labour migration system found in Indonesia today by creating networks across the Indian Ocean region, particularly between Dutch-controlled *Batavia*, South Asia, and Arabia. The diverse nature of persons engaging in the trade whether private or public meant that there was no system of government control over the process. The way in which people were held in captivity also varied: The "open system," allowed for some social mobility between the slave classes and for some degree of upward mobility while in the "closed system," mobility between classes was not possible.

The impact of open and closed systems is apparent in contemporary labour migration patterns, which represent an amalgamation of state rules, circumvented by private individuals, corporations, and other societal actors actually responsible for controlling the labour migration process. One implication of this fragmented system is that labour migrants find themselves working in situations akin to the closed system, and the stigma associated with such slavery makes re-entry into Indonesian society particularly challenging. For example,

labour migrants who find themselves physically, verbally, or sexually abused will likely face discrimination within their communities upon return to Indonesia. Labour migrants, who have wages withheld, may find themselves unable to repay debts owed to brokers for facilitating the migration process, and are therefore vulnerable to further exploitation.

It appears that improvements have not been made with regard to the protection of migrant workers because the state has been able to shield itself from criticism as a result of the dominance of individuals and private entities in controlling the labour migration process. In short, Indonesia's labour migration system is complex and therefore difficult to regulate. The historical legacy of non-state entity involvement in the labour migration process will be challenging to transform. It may be that without an increased sense of moral and ethical responsibility on the part of the Indonesian government towards the wellbeing of its nationals abroad that strategies focused on economic growth will trump strategies based on human rights. It is likely that change will not be achieved without the participation of other Southeast Asian states as well and a commitment on the part of migrant-receiving governments for the improved treatment of foreign workers.

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THE CARTEL OF GOOD INTENTIONS?

OREC AND FOOD SECURITY IN ASIA

Matthew Brummer¹

Abstract

This paper examines the issue of food security in Asia as it relates to the production, consumption and trade of rice. The Organisation of Rice Exporting Countries (OREC) is used as a foundation from which to assess the potential economic and political implications of the rice price-fixing regime forming in South East Asia. While the case is made that theoretically OREC has the potential to serve as a value producing mechanism for the greater good, assuming realistic conditions, this paper recommends against the formation of OREC as a cartel.

Three recommendations aimed at alleviating rice market asymmetries are offered in lieu of OREC as a supply management regime. These are: (1) OREC as a rice traders' association under the auspices of the existing body the Ayeyawady – Chao Praya – Mekong Economic Cooperation Strategy (ACMECS); (2) the formation of an OREC lobbying arm geared towards reducing ASEAN and APEC rice trade restrictiveness; and (3) OREC as a guarantor of regional and global rice stock reserves, and the creation of a rice storage facility network throughout the sub-region. While a more comprehensive and integrated framework for information sharing aimed at solving market inefficiencies is recommended, the notion of OREC as a cartel of good intentions is rejected.

We don't aspire to be like OPEC...

*We hope to be just a group of five to help each other in trading rice on the world market.*²

--Thailand Prime Minister Samak Sundaravei

*We will not only ensure food security in each of our own countries, but will help solve the entire problem of (food) shortages across the region and the world.*³

--Cambodian Prime Minister Hun Sen

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² 5 Asian Nations Are Weighing a Rice Cartel, Thomas Fuller, The New York Times: May 1, 2008.

³ Cambodian PM: Rice cartel to benefit regional, global food security, Du Guodong, China View: May 5, 2008.

Introduction

The Organisation of Rice Exporting Countries (OREC) would initially comprise of Thailand, Vietnam, Cambodia, Laos, and Myanmar, with the stated goal of harmonising rice supply and demand and stabilising its price for the benefit of both consumers and producers. The organisation (OREC International) is currently in the nascent stages of its formation and little information has been made public about its design or functional framework. Ideologically, the organisation is said to build off Ngo Van Tan's 2005 *Ideology of Rice Power*, in which the academic and social activist champions the rights of the rice farmers in developing countries and promotes a form of wealth redistribution via profit sharing and reinvestment. (OREC International) Leaders from OREC member states would have the world believe that the organisation does not constitute a threat to rice accessibility or national food security, and that it is not a scheme to hold prices at artificially high levels. To many, these words ring hollow, with major rice importing countries accusing the organisation of being morally unethical and structurally unsound. (Bloomberg 2008) The proposed cartel coincides with a highly volatile grain commodities market, with rice prices doubling in 2008 alone, followed by a turbulent 2009.

Most recently, fires in Russia, floods in Pakistan, and drought in major grain producing countries has reinvigorated food security issues globally with grain prices again on the rise. Asia accounts for 90 percent of global rice consumption, with OREC member countries Thailand and Vietnam accounting for a 51 percent share of the world's rice exporting market. (IRRI World Rice Statistics Database) Understanding the economic and political significance of OREC, its role as a dealer in Asia's principle food staple, and the processes involved in its creation is important not only to policy makers charged with upholding sovereign food security rights or analysts interested in the grain commodities market, but also for academics and NGOs focusing on issues of human rights and poverty reduction, and to the farming community at large.

This paper examines the potential political and economic implications of OREC as they relate to food security issues in Asia. The fundamental nature of cartels is discussed to better assess OREC's likely trajectory as it moves forward, both in terms of potential gains and losses and its long-term legitimacy. Issues relating to rice price volatility, the relationship between food security and political stability, and trends in trade and rice stock reserve policies are touched upon to better understand the factors that contribute to the rice arena.

The paper concludes by rejecting the assumption that cartels are inherently evil. However, due to political and moral sensitivities surrounding rice consumption, the lack of true and sustainable monopolistic conditions, and the built-in flaws of

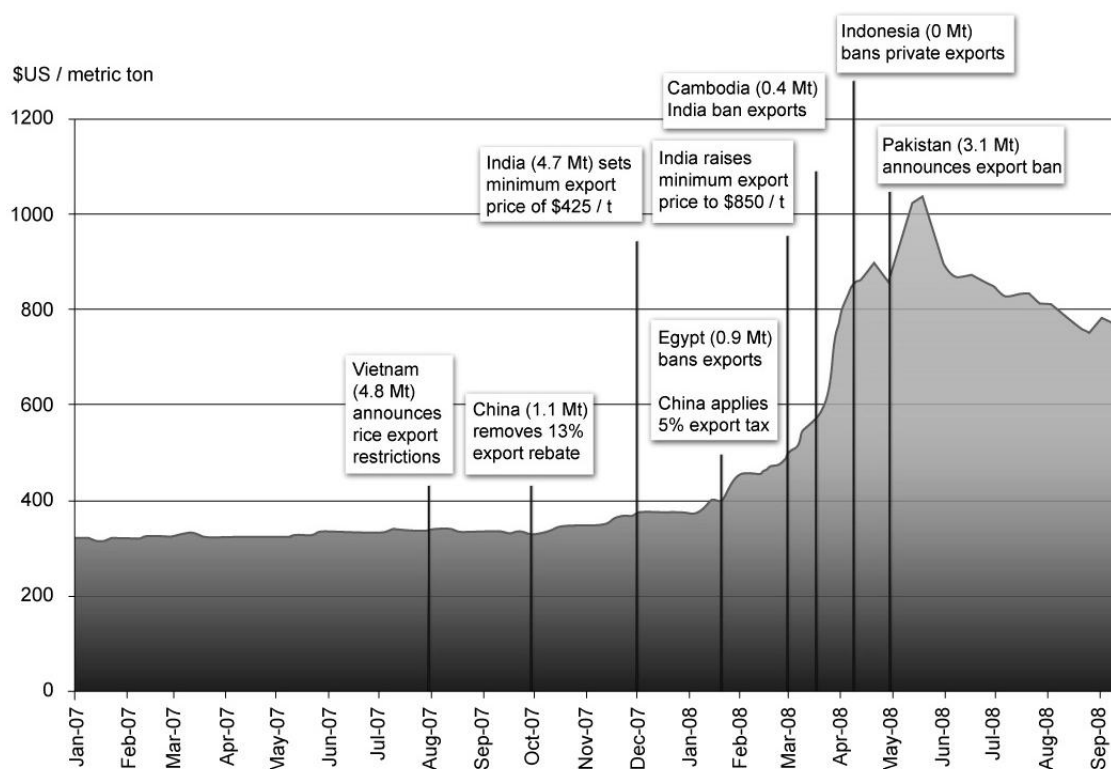
price-fixing regimes, further efforts geared towards OREC's creation as a price-fixing organisation are found to be counterproductive for both member countries as well as rice importing countries. Three policy recommendations are offered that point to a more sound foundation from which to establish OREC as an intergovernmental organisation. These are: (1) Establish OREC as an extension of ACMECS, to serve as an intergovernmental rice traders association, (2) Create an OREC lobbying arm geared towards reducing ASEAN and APEC rice trade restrictiveness, and (3) Form a network of rice storage facilities throughout the sub-region to serve as a regional and global reserve-stock buffer. While a more comprehensive framework for information sharing that is geared towards solving market inefficiencies is recommended, the notion of OREC as a cartel of good intentions is rejected.

Rice Price Volatility: Recent Market Movements and Drivers

As a cartel's objective is to influence price by means of managing supply, it is important to understand recent events, trends, and anomalies in the rice market to accurately assess OREC's potential utility. In 2008, the price of 100 Percent Grade-B Thai White Rice (often used as an industry benchmark) more than doubled, reaching a peak on May 21 of US\$ 1,038 per metric ton. (Bloomberg Market Data 2010) Similar spikes in other grain commodity prices were attributed to a decrease in supply. However, while several large rice producing countries did experience production decreases during this period, the supply of rice in the global market remained sufficient to meet existing demand. (USDA January 2010) Production forecasts pointed to healthy expected returns of future harvests for major rice exporting countries; nothing alarming could be seen in the projected demand. (USDA 2007) Yet rice prices soared, due in large part to panicked and irrational policies of several major rice-producing countries. Vietnam, for instance, the world's second largest rice exporter, closed its entire export market in August 2007 due to (unfounded) worries of domestic shortfall. These worries later proved to be self-fulfilling as they helped trigger a global protectionist response. Sensing a tightening trade market, China moved to reduce domestic rice exports by eliminating its 13 percent rice export rebate in October 2007, and several months later, replaced it with a five percent export tax. (Bloomberg 2007) In response, India and Cambodia banned exports and prices continued to rise. Panicked buying found a home in rice reserve policies around the world, reversing a trend of shrinking stockpiles (USDA March 2010), and by April 2008 the United Nations issued a warning of mass starvation in Asia. (Thomson Dialog NewsEdge 2008)

That was two short years ago, and while rice prices slowly retreated to more sustainable levels, reaching US\$ 458 per metric ton on 21 July 2010 (Bloomberg Market Data 2010), recent natural disasters, including widespread fires in Russia, floods in Pakistan, and damaged / reduced crops in China point to a possible second-coming of the 2007-08 food crisis. Indeed, rice prices, up 8 percent from July to September 2010, along with wheat and barley prices, are on the rise, while global production forecasts have been lowered for 2010-11. (USDA September 2010)

Figure 1: Political economy events leading to 2008 rice price crisis



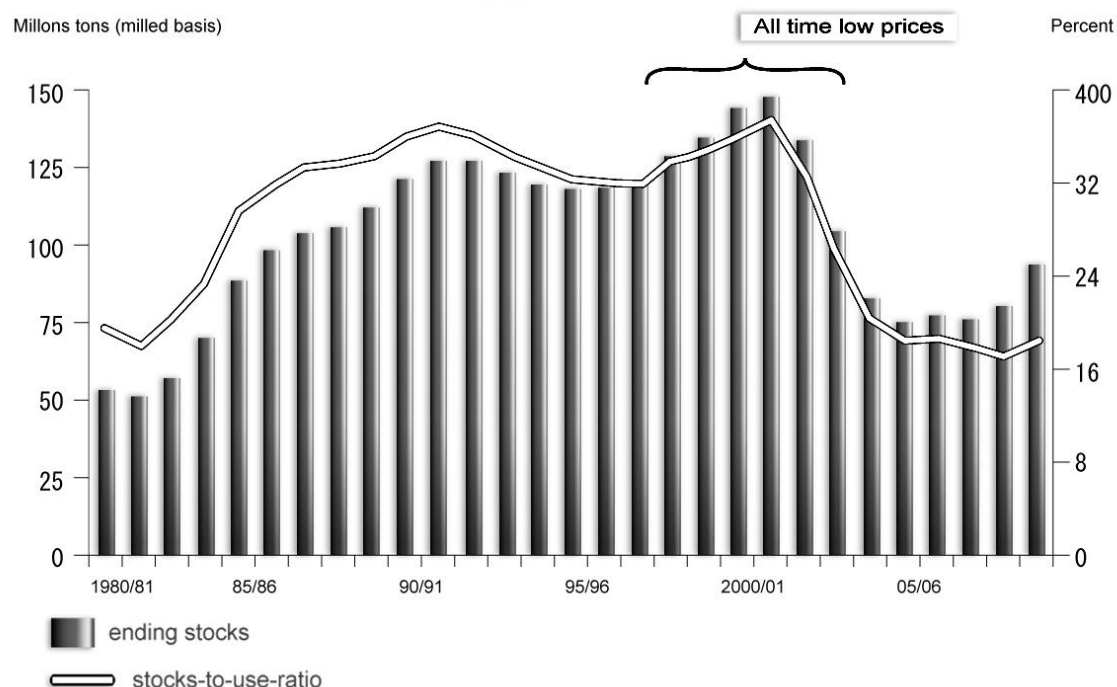
Source: Bloomberg 2007; Bloomberg 2008; Egypt News 2008; The China Post 2008

Rice producers are still reeling from the global financial crisis. In June 2008, rice prices began to plummet, with 100 Percent Grade-B Thai falling to US\$ 574 per metric ton in early December, compared with the prodigious US\$ 1,038 per metric ton in May of that same year. (Bloomberg Market Data 2010) This fall was attributed to both record rice production and a drop in the price of oil, among other factors. The downward push of commodity prices was exacerbated by the need of speculators to sell their futures positions in order to remain liquid in the face of the credit crunch, leaving farmers and rice producers in a difficult situation. Fertiliser prices, particularly for urea and ammonia, also plummeted globally, catching many farmers off guard – having just harvested a low-price crop produced with high-priced inputs. Faced with low prices, and recently

battered by a turbulent market, rice farmers throughout Asia embarked on a “play it safe” strategy, with many reducing their inputs for 2009 crops (resulting in a reduced output). (IRRI 2008) The credit crunch exacerbated the situation by making it difficult for farmers around the world to secure credit for purchases, further restricting production.

After the rapid fall in prices from their May 2008 high, 2009 saw extreme fluctuations. This time, however, concern of supply shortages in several major rice-consuming countries was the catalyst for turbulent prices. According to International Rice Research Institute (IRRI) data, demand growth has been met in recent years by adding more farmland acreage to rice production, but it is “very unlikely that this will continue in the future, with rice area already at a historic high.” (2008) Furthermore, over the past decade, population and income growth have far outpaced productivity growth as measured by rice yields per hectare, with rice stocks being tapped to help meet demand. (Asian Development Bank 2008)

Figure 2: World Rice Stocks & Use-Ratio



Source: *Production, Supply and Distribution Database*, Foreign Agricultural Service, USDA

Clearly, the rice market faces difficult and uncertain times, and more efficient, cost effective technologies are needed in order to meet future demand. These technologies take time to develop and implement – time the poor of Asia cannot afford. For Asia, home to two-thirds of the world’s poor, many of whom rely on

rice for the majority of their daily calorie intake, these fluctuations in price are of serious concern.⁴ Coupled with shrinking water tables in China, drought in India that has threatened to turn the country into a net importer in 2010, devastating floods in Pakistan and fires in Russia, farmland scarcity (and reduction due to urbanisation in many major rice producing countries) and a lag in new more efficient rice technologies, the issue has become critical for Asia's most impoverished.

What then is an appropriate response? Can an organisation designed to stabilise the rice market be an answer to the asymmetries that plague it? Can OREC be the solution to the threats facing Asia's food staple and regional food security?

A Cartel Coming to a Famine near You: OREC as a Value Producer

The word *cartel* often invokes unease and suspicion. This may be due in part to an innate mistrust of groupings that we are left out of, or unsettling experiences with them in the past, such as with OPEC. Most economists see them as value detractors, reducing total welfare of society. Human rights advocates often see them as infringing on one's right to purchase a product at the fair and *natural* price, and governments globally have laws designed to prevent their formation. But are cartels inherently evil? Are they by nature designed to profit only the seller at the expense of the buyer? Or can a cartel be a value producing mechanism for the greater good of society at large? Can OREC benefit both the consumer and producer and have a positive effect on food security in Asia?

Market structure economics proposes that a cartel will set the supply and price where Marginal Cost (MC) is equal to Marginal Revenue (MR), thus maximising its profits.⁵ (McConnell 2006) Deadweight loss will be incurred by society, as the consumer surplus shrinks in the face of forced, unfavourable price setting. In theory, the profit gained by the monopoly – or a true cartel – cannot be greater than the deadweight loss, thus ensuring an aggregate loss to society.

However, there are several benefits that can potentially be gained under cartel conditions, and for OREC to be viewed as a net value producer, these must be met. The standard assessment as depicted above assumes that the cost structure facing a cartel equals that of the competitive market. However, this may not

⁴ Such fluctuations, evidently, are due at times to issues of supply/demand, and at others to misinformation and political economy discord.

⁵ Marginal Cost (MC) is the derivative of total production costs with respect to the level of output, while Marginal Revenue (MR) is the change in total revenue / the change in number of units sold. Monopolies wishing to maximise profit (at least in the short-term) set price at $MC = (dVC/dQ) = P+Q*(dP/dQ) = MR$

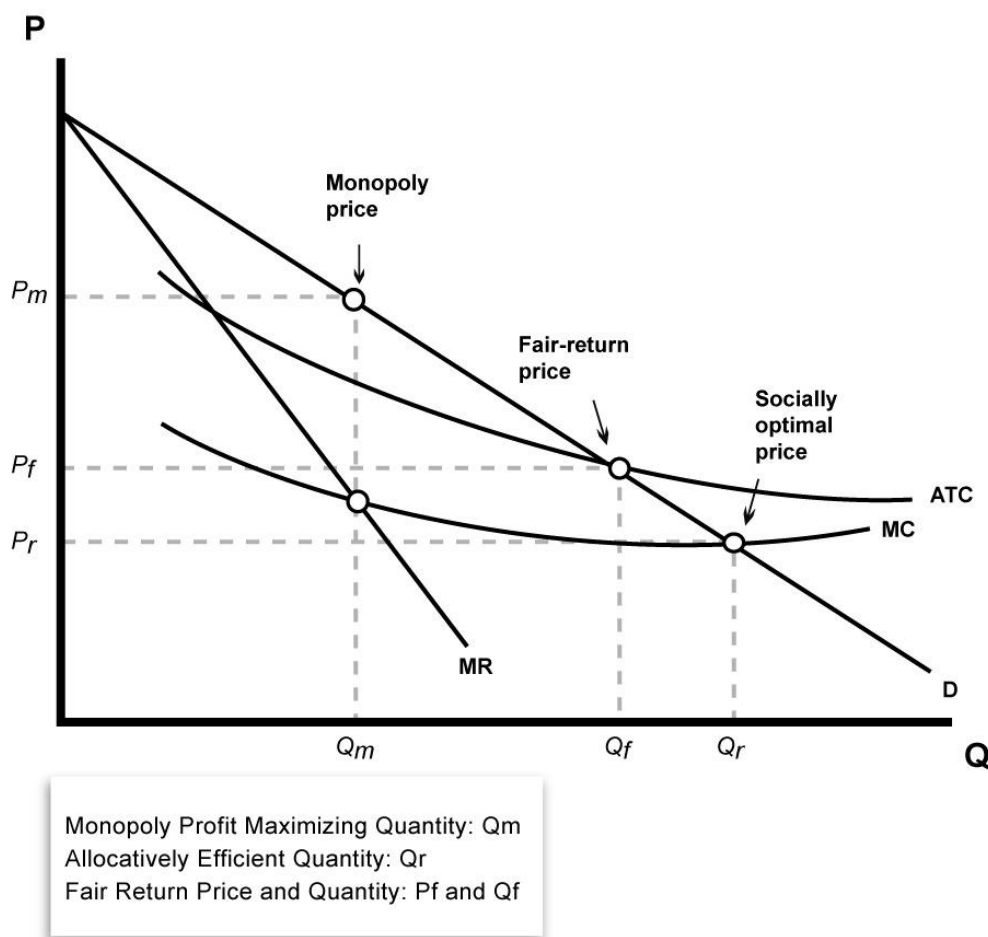
always be so, in which case both lower input costs available to the monopoly, combined with potential economies of scale, may lower prices to the benefit of consumers (assuming the cartel deems it beneficial to undercut the competitive market price in order to insure stiff barrier to entry). While perhaps not entirely compensating for the deadweight loss incurred at $MC=MR$, the loss will be reduced.

OREC, with its member states hailing from developing countries with low labour costs (yielding a less expensive total input burden), is well positioned to take advantage of an uneven global cost structure compared to more developed nations. At the same time, by combining their efforts to maximise efficient output, economies of scale may lead to an even lower total cost structure. As rice may be stored for over thirty years, all excess production (supply not released to the world market) could be readily stockpiled for future allocation. Indeed, OREC would do well to promote itself as a “world storage” guarantor. As global rice stocks have reached historic lows in recent years, if OREC were to serve as a price (and supply) stabiliser by addressing one of the reasons for its recent fluctuations (misinformation and political economy discord) both producer and consumer would stand to benefit.

There is currently no scientific method to quantify the benefit of supply stability in terms of social welfare, so measuring its net worth in monetary terms is not possible. That being said, for consumers and producers alike there are real benefits in terms of both budgeting and security in having a stable price and stable supply associated with a commodity. When the commodity is a staple food item, the benefits increase as the importance of maintaining security increases. Hedging against instability of prices can also be costly; a stable rice price would greatly reduce these costs for producers, governments and traders. If OREC were to guarantee supply adequate to meet the majority of global demand, at a *fair and reasonable* price, food security in Asia and around the world would increase. The *reasonable* price structure would have to be designed around a “fair return price”⁶ where $\text{Price (P)} = \text{Average Total Cost (ATC)}$, with OREC’s profit necessarily less than what it would be under true monopolistic conditions.

⁶ Where Average Total Cost (ATC) equals Price (P), a firm will break even. ATC is the total cost per unit of output incurred (in the short-run).

Figure 3: Profit Scenarios under Monopoly Conditions



Source: *Economics*. McConnell, C., Stanley L. Brue. Irwin McGraw-Hill, 2006.

In short, if the deadweight loss incurred by a higher price were less than the benefits offered by price and supply stability, OREC would serve as a value producing mechanism with a positive social welfare effect⁷. Quantifying this in a convincing manner however, as a means of insuring foreign governments of its legitimate potential, has not been accomplished.

Indeed, there are other difficult-to-measure benefits of monopolies that can add to the greater good of society. As University of Milan Professor Federico Estro argues (2004), provided that a market is characterised by free entry (which the rice market certainly is), monopoly power can be good for innovation as the firm, or cartel, has more incentive than any other to invest in research and

⁷ This relationship could also be understood in terms of Kaldor-Hicks efficiency which states that an outcome is considered more efficient if a Pareto optimal outcome can be reached by arranging sufficient compensation from those that are made better off to those that are made worse off so that all would end up no worse off than before.

development. As previously mentioned, the rice arena is in need of better, more efficient technology; OREC as a cartel would serve as a catalyst in driving this needed innovation.

Good from afar but Far from Good: OREC and Cartel Deficiencies

While it is theoretically possible for OREC to serve society's best interests, many assumptions have to be made and risks taken for this to be realised – risks governments around the world will not be willing to tolerate. Assuming a reasonable pricing scheme designed by OREC was to pacify the global community, that a pledge to create and responsibly utilise a stock reserve network were both feasible and accepted internationally, and that member states were to abide by the organisation's agreed upon trade and pricing structure (and not cheat), OREC would be positioned to benefit both the consumer and producer, and to contribute to added food security in Asia. The likelihood of meeting any of these assumptions is rather bleak. For OREC to contribute positively to regional social welfare, and indeed survive as a trade regime, all these criteria would have to be met. As it is currently conceived, the organisation would not be sustainable.

For a cartel to enjoy monopoly power several critical criteria must be met. First, there must be substantial barriers to entry in order to prevent competition. Second, members of the cartel must adhere to the organisation's trade policies and agreements in order to protect the effectiveness and legitimacy of the cartel. While OREC would control over 50 percent of the world's rice export market, and member states' geographical positioning and climate conditions are ideal for rice production and trade, they hold no special or ultra-unique advantages that would prohibit foreign governments from increasing their domestic production in order to ensure sovereign food security. OREC is not OPEC; it does not enjoy natural monopoly-like conditions, and it cannot fix production or supply over the long-term – rice is renewable, oil is not.

OREC's ability to manipulate the international price of rice is suspect, as abusive behaviour on their part – withholding supply to drive up prices – would be met with stiff resistance from foreign governments. Further complicating the practical benefit to OREC members is the very design of the rice market. Where OPEC deals with several giant companies for sale, storage, and production, the logistics facing OREC and its thousands of farming associations, producers, and exporters, would be immense. Thai Rice Exporter Association's Vice President of the Board of Directors Mr. Sermsak Kuonsongtum puts it bluntly, "We like (the) idea of

OREC, but it is not possible... hundreds of competitors working together is not possible like this.”⁸

Many economists believe that price-fixing regimes are inherently unstable and that they inevitably break down. (Stigler, G.; Levenstein, M.) The Prisoners’ Dilemma suggests that all collusive agreements tend to fail eventually because although price fixing is in the joint interests of all cartel members, it is not a profit maximising equilibrium for each individual firm. A firm can expect a larger share of the common profit by introducing some degree of competition with regard to the other members. Cheating may prove too enticing for the myriad of dealers and traders operating out of OREC member countries, and if selling at lower-than-agreed-upon prices were discovered, the cartel would lose its legitimacy. Cheating is only one of the hazards to cartel stability. In order to retain customer loyalty, there are incentives to grant price discounts where sales to buyers are large and infrequent, and of course, perhaps the greatest threat of all is that high prices and profits will attract competition.

Food security and political stability are often mutually dependent and reinforcing. In times of political upheaval food security can be jeopardised, whereas food insecurity can lead to social instability and political revolution. China’s quiet abandoning of its food self-sufficiency policy, for instance, comes at a time when it will have to import massive amounts of grain to meet increasing domestic demand. This change in policy was partially rooted in a persistent fear within the Chinese government that food insecurity would provoke widespread anger against the Communist Party. (Brown 1995) Food security thus becomes a matter of regime survival, and rice as a staple food throughout Asia is certainly no exception to the rule. OREC is perceived by many rice importing countries to be a threat to sovereign food security, and has been publicly denounced by the Asian Development Bank president Haruhiko Kuroda as harmful to both producers and consumers. (Bloomberg 2008)

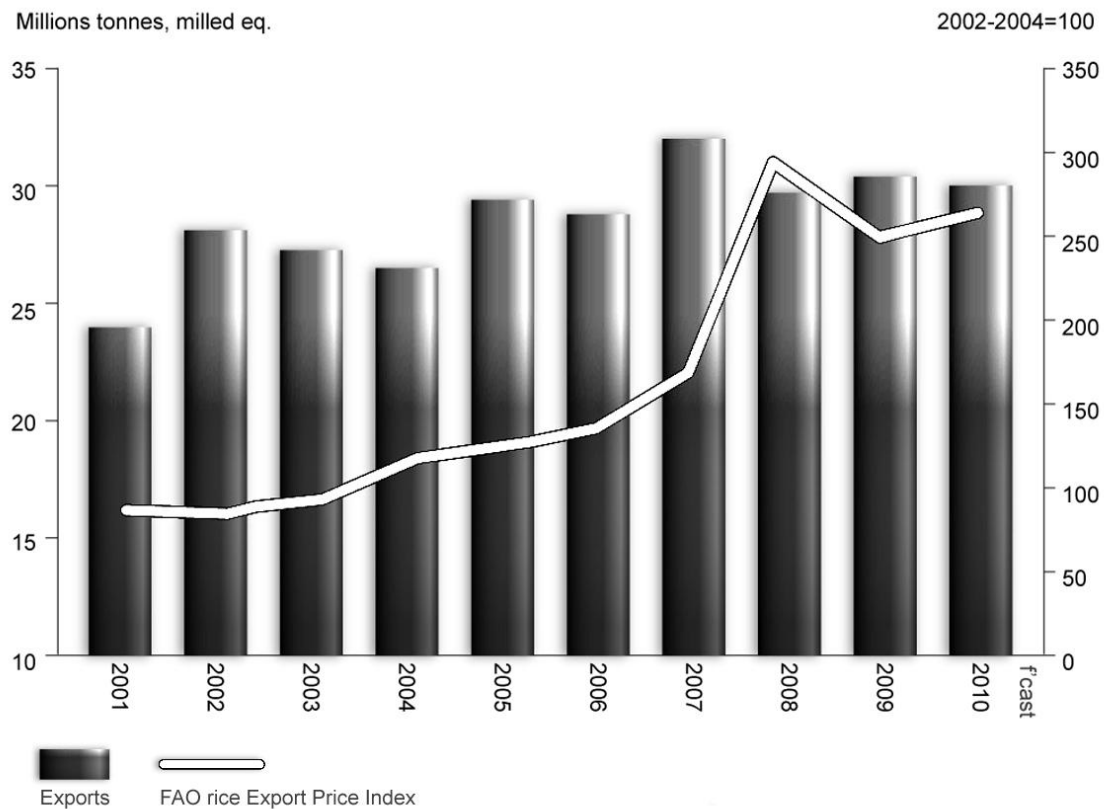
If OREC were to officially form, its member states should expect a regional, pronounced backlash, as foreign governments seek to even the playing field via both reactionary trade policies and increased domestic production. Ms. Panadda Diskul, head of Thailand’s Office of Rice Trade, Ministry of Commerce, notes, “We talk about cooperation when (rice) prices are too high or too low, but when importing countries hear OREC, we receive a lot of negative reaction... talking stops.”⁹ And while coverage in the media and diplomatic dialogue died down after prices retreated in 2009, Diskul mused, “...do not be surprised if we hear

⁸ Interviewed by Matthew Brummer, September 16, 2010.

⁹ Interviewed by Matthew Brummer, September 16, 2010.

more talk (of) OREC if prices go very high again.” If this happens, she continued, there is a real possibility of prices once again threatening export market equilibrium, as seen in 2008.

Figure 4: Global Rice Trade & Price Index



Source: *Rice Price Update 2010 Database*, Food and Agriculture Organization, United Nations

Recommendations: A Change in Philosophy

In order for OREC member states to achieve their goals of increased prosperity and bargaining power, and the reduction of distribution and production inefficiencies, they must avoid designing their organisation as a cartel. Somewhat ironically, OREC would be best served by focusing on information sharing and trade liberalisation of the rice market as a means of expanding market share, a starkly different approach to the formation of a price-setting regime. The five member countries have already formed the Ayeyawady-Chao Praya-Mekong Economic Cooperation Strategy (ACMECS) in order to utilise one another's comparative advantages to promote balanced development in the sub-region. OREC would do well to build off of the ACMECS design: an extension of this framework specifically focused on the rice market. To this end, the following should be undertaken:

- The establishment of OREC as an ACMECS rice traders association, designed to allow policy and technical cooperation necessary to achieve an integrated, highly efficient sub-regional rice production, distribution, and research network. OREC should include direct input and participation from both the private and public sector in the form of a formal, institutionalised *Rice Dialogue*. Short and long-term measures that are necessary for improving farming productivity should be undertaken, including a common fund for rural infrastructure development geared towards enhancing rice production efficiency. The Thailand-Vietnam Rice Trade Cooperation, established in 2001, should be used as a platform from which to expand cooperation throughout the sub-region.
- The creation of an OREC lobbying arm geared towards reducing ASEAN and APEC rice trade restrictiveness, and reinvigorating Doha Round negotiations. Currently rice exports account for only six to seven percent of global production, leaving considerable scope for market liberalisation. OREC member countries with their newly formed rice traders' association would be well positioned to take advantage of a larger export market and by expanding global rice trade the organisation would reduce risks of dramatic price moves caused by relatively small quantity moves. Indeed, both producers and consumers would benefit by the reduction of trade barriers. (Bhagwati 1993)
- The pooling of OREC member resources and technical know-how to form a network of rice storage facilities throughout the sub-region. The storage should be wholly separate from the supply market, and serve as a "means of last resort" for the global community. Stocks play a key role in equilibrating markets and smoothing price variations. A clear distinction between providing a buffer against shocks to the rice market and embarking on a hoarding strategy must be clearly defined in order to avoid adverse reactionary policies from foreign governments. Transparency will be important, and consultation with an open, established committee such as the ASEAN Food Security Board should be developed. OREC, as manager of this global rice-stock-reserve buffer, would both reduce rice price fluctuations caused by political-economy discord, as well as give member countries an important and prestigious role to play in global poverty reduction.

While New York or London are generally considered the global centres of information, for a regional product – like rice, given that 90 percent of its

production and consumption takes place in Asia – a local information hub stands to benefit market and trade facilitation. The aforementioned ACMECS rice traders association would be a positive move in this direction. OREC's initial impulse to form an organisation geared towards reducing discrepancies and asymmetries in the rice market was a good one. Designing it as a price-fixing regime was not. By establishing themselves as leaders in rice research and technology, and reducing inefficiencies while exploring new opportunities for collaboration in the sub-region, OREC member countries would be ideally positioned to take advantage of free market utilities. Other sub-regional benefits of such a design would also likely be realised, including increased access and supply reliability of rice, enhanced food and worker safety, and strengthened environmental security and sustainability measures. (International Food and Trade Policy Council 2008)

Conclusion

Rice has been cultivated in Asia for thousands of years and is imbedded not only as the regions staple food source, but also in its culture and psyche. (Vaughan 2008) An organisation designed to limit or manage its supply would surely be met with strict and swift regional resistance, and would be, one could argue, morally and ethically unsound. While OREC as a cartel could theoretically benefit producer and consumer, realistically the risks and assumptions required to bring this to fruition are insurmountable. Indeed, in attempting to increase control over the supply and price of rice, OREC may experience the reciprocal effect as foreign producers seek to gain a larger share of the export market. This paper has highlighted some of the difficulties faced in forming a cartel-like organisation in the rice arena. It has argued that it is not a strategically prudent initiative, and that OREC as a price-fixing regime would not serve the best interests of its members or the global community. As recommended in the previous pages, OREC member states would stand to gain considerably from rice market liberalisation, a stock reserve network, and increased sub-regional cooperation. OREC as an intergovernmental body, focused on expanding cooperation and the rice technological frontier would yield a positive net welfare effect and help ensure regional food security. OREC as a cartel geared towards price manipulation would not. As Ken Ash, OECD Director of the Trade and Agriculture Directorate pointed out, "why would they (OREC) be the latest and greatest supply management scheme when these have never worked, on a global level, in history? There are potentially more interesting solutions to address fluctuations in price and supply."¹⁰

¹⁰ Interviewed by Matthew Brummer. December 8, 2009.

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US-JAPAN MISSILE DEFENCE COOPERATION: CHINA'S REACTIONS AND RESPONSES

Andy Forrest¹

Abstract

This article deals with the important and enormously complicated issue of US-Japan Ballistic Missile Defence¹ (BMD) cooperation. A context for analysis is developed through the consideration of China's views of the causes and consequences of the highly controversial December 2003 Koizumi Cabinet decision to commit Japan to the US-led missile defence programme. An analytical trajectory is drawn between that decision and the emerging shapers of China's strategic thinking on the process of political, legislative and force-structure reform, which is underway in Japan's security policy. It begins by discussing the rationalisation used by Tokyo and Washington to justify BMD cooperation, and how it is linked at the various different levels of China's policymaking to 'new' threats that have emerged over the last seven years. This connection highlights the pressing need to distinguish between the following questions: what are missile defences (in an operational context), and what are they being used for? It concludes by arguing that the Koizumi and subsequent administration's enthusiasm for US-Japan BMD cooperation is, to many Chinese, tantamount to a long-term Japanese commitment to the materialisation of a new regional security order – one that is capable of forcing Japan to take on a larger security role and severely curtailing China's strategic reach to the outside world. This, for now, makes the very idea of missile defences one of the biggest impediments to more open, trusting and cooperative relations between China and Japan.

The accelerated emergence of a more assertive Japan over the last decade is, to many Chinese strategic observers, largely attributable to the convergence of two driving forces: the normalising aspirations of the so-called 'rightist' factions in Japan's security policy decision making establishment; and the US' desire to see Japan increase its contributions to regional and global security matters. This paper argues that it is in the context of these dual considerations that it is possible to develop our capacity to understand why US-Japan BMD cooperation has made it so difficult in recent years for China's leaders to downplay growing concerns that the US-Japan alliance is fast developing into an equal security partnership of regional and global significance. This context can thus help explain why missile

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defences are changing official Chinese thinking on the methods sought and used by Japan, to pursue its security aims.

The North Korean Nuclear Weapons Threat Rationale

American and Japanese interest in missile defences and the question of how to deal with the North Korean nuclear weapons threat are politically and strategically linked. Most experts in the field (e.g. Alagappa 2008; Richardson 2006) recognise the North Korean nuclear programme's potential to further destabilise the strategic balance of Asia. Given that the North Korean nuclear weapons threat is one of the most pressing national security concerns for both Japan² and the US, this first section argues that any analysis of China's views of the causes and consequences of US-Japan BMD cooperation must be preceded by some background discussion of how the notion of a nuclear-armed North Korea has shaped Japanese thinking on the merits of missile defences. It is essential to understand China's thinking on how the notion of a nuclear-armed North Korea has been used by Japan and the US to explain the rationale, to both domestic and international audiences, behind the need for increased coordination on international security issues. In a nutshell, it is essential to explain why missile defences have emerged over the last seven years as one of the most problematic issues in the Sino-Japanese relationship.

Japanese involvement in the development of BMD began in earnest in December 1998 when the National Security Council of Japan approved the initiation of cooperative technological research with the US. (Hughes 2001, 69) In April 1998, North Korea launched its *Taepodong 1* ballistic missile over the northern part of the main Japanese island of Honshu, which splashed down in the Pacific Ocean. (Cronin 2005, 57) Since that demonstration of Pyongyang's capabilities (if not intentions), the threat posed by the North Korean nuclear weapons programme has been frequently used by Tokyo not only to justify US-Japan missile defence cooperation, but also to establish a focal point around which domestic support for a more assertive overall national defence and security policy can be formed. This has forced a major rethink in Beijing, and elsewhere, of the way domestic and international contexts come together to promote mistrust and suspicion between China and Japan.

Indeed, Japan has much to lose from continued instability on the Korean peninsula, such as an increased threat of nuclear warfare within close proximity. However, to some, it also has much to gain. This view is not entirely

² Geographically, Japan is very close to North Korea and therefore is vulnerable to surprise attack.

unwarranted. The notion that a hostile North Korea provides incentives for Japan to strengthen its security policy featured prominently in the argument put forth by several scholars (eg. Harrison 2005), in the years following the 2003 Koizumi Cabinet decision that the threat posed by North Korea was being exaggerated by the Bush administration to justify the incorporation of Koizumi's domestic reform agenda into the military expansion of the Japanese state. This perception that the North Korean nuclear weapons programme was being used by some in the US to facilitate the emergence of a more assertive Japan would have influenced China's strategic thinking on Japan from the beginning of Koizumi's prime-ministership. (Auerback 2005, 2) This is important to keep in mind when thinking about why Japan's recent actions as a security actor have tended to elicit hostile responses from China. It is also important to keep in mind when thinking about how that hostility has made it easier for Tokyo to convince the Japanese citizenry that US-Japan BMD cooperation is the least politically burdensome countermeasure to North Korean nuclear weapons (and China's growing assertiveness).

Political, Legislative, and Force Structure Implications

I will now consider the political, legislative and force structure implications of US-Japan BMD cooperation for Chinese thinking on Japan. In doing so, I will identify some of the more subtle ways in which negative sentiments about Japan can now be used to challenge the domestic legitimacy of the Chinese leadership.

Political Implications

From a political standpoint, Japan's commitment to BMD is, in the Chinese view, more than just an expression of Japan's willingness to increase its contributions to international security matters. Indeed, over the past three decades, two main political factors have limited Japan's international security role – both legacies of the Second World War: (1) the deep-seated mistrust of Japan from the major players in Asia stemming from Japan's militaristic past; and (2) the reluctance of the Japanese people to break with the pacific traditions set out in Article 9 of the 'Peace Constitution'³. (McCargo 2004, 180) In looking at China's views of Japan's interest in BMD from a political standpoint, it is useful to consider how the timings and pretexts surrounding the Koizumi Cabinet decision affected Chinese thinking. Assessing how far Tokyo is now willing to go to uphold the pacific constraints on Japan's international security role also has merit.

³ Article 9 of the Japanese Constitution is sometimes referred to as the 'Peace Clause' because it prohibits an act of war by the state.

It is worth noting here that the Koizumi Cabinet decision on BMD was made shortly after two equally controversial developments: Japan's July 2002 decision to seek the passage of its own Japanese Anti-Terror Special Measures Law (ATSMML), allowing Japan to support US-led deployments abroad at short notice; and a Japanese parliament bill enabling the Japan Self-Defence Force (JSDF) to participate in United Nations peacekeeping operations abroad. (Ibid, 183) Both developments helped establish a trend towards activism that, in the Chinese view, would have made US-Japan BMD cooperation seem much more antagonistic than it would have seemed in another context. This explains why China's opposition to US-Japan BMD cooperation increased. Indeed, it became clear to most that the Bush administration sought closer security cooperation with Japan because it felt that China's political architecture did not conform with the pattern of relations in the American-brokered international order.⁴ "[W]e express our deep concern over the major readjustments of Japan's military and security strategy and the possible impacts arising thereof [...] due to historical reasons, the developments in Japan's military and security have always been a very sensitive issue"- Chinese Foreign Affairs Ministry spokeswoman Zhang Qiyue said in her regular press conference on 14 December 2004 (Embassy of the People's Republic of China in India).

Another important political implication of Japan's interest in BMD is the signal it sends regarding Japan's support of regional institutions.⁵ In contrast to Japanese policies during the 1990s which focused on building political influence through regional institutions, the 2003 Koizumi Cabinet decision on BMD gave Beijing no real choice but to interpret it in the context of Japan's waning support for regional institutions. Evidence of a less commonly accepted need to deal with regional security issues through regional institutions can be found in the 2008 tripartite summit meeting between the heads of the governments of Japan, South Korea and China. Hosted in Fukuoka by Prime Minister Taro Aso, this was the first stand-alone trilateral summit between the leaders of these three East Asian

⁴ That the Bush administration was at the very least not going to go out of its way to avoid antagonising China was, to many within and outside China, confirmed well before Japan's 2003 decision on BMD by a series of explicit attributions to China of threat. To cite but one example here, in May 2000 Condoleezza Rice (2000, 55) said that, 'China resents the role of the United States in the Asia Pacific' ... 'China is not a status quo power but one that would like to alter Asia's balance of power in its own favour': implying, so it seemed, that the Bush administration had resolved to find new ways to sell the idea that China is a revisionist power destined to clash with America.

⁵ These institutions include Asia-Pacific Economic Cooperation (APEC) and the Association of Southeast Asian Nations (ASEAN). I mention this not to branch off into discussion of regional institutions in their own right, but rather to help explain how the various elements of dissonance in their bilateral relations are now seen to be related to US-Japan BMD cooperation.

Powers. (Weatherbee 2009, CSIS) What is notable about this meeting here is that previously formal summitry between the 'big three' has been perceived to be heavily reliant on the Agency of the ASEAN nations⁶. The 2008 Fukuoka summit therefore suggests one of two things: that it is wrong to assume that the political differences between China, Japan and South Korea are so pronounced that they cannot be overcome without the neutral playing-field of ASEAN; or, that the goals of shaping the regional order to their own advantage precludes any unnecessary regionalisation of emerging security issues. This remains politically problematic for Beijing for several reasons. It raises doubts in the Chinese popular mind about the legitimacy of regional institutions. If regional institutions are no longer viewed in Tokyo and Washington as the preferred means to deal with China, then why should they support them?

China's leaders do not want to be forced to answer this question directly. For doing so can only expose them to external accusations that they are dissatisfied with the existing regional order and desire to change it. This in turn promotes a negative conspiratorial perception of China's rise abroad that can be used to justify insinuations in Japan that China must be constrained. Under these conditions, US-Japan BMD cooperation becomes evidence that Tokyo has decided its interests are now best served by carrying a larger share of the burden of the US-Japan security alliance.

Legislative Implications

Prior to the Koizumi Cabinet decision on US-Japan missile defence cooperation, Japan's reluctance to participate in the U.S-led BMD programme had been based on three legal arguments: (1) Article 9 of Japan's 'Peace Constitution' renounces collective defence rights preventing (or at least severely curtailing) Japanese participation in multinational defence programmes; (2) parliamentary resolutions prevent Japan from using outer space for military purposes; and (3) Japanese law specifies that dual use technology⁷ can only be exported to the US and that all measures must be taken to prevent the US from transferring such technology to a third party. (Opall-Rome 1993, 14) Since late 2003, successive administrations have sought passage around these arguments in a number of ways. In early-2004, for example, *The Nihon Keizai Shimbun*, a leading economic newspaper in Japan, reported that the Japanese Defence Agency (JDA) would seek revision of the Self Defence Law that would allow Japan to mobilise the JSDF for a counter-missile attack on the order of the Prime Minister. This previously required a decision by the Cabinet that a threat of attack exists, and then a Diet decision to deploy the

⁶ Specifically, the ASEAN + 3 format.

⁷ Technology that can be used for peaceful and military purposes.

JSDF (Nikkei). Following this, a report by the LDP Defence Policy Subcommittee, which advocated amending Article 9 of the 'Peace Constitution' was released. Then, in July 2004 the JDA established a Missile Defence Office to deal with legal problems stemming from US-Japan BMD cooperation. Finally, in October 2004 the Acquisition and Cross-Servicing Agreement was revised, expanding the scope of cooperation between Japan and the US.⁸ (Roy 2005, 194) The decision to revise this agreement highlighted the strong differences of opinion about the legality of US-Japan missile defence cooperation between the rightist factions of the LDP and its junior coalition partner New Komeito, with the latter eventually agreeing to consider amending Japan's laws regarding the transferring of BMD technology.

However, New Komeito remained opposed to their complete removal as proposed by the LDP at that time. It should be noted here also that although the 2005 National Defence Policy Outline (NDPO) did not raise the issue of revising Japan's self-imposed ban on arms exports directly, these developments would have made it difficult for many Chinese not to think that Tokyo had decided to allow technology developed in relation to BMD to be exported to the US. (Fouse 2005, 4) They would have also made it difficult for Beijing to play-down the broader concern, which was (and still is) that the weakening of these self-imposed bans could be a precursor to the lifting of other bans, including the ban on nuclear weapons production.

Force Structure Implications

While it is important to emphasise that overall military assets are seldom a useful way to gauge whether or not a state perceives another as a threat, they nevertheless warrant some consideration here as they do play a role. US-Japan BMD cooperation has a number of direct and indirect force-structure implications for Japan, all of which have the potential to influence Chinese thinking on the methods used by Japan to pursue its security aims. In mid-2005 Japan formalised its intention to shift its military focus away from old Cold War threats to guarding against dangers emanating from China and the Korean Peninsula. (Brooke 2004, 15) This shift of military focus resulted in a major reduction in Japanese military spending on tanks and artillery: since mid-2005 both have been cut by one-third, or around 600 in each category. (Tanter 2005, 15) The bulk of this money has since been re-invested in the US-led BMD programme and the

⁸ This revision of the Acquisition and Cross-Servicing Agreement was significant because it allowed Japan to supply ammunition to US forces.

creation of the squadron of Japanese midair refuelling planes.⁹ Specific developments aside, the point to emphasise here is that this reduction in military spending would have been seen by Beijing as an indication of Japan's intention to not only do more with less, but also to make it harder to distinguish between offensive and defensive actions. The analogy that a missile defence system is a 'protective shield' does, of course, suggest that missile defences are purely defensive in nature, posing no threat to anyone. In the post-war era Japan's 'Basic Defence Force Concept' has been based on a commitment that Japan's defence aims would not exceed the minimum necessary for self-defence. In much the same way as the 'Basic Defence Force Concept' represented a lowering of the standard for Japan's defence by placing most of Japan's security in the hands of the US (Viotti 2005, 258), Japan's commitment to BMD can, because it implies increasing Japanese involvement in security matters, easily be seen as representing a break with this concept.

To be clear, China is concerned about the implications for Sino-Japanese relations of a more centralised command structure between Japan and the US. This worries China's strategists because a centralised command structure would increase intelligence sharing, technology exchange (which is crucial for the development of a rapid reaction force) and permit Japan to develop a new multifunctional military capability that integrates the JSDF deeper into US global strategy. (Fouse 2005, 1) The creation of four MSDF *Aegis* equipped destroyers with Standard-3 missiles to attack other missiles in the outer atmosphere (to be completed by late-2011), and four air force defence units equipped with *Patriot* Advanced Capability-3 missiles to intercept missiles that reach the lower atmosphere is indicative of this more mutually reinforcing approach. (Tanter 2005, 12)

US-Japan BMD cooperation is, it seems, inseparable from China's strategic thinking on the broader shifts that have occurred in Japan's strategic policy over the last seven or so years. It is certainly inseparable from Chinese thinking on the logic behind strengthening US-Japan security arrangements. The very concept of missile defences is viewed by many observers (e.g. Janes 2009; Krepon 2002) as symptomatic of a new form of global dominance designed to shift the 'hard power' burden from the US to its allies. To those with a zero-sum view of the world, this means that the implicit goal of US-Japan BMD cooperation is to prevent the American-brokered regional order from being undermined by other powers. This way of thinking about missile defences clearly places narrow

⁹ This was part of an overhaul of Japanese defence policy described by one Japanese Defence Agency (JDA) official as the first JSDF budget reduction in memory (Oberle 2005, 52). Notably, the acquisition of a squadron of midair refuelling planes makes it possible for JSDF aircraft to fly missions to North Korea and return home without landing.

limitations on subjective interpretations in China about who America's friends and enemies are now, and will likely be in the future. This is something that the lesser powers in the region with a clear vested interest in preserving good relations with the US, China and Japan would be acutely aware of. Lawrence Kaplan perhaps sums up this widespread strategic uneasiness best when he writes, "missile defences aren't really meant to defend America ... it's a tool for global dominance." (Callinicos 2003, 72)

China's Opposition to Theatre Missile Defence (TMD) in Japan

Japanese TMD has unavoidable implications for China's handling of the Taiwan issue. This is partly because of the signal it sends about Japan's willingness to become involved in an armed conflict between the US and China and partly due to the growth of pro-Taiwan sentiments in Japan over the last decade. It should be noted here that there was not a single pro-China figure in the Koizumi Cabinet, and this might have contributed to the Chinese perception that the decision on BMD was tantamount to America's 'One-China' policy. (Auerback 2005, 1) This is important because it provided Beijing with incentives to let ideological considerations creep into official Chinese thinking on the BMD issue. For example, in response to a question in July 2005 over possible Japanese involvement in a Taiwan Strait conflict, Major General Chenghu Zhu (quoted in Ding 2008, 9) said "China would have no choice but to respond with conventional force during such a conflict." China's leaders feel they would have no other choice because that is what the Chinese people would expect them to do in such a situation – even if it may not necessarily be the course of action that China's leaders want to take. Perhaps, China's leaders also believe that a show of strength would be an appropriate response to such an act of provocation. This scope for interpretation makes it difficult to know how anxious Beijing becomes when Tokyo implies that China need not feel threatened by Japanese TMD so long as it does not launch a missile strike against Taiwan.

If Japanese TMD were deployed under the auspices of the US-Japan alliance in a confrontation between China and the US in the Taiwan Strait, China's ability to deter Taipei through the threat of missile attack would be compromised. China's leaders are aware of this. Nevertheless, China still relies on the threat of ballistic missile attack to prevent Taiwan from declaring independence.¹⁰ As long as this is the case, much depends on China's strategic policy perspective on the strength of

¹⁰ In the past, China has sought to intimidate the Taiwanese government using short-range ballistic missiles, such as the missile test fired across the Taiwan Strait in March 1996. (Hughes 2002, 75)

Japan's convictions to engage in a regional conflict against China based on its ideological affiliations with Taiwan. A Japan that is fully equipped with TMD, and committed to defending Taiwan on the same ideological grounds as the US, carries a very different meaning to the Chinese than a Japan that is equipped with TMD but is seeking to avoid involvement in US-led conflicts abroad. This partly explains why Japan's policies and actions regarding Taiwan are still important to official Chinese thinking. On the other hand, this explains why the US can use US-Japan BMD cooperation to make Japan seem more committed than it is (or wants to be seen to be) to defending Taiwan on ideological grounds. As Chinese Foreign Ministry spokesman Shen Guofang (quoted in Richardson 2000, 98) said in response to the 1999 revised US-Japan security guidelines, "whether the Taiwan Strait is included in the scope of US-Japan security cooperation directly or indirectly, it would be infringing on and interfering in China's sovereignty. This would be unacceptable to the Chinese government and people." Notably, the sections of the Revised Guidelines (quoted in Murata 2000, 57) that drew the most virulent criticism from the Chinese read as follows:

"[W]hen a situation in areas surrounding Japan is anticipated, the two Governments [Japan and the US] will intensify information sharing and policy consultations, including efforts to reach a common assessment of the situation."

"The two Governments will take appropriate measures, to include preventing further deterioration of situations, in response to situations in areas surrounding Japan ... They will support each other as necessary in accordance with appropriate arrangements."

"As situations in areas surrounding Japan have an important influence on Japan's peace and stability, the [Japanese] Self-Defence Force will conduct such activities as intelligence gathering, surveillance and minesweeping, to protect lives and property and to ensure navigational safety. U.S. Forces will conduct operations to restore the peace and security affected by situations in areas surrounding Japan."

Viewed against the backdrop of these expressed commitments, it is not surprising that China's concerns about Japanese TMD became more pronounced after Japan agreed for the first time in early-2005 to extend its geographic military protection to Taiwan. (Bin 2005, 3) It is important to acknowledge that China's opposition to this decision was less reflective of an abstract respect for international principles and multilateral institutions¹¹ than it was of a strong sense of national interest. Either way, this decision exposed a security dilemma between China and Japan: one that is unlikely to be resolved as long as China's

¹¹ Chinese scholar Zhu Lijiang (2007, 711), for example, has argued that "Japan and Taiwan should maintain a state-to-state relationship ... relating to fundamental principles of international law: territorial integrity, non-interference of internal affairs, non-proliferation and disarmament and friendly cooperation."

leaders feel pressured from within to assert that America's push for TMD in Japan is aimed at encouraging Tokyo to get more involved in the development of new strategies to contain their country. Ironically, this kind of thinking makes a cooperative relationship between China and the US both essential in terms of managing Sino-Japanese relations and more difficult to maintain. This is an extremely dangerous situation if one assumes that if the US deployed Japanese TMD to defend Taiwan in a future crisis situation, China's relationship with both Japan and the US would likely suffer a major setback.

Another concern for Beijing is that US-Japan TMD cooperation will inculcate negative-conspiratorial speculation within some quarters of Chinese society about expanded US-Taiwan and Taiwan-Japanese military cooperation. (Yali 1999, 12) Reflecting this concern, Chinese officials have long made a point of stressing that any transfer of missile defence-related technology within this emerging tri-lateral security alliance would have destabilising implications for regional security. In February 1999, for example, Chinese Arms Control Ambassador Sha Zukang (quoted in Ding 1999, 95) said in a speech delivered to the 7th Carnegie International Non-Proliferation Conference that "joint development [missile defence] programs will lead to proliferation of missile technology ... breaking the limits imposed by the Anti-Ballistic Missile Treaty and rendering the treaty virtually meaningless." The obvious implication here is that, to China, such a transfer would constitute a form of missile proliferation because similar technology could be used by Japan and/or Taiwan for offensive strategic purposes. The less obvious but more important implication is that any Chinese leadership that is put under increasing domestic-political pressure will eventually run out of ways to avoid exaggerating the threat posed by these US-Japan-Taiwan security arrangements.

If Chinese opposition to expanded US-Taiwan and Taiwan-Japan security cooperation makes it increasingly difficult for Beijing to entertain alternatives to a realist vision of Asia's future, there is little incentive for China's leaders to manipulate public opinion in ways that could in the future make it easier to accommodate a larger security role for Japan. This is because the potentially devastating domestic ramifications of an actual or perceived abandonment of China's pledge to recover Taiwan, added to tensions spiralling from Japan's renewed assertiveness (i.e., a rapid increase in bottom-up venting of anti-Japanese feeling in China) makes the risks to domestic stability too great. Without new incentives for Beijing to take such risks, it seems unlikely that China's fifth generational leaders will be willing to separate the Taiwan issue from the other politico-strategic wedges that currently exist between China and Japan. This is precisely the kind of situation that China's leaders were seeking to avoid when they warned Washington during the 1990s that missile defences would carry an

entirely different political meaning for their country if the US produced them without Japanese assistance. (Christensen 1999, 75)

China's Opposition to National Missile Defence

China appears to have one overarching objection to National Missile Defence (NMD): It potentially undermines China's strategic nuclear deterrent. That this is not a new concern for Beijing (which is to say a bi-product of the Bush and Koizumi administrations' policies and actions) is suggested in the following remarks attributed to Sha Zukang at the turn of the new century. "To defeat your defences [NMD] we'll have to spend a lot of money, and we don't want to do this. But otherwise, the US will feel it can attack anyone at any time, and that isn't tolerable ... We hope [America] will give this up. If not, we'll be ready." (Quoted in Eckholm 2000, 1) To most politically aware Chinese, the development and maintenance of a credible nuclear deterrent is essential for China to be recognised internationally as a truly great power. Despite a steadily expanding defence budget and a new wave of Chinese military modernisation – as of mid-2002 China's strategic nuclear forces were estimated to be the smallest of the declared nuclear powers (not including North Korea). With an arsenal of 25 land-based Inter-Continental Ballistic Missiles (ICBMs) in 2002 (Shambaugh 2002, 255), increasing to 50-55 by 2009 (DoD 2009) – China's nuclear forces still lag far behind those of the US.

While the increasing pace and scope of China's military modernisation clearly has important implications for Asia's future, it is sufficient to note here that a fully operational NMD system would also accelerate the expansion of China's strategic nuclear forces. This would in turn make it easier for Japan and the US to exaggerate China's threatening nature by linking the need for NMD to their evolving strategic priorities. This partly explains why those who are quick to subscribe to rationalist arguments about the causes and consequences of China's expanding power (e.g. Friedberg 2000; Lind and Christensen 2000) are also quick to argue that missile defences (both NMD and TMD) will increase the potential for spiralling tensions in the region. This argument rests on the assumption that as long as the US is able to manipulate Japan's strategic environment in ways that blur the line between offence and defence, missile defences will be seen by US planners as a useful means to increase Japan's military spending, improve their operational capacity and, if necessary, force them to rely more heavily on its own military capabilities. Thinking about US-Japan BMD cooperation in this way is limiting because it perpetuates the security dilemma theory, which presupposes that in any anarchic system mistrust between two or more potential adversaries will result in each side taking defensively motivated precautionary measures (building up their military forces). (Christensen 1999, 50) Any analysis of China-Japan security relations that proceeds from this premise makes it very difficult to

imagine a strong Japan and a relatively strong China peacefully coexisting independently of the interests of the US. (Jervis 1978, 171) This difficulty derives from the fact that US-Japan BMD cooperation can be used to justify claims that Beijing will never accept a larger (and more independent) international security role for Japan. According to those who make this claim, the extent to which one is for or against missile defences is determined by the extent to which one is for or against China (and change). The problem is that this logic dictates that one must choose. The division that this kind of 'Othering' allows makes it sensible for those who subscribe to balance of power considerations intuitively to assume that once BMD become fully operational enormous pressure will be exerted on Beijing to obtain assurances from Tokyo that US-Japan BMD cooperation is not part of a strategy to hold China down. Moreover, any Japanese government that does not provide Beijing with such assurances will knowingly be sending a signal that Japan feels it has nothing to gain from convincing China that it is not aligning itself against it.

Conclusion

In making the analytic distinction between the questions 'what are missile defences (in an operational context),' and 'what are they being used for,' this article has illustrated how US-Japan BMD cooperation has forced a major rethink in Beijing. It has shown why many Chinese now believe that missile defences are being used by the US to weaken the constraints on Japanese normalisation, highlight the anti-China elements of the US-Japan security alliance, interfere with cross-Strait dialogues and draw questions about Japan's security goals. All considered, this has made it more difficult for China's leaders to deflect claims that Japan has made a conscious choice between being seen as a pacifist, diplomatically aloof middle power and being appreciated for its security affinities with the US.

To summarise, while the main purpose of missile defences is to deter and defend against ballistic missile attacks, their higher purpose in the context of Japan's evolving security role is to establish precedents for expanded JSDF involvement in international security matters of strategic importance to China and the US. Recognising this, and the causal links between the external problems for China created by a larger security role for Japan and the growing importance of public opinion to China's strategic policy, we can conclude from the evidence presented in this article that US-Japan BMD cooperation has further exposed the lack of trust in Sino-Japanese relations. As Andrew Kydd (2005, 3) recently observed, "states that trust each other can cooperate; states that do not end up in conflict. As such, states constantly make inferences about each others motivations." Just as the Reagan-led SDI programme was used in the 1980s to achieve political and

strategic goals in areas such as arms control and constraining Soviet military build-ups, the current Bush-initiated programme is now being used to strengthen America's strategic position in Asia. This, for now, despite the subtle policy shifts brought about by the recent changes of government in Japan and the US makes the very idea of missile defences one of the biggest impediments to the development of more genuinely cooperative relations between China and Japan.

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IS UNTYING OF AID THE ONLY SOLUTION TO THE PROBLEMS OF TIED AID?

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Abstract

In terms of the "two-gap" model of development, "Savings determine investments and per capita income determines savings." Since developing countries have low income and accordingly low savings, they are caught in a 'vicious circle of poverty'. It is argued that investment financed by foreign aid can break this vicious circle and connect developing countries to "the virtuous circle of productivity and growth."² It is in an attempt to break free of the vicious circle that assistance in the form of foreign aid is provided. This article provides a solution to the problem with tied aid through observations derived on using the theory of social cost and how we may use tied aid as a tool to alleviate poverty in developing countries.

Introduction

Developed nations grant aid to developing nations in many forms. Tied aid and untied aid are two such methods by which aid is distributed. In general, when aid is freely available to buy goods and services from any source, it is called untied. Aid restricted to the procurement of goods and services from the donor country is considered tied aid.

Tied aid, as defined by the U.S. Export-Import Bank, is "Government-to-Government concessional financing of public sector capital projects in developing countries that require the recipient government to purchase goods and services from the donor government." Tied aid is provided by the aid agencies of developed-country Governments, sometimes in joint financing packages with their national export credit agencies. It usually involves total maturities of longer than 20 years; interest rates equal to one-half to two-thirds of market rates in the currency of denomination; or large grants (equal to more than 35 percent of

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² Zulfiqur Ahamad Amin, "Aid and deepening poverty" Documents for small and business professionals, found at <http://www.docstoc.com/profile/zulfiqur786> accessed on 14th September 2010

contract value) offered in conjunction with regular export credits. Regular export credits - involving terms up to and including 10-12 years - are not considered tied aid.³

It has been observed that while the conditions of tied aid generated by a donor imposes damage to the development of the recipient, circumstances where the recipient extricates itself from receiving tied aid creates similar damages to the donor. What drives the donor countries to provide tied aid to its recipients is to create a market for its exports; hence, if the world moves towards untied aid, the donors could loose their drive to grant aid to developing nations. The question then becomes: should either party loose out by untying aid in full? As Coase affirms in his article *The Problem of Social Cost*, "the problem is to avoid serious harm"⁴ which requires one to examine issues "in total and at the margin".

However, "the standard economic policy analysis involves the comparison of some existing situation with the ideal optimum conditions of welfare economics, and when there is a divergence, recommending policies which will move the market to this ideal achieve optimum." (Medima 1998, 164) According to this standard economic policy, in order to achieve the optimum condition of welfare economics, the donor countries themselves have decided to untie aid with the hope that this would eradicate the harm caused by tied aid and help achieve the goal of an aid free world. Yet, as stated in Coase's article, what needs to be done is to take the situation in its entirety and compare it with the total effect of the policy change. What is required are policy recommendations that should take into account how the market actually operates and how the donor carries out the tasks entrusted to it. (Weston 1974, 183) As stated by Coase, "in order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost. (...) Once the costs of carrying out market transactions are taken into account it is clear that (...) a rearrangement of rights will only be under taken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about." (Coase 1960, 1)

³Office of Finance, Department of commerce USA, "What is tied aid" Found at <http://www.ita.doc.gov/td/finance/22.html>, accessed on 10/10/2010

⁴ Ronald Coase, "The Problem of Social Cost" *Journal of Law and Economics*, October 1960.

This paper lays down the rationale for pursuing tied aid, the setbacks of following this course of action and the “cost” of the move towards the ‘untying’ of tied aid. It observes the market for tied aid and its behaviour, and the impact of choosing this instrument and concludes by proposing a solution that would boost development in the recipient countries while accruing minimum transaction cost.

Why Tied Aid Exists

In order to understand how tied aid could be regulated, the paper will first look into the reasons for its existence.

From a “macroeconomic perspective tied aid is the financial outflow of funds from the donor country” which a donor “concerned with its balance of payment will usually offset by increasing their exports through aid tying.”⁵ For example, if a donor country is to provide aid for the construction of highways in the recipient country, it will tie the recipient to export machinery, equipment and other materials necessary for the construction of the highway from the donor country at the expense of the recipient.

Often business lobbyists of donor countries advocate for tied aid as it provides them with indirect subsidies if the funds are spent on their products. At times tied aid is even used to unload excess goods, which would not otherwise be sold. (A. Shah 2010) Some firms in donor countries may view tied aid as a means to help them win contracts less competitively amongst the aid recipient countries. This would imply a subsidy to enterprises in donor countries

However, tied aid has been found to bring no macroeconomic benefits to a donor country as it merely represents a small percentage of a country’s total exports (Cambridge International Model United Nations XIII 2007, 5-6). Therefore it is improbable for a donor to say that it provides significant macro-economic benefits to any donor’s domestic employment or balance-of-payment aggregates. Nonetheless, aid in general is perceived to be necessary for the development of all countries. The reason being that aid increases the financial capacity of developing nations to procure the products of developed nations in the future. This has tremendous macro-economic value to the developed nations. Therefore if one looks at tied aid as opposed to untied aid we see that a donor country has at times more benefits in pursuing a policy of tied aid than the alternative.

⁵ Policy brief ,Untying aid to least developing countries, OECD, July 2001, www.oecd.org/dataoecd/16/24/2002959.pdf

Additionally, development assistance extends beyond mere economic exchange. It is seen as an “expression of donors’ intent and willingness to cooperate on a personal level with the citizens of developing countries”. (Cambridge International Model United Nations XIII 2007, 5-6) To emphasize on these, many donors want their aid efforts to be clearly visible. Tying aid to the purchase of goods and services of the donor country can sometimes provide such visibility.

On the subject of untying aid, donors have argued that recipient governments may be incompetent or unrepresentative, and thus less qualified to determine how aid should be spent. The argument set forth by the donor countries is that “tied aid prevents the effectiveness of aid to be affected by any corruption or incompetence of the recipient government”. (Cambridge International Model United Nations XIII 2007, 6-5)

Not only does tied aid regulate abuse and corruption, but it also generates quick responses from the recipient government, as time is money and the government institutions that conducts the project is answerable for any delay. (Cambridge International Model United Nations XIII 2007, 5-6)

From a political perspective, “some donor governments have argued that tying aid strengthens public and business support for the aid effort. Untying aid, in turn, could then negatively influence already squeezed aid budgets”. (Cambridge International Model United Nations XIII 2007, 5-6) In my view most recipient countries agree to a tied aid agreement for two reasons: first, the necessity for financial aid and second, the necessity to build good relations with stronger and more powerful countries.

Problems with Tied Aid

This section looks at the problems faced by the recipient countries when they burden themselves with tied aid. It is necessary to understand the problems caused by tying aid in order to understand the arguments favouring the untying of aid.

Due to the circumstances that initiate the recipient countries to enter into agreements for tied aid, tied aid creates adverse political, social and economical consequences on developing countries. In order to understand why tied aid may not be considered to be a good policy decision by either developing or developed nations, there is a need to examine the drawbacks of tied aid.

Wealthy donor governments frequently "tie" their foreign aid by linking official support for developing nations to the procurement of specific goods and services from the donor nation. (Rosefsky 1993) In other words, "tied aid is concessional financing linked to the procurement of particular goods and services from the donor country". (Barreda 1993) This means that tied aid orders developing nations to buy certain products exclusively from the donor country in return for development assistance. (Deen 1994) In the year 2006, it was reported that "about 60-75 percent of Canadian aid is tied (one of the world's highest amounts). The US, Germany, Japan and France... insist (ed) that a major proportion of their aid money be used to buy products originating only in their countries." (Cambridge International Model United Nations XIII 2007, 5-6) For example, studies reveal that Japan, being the single largest donor to The Philippines, "earns from 75 to 95 cents for every dollar of aid it gives from the goods and services of the recipient country". (Nora 2008) The recipient country ends up paying the majority of its loan money back to the donor country and further ends up with the burden of being in debt to the donor. Therefore in addition to the debt the recipient country owes the donor, it additionally pays the donor country more than half the loan amount through tied aid transactions.

Another downside of tied aid is the fact that it is more favourable to capital-intensive projects than poverty focused programs. It generally leads to the use of such goods, services and technology which some recipient countries almost never have the capacity to maintain or utilise, and which would conflict with their priorities and specifications. (Simon 2003) Therefore, at the end of the project period, the developing country generally is not able to maintain the structures and equipment left behind in an optimal fashion. In certain instances the recipient country may not even be able to afford to repair equipment when needed. The funds spent on such technology become a waste. Furthermore, the concentration on capital based projects would completely divert the donor countries of its main goal of reducing poverty of the recipient country.

Moreover, it is not only the economy of a country that is affected by these tied aid agreements. In certain instances, the welfare of the people of a country is affected to a significant extent. Requiring that goods and services be bought from the donors' industry denies the recipient country the benefit of free trade and the best-value goods and services available in the global market, thus diminishing the value of the aid and the projects that it supports. (Arrowsmith and Chimah 2009, 707) For example, the US, as a condition to funds being doled out to Africa to fight HIV/AIDS, insist that the continent's governments purchase anti-AIDS drugs from them instead of buying cheaper generic products from South Africa, India or Brazil. As a result, Africa must use drugs, which cost these governments

up to US\$ 15,000 a year compared with US\$ 350 annually for generics. (Deen 2004) The recipient country loses its chance of optimizing on financial aid by utilizing the same funds for better value drugs.

Further, tied aid has now evolved in to an instrument used by powerful donor nations to control public opinions and voices of their recipient countries. One such example is the African Growth and Opportunity Act (AGOA), US legislation signed in May 2000. Rules of origin for goods exported under AGOA have been written specifically to create markets for US materials, and do not sufficiently guard against wholesale use of foreign materials and even foreign work forces. (Deen 2004) Under the said Act "If a country is to be eligible for aid under AGOA, it has to refrain from any actions that may conflict with the US's "strategic interests" (Deen 2004)

"The potential of this clause to influence (the) countries' foreign policies was hinted at during debates at the United Nations over the invasion of Iraq." (Deen 2004) As a result, several African members of the UN Security Council, including Cameroon, Guinea and Angola, were virtually held hostages when the US was seeking council support for the war in 2003. "The message was clear: either you vote with us or you lose your trade privileges". (Deen 2004) Such tied aid agreements infringe on a nations' sovereignty and commit them to economic policies that harm the most vulnerable people of these countries. (Deen 2004)

The Untying of Aid

In order to understand whether the untying of aid is the best possible solutions in the aforementioned scenarios, it is important to understand the steps already taken towards achieving this.

The first attempt at untying aid was made in 1969 and thereafter in 1974. Despite donor countries agreeing to the "Memorandum of Understanding for the Reciprocal Untying Bilateral Development Loan", this agreement never became fully operational. (Wire 2008) However, the biggest effort to untie aid was made through the Paris Declaration on Aid Effectiveness. Officially, the Paris Declaration aimed to lower the transaction costs faced by the recipient countries from administering aid flows. It focused on the delivery of aid to partner countries based on their priorities and aimed to "ensure that the country had the strategic and financial capacity to implement them". (World Bank 2008) It strove to make aid delivery more prompt and to decrease tied aid. The aim was that the donor countries were to achieve these targets by 2010. However, the Declaration failed to achieve these targets or to reduce the higher transaction cost the process

imposes on the recipients. We have now reached the later end of 2010 and yet are no closer to achieving these goals. (World Bank 2008) And the targets and deadlines for decreasing tied aid in the Paris Declaration remain extremely vague.

In addition, although a majority of the donor countries claim that most of the aid is already untied as per the terms of the Paris Declaration, “there is an absence of quality control, data presented by the donors and the partners of the Paris Declaration when completing the monitoring questionnaires. For example, a majority of the questions are addressed only to the donors, which makes it very difficult for partners to verify the data provided to them by the donors. As a result, when the donors report that the majority of their aid is untied, it is very difficult to challenge the data”. (Venter 2008)

It has also been observed that contrary to the stated objective of the Paris Declaration, there is a lack of mutual accountability. If the “recipient” countries do not perform, they are subjected to penalties but if the “donor” countries (Amin, 2009) do not perform, there are no penalties. On the issue of loan risk, for example, in normal business transactions, lending banks take risks as well as the borrowers but in the aid architecture proposed by the Organization for Economic Corporation and Development (OECD), only the recipient country takes all risks. (Amin 2009)

Further criticisms of the Paris Declaration has been levelled at the compliance tests administered by the World Bank as it fails to take account of the economic and social policies of the “recipient” countries. It has also been observed that aid giving is still governed by the donors who determine the method of harmonization by use of procedures that may be considered alien to recipient country. (Amin 2009) Therefore, although the Paris Declaration talks about “national ownership” where the government exercises effective authority over development policies and activities (OECD, 2008), the reality is quite the opposite in many cases.

As has been mentioned, it is also noted that “if the performance of the recipients falls short of the expected indicators, then direct budget support. (Tandon 2008) It can become the instrument for stopping flow of aid when a country fails to meet the targets set by the donors and the World Bank. “On the current trend of aid giving the poverty reduction strategies’ and assessment undertaken by the World Bank (see World Bank Comprehensive Development Strategies and Aid Effectiveness Reviews) show that very few of them provide the level of operational detail that specifies how objectives are to be achieved through policy actions”. (Tandon 2008) At the UN General Assembly held in Sept 2010, German

Chancellor Angela Merkel dismissed the commitments made in 2000. "The international community gave itself real goals 10 years ago," she said. "Unfortunately, today we have to recognize that we are probably not able to reach these objectives." She blamed the poorest countries for the failure to achieve these targets, warning them that "development aid cannot continue indefinitely." (Auken 2010) US President Barack Obama sounded similar themes, he proclaimed that his administration is "changing the way we do business" in relation to international aid. "For too long we've measured our efforts by the amount of money we've spent," he said. Such assistance, he stressed, bred "dependence," insisting that this was "a cycle we need to break." (Auken 2010)

Although the Accra High Level Forum was held in September 2008 in an attempt to improve and monitor the progress of the Paris Declaration, it has been stated by Transparency *International* "the Accra Action Agenda, ultimately fell short on specific time lines and concrete commitments to increase accountability and transparency in the development process". (Jcollodi 2008) Despite its nice language and promises, the Accra Action Agenda (AAA) does not have enough benchmarks and measurable outputs". (Ibid) "It is not enough when donors say they will 'untie aid to the maximum extent', without defining what that means". (Ibid) Though partial success was achieved in improving the medium-term predictability of aid with a commitment from donors to provide "regular and timely information on their rolling three to five year forward expenditure and/or implementation plans". (Tujan 2009) There was no further progress on untying aid beyond what the Development Assistance Committee of the OECD had agreed in May 2008, i.e. to extend the process to eight more countries that were part of the Heavily Indebted Poor Countries (HIPC) initiative. (Tujan, 2009)

Although donors agreed to "elaborate individual plans to untie their aid to the maximum extent", there is no timeline set on when they are to produce these plans, nor was any target specified. In addition, there was no agreement to extend aid untying to technical assistance aid or food aid. It has also been observed that there was resistance from many donors, including the European Union, for specifying a timeline, along with stubbornness from the US against approving even the mere mention of "food aid", despite a push from the French for including the phrase "more flexible use of food aid". (Accra Agenda, 2008) Such behaviour has led many critics to say that "under the pretext of making aid more effective and accountable to the citizens of the 'donor' countries, the concept of 'Aid Effectiveness' under the Paris Declaration is a form of collective colonialism by Northern 'donors' of those countries in the South that (because of their weakness and vulnerability and psychology of 'dependency') allow themselves to be subjected to it." (Tandon, 2008)

Scholars such as William Easterly, formerly working for the World Bank, argued that top-down, donor-driven aid does not work and that aid can only play a supportive role to domestic efforts. Stephen Browne (2006) emphasized on inadequate market signal mechanisms in the aid market and the way in which donor domination distorts supply and demand. Roger Riddell (2007) showed how short-term political interests distort aid and argued that the aid industry must change radically to become the effective 'force for good' that it is often claimed to be. (Picciotto 2007)

Therefore it can be observed that, as stated by Riddell and Lancaster (2006), the purposes of aid are mixed and even though ethical concerns dominate the realm of aid, considerations of national self-interest inevitably come into play. This clearly shows, as concluded by Lancaster, that "assessing aid as if poverty reduction as its only motivation is self-defeating" (Amin 2009)

Coasian View on Tied Aid and Efficiency

As mentioned in the introduction to this article, in order to achieve the best possible solution to a problem, one must look at the problem comprehensively and bear in mind that countries are controlled by the representatives of its people. Therefore, a responsible country would act to ensure that it achieves its goal with minimum transaction cost.

It is now well known and understood that tied aid is more beneficial to the developed donor than the developing recipient. So, taking the net result of tied aid we see that the donor country achieves its goals in terms of its aid obligations and further lays down the foundation for a prospective market of its manufactures. The developing nation on the other hand, will be pushed into a situation where it is in debt to the donor country in addition to being left with addressing the significant additional inefficiencies created by the tying of aid.

Therefore, if one is to observe the concept of tied aid in terms of the example given by Coase (1960) in the *Problem with Social Cost*, the tying of aid is a by-product of a donor country's long-term plans to ensure its own development. To put it metaphorically, the smoke that comes out of the factory is the tied aid while the product of the factory is the gain to the development of the donor country, while the neighbours in the adjoining lands are similar to the recipients and the harm they suffer is the stagnation of development and accumulation of debt. In this regard the argument that the benefit from the factory in Coase's case is purely to the factory owner i.e. the donor.

The lack of progress towards untying aid in the Accra Action Agenda, and the behaviour of the donor countries as a whole indicate that the transaction cost of untying aid (together with current market conditions) outweighs the profit gained by receiving aid.

Aid reflects the desire of the donor countries to provide income support to reduce poverty and raise consumption levels. However a second key motivation (in addition to the political gain) for aid is to facilitate economic development and growth by directly investing in the productive capacity of the private sector of the donor country. (Tekin et al. 2008)

In monetary terms, the tied and untied aid differ in a fundamental way that a donor country would provide aid to a recipient where it is felt that the economic gain of doing so will far outweigh the outcome of using the same money in its own country. Not only does tied aid ensure that the donor country can invest most of the aid back into its own country but it also minimises the flow of currency that goes out of the country while ensuring that more currency would flow in. "The problem which we face in dealing with actions that have harmful effects is not simply one of restraining those responsible for them. What has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produces the harm." (Coase 1960) What could happen in a situation where policy demands untied aid is that where the transaction cost is higher than the end profit, the donor countries are likely to use its money within the country for its own development rather than use it for donating aid.

Thus, untying all aid given by donor countries to recipient countries could cause the recipient to lose any aid it may gain by obtaining tied aid. However, on the other hand, by obtaining tied aid under the present environment, the recipient countries will face great difficulty in achieving its developmental goals. The question then becomes: How can this problem be solved?

Proposed Solution

If history is to serve as a lesson for our future, it can be observed that the "global economic recession in the early 1990s produced large fiscal deficits in donor countries that led to deep cuts in Official Development Assistance (ODA). Aid fell from 0.33 percent of gross national income (of a donor country) in 1992 to 0.22 percent in 1997. Therefore, aid cuts at this point in time would place a dangerous

additional burden on developing countries already faced with restricted sources of income and increased poverty, and perhaps undo some of the progress already made towards meeting the Millennium Development Goals.”(Ahamad 2008) Therefore looking at the current economic situation from a developing country’s point of view, it is advisable not to disregard tied aid altogether.

A developing country can never claim tied aid as their due since aid is something that a donor country provides at its own will, and in turn expects that part of the aid would be invested in their country. The problem, however, occurs when the developing country is saddled with the burden of paying the loan as well as the interest due on the loan in addition to being burdened with goods it cannot afford to maintain or run, whereas, the same amount of aid could have been utilised more efficiently had it not been tied.

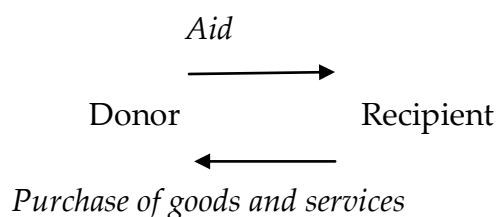
This being the context, the question of maximising the benefit of tied aid still remains. Can it be done at all? Given that tied aid is that last bit of aid a developing country can scrape from a donor (If not it would never have been tied in the first place), they should try to take advantage of the situation. The answer to these questions could lie in the highly controversial derivatives market. In this regard, payments made on tied aid in light of a swap transaction in the derivatives market have been observed.

The basic idea of a swap is that “if I find an obligation to pay money that I think is too onerous then I can swap that obligation for one which I consider to be acceptable.”(Hudson 2009) A swap is a mode used by parties to benefit from the position of another party. For example, the reason that a party enters into swap transactions such as foreign exchange swaps is for mutual benefit wherein one party is a foreign exchange spot trade, and the other is a foreign exchange forward transaction.

The recipient countries could solve this issue by entering into agreements that complement the tied agreement while being beneficial to both parties in the long term. It is clear that donor countries are more inclined to provide tied aid for commercial investments. Therefore by investing in tied aid projects where there is an industry in the donor country and a market in the recipient country could benefit both counties. This could be done by netting off the payments owed to the party by its counterparty.

Figure 1: Proposed Netting- off Transaction

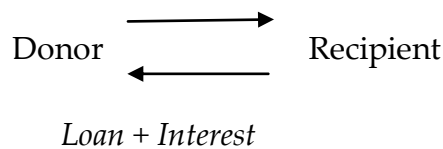
Beginning of the transaction



(Donor gives aid to recipient, recipient purchases good)

Conclusion of transaction

Purchase of goods and /or services



{Donor purchases goods/ services from Recipients, which is netted off for the loan + interest payable to the recipient}

Source: Senanayake, H (2010)

A very simple example of this would be if a recipient country needs to improve its port but does not have the financial or the technical capacity to do so. In such a case, assistance in the form of tied aid can be utilised for an extension of the port. However, instead of paying back the aid loan and interest due, the recipient will reciprocally allow ships from the donor country priority over other ships to enter into that particular portion of the port. The aid will be paid to the donor country by netting off the port charges and costs against the tied aid loan granted by the donor. Furthermore, on the assumption that the extension of the port is large enough to dock more than one ship, the recipient country, while accommodating the donor country loan can in addition profit from the other ships that may come into the port.

An example of a more complex nature to optimise on this mechanism is by applying it on a social policy such as education where a donor who has an excess of unemployed teachers would grant tied aid for development of education on the basis that the loan cost will be netted off against the expenses the donor will

incur by the existence of the unemployed teachers within the donor country i.e. payment to the teachers at price agreed by parties will be netted off against the salaries of the teachers. Here aid is tied by making it mandatory to recruit foreign teachers, while this will depend on the amount of teachers necessary, their wages etc. The said teachers will be in the country until the debt due under the loan is repaid in full (these netting off transactions will solely be for the purpose of payment and will be independent of the tied aid agreement). It is pertinent to note that while this solution derived at by observing how a swap transaction works it is not meant to be identical in nature to that of a swap.

Though there are solutions to the problems caused by tied aid, there is also a threat that there might be an increase in the amount of tied aid while decreasing the amount of untied aid. Therefore regulators should concentrate not on the untying of aid but on optimizing on the quota of tied and untied aid that a donor country may give to developing countries as is agreeable to both parties concerned. In order to increase the bargaining power of the recipient country, it may put forward the developmental projects that it intends to start so that based on their needs the donor countries may decide which project they wish to invest in. This in turn would elevate the bargaining power of a recipient country.

However a distinction should be made between solutions such as these and commercial agreements such as contracts like the joint venture between De Beers and the Government of Botswana. In the case where the parties are two countries, firstly the donor country has no holding or title to the development and there is no obligation on the developing country to comply with the demand of the donor (this minimizes the occurrence of situations such as “the plight of the San’s in resettlement”. (Tekin et al. 2008) Secondly because the donor country has no control over the development project upon its completion, the whole profit derived from the development is with the recipient.

Conclusion

The time has come for taking a new approach to tied aid whereby it creates an environment, which is beneficial to all parties. Clearly the steps taken so far are not adequate in resulting in the efficient untying of aid. As Edward de Bono once said “We may need to solve problems not by removing the cause but by designing the way forward even if the cause remains in place.” While developing countries should not attempt to untie the aid already flowing their way, it would be beneficial for all parties involved to invest the aid money in areas that both the parties are interested in. In return for the tied aid, the recipient should agree to prioritise the donor. If recipient countries are creative enough, this method may

be used by countries even for infrastructure development projects such as construction of highways.

While this does not create a complete win-win solution to both parties, this would bring us closer to the goal of effective development by increasing the bargaining power of the developing countries and making their voices heard in the area of tied aid. It may also bring us closer to the day where the world would no longer be in need of developmental aid.

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REVIEW OF DAVID KILCULLEN'S COUNTERINSURGENCY

Reuben Hintz

The spring of 2006 was a dismal time for US foreign policy. The combination of the Taliban's defeat in the fall of 2001 and the capture of Saddam Hussein in 2003 had seemed to signal that the American "neocon" strategy of regime change by military force was infallible. Yet, less than three years later a full-scale insurgency continued to rage in both Iraq and Afghanistan. In Iraq an all-out civil war between rival Sunni and Shiite communities threatened to break out, while the US and its "Coalition of the Willing" seemed powerless against local militants who relied upon little more than homemade bombs. In Washington decision-making circles, an increasing number of influential voices began to argue for a complete withdrawal from the country.

Into this setting stepped one of the more unlikely protagonists of American history. David Kilcullen was a consultant on counterinsurgency with a resume that read like a Hollywood script: As an Officer in the Australian Army, Kilcullen became fluent in Indonesian and spent time training with Indonesian Army units. This led to a PhD dissertation on the insurgency that

occurred in West Java in the 1950s and 1960s, based on 4,300 hours of oral interviews with locals who had lived through the events. In 1999 Kilcullen went to East Timor with the Australian Army, where he found himself in the middle of the largest firefight between INTERFET and Indonesian middle forces. Upon leaving his old job in 2005 to join the US government as an advisor, Kilcullen was arguably the world's pre-eminent expert on counterinsurgency theory.

Kilcullen's first contribution to the effort to help stabilise Iraq came in the form of a short paper called *Twenty-eight Articles*. This modern update to T.E. Lawrence's famous *Twenty-Seven Articles* was an attempt to provide succinct and relative guidance to American foot soldiers that were experiencing the difficulties of fighting a low scale counterinsurgency that they were never trained for. Each of the articles is only a paragraph long and cuts straight to the point. The issues Kilcullen addresses seem obvious, but represent a revolutionary change in mindset for a military that still retained much of its Cold War mentality. "Know

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your turf. Know the people, the topography, economy, history, religion, and culture. Know every village, road, field, population group, tribal leader, and ancient grievance,"¹; "a defection is better than a surrender, a surrender is better than a capture; and a capture is better than a kill."²; "Provided you mobilise the population, you will win."³ Within days of being drafted, Kilcullen's pamphlet went viral around the US military and its allies. Later, Kilcullen joined the staff of General David Petraeus and assisted him in the planning of the now infamous 'Surge' effort in 2007. Kilcullen has gone on record as declaring the invasion of Iraq "a mistake,"⁴ yet his ability to apply academic lessons to difficult real world situations played a crucial part in allowing the US to salvage what it could out of what had seemed to many like a lost cause.

Given his military background, what is most striking about Kilcullen's message is how much he sounds like a political scientist. The core of his argument is that counterinsurgency campaigns are about governance and institutional capacity, not just fighting. Kilcullen quotes French theorist Bernard Fall "a

government that is losing to an insurgency isn't being out-fought, it's being out-governed."⁵ In other words, successful insurgencies thrive on the inability of the host state to carry out the basic institutional functions of providing security, law and order. If the legitimate government, which is supposed to be providing these services, is absent, another actor will appear on the scene to fill the gap. While military force might cause an insurgent force to temporarily lay low, the only way to truly bring about long-term peace and stability is building up local institutional capacity.

The main limitation of *Counterinsurgency* is that it appears to be a hurried compilation of various short pieces by the author. While there is nothing wrong with compilations, the failure of the publisher to explicitly state that this is what is on offer might disappoint some readers. The essays range from the afore mentioned *Twenty-Eight Articles*, a section on using metrics in counterinsurgency, a history of the Java insurgency of the 1950s and 1960s, an in-depth and very personal account of the brief firefight the author experienced in East Timor, and the implications of facing a counterinsurgency against terrorist networks which are global in nature instead of localised like their predecessors. While all the essays are

¹ Kilcullen, David, *Counterinsurgency* (2010, Oxford University Press), p. 30

² Ibid, p. 45

³ Ibid, p. 48

⁴ Kilcullen, David, *Small Wars Journal*, "My Views on Iraq," July 29, 2008, <http://smallwarsjournal.com/blog/2008/07/my-views-on-iraq/>

⁵ Bernard B. Fall, "The Theory and Practice of Insurgency and Counterinsurgency," *Naval War College Review*, U.S. Naval War College, Newport Rhode Island, April 1965.

useful, it is still somewhat unfortunate that a book with such a definitive title is not definitive in substance.

There is no guarantee that the ongoing Afghanistan 'surge' effort, which includes many hallmarks of a Kilcullen sponsored effort, will turn out the same way as its Iraqi predecessor did. Between ongoing allegations of corruption in the Afghan government, geography that is far more rugged than Iraq, and a population that has a historic reputation for outlasting invading foreign armies, the success of even the most well-planned campaign is far from

assured. Yet, whatever the outcome of the US led campaign in Afghanistan will be, policy makers around the world would be wise to study the principles that Kilcullen espouses. The reality of ongoing civil conflicts in Columbia, the Congo, India's "Red Corridor," and the potential for future strife in a dozen other locales suggests that the ability to develop and implement effective counterinsurgency policies will unfortunately remain an important skill for practitioners for a long time to come.

REVIEW OF ERIK REINERT'S *HOW RICH COUNTRIES GOT RICH AND WHY POOR COUNTRIES STAY POOR*

Zanele Hlatshwayo

The world is witnessing a growing wave of criticism of the standard model of neoclassical development economics. This model derives from the basic principles of market economics which state that at equilibrium, the output of various factors of production are valued at the most efficient prices. The result of this engineering approach to economics has been to create a set of models that are, for the most part, greatly at odds with the empirical reality. Enter heterodox economics and Erik Reinert.

In his book *How Rich Countries got Rich and How Poor Countries Stay Poor*, Reinert joins a growing pool of researchers (including the prominent economist Joseph Stiglitz), who are offering alternative theories distinct from the standard neoclassical model to explain economic phenomena. Reinert's primary argument is that there is a dichotomy between the recommendations that are offered to developing nations by development officials from the industrialised world and the policies adopted by such nations when they themselves were on the path towards development. He rejects Ricardian economics which states that economic efficiency requires nations to specialise in the production of items for which they enjoy a comparative advantage and import

those good and services which they produce less efficiently. This theory, according to Reinert, is underpinned by two flawed assumptions: firstly, that there are no qualitative differences between economic activities meaning that there is no difference for instance between specialising in manufacturing or agriculture. The second assumption is that there is no room for a change in specialisation. Reinert argues that if this international trade theory is adhered to, developing countries are likely to land in a poverty trap, "into primitivisation: specialising in being poor" (Chapter 4).

The Ricardian model is exactly what international institutions are imposing on developing countries today by encouraging them to gear their whole economies towards raw materials. They are encouraged to focus on one tradable commodity rather than diversify. In addition, developing countries are often forbidden from using tariffs, subsidies, or other forms of market protection to develop any kind of manufacturing industry. The example of Mongolia offered by Reinert supports this claim. According to Reinert, Mongolia was chosen to become 'the World Bank's star student of the former Second World' just after the collapse of the Soviet Union (Reinert 2008, Chapter 3). It was

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supposed to open up its economy to globalised trade and specialise in the production of computer software. The result was that Mongolia's growing industrial sector was destroyed, wages were halved and the project of producing computer software was a failure, given that Mongolia's infrastructure was not adequate for such a strategy. Reinert labours the point that the key to development lies in the synergy between different sectors of the economy: that agriculture will be more productive when manufacturing is present.

This book's answer to the problem of development is based on one simple principle: emulation. Reinert encourages developing nations to follow in the footsteps of industrialised nations at the time when they chose to develop their economies. This primarily entails protecting infant industries until such a time that they are able to compete internationally. Industrialising nations in the early 1700s sought to attain manufacturing parity with their neighbours with the judicious usage of tariffs and patent protection. They emulated industrialised countries in the importation of raw materials and the exportation of manufactured goods (Reinert 2008, Chapter 5).

Examples used by Reinert include wealthy countries like Holland, England, and Italy, which developed through rounds of diversification and industrialisation protected by government intervention. Holland followed the process through ship-

building and England started with wool, and later developed its cotton industry. Both nations accepted that selling finished products was more productive than selling raw materials. As such, they used tariffs and sanctioned monopolies to protect their early industries from foreign competition.

Reinert offers another assault further in the book, this time on the idea of globalisation as the solution to the troubles of developing countries. In his chapter '*Globalisation and Primitivisation: How the Poor Get even Poorer*', Reinert makes the contrarian argument that although there may be benefits to globalisation, there are also arguments against its implementation. (Reinert 2008, Chapter 7). The obvious benefits include increasing returns to scale, technological change and innovation, but the problem, according to Reinert, is that neoclassical economic analysis does not adequately capture the reasons behind the skewed results that invariably occur when hugely disparate economies (technological levels, productivity and differing layers of human capital development) are forced to compete in the same space. The antidote to this effect, he argues, is to adopt protectionist trade principles before embarking on freer trade.

Although Reinert tackles key questions in depth throughout the book, some issues are left unaddressed. For example, while the role of regional integration is widely regarded as being key to economic

development, it is hardly mentioned in the book. What is also missing from Reinert's work is an analysis of how nations seeking to industrialise can obtain developmental capital without being constrained by the international financial institutions and their lending conditions which promulgate neoclassical economic policies. Nevertheless, Reinert's central thesis remains intact throughout the book: recommendations offered to developing nations that are based on Ricardian principles of comparative advantage will not work. In sum,

Reinert has produced a remarkable and historically aware book that at the very least adds freshness to the debate on how to tackle the serious problem of economic development. It exposes the neoclassical economics as embedded in the Washington Consensus as inadequate. It lands powerful punches and leaves the reader wondering indeed whether the conventional path to economic prosperity is the correct path at all. "Do not do as the Americans tell you to do, do as the Americans did," concludes Reinert.