Breaking the Weak Governance Curse: 
Global Regulation and Governance Reform in Resource-Rich Developing Countries

by

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A thesis submitted in conformity with the requirements for the degree of Doctor of Juridical Science

Faculty of Law
University of Toronto

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Abstract

There is growing consensus that unless resource-rich developing countries improve their domestic governance systems, rising exploitation of mineral, oil and gas resources may result in long-term adverse developmental outcomes associated with the “resource curse”. Despite the consensus, reforms do not abound. This dissertation investigates the obstacles to such reforms, and the mechanisms and strategies that can possibly overcome these obstacles.

I argue that two trapping mechanisms are binding these countries to a “weak governance curse”. One mechanism is the phenomenon of path dependence, which makes a dysfunctional governance path initiated at a past historical juncture resistant to change over time. The other mechanism is rent-seeking behaviour associated with high resource rents, which creates perverse incentives for political and economic actors to resist reforms.

The Law and Development literature has recently produced a rich body of knowledge on governance reform in developing countries, yet it has largely neglected the potential role of
innovative global regulatory mechanisms, beyond development assistance, in this process. I argue that this evolving literature ought to draw from global regulation studies to investigate the interaction between unconventional global regulatory mechanisms and domestic governance reform. In this thesis I analyze whether extraterritorial home country regulations, such as anti-bribery, anti-money laundering and securities disclosure regulations, and transnational public-private partnerships, such as the Extractive Industries Transparency Initiative, may offer institutional opportunities for external and internal actors to facilitate policy reforms in resource-rich and governance-poor countries.

My conclusion is twofold. First, there is reason for cautious optimism regarding the potential for unconventional global regulatory mechanisms to provoke positive feedback effects in domestic governance reform. These mechanisms can open innovative institutional pathways of influence to outsiders and insiders promoting governance reform. Second, instead of searching for a regulatory silver bullet, the most promising way to promote reforms in resilient dysfunctional governance systems is to make use of the wide range of conventional and unconventional mechanisms available. A constellation of regulatory instruments opens up the possibility for outside and inside reformers to benefit from a different policy mix of available mechanisms, depending on the specific circumstances of a given country at a particular time.
Acknowledgments

Writing this doctoral dissertation was a formidable challenge. I am most grateful for the help, support and friendship of a battalion of individuals that collectively provided me with the illumination and warmth that encouraged me to keep going each and every time I faltered along the way. They all made important contributions to this project, and are worth their weight in gold.

This thesis would not have been possible without the help, support and patience of my two co-supervisors, Prof. Michael Trebilcock and Prof. Mariana Prado. I would like to express my profound gratitude to Prof. Trebilcock, who generously shared his experience and unsurpassed knowledge. The fact that from day one, and throughout, he pressed me to clearly articulate my research questions and my tentative original contributions to scholarship and to write, write, write, did not make my life easy. And yet this was an effective and welcome driver that motivated me to transcend my own limits. Prof. Prado’s unwavering support, dedication and friendship has been invaluable on both an academic and a personal level, for which I am extremely grateful. Her sharp intellectual insights helped to shape this dissertation and to sophisticate my academic thinking in ways that would not be possible otherwise. She managed to provide her outstanding feedback and to push me intellectually in the most unassuming and friendly way, during our Wednesdays’ work sessions over coffee, which I came to look forward to and will miss dearly. Most of all, Prof. Trebilcock and Prof. Prado were inspiring examples of working hard out of sheer love and dedication to the field. I will carry this inspiration wherever I go careerwise. They are perfect illustrations that “a teacher affects eternity; s/he can never tell where her/his influence stops (Henry Adams).” I would also like to thank the exceptional contributions Prof. Steven Bernstein, Prof. Benedict Kingsbury and Prof. Audrey Macklin made to this dissertation.

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I am indebted to many colleagues and friends from the University of Toronto, including Zoe Sinel, Howie Kislowicz, Mike Pal, and from the Toronto Group for the Study of International, Transnational and Comparative Law, Claire Mumme, Carolina Ruiz, Sujith Xavier and Prof. Peer Zumbansen, who provided me with editing, peer support and insights and helped me in so many ways during these four years. I cannot thank Gail Henderson, Amar Bhatia, Kim Stanton, Amaya Alvez and Derek McKee enough, for being always ready to comment, to make suggestions, to proofread or to just be amazing friends.

The family of friends outside the law field that supported me throughout the process with their company and affection also deserve my deepest gratitude, especially Alexa, Paola & Rinaldo, Maira & Bryce, Keri, Mercedes, Ana & Anil, Luiza & Yuri, Amber, Lee, Ann & Phil, Marcia, Mary-Ann, and many others. All these individuals were essential pieces of this doctoral project. Finally, I am most grateful to my family back in Bahia, who were gracious and patient with my prolonged absence. I look forward to making up for this lost time with a lot of shared time and love.

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Chapter 1
The Resource-Rich and Governance-Poor Conundrum*

1.1. Introduction

There is a resource boom happening in very poor developing countries that are in great need of attracting foreign direct investment for development.\(^1\) Unfortunately, according to the resource curse literature, this boom will likely lead to worse development outcomes in these resource-rich but poor countries than in their resource-deprived peers in the long run. Why? This is the conundrum this chapter intends to explain, drawing from the vast academic literature on the topic.

To discuss this conundrum, this chapter will be organized as follows. Section 1.2 shows the resource boom that countries with very low development indicators and very weak governance systems have experienced in the last 20 years. Section 1.3 argues that there is strong academic consensus around the idea that domestic governance is key to improving development outcomes (“governance matters”). Section 1.4 indicates how this consensus around the critical role of domestic governance systems is also present in the literature focused on resource-rich countries (also known as the literature on the resource curse) and concludes by indicating that there is compelling evidence that resource wealth does not substitute for missing governance systems as an engine for development; on the contrary, resource wealth makes development prospects worse if there is a significant domestic governance deficit.

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1.2. The resource boom in governance-poor LDCs

The United Nations publishes an annual list of the least developed countries (LDCs) representing the “poorest and weakest segment of the international community.” In 2012 this list contained 48 countries with very low human development indicators. In these countries poverty is widespread, levels of undernourishment are very high, as are mortality rates for mothers and children under five. Literacy and secondary school enrollment rates are very low, as are the rates of access to clean water and sanitation. Most citizens in these countries lack political rights. Access to justice, including remedies for violated rights, remains a chimera.

According to Paul Collier, the bottom billion of humanity currently live in these countries. Collier argues that these countries have “missed out on global prosperity”: while many developing countries have been able to experience remarkable improvements in development indicators in the last decades, this group of countries has lagged far behind. The 2011 United Nations Report on the LDCs corroborate Collier’s arguments:

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2. The United Nations consider the following three criteria to determine if a country classifies as LDC: “(a) A “low-income” criterion, based on a three-year average estimate of the gross national income (GNI) per capita, with a threshold of $905 for possible cases of addition to the list, and a threshold of $1,086 for graduation from LDC status; (b) A “human assets weakness” criterion, involving a composite index (the Human Assets Index) based on indicators of (i) nutrition (percentage of the population that is undernourished); (ii) health (child mortality rate); (iii) school enrolment (gross secondary school enrolment rate); and (iv) literacy (adult literacy rate); and (c) An “economic vulnerability” criterion, involving a composite index (the Economic Vulnerability Index) based on indicators of (i) natural shocks (index of instability of agricultural production, share of the population made homeless by natural disasters); (ii) trade shocks (an index of instability of exports of goods and services); (iii) exposure to shocks (share of agriculture, forestry and fisheries in GDP; index of merchandise export concentration); (iv) economic smallness (population in logarithm); and (v) economic remoteness (index of remoteness). This list includes 1 country from Latin America (Haiti), 14 from Asia and the Pacific and 33 from Africa. In 2011 South Sudan was granted formal international recognition as a new country, separating from Sudan. South Sudan will likely be included as the 49th country in future LDC’s lists. See UN Conference on Trade and Development (UNCTAD), The Least Developed Countries Report 2011, online: United Nations Conference on Trade and Development <http://www.unctad.org/en/docs/ldc2011_en.pdf> [UNCTAD, LDCs 2011].

3. According to the 2012 LDC’s Factsheet published by the United Nations 832.33 million people lived in LDCs in 2010, and the projection was that this number would increase to 1.04 billion in 2020. More than half of the LDCs’ population in 2012 lived on less than $1.25 (PPP) per day. Only 36% of population had access to improved sanitation facilities. UN Development Policy and Analysis Division, United Nations LDC Factsheet, 2012, online: UN <http://www.un.org/en/development/desa/policy/cdp/ldc/profile/country_206.shtml> [UN LDC Factsheet 2012].


5. The 2005 United Nations Annual Human Development Report confirms Collier’s argument: For most of the past 40 years human capabilities have been gradually converging. From a low base, developing countries as a group have been catching up with rich countries in such areas as
Relative to the real GDP per capita of other developing countries, the LDCs had fallen from almost 40 per cent of their level in 1970 to less than 20 per cent by the mid-1990s. […] But the real GDP per capita of LDCs was only 1.5 per cent of that of developed economies in 2009. Moreover […] there has been no improvement of the real GDP per capita of LDCs relative to other developing countries. Thus, even with the growth performance they recorded during the 2000s, LDCs were not able to start a process of closing the gap with other developing economies.

LDCs generally experience a sheer lack of national capital, both public and private. They need to attract foreign capital, either in the form of official development assistance (ODA) or in the form of foreign direct investment (FDI). Yet, LDCs as a group have faced daunting challenges in attracting significant amounts of ODA or FDI, especially in the current global scenario. The life expectancy, child mortality, and literacy. A worrying aspect of human development today is that overall state of convergence is slowing—and for a large group of countries divergence is becoming the order of the day.


6 UNCTAD, LDCs 2011, supra note 2 at iv.


8 Although there is extensive debate in the literature whether both official development assistance and foreign direct investment can truly provoke positive effects on economic growth, whether there are pre-conditions for these effects to happen, and what these pre-conditions would be. David Dollar & Victoria Levin, *Sowing and Reaping: Institutional Quality and Project Outcomes in Developing Countries*, World Bank Policy Research Paper No 3524 (2005), online: The World Bank eLibrary <http://elibrary.worldbank.org>.

9 A 2009 study, for example, used a series of benchmarks to assess what would be minimal levels of ODA necessary for some development projects to succeed, and found that 37 out of 61 low income countries received insufficient ODA according to at least one of the benchmarks. The debate on how much aid would be “sufficient” is still unsettled in the literature. See OECD, Robert Utz, *Will Countries that Receive Insufficient Aid Please Stand Up* (2010), online: OECD <http://www.oecd.org/dataoecd/60/22/46859477.pdf>. See also OECD, Development Cooperation Directorate (DCD-DAC), *Annual Report: Resource Flows to Fragile and Conflict-Affected States 2010* (2010) online: OECD <http://www.oecd.org/document/13/0,3746,en_2649_33693550_45789965_1_1_1_1,00.html>. The situation is deteriorating, rather then improving, in the last years. Bilateral ODA flows to LDCs in 2011 dropped 9% in real terms as compared to 2010, for example.

10 The African continent, that houses most of the LDCs, witnessed its share of global FDI inflows reduce from 7% in 1991 to 2.7% in 2006. Since 2007 Africa’s share of global FDI started increasing, to 3.5%, and despite the global economic crisis its share grew to 5.2% in 2008. However, after reaching $17 billion in 2008, FDI inflows declined again to 14 billion in 2010. UNCTAD, LDCs 2011, supra note 2. There is a large and growing literature investigating the manifold and complex obstacles that hamper LDC’s attempts to attract FDI, with high political risks being one of the most cited. Theodore Moran, for example, argues that as opposed to portfolio investors,
only exception is FDI flows directed to the extractive sector. Resource-rich LDCs have attracted significant amounts of FDI to their extractive sector due to their resource endowments. The presence of natural resources is an absolute factor of attraction for FDI, independent of “other factors that would usually attract or discourage investors”. In countries where the resource potential is really extraordinary, like Sudan and Angola (oil), or DRC (minerals), significant amounts of FDI have been flowing for some time. However, investors have historically shown reluctance to invest in other LDCs. Despite their resource wealth, political risks and concerns with international image and legitimacy kept investors away. Yet with the multinational corporations are usually extremely risk averse, since they usually make capital intensive “irreversible commitments”. According to Moran: The list of what multinational corporate community considers the ingredients for a good investment climate is long and demanding: low inflation, equilibrium exchange rates, steady economic growth, reliable infrastructure, high literacy rates, liberalized trade, little ethnic tension, minimal corruption, stable and transparent political institutions and procedures, independent and capable judicial systems, and more recently, low incidence of HIV-AIDS, malaria and other infectious diseases and extensive access to the Internet.” Moran goes on to say that even when some LDCs have successfully addressed at least some of these issues, the perceived investment risk could remain high. Thus, these countries would also need to create investment promotion agencies to provide reliable information, reduce uncertainty and build trust. See Theodore H Moran, Harnessing Foreign Direct Investment for Development: Policies for Developed and Developing Countries (Washington, DC: Center for Global Development, 2006). See also Luiz de Mello, “Foreign Direct Investment” in David Alexander Clark, ed, The Elgar Companion to Development Studies (Cheltenham: Edward Elgar, 2006); Nathan M Jensen, Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment (Princeton: Princeton University Press, 2006); Joseph E Stiglitz, Making Globalization Work (New York: WW Norton & Co, 2006); Collier, The Bottom Billion, supra note 3; OECD, DAC International Network on Conflict and Fragility (INCAF), Ensuring Fragile States Are Not Left Behind, 2011 Factsheet on Resource Flow in Fragile States (2011), online: OECD <http://www.oecd.org/dataoecd/5/11/49108935.pdf>.

11 LDCs’ share of oil and mineral global exports have doubled in the past decade, according to the United Nations. UNCTAD, LDCs 2011, supra note 2. According to Dambisa Moyo as of September 2010 20% of US daily crude imports were coming from Sub Saharan African countries (Nigeria, Angola, Gabon, Equatorial Guinea and Congo Brazzaville). Besides attracting FDI for resource extraction from Western developed countries, resource-rich LDCs have also attracted significant amounts of FDI from China. Moyo argues that in April 2010 one third of China’s oil imports came from Africa (20% coming only from Angola and 5% coming from Sudan. See Moyo, supra note 1 at 58. On Chinese growing engagement in resource extraction in Africa see also Mark Klaver & Michael Trebilcock, “Chinese Investment in Africa” (2011) 4:1 The Law and Development Review 168.

12 Investors may use rational selection or advance planning when choosing where to invest in a new soy plantation, by evaluating water and energy availability, adequate weather, business environment, rule of law, etc. They may also avoid placing a new manufacturing plant in indigenous or ecologically rich and preserved areas. Nevertheless, no amount of technology and sound business management is able to move the oil stocks from Sudan to better-governed South Korea. Or to move the world’s current largest single nickel deposit from ecological sensitive indigenous land in Goro, New Caledonia, to conflict-free Taiwan. Jennifer L Tobin & Susan Rose-Ackerman, “When BITs Have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties” (2011) 6:1 The Review of International Organizations 1.
intensification of geopolitical factors - such as the exhaustion of easier and higher-grade mineral deposits in Western developed countries, increases in extraction costs in these countries due to more stringent environmental and social regulations, and higher demand from emerging economies – the trade-offs seem to be changing. There has been a new scramble for natural resources in the LDCs. Traditional mining economies have received larger inflows, or experienced a marked resurgence after a long period of stagnation, while others have been receiving their first significant extractive investments. There are signs that this new resource rush in LDCs is only beginning.

In *The Plundered Planet*, Paul Collier highlights the marked differences in known mineral endowments among developed countries (OECD) and the LDCs. According to his research based on World Bank data, OECD’s known mineral endowments in 2009 were five times higher than those of the LDCs. Collier argues that since the average real mineral endowments is probably similar for the two groups, this is strong evidence of the untapped potential for natural resource exploitation in LDCs. As Collier recognizes in his book, the discovery and exploitation of this resource potential in the bottom billion has already begun. FDI to the mining, oil and gas sectors in Africa, and specifically in many Sub-Saharan African countries, for example, has grown markedly in the last 10 years, with growing capital flows from emerging economies such as Brazil, India and Russia, but especially China, joining Western countries’ FDI flows. This

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13 According to the Report *Breaking New Ground*, for example:
[T]here has been a gradual migration of minerals production to many developing countries, largely because low-cost mineral deposits in [developed] countries have in many cases been mined out. The difficulties and longer lead times in getting environmental permits and the higher labour costs for projects in most industrialized countries have also contributed to this change.

14 Collier, *Plundered Planet*, supra note 1; Moyo, supra note 1.


16 Although the presence of emerging economies’ capital investments in resource-rich countries in Africa and elsewhere still pales in comparison with investments from developed countries, the very visible exponential growth of China’s investment presence in Africa in general, and in Africa’s natural resources sector in particular, has provoked a lively scholarly and policy debate on China’s motives, approaches and effects in Africa. China has jumped to 5th place as the largest country of origin of FDI in the continent in 2009. Sanne van der Lugt & Victoria Hamblin, *Assessing China’s Role in Foreign Direct Investment in Southern Africa* (2011), online: Center for Chinese Studies at Stellenbosch University and Oxfam Hong Kong <http://www.ccs.org.za/wp-content/uploads/2011/03/Final-report-CCS-March-2011-CCS.pdf>. Mark Klaver and Michael Trebilcock, for example, argue that the primary motivation behind Chinese exponential capital investments in the continent is to
trend is likely to intensify. Despite losing momentum after the 2008 global economic crisis, statistics show remarkable and unprecedented FDI inflows to Africa. FDI inflows to Africa as a continent surged in 2008 to a record level of USD $72 billion, largely due to investments in the extractive sector.\textsuperscript{17} This growth was 8% above that of other developing countries. Although FDI inflows to Africa fell around 20% in 2009 (to USD 59 billion) and were expected to fall more in 2011 (to USD 50 billion), the projection is that growth in emerging economies will prevent further declines, and that inflows will grow again when the global economy recovers.\textsuperscript{18} A very similar trend was observed in African LDCs. Increased levels of FDI inflows for this group of countries was also mainly spurred by mineral investments:

FDI inflows […] were largely concentrated in a few natural-resource-rich countries. The main recipients among the LDCs of Africa in 2008 included: Angola, Sudan, Madagascar, Guinea, Equatorial Guinea and the Democratic Republic of the Congo, in that order.\textsuperscript{19}

\begin{flushright}
secure access to natural resources, although it also seeks access to local markets and to capitalize on many African countries’ preferential trade access to developed countries’ markets. Klaver & Trebilcock, supra note 11. See also Vivien Foster et al, Building Bridges: China’s Growing Role as Infrastructure Financier for Africa (Washington, DC: The International Bank for Reconstruction and Development/The World Bank, 2008), online: European Union – Africa Infrastructure Trust Fund <http://www.eu-africa-infrastructure-tf.net/attachments/library/wb-chinas-growing-role-as-infrastructure-financier-for-africa.pdf>. There is no doubt that China is strategically seeking access to the untapped African resources, and that China’s approach of low interest rates, investment packages, and “unconditional” aid attracts much favor from resource-rich poor developing countries. Yet, the reality seems to be more nuanced, especially in what relates to China’s supposed disregard for development, and also as it relates to the effects of China’s presence in developing countries. For a noteworthy account of the peculiar characteristics of Chinese aid and FDI investment in Africa, including to the extractive sector, See Deborah Brautigam, The Dragon’s Gift: The Real Story of China in Africa (New York: Oxford University Press, 2009). Brautigam recognizes the growing presence of Chinese investments in natural resources in Africa, but places it into perspective by illuminating the presence of Western countries’ investments as well. She also proposes to demystify many of the accounts that China’s presence will derail Western attempts to improve governance and reduce poverty in Africa. For other analytical research and recent information on Chinese engagement in Africa, see the Center for Chinese Studies at Stellenbosch University in South Africa, The Centre for Chinese Studies, online: CCS<http://www.ccs.org.za>. See also Moyo, supra note 1.
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\textsuperscript{17} And yet, Africa’s share of worldwide inflows was still only 4.5% in 2010, although it grew from a very low base of 0.7% in 2000. See African Economic Outlook, External Financial Flows and Tax Receipts to Africa (2012), online: African Economic Outlook <http://www.africaneconomicoutlook.org/en/outlook/external-financial-flows/>.
\textsuperscript{18} Ibid.
\end{flushright}
By all indications, the untapped mineral endowments of LDCs are quickly being discovered, and FDI is flowing fast, from developed and emerging economies alike, to exploit these global supplies of essential minerals.

Many of the countries with the lowest development indicators in the planet are experiencing this resource boom. A quick look at the 2011 United Nations Development Program (UNDP) list ranking countries that present low human development indicators is sufficient to illustrate this fact. The table below shows the countries on that list, which included a total of 46 countries with low human development indicators in 2011. The countries whose economies rely on exportation of natural resources, or which are anticipating a significant increase in existing exporting volumes (in period 2005 to 2015) are highlighted.

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<td>Haiti</td>
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21 The 2006 Report “Meeting the Challenge of the ‘Resource Curse’”, prepared by the Bureau for Resources and Strategic partnerships of the United Nations Development Program, presents a list of low income countries that are “first timers” in terms of reliance in natural resources exports, including: Chad, Sao Tome e Princ, Cote Ivoire, Malawi, Ethiopia, Central African Republic, Benin, Nepal, Timor leste and Cambodia. Among the low income countries anticipating substantial increases in resources exports are: Tanzania, Kenya, Sudan, DRC, Sierra Leone, Angola and Equatorial Guinea. See Overseas Development Institute, *Meeting the Challenge of the ‘Resource Curse’: International Experiences in Managing the Risks and Realising the Opportunities of Non-Renewable Resource Revenue Management* (London: Overseas Development Institute, 2006), online: Overseas Development Institute <http://www.odi.org.uk/resources/docs/839.pdf>. Note that Equatorial Guinea is not included in the list of countries with low human development indicators only because it has extremely high levels of GDP per capital due to its extraordinary levels of oil and gas exports. EG’s other development indicators in health and education, for example, are equal to or worse than other low development indicators countries.
Burkina Faso  169  Sudan  157  Nepal  145  Pakistan  
180 Sierra Leone  168  Gambia  156  Nigeria  144  Sao T. Prince  
179 Central Afr. Republic  167  Benin  155  Senegal  143  Kenya  
178 Guinea  166  Rwanda  154  Yemen  142  Solomon Islands  
177 Eritrea  165  Djibouti  153  Papua N Guinea  
176 Guinea-Bissau  164  Zambia  152  Tanzania  

Table 1.1 United Nations Development Program, UNDP, Human Development indicators Report, 2011.

In the following paragraphs I will describe recent trends in three of the countries at the very bottom of the UN low development indicators list – the Democratic Republic of Congo (DRC), Niger and Mozambique - to give a better illustration of the scale of this trend.

DRC, for example, ranks 187, with the lowest ranking of development indicators of all countries worldwide. Since King Leopold of Belgium forcibly seized control of the territory surrounding the Congo River that would later become the DRC in the 1880s, this country has been an important source of renewable (rubber, ivory, timber) and non-renewable (cobalt, copper, diamonds, zinc, gold, coltan) resources to the global market. The mineral potential of DRC is considered enormous. The country is estimated to hold 65% of the world’s reserves of cobalt, and extensive untapped offshore reserves of oil. Having also been blessed with lush forests, mighty rivers and fertile lands, DRC is one of the countries best endowed with natural resources, both in Africa and globally. A history of nationalistic authoritarian rule hostile to foreign investment, followed by long years of civil war, has left most of this potential untapped.

Following a peace agreement in 2003, a new constitution in 2005, and elections in 2006, DRC

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has seen a significant increase in FDI inflows to its mining sector. From 3% in 2007 FDI grew to 14.8% of GDP in 2008. Although there was a steep drop to 5.8% in 2009, FDI inflows to DRC were expected to grow again to around 7% of GDP in 2012, mainly as a result of investments in natural resources.\(^\text{25}\) Mining activities grew 11.8% in 2010, following growth of 7.1% in 2009.\(^\text{26}\)

Just one ranking above DRC, at 186, is Niger. Niger is only now beginning to be recognized as a resource-rich country. This Western Africa country has 80% of its territory covered by the Sahara desert.\(^\text{27}\) According to Fugelstad, Niger is “one of the largest, hottest, poorest, most thinly populated, most rural and most landlocked states of the world”.\(^\text{28}\) Indeed, Niger has consistently been one the least developed countries in the world according to human development indicators.\(^\text{29}\) The country’s economy has historically relied on agriculture, and its population has suffered a long history of repeated droughts and famines.\(^\text{30}\) Niger has received small amounts of FDI to exploit its uranium resources for some time, but recent discoveries have greatly increased the amount of this country’s known reserves of uranium and oil.

In 2003, a large-scale aerial geophysical prospection campaign led by the French Mining company Areva confirmed that northern Niger held significant untapped deposits of uranium, including a deposit known as Imouraren. Situated in the North of Niger, the Imouraren deposit is expected to become the largest open-pit uranium mine in Africa and the second largest in the World Bank, Democratic Republic of Congo, Enhanced Integrated Framework Program (2010), online: The World Bank<br>http://siteresources.worldbank.org/INTCONGODEMOCRATIC/Resources/DRC_DTIS_English_August2010.pdf?resourceurlname=DRC_DTIS_English_August2010.pdf>,

26 “Several Mining firms that had shut down or reduced activity in 2009 resumed operations. In 2010, output of copper rose 54.3% and cobalt 65.3% from 2009.” China, followed by India and Korea, are emerging as investors in the DRC economy, including in mining. Turkey and Brazil have a smaller presence so far. Congo, Democratic Republic 2011, online: African Economic Outlook <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/Country_Notes/2011/Full/Dem%20Rep%20Congo.pdf>.


world. Production is expected to start in 2013 and to last more than 35 years. In 2007 uranium ore was already the country’s leading export product (218 million Euros). Although uranium revenues represented only 5% of Niger’s GDP in 2007 and generated an estimated 5% of Nigerien tax revenues, this was set to increase significantly as exploitation of Imouraren gains momentum. Niger is also exporting significant quantities of gold and it is increasing its oil production. The prospects are for Niger to fast discover more of its untapped mineral potential, and it is not alone.

Mozambique, ranked 184, is also a new member of the “resource-rich club”. As a Portuguese colony Mozambique was a source of ivory, gold, rubber, oilseeds, sugar and slaves to the global economy. After independence in June 1975, the Mozambican economy faced a series of major stumbling blocks including the effects of a violent and long guerrilla civil war, crippling external debt, droughts, floods and famines. The country became heavily dependent on foreign aid. Until 2006 mining represented only 0.5% of Mozambican GDP and made an insignificant contribution to the state budget, while mineral exports were also negligible. Meanwhile, foreign aid represented 50% of state revenues in 2006. In 2008, a world-class deposit of coal was discovered in Tete, the least developed province in Mozambique, which positioned the country to be the

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31 By October 2007 Niger had awarded 90 new exploration permits for uranium mining in the northern desert region, with 90 more under consideration. The Imouraren deposit alone was anticipated to double Niger’s current uranium ore production and to elevate the country to second place among global uranium producers. Emerging economies, especially China, are investing in Niger’s natural resources. In 2010 China Nuclear Engineering and Construction Corporation (CNEC) began a partnership with a Nigerien corporation, SOMINA, to produce uranium from the Tiguidan Tessoum mine, in the north of the country. China is expected to replace France as Niger’s leading economic and trading partner soon. African Economic Outlook, Niger, online: African Economic Outlook <http://www.africaneconomicoutlook.org/en/countries/west-africa/niger/>.


34 Jeanne Marie Penvenne & Kathleen Eddy Sheldon, eds, “Colonial Mozambique” in Encyclopedia Britannica online.
second-largest coal producer in the continent, after South Africa. Since then Mozambique has attracted massive inflows of FDI for coal extraction from Brazilian, Chinese, Indian, Australian and American corporations. Private investment increased 109% in 2009 and 66.3% in 2010, pushed mainly by investments in mega-projects to extract and export coal.\(^\text{35}\)

Significant new discoveries are occurring in a number of other LDCs. In addition to the countries mentioned above, significant new oil deposits have been found in Equatorial Guinea, Chad, Ghana, Sao Tome and Prince; bauxite in Guinea;\(^\text{36}\) diamond and oil deposits in Sierra Leone;\(^\text{37}\) as well as new gold deposits in Mali. The list could be extended.

It seems intuitive to assume that if a poor developing country - with low levels of domestic capital, with scant access to FDI and highly dependent on foreign aid - suddenly finds rich deposits of prized minerals, oil or gas, this will greatly enhance its chances of improving economic growth and other development indicators. Indeed, the economic exploitation of abundant natural resources has been historically promoted as a key engine for developing countries seeking to achieve economic growth and improve their social indicators. If this assumption is correct, the fact that at least 26 out of the 46 countries showing low development indicators have sizeable deposits of mineral resources, and that these resources are attracting

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\(^{36}\) Guinea, number 178 in the UNDP list, a country where food crisis are common, is the world’s second producer of bauxite (behind only Australia) and has around one third of the world’s known reserves of this mineral. According to Vale, a Brazilian multinational mining corporation, Guinea has some of the best underdeveloped iron-ore deposits in the world. Vale's CEO stated that “The deposits are considered as “high quality and [to have] the development potential for a large-scale and long-term project with low operating and investment costs”. “Brazil's Vale Pays $2.5 Billion For Seized Rio Tinto Ore Assets In Guinea” *Bloomberg News* (30 April 2010), online: Bloomberg <http://www.bloomberg.com/news/2010-04-30/vale-to-buy-51-of-bsg-resources-guinea-iron-ore-business-for-2-5-billion.html>.

\(^{37}\) Sierra Leone is ranked 180 in the UN list of low development indicators. Sierra Leone’s resource wealth has been known for some time. Before its long and violent civil war, Sierra Leone used to be a leading producer of diamonds, besides being rich in other precious, base, ferrous and industrial minerals. Sierra Leone’s mining sector was almost totally disrupted during the war, with the ban on its “blood diamonds” becoming a worldwide symbol of consumers’ campaigns to avoid complicity with natural resources being used to feed conflict. But new discoveries are being added to this country’s known resource endowments. The country has learned that it is also rich in oil. In 2009 American oil and Gas Company Anadarko announced a deepwater oil discovery off the coast of Sierra Leone. Alan Petzet, “Discovery off Sierra Leone May set up 700-mile play” (2009) 107 Oil and Gas Journal 36. See also *Anadarko 2009 Annual Report*, online: Anadarko Petroleum Corporation <http://www.anadarko.com/SiteCollectionDocuments/PDF/APC_Annual09_FINAL.pdf>.
FDI, could therefore present their unprecedented opportunity to finally begin to catch up with other developing countries.

In the 1980s, however, a multitude of case studies and theories began to challenge the idea that resource wealth automatically produces positive effects in development outcomes. Two of these theories are important for this chapter. One theory proposes that the key to spearhead development is not resource wealth, but sound domestic governance systems. In other words, governance is what really matters for development. I address this theory in the next section. The second theory is in fact a spin-off of the first, proposing that sound domestic governance systems are even more important for resource-rich countries, since a governance deficit is the key explanation for why some resource-rich developing countries are falling prey to the phenomenon known as the resource curse. I address the resource curse related theories in section 1.4. Together, these two theories place a major condition on the potential of the current resource boom to improve development indicators in LDCs: positive development outcomes can only take place if resource-rich LDCs possess, or if they build, sound governance systems.

1.3. The “governance matters” consensus in development studies

Since WWII scholars from fields as diverse as economics, political science, international relations and legal studies have devoted attention to the question of how developing countries can improve their social and economic indicators and close the development gap that separates them from Western industrialized countries. Development theories and practices have undergone a sea change in the last 50 years. First, the initial focus on economic growth as the primary end of development - which has been widely criticized as too narrow – has been broadened to include

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other ends such as reducing poverty and enhancing human capabilities.\textsuperscript{39} Second, and related, academia and development agencies have begun to rely on a much broader set of indicators to measure development, beyond the classic gross domestic product and income. The adoption of human development indicators (HDI)\textsuperscript{40} by the UN expanded the indicators of progress and well-being to include access to health and knowledge, besides income.\textsuperscript{41} Third, development agencies have striven to improve coherence and coordination in order to leverage various development initiatives at both the national and multilateral levels. The Millennium Development Goals (MDGs) are an example of such coordination of goals.\textsuperscript{42}

This section will address yet another relevant change that occurred in development studies, regarding the means used to achieve desired development outcomes, however defined. Different – and sometimes opposing – theories on the most effective means to achieve development outcomes have waxed and waned in the last fifty years. These theories ranged from the need to invest in infrastructure, to the need to prioritize technological transfer, to the need to radically


\textsuperscript{40} The Human Development Index (HDI) was developed to measure progress in developing countries beyond purely monetary figures such as GDP. Three key elements of development are a long and healthy life, knowledge, and a decent standard of living. Therefore data on life expectancy, adult literacy, school enrolment and GDP are combined to calculate the index. The Human Development Reports also use the Gender Related Development Index (GDI) and the Gender Empowerment Measure (GEM) to report on gender inequality. HDI 2011, \textit{supra} note 20.

\textsuperscript{41} The discussions on how to improve progress indicators continue. There are ongoing efforts, for example, to devise other indicators to measure well-being that go beyond the present time. The sustainability indicators would measure the potential reproduction or improvement of current well-being levels over time. This is the first attempt to incorporate measures of environmental conditions that may impact the well-being of present and future generations. In 2008 French President Nicholas Sarkozy created a commission formed by economists Joseph Stiglitz, Amartya Sen and Jean Paul Fitoussi, to “identify the limits of GDP as an indicator of economic performance and social progress, including the problems with its measurement; to consider what additional information might be required for the production of more relevant indicators of social progress; to assess the feasibility of alternative measurement tools, and to discuss how to present the statistical information in an appropriate way.” This Commission initiated a debate on measures of sustainability. See Joseph E Stiglitz, Amartya Sen, & Jean-Paul Fitoussi, \textit{Report by the Commission on the Measurement of Economic Performance and Social Progress} (CMEPSP) online: CMEPSP <http://www.stiglitz-sen-fitoussi.fr/documents/rapport_anglais.pdf>.

\textsuperscript{42} In 2000, the leaders of all countries in the World and representatives from the leading development agencies agreed during a UN meeting to pursue a set of targets ranging from halving extreme poverty to achieving universal primary education in each developing country. These targets, or goals, were called Millennium Development Goals. UN, \textit{United Nations Millennium Development Goals: Background}, online: UN Millenium Development Goals <http://www.un.org/millenniumgoals/bkgd.shtml>.
change the international economic and political order. The last two decades have witnessed the elevation of institutional theories of development to the forefront of mainstream development studies. Exponents of institutional theories recognize that promoting development requires policies to improve physical infrastructure, to enhance financial and human capital, and/or to address geopolitical, geographic, historical and cultural factors. Institutionalists make a compelling case, however, that investing in the improvement of the institutional, or governance framework within developing nations is the most effective way, even a pre-requisite, to promote development. A “good governance” framework, according to institutional theorists, is key to facilitate the achievement of all development objectives, and to address negative disruptions and externalities inherent in the development process.

Scholarly debates on the different and most effective means to promote development have followed a long and contested path to arrive at the present point. Modernization theories occupied centre stage in development studies in the first two decades following WWII.

Development theorists, particularly from Western Europe and North America, largely agreed on two points. First, there was an evident process of gradual decoupling of the economies of most developing countries from the economic progress experienced by industrialized developed nations. Second, this decoupling could be explained by developing countries having backward economies that were proving adverse to industrialization through successive waves of technological innovations.

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43 Despite the widespread use of terms such as governance and institutional framework in the development literature, there is still no consensus on a single definition for these concepts. Throughout this chapter I will use the terms governance and institutions sometimes interchangeably (and imprecisely), and sometimes referring to specific definitions offered by key development scholars. For a discussion on definitions of governance see Daniel Kaufmann & Aart Kay, “Governance Indicators: Where Are We, Where Should We Be Going?” (2007) World Bank Policy Research Working Paper 4370. For a discussion on definition of institutions under a political science perspective, see Andre Lecours, ed, New Institutionalism, Theory and Analysis (Toronto: University of Toronto Press, 2005).


45 Early development theorists had predicted the opposite result, expecting a convergence between developed and developing economies over time. The idea was to follow the successful experience with the Marshall Plan, when large injections of foreign aid, infrastructure rebuilding and technical assistance helped European states to steer their economies back to growth after the devastating effects of the war. It was assumed that foreign aid and state planning in developing countries would suffice to tackle any shortcomings and market failures that were hampering economic progress. It was also assumed that economic growth would trickle down to all social strata and improve other development indicators beyond the economic ones.
Some development scholars recognized that developing countries had inherited these dysfunctional and backward economies from their former colonizers, but this recognition was more in the background, having no further effect in policy prescriptions. Other development scholars, however, argued that the perpetuation of the backward characteristics of developing countries’ economies was mostly a result of, or at least compounded by, cultural and religious factors that interfered with the economic incentives and slowed down technological innovation. Either way, developing countries had to modernize their economies and their cultures in order to follow the path of industrialized countries. The focus was therefore on the need for states in developing countries to adopt key domestic economic policies.

One famous strand of modernization theory, advocated by Walt Rostow, claimed that economic take-off and maturity would follow a state-groomed process of growth through stages. As preconditions to take off, states should create enclaves of modern activity in a few strategic manufacturing industries, which would later be expanded to the whole economy. This was supposedly the process that had already happened in developed countries. For another strand of modernization theory, the problem was basically lack of internal savings. The state needed to create policies to attract or leverage enough capital for a “big push”. The main message from modernization theory to developing countries could be summed up as: you will reach our development levels if you use our financial assistance or private investment (to cover the lack of domestic capital) and reproduce our model (including incorporating our values and copying our technologies).

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47 Rapley, supra note 44; Meier, Development Economics, supra note 38.


Another group of development scholars, however, would develop a very different and much more critical view of the causes of underdevelopment, as well as the policies developing countries needed to ensure economic growth. Dependency scholars argued that developing countries were now latecomers in a globalized industrial economic system, and were therefore starting from an already disadvantaged basis. The economies developing countries inherited from colonial times (mostly agrarian or resource-led) had historically been, and remained, linked to the industrialized economies in a dependent condition. In these circumstances, if developing countries just followed the model of developed countries, they would remain dependent and underdeveloped. For many advocates of dependency theories, development was a zero sum game. Europe first, and North America later, had only been able to achieve their high levels of development due to imperialist and colonialisist systems.

Some dependency theorists argued that the formal end of colonialism had been the starting point of a neo-colonial process. Developed countries were now promoting their further progress by using the international political and economic systems to exploit the human and the natural resources of developing countries, thus impeding these nations from achieving their own economic and social progress. Dependency theorists argued that developing countries faced the following structural problems, among others: the persistence of very unequal terms of trade between primary commodities and industrial products; the repatriation of expressive profits by Northern transnational corporations operating in the South; the imposition of rules that impeded developing countries benefiting from free trade such as high levels of tariff protection towards

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51 For Raul Prebish, one of the main founders of dependency theories, developing countries were in the periphery of the global economy, while developed countries were in the center. The economic problems at the periphery were just effects, while the main causes were to be found in the policies coming out of the center. That is, for Prebish and other dependency theorists the mains problems were external to developing countries. Domestic issues such as culture, values, backward or dysfunctional institutions and inadequate policies were not taken seriously by dependency theorists. James M Cypher & James L Dietz, *The Process of Economic Development*, 3d ed (New York: Routledge, 2009) at 185.

52 Ibid. Not all dependency theorists adhered to this radical zero-sum view, though. Those such as Fernando Henrique Cardoso argued that it was possible for developing economies to develop, despite the unfavourable international framework. Fernando Henrique Cardoso & Enzo Faletto, *Dependency and Development in Latin America*, translated by Marjory Mattingly Urquidi (Berkeley, University of California Press 1979)
primary or semi-manufactured products exported by developing countries;\textsuperscript{53} and intellectual property regimes that restricted the transfer of technology and knowledge Southbound. Dependency scholars argued that these biased rules of the game were extremely unfavorable to closing the development gap.\textsuperscript{54}

Dependency theories originated - and became extremely influential - in Latin America, where many of its main advocates were based.\textsuperscript{55} They would gain significant currency in parts of Africa and in other developing regions, though they remained less influential than in Latin America. The message of dependency scholars to developing nations can be summed up as: in order to develop you must devise “autonomous national development strategies”.\textsuperscript{56} Dependency scholars argued that developing nations had to protect their economies from the unfair competition of industrialized nations, by turning away from open-door strategies of integration with the global economy.\textsuperscript{57} The recommendation was the adoption of initiatives with the objective to, among other things: protect infant industries; substitute imports by subsidizing local production; and create strategic nationalized industrial sectors. There were also recommendations to impose restrictions on foreign direct investment, since transnational corporations were seen as detrimental to development. In practice, most developing countries ended up using development assistance and/or FDI to finance their policy initiatives, since they faced a serious shortage of domestic capital.

Although they were considered to be on opposite sides, modernization and dependency theories coincided in one important aspect. They both subscribed to the idea that the state should be the main driver of development. A developmental state was considered key to address market or


\textsuperscript{54} Dependency scholars advocated, therefore, for a more radical departure from classical economic prescriptions that were overly based on the situation of developed countries.

\textsuperscript{55} A number of dependency scholars were linked to the UN Economic Commission for Latin America (ECLA), which was in the 1950s and 1960s directed by Raul Prebisch, an Argentinean economist. See Francis G Snyder, “Law and Development in the Light of Dependency Theory” (1980) 14:3 Law & Soc’y Rev 723.

\textsuperscript{56} Rapley, \textit{supra} note 44.

\textsuperscript{57} See Ferraro, \textit{supra} note 50.
structural failures, whether domestic (modernization) or international (dependency). Most developing countries, inspired by these theories, used substantial official development assistance and domestic capital to invest in key state interventions following one of these models. Most of them largely failed to achieve the expected levels of economic growth and social development that would enable them to converge with developed countries. Many developing countries ended up owing huge external and internal debts instead. The exception was a handful of East Asian countries. Following the model adopted by Japan, they chose to use state intervention to promote export-oriented policies to spearhead economic development, achieving what came to be known as the “East Asian miracle.”

These mixed results contributed to the strong neoclassical reaction that took place in development circles in the late 1970s and throughout the 1980s. The academic movement away from prescriptions of strategic state interventions in the economy followed a marked political change towards neoliberal reforms within developed countries, which were facing economic stagnation and high inflation rates themselves. This was the case, for example, in Britain (under Thatcher beginning in 1979), in the United States (under Reagan beginning in 1981), in West Germany (under Kohl beginning in 1982), and in Canada (under Mulroney beginning in 1984). At that stage, the mainstream economic development scholarship began to echo the voices of scholars arguing that the economic troubles faced by developed and developing countries alike resulted from widespread government intervention in the economy. Government intervention was enabling serious misallocation of resources, and distorting markets and prices. A radical shift in the concept of what should be the role of the state in development would soon take place, a shift that had significant policy implications for developing countries.

The emphasis started shifting to the importance of using state intervention solely to get macroeconomic fundamentals right, to open up to trade and to create an enabling environment for the private sector. In the 1980s and early 1990s the gospel was that capital-poor developing countries would achieve economic growth and improve human capabilities if they were able to

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58 The stunning economic growth of East Asian “tigers” has generated a rich body of research trying to explain their success, and many attempts to replicate their model to other developing countries. Excitement with the East Asian model only subsided in 1997, in the wake of the Asian crisis, which exposed some of the shortcomings of their exported-oriented, FDI fuelled economic model.

59 Rapley, supra note 44.
attract FDI and integrate into the global economy, instead of relying mostly on ODA to promote state-centered development. Another mantra was that the state had no role in performing economic activities, and that fostering private competition would lead to more choice, better products and lower prices for consumers, boosting economic growth and increasing general welfare.

This set of neoliberal prescriptions would become known as the “Washington Consensus”. With technical and financial support from the International Monetary Fund (IMF) and the World Bank, many developing countries followed the prescriptions of this consensus. With varied levels of success, they implemented policies to liberalize their markets, to privatize state enterprises, to balance their fiscal accounts and to reform their property rights and contract laws. Despite these reforms, the elusive improvement in development indicators was either feeble, unstable, or did not materialize. Some developing countries even suffered a worsening of social conditions. Furthermore, the Washington Consensus in the way it evolved in theoretical and policy circles clearly diverged from important aspects of the successful strategy adopted by the newly industrializing economies (NIE) of South Korea, Taiwan, Hong Kong and Singapore, and to the strategy adopted by Western countries when they themselves were industrializing. In East Asian NIEs, states had played a leading role in national development through support to

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60 In 1989, in a paper presented at a conference on development in Latin America, economist John Williamson argued that the United States government and international financial institutions had achieved consensus on a set of policy prescriptions necessary for economic development in Latin America. Contrary to many accounts, Williamson insists that the list reflected some level of policy consensus that required government intervention in areas not directly related to markets, such as the need to redirect public spending from subsidies ("especially indiscriminate subsidies") towards broad-based provision of key pro-growth; the expansion of pro-poor services like primary education, primary health care and infrastructure investment; and the expansion of the tax base. Williamsom argues, however, that the policies that at the time had reached broader consensus gave a privileged place to markets in promoting development, including the importance attached to attracting private capital in the form of FDI to generate economic growth, privatization and de-regulation. For the full list of measures considered to be conducive to development at the time, see John G Williamson, “Lowest Common Denominator or Neoliberal Manifesto? The Polemics of the Washington Consensus” in Richard M Auty & John Toye, eds, Challenging the Orthodoxies (Hampshire: Macmillan Press, 1996) at 13.


specific export-oriented industrial sectors, by for example encouraging private investment and credit allocation.

These disappointing results informed many criticisms of the one-size-fits all approach of free markets and scant or no state intervention. Several critics went so far as to point to this failure as evidence that the development discourse was being used to impose a neoliberal international system that was detrimental to developing countries and aimed only to benefit economic elites in developed nations.\(^63\) Institutions such as the World Bank and the United Nations Development Program began a new shift, focusing their development assistance on poverty reduction, instead of macro-economic policies. A group of economic scholars who were also critical of the existing theories of economic development started calling attention to what they saw as the fundamental shortcoming of modernization, dependency and Washington Consensus theories: the neglect or dismissal of the role played by market and state institutions alike in the development process.\(^64\)

These scholars were part of the New Institutional Economics (NIE), an economic theory that was beginning to exert a strong influence in development studies by informing institutional theories of development.

NIE claimed that by focusing on a false dichotomy between the primacy of state-oriented versus market-oriented policies, the earlier theories had largely ignored or assumed away the seminal role played by existing and evolving historical, legal, social and political institutions at the domestic level. These institutions (or governance systems) were in fact the key to understanding

\(^63\) See e.g. Robert H Bates, who commenting on the economic changes promoted during those years proposes the existence of a political reason behind the silence by reformers on the obvious pre-conditions that would be necessary in order for these economic policies to generate positive results: “The silence underscores that the roots of economic reform at the time were political: they derived not from theory but from ideology.” Robert H Bates, *Beyond the Miracle of the Market*, 2nd ed (Cambridge: Cambridge University Press, 2005), at xvii.

\(^64\) Institutional theories of development began to gain increasing currency in reaction to the incapacity of orthodox development economics to explain this persistent failure of both dirigiste and neoliberal development approaches. Francis Fukuyama, however, argues that the 1980s studies on the way institutions (he focus on formal ones) influence development was not a novel approach. It was in fact being reinserted in the research agenda of political science and economics, after a period where studying the effects of political culture and value systems in development had become mainstream. Francis Fukuyama, “Do Defective Institutions Explain the Gap Between The United States and Latin America?”, *The American Interest Online* (November 2006) online: The American Interest <http://www.the-american-interest.com/article.cfm?piece=198> [Fukuyama, “Defective Institutions”].
the success or failure of policy implementation. NIE deviates from former economic
development theories in, *inter alia*, the following ways:

1) NIE recognizes that physical geography, geopolitics, culture and tradition and capital (internal
savings, FDI or official aid alike), all play a part, but claims that they could not in isolation
explain development success or failure. A sound institutional framework would constitute the
most important variable influencing the capacity of a country to overcome the absence, or to take
stock of the presence, of other variables.

2) NIE negates the misleading dichotomy of state versus markets, emphasizing that the state
could never be treated as an exogenous actor in development policy. Both private and public
actors have an important role to play in development. Institutionalists claim that the right mix
would depend on specific institutional frameworks of each country, reflecting historical, social,
political and cultural contexts.

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65 For Douglass North, one of the founders of NIE:
Successful development policy entails an understanding of the dynamics of economic
change if the policies are to have the desired consequences. And a dynamic model of
economic change entails as an integral part of that model analysis of the polity, since it is
the polity that specifies and enforces the formal rules.
See Douglass North, “The New Institutional Economics and Third World Development”, in John Harris, Janet
Routledge, 1995) at 22.

66 Mancur Olson, “Big Bills Left on the Sidewalk: Why Some Nations are Rich and Other Poor” (1996) 10 Journal
of Economic Perspectives 3. Contra, Sachs who maintains that geography is a leading variable. Jeffrey D Sachs,
“Institutions Don’t Rule: Direct Effects of Geography on Per Capita Income”, NBER Working Paper No 9490
(2003). He also cites other variables such as cultural barriers, poverty trap (lack of minimum capital), fiscal trap due
to high indebtedness, trade barriers, lack of innovation investments and incentives, etc. Sachs, *The End of Poverty*,
*supra* note 7 at 60.

67 North, *supra* note 65.

68 NIE also rejects the isolation of economic theories from other disciplines as a fallacy. NIE argues that
institutional frameworks affecting economic development are socially embedded, and thus political science, law,
sociology, psychology were reintroduced as indispensable tools in the arsenal of economists trying to explain
institutional design and change. See Paul L Joskow, “Introduction to New Institutional Economics, a Report Card”
University Press, 2008) at 4. According to North, NIE retained from neo-classic economic theory the “fundamental
assumption of scarcity and hence competition”, the basis of a rational choice approach. North, *supra* note 65 at 17.
Consequently, NIE also recognizes the power of economic incentives. It nevertheless qualified important concepts
or assumptions deriving from neoclassicists. Economic interactions are undertaken in a context of incomplete
information, bounded rationality and pervasive market failures and externalities that produce relevant social and
economic costs. Institutions are the key element to: reduce transaction costs; correct market failures; minimize or
compensate negative externalities; and optimize individual and, especially, collective welfare. Bates, *supra* note 63,
at xviii. Instead of dismissing the extensive use of mathematical modeling by neoclassic economics, deemed by
economists as an important methodological advance, NIE affirmed: “the determinants of institutions [are] also
NIE has acquired a central place in development studies in the last two decades. The existence of a series of empirical studies providing favorable evidence of the primacy of institutions in explaining development success or failure has undoubtedly contributed to this prominence. There is a solid, and growing, empirical literature providing corroborative evidence of the primacy of institutions to explain development success or failure. In a leading study investigating the contributions of geography, trade and institutions in income levels, for example, Rodrik, Subramanian and Trebbi found that “the quality of institutions ‘trumps’ everything else.” Daniel Kaufman undertook a cross country analysis of six indicators of governance (institutions) and found that:

[A] country that significantly improves key governance dimensions such as the rule of law, corruption, the regulatory regime, and voice and democratic accountability can expect in the long run a dramatic increase on its per capita incomes and other social dimensions.

Institutional theories have re-emerged not only in economics, but also in political science and sociology studies, as a reaction to perceived limitations of behavioural, rational choice, Marxist, systems and functionalist theories that prevailed in the previous decades. Historical institutionalism, for example, purporting that institutions play a key role in structuring political and social behaviour, became one of the main movements in political science. See Theda Skocpol, States and Social Revolutions (Cambridge: Cambridge University Press, 1979). A recent reaffirmation of NIE theories is found in Acemoglu and Robinson’s new book Why Nations Fail. Acemoglu & Robinson, supra note 38.

Prado and Trebilcock argue that one of the distinct features of the institutional theory is exactly that it has an empirical pedigree that is largely missing in many others. Prado & Trebilcock, supra note 38. For a review of this empirical literature see Ashok Chakravarti, Aid, Institutions and Development: New Approaches to Growth, Governance and Poverty (Cheltenham: Edward Elgar, 2005).


A series of other studies reaching the same conclusion followed, bringing institutional theories to the forefront of development studies. Institutional theories had significant implications for the research agenda of development scholars. A whole constellation of consequential research questions opened up for investigation: what exactly is meant by institutions; how are institutions shaped; why do they change or why do they not change over time; what is their direction of change; which institutions matter for which development goals and how; etc.

Most of these research questions are still unsettled in the institutional development literature. Despite this lack of conceptual clarity, institutional theories of development have had a significant impact on development practice. Promoting governance reform in developing countries became the primary goal for many bilateral and multilateral bilateral agencies engaged in development assistance. Daniel Kaufmann and colleagues gave an important impetus to this

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74 This includes the very definition of institutions. The most influential definition was offered by Douglass North: Institutions are the rules of the game of a society, or, more formally, are the humanly devised constraints that structure human interactions. They are composed of formal rules (statute law, common law, regulations), informal constraints (conventions, norms of behavior, and self-imposed codes of conduct), and the enforcement characteristics of both.

North differentiates institutions from organizations. For him, organizations are the players using the rules of the game. This could be any group “bound by a common purpose to achieve objectives”, ranging from political bodies such as political parties and governmental agencies, to social bodies such as churches, clubs and schools, to economic ones such as firms, cooperatives, etc. Greif proposes a broader definition of institutions, tying North’s economic definition with definitions used in sociology and political science. For Greif institution is defined as a system of institutional elements that conjointly generate a regularity of behavior by enabling, guiding and motivating it. AvnerGreif, “Institutions: Theory and History” Cambridge University Press [forthcoming]; Brousseau & Glachant, supra note 68 at 77. For some, North’s definition is already too generic. For example, Prado and Trebilcock argue that

By including informal constraints in his definition, North’s conception becomes so encompassing that it includes almost any factor that may influence human behavior and hence risks losing any operational content.

See Prado & Trebilcock, supra note 38. Fukuyama, on the other hand, claims that “the eliding of formal and informal institutions made North’s definition conceptually robust and useful as a means of attacking the institution-less premises of earlier neoclassical economics”. He nevertheless, argues that even though the ‘new institutionalism’ recognizes the difference and the importance of informal institutions, it “oftentimes failed to separate them out clearly as a distinct conceptual category subject to a very different evolutionary dynamics”. Fukuyama, “Defective Institutions”, supra note 65. In sum, the definition of institutions is still an open debate in the literature.
institutional work on the ground, when they proposed a few basic measurements of governance to guide policy work.\textsuperscript{75} Kaufmann (initially with Aart Kray and Pablo Zoido-Lobaton) initiated the governance measurement project in 1996, calling it the Worldwide Governance Indicators (WGI).\textsuperscript{76} The idea was to collect existing sources about institutional indicators and combine them in six composite governance indicators.\textsuperscript{77} The indicators of governance they propose are:

\textbf{Voice and Accountability}: meaning “the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, association, and the press;”

\textbf{Political Stability and Absence of Violence}: the likelihood that the government will be destabilized by unconstitutional or violent means, including terrorism;

\textbf{Government Effectiveness}: the quality of public services, the capacity of the civil service and its independence from political pressures; the quality of policy formulation;

\textbf{Regulatory Quality}: the ability of the government to provide sound policies and regulations that enable and promote private sector development;

\textbf{Rule of Law}: the extent to which agents have confidence in and abide by the rules of society, including the quality of property rights, the police, and the courts, as well as the risk of crime;

\textbf{Control of Corruption}: the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as elite "capture" of the state.

A database with worldwide indicators has been produced biannually from 1996 to 2001 and annually from 2002 onwards. In 2009 it covered 212 countries and territories. The WGI has become the most widely used database on governance by development scholars and


\textsuperscript{76} The first report was published in 1999. Ibid.

\textsuperscript{77} These aggregate indicators are based on hundreds of specific and disaggregated individual variables measuring various dimensions of governance, taken from 35 data sources provided by 33 different organizations.
practitioners, giving even more prominence to the governance matters consensus. And as a result of this prominence, there has been a significant surge in development assistance for institutional or governance reform in developing countries, which has now reached billions of dollars.

It is important to note that despite this commanding consensus that “governance matters”, there has been no similar consensus on “how” exactly governance matters, and whether and which governance mechanisms matter more than others. For some scholars, this theoretical and conceptual opacity is so problematic as to defeat the explanatory power of institutional theories of development. For other scholars, like economist Joseph Stiglitz, institutional theories of development are no more than an improved version of the neoclassical theories. Stiglitz claims that institutionalists still place too much emphasis on institutions that are primarily enabling for markets, neglecting other important drivers of positive development outcomes. Stiglitz advocates a new approach, which has become known as the Post-Washington Consensus. This approach recognizes the importance of both market and state institutions to achieve not only economic growth, but also other development indicators and a better distribution of income and opportunities.

There are also those that do not adhere to this consensus, or that offer important qualifications to it. Jared Diamond, Jeffrey Sachs and others, for example, claim that when a country is at very low levels of development, which is the case of LDCs, a focus on promoting governance reforms would be misguided. Sachs and his colleagues advocate a “big push” in official development

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78 In the early 2000s, the United Nations Commission for Africa started a large-scale project named “Measuring and Monitoring Progress Towards Governance in Africa”. It covered 28 countries.
79 See David Trubek, “the Rule of Law in Development Assistance: present, Past and Future” in Trubek & Santos, supra note 39.
81 For Fukuyama institutions matter less if one is talking about formal institutions only (constitutions, legal codes, electoral systems, etc). Francis Fukuyama, ed, Falling Behind: Explaining the Development Gap Between Latin America and the United States (New York: Oxford University Press, 2008). [Fukuyama, Falling]
assistance to finance infrastructure and disease control instead. Mushtaq H. Khan argues that the attention to the need to improve governance systems in developing countries is welcome and important, but should not be considered a pre-requisite for economic growth and positive development outcomes. Khan argues that the reduction of corruption, greater accountability, improvement in the rule of law and other goals of good governance, are very desirable on their own terms. They should therefore remain as long-term goals for developing countries. Khan argues, however, that progress on these fronts is unlikely to be significant enough or quick enough to make a sufficient impact on development. The focus should be in identifying specific growth-enhancing governance capabilities that could feasibly be tried to address specific market failures that are constraining growth. Paul Collier argues that the relationship between the quality of governance and economic performance is highly dependent on circumstances. If some conditions are right, economies can grow significantly despite the governance deficit (e.g. Bangladesh). Normally, however, weak governance is very detrimental to economic growth.

These criticisms raise important points and there is a pressing need to develop research on the many unresolved questions related to how institutions are formed, how they change, and how exactly they influence development outcomes. Yet, the empirical literature on the correlation of sound governance systems and development outcomes make the “governance matters” theory a very strong case. As Fukuyama puts it: “the institutionalists have won this argument hands down.” Besides, the “governance matters” consensus also provides the most compelling explanation for a development conundrum that has been puzzling scholars for decades. This conundrum is the fact that a group of resource-rich countries were showing lower rates of economic growth and worse social indicators than their resource-poor peers in the long run, a phenomenon known in the literature as the resource curse, to which I turn next.

86 Based on the development literature, Khan also includes the reduction in expropriation risk as a goal of good governance.
87 Collier, The Bottom Billion, supra note 4.
88 Fukuyama, Falling, supra note 81.
1.4. The “governance matters” consensus in the context of resource-rich countries

Since the 1980s a series of studies have indicated that, in fact, exploiting vast deposits of oil, gas or minerals not only does not provide a guarantee of improving development outcomes; relying on exports of extractive resources could, paradoxically, have a negative impact on a country’s development outcomes in the long run. These studies form the literature on the “resource curse” phenomenon. One clarification is important at the outset of this section. Most of the resource curse literature does not in fact claim that resource abundance per se always places resource-rich countries at risk of negative development outcomes. Only countries that have high ratios of natural resource exports rents to GDP, or whose state budgets are mostly dependent on these rents, are at risk.\(^89\) Moreover, some countries with high ratios of natural resources to GDP can still develop if they have good governance systems, as explained in this section.

This section is organized as follows: I begin in 1.4.1 by presenting the resource curse theory, clarifying that while there is strong consensus on the negative effects of high dependency on resource exports on the long term economic prospects of developing countries, the same cannot be said about the negative correlation between resource exports and negative political outcomes; 1.4.2 emphasizes that resource exploitation is also associated with serious environmental and human rights violations in developing countries, which adds to the perception of a “curse”; finally, 1.4.3 establishes the emerging link between the “governance matters” consensus and the resource curse thesis.

1.4.1. The resource curse thesis

What exactly does the expression “resource curse” mean, and does this phenomenon really exist? A review of the resource curse literature shows three distinct negative externalities generally associated with resource dependency: lower rates of economic growth; weakening of democratic institutions; and higher prevalence of civil conflicts. While the correlation of resource-dependency and negative economic indicators is less controversial in the literature, the two other correlations remain disputed.

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\(^89\) The literature is not settled on what would be a threshold of resources exports ration to GDP that would trigger the higher economic risks.
In 1993 Economic Geographer Professor Richard Auty published a book entitled *Sustaining Development in Mineral Economies - The Resource Curse Thesis*. Auty argued that there was growing evidence that natural resources dependency could cause harmful economic and political effects in low- and mid-income developing countries leading to lower rates of economic growth as compared to their resource-deprived peers. Auty was building on many earlier studies that had documented adverse economic effects of resource abundance on growth rates. These included a series of studies undertaken by Middle Eastern scholars that had been trying to understand the failure of oil-rich states to translate successive waves of oil windfalls into sustainable development. Professor Auty called this phenomenon a “resource curse”. Auty was writing at a time when development scholars and practitioners were seeking to understand the failure of most low-income countries to catch up with the levels of material and social progress achieved by developed countries, despite the substantial provision of development assistance that low-income countries had received in the decades after WWII and in the decolonization process (section 1.3).

The counterintuitive lower growth rates of resource-rich countries when compared to other developing countries that were resource-deprived - despite having more capital available to finance development policies - added another dimension to the larger puzzle of the decoupling trend among developed and developing countries. In his book, Auty addressed this question by describing the combination of potential negative economic and political effects that were characteristic of resource dependent economies; and by showing how these effects had affected growth. Auty’s study showed that growth in GDP per capita of resource-rich economies from 1971 to 1983 had been -1%, compared to +0.7% in resource-deprived economies. Auty’s thesis of a resource curse has since then prompted a plethora of empirical and theoretical studies among

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economists and political scientists, which set out to investigate the possible relationship between resource dependency and negative development outcomes.

In 1995 economists Jeffrey Sachs and Andrew Warner undertook a more comprehensive study that found that economies with a high ratio of natural resource exports to GDP in 1970 (the base year) tended to grow more slowly than other economies during the subsequent 20-year period (1970-1990). This negative relationship remained true even after controlling for variables such as integration in the global economy, fiscal deficits, inflation rates, etc. Their study was the first worldwide comparative study of resource dependent countries, examining ninety-five countries. Sachs and Warner’s research confirmed once again the earlier findings of adverse economic effects of resource wealth on growth rates. Subsequent studies would show that other negative socio-economic indicators, such as greater income gaps between rich and poor, also characterized resource-dependent countries. No subsequent research has contested these findings. The literature proposes four main economic explanations for the lower growth rates: the Dutch Disease; high volatility of mineral commodities; declining terms of trade; and the enclave nature of the sector.

The term Dutch Disease was first coined in 1977 to refer to the negative effects of the 1970s boom in North Sea natural gas exploitation in the Netherlands, which led to the contraction of the agriculture and manufacturing sectors of the Dutch economy. This contraction happened

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95 For a complete list of economic externalities of resource dependency see Meeting the Challenge of the Resource Curse, supra note 21.
due to the appreciation of the country’s currency that left other exports less competitive in international markets; and due to a pull effect that shifted capital and labor force from other economic sectors to the thriving gas sector. The full economic effects of the contraction of the Dutch agriculture and manufacturing sectors were felt strongly when gas prices decreased, causing a significant shrinkage of the country’s budget. The same pattern was recognized in other countries experiencing booms in natural resource exploitation, especially in the non-renewable resources sector.97 Economists have proposed a series of measures to counteract the Dutch Disease effects, such as the creation of stabilization funds denominated in a foreign currency, to avoid currency appreciation, and the use of revenues to diversify exports and to subsidize other economic sectors.98

The high volatility of prices of natural commodities, in particular minerals, is a second proposed explanation for the medium- and long-term lower growth of mineral dependent countries.99 The negative economic effects arise due to the difficulty of managing an economy and public finances with marked variances in terms of revenues accruing to the government’s budget. Economists propose two basic remedies for the high volatility of resources revenues: the creation of commodities stabilization funds; and the establishment of careful fiscal policies (to ensure savings in order to both control the tendency to over consumption and investment during booms, and to adjust to post-boom downswings).100

Earlier, several economists also proposed that declining aggregate terms of trade for natural commodities, compared to manufactured ones, could also explain the medium- and long-term

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97 The Dutch Disease effects can in fact result from any large inflow of foreign currency, having been associated with foreign aid and substantial increases in foreign direct investment as well.
lower growth of resource-rich countries. This theory was based on the assumption that manufactured goods would gain value against natural commodities over time, making resource-rich countries pay more for their imports and receive less for their exports. The “declining terms of trend” explanation was part of the larger group of dependency theories that were highly influential in the 1960s, which also argued that the control of mining exploitation by TNCs led to them setting prices and circumventing taxation in order to raise their profits to the detriment of the host country’s development. 101

The 1970s was marked by a wave of nationalization of mining and oil industries in developing countries and windfall revenues accruing to most resource-dependent countries in the subsequent mineral booms. Yet, the absence of long-term positive economic growth in resource-rich developing countries despite these policies showed that the underlying causes of the negative developmental impacts of resource-led economies were more complex than presented by the exploitative terms of trade theory. 102 Echoes of theories emphasizing the negative effects of international economic structures on the economies of resource rich countries still survive, although in modified versions. When the World Bank promoted a wave of policies to encourage resource-rich developing countries to grant significant tax incentives to attract mining investments, for example, there was strong reaction by those claiming that this could clearly have the effect of negatively affecting these countries economic growth, instead of boosting their economies. 103

Lastly, some authors cite the enclave nature of the extractive sector as another factor contributing to lower levels of growth in the economy as a whole. An enclave sector has the following special characteristics, which sets it apart from other economic sectors: high capital intensity; modest

101 On dependency theories see Ferraro, supra note 50.
102 According to Kaplinsky the picture is more nuanced, and there are signs of an inverse phenomenon happening today. He argues that the decrease in costs for most manufactures and the strong demand for natural commodities caused by the industrialization of emerging economies such as China and India is leading to a declining terms of trade equation from manufactures in relation to natural resources. Raphael Kaplinsky, “Revisiting the Revisited Terms of Trade: Will China Make a Difference?” (2006) 34:6 World Development 981.
local production linkages; low employment rates; and low revenue retention. The average share of purchased inputs in the mining industry is only 40% of gross revenue, compared with 70% or more for manufacturing, a sector that is in general far less capital-intensive. Besides, mining, oil and gas corporations operating in developing countries are often foreign-owned and employ a small, highly trained, often foreign workforce. Thus, the strongest positive economic impact from oil, gas and mining activities is often taxation, which is nevertheless highly sensitive to the scale of the rents. Economists argue that the remedy for this shortcoming is to use mining, oil and gas revenues to promote a more diversified economy over time.

All these negative economic impacts of a resource-driven economy, as well as the effective economic policies to address them, have long been identified in the literature. The question is why the resource-dependent countries do not act on them? For many commentators, this failure is clearly of a political rather than of an economic nature. These countries lack either political institutions capable of applying the remedies, or the political will to do so, or both. Indeed, the resource curse also includes a set of negative political impacts related to the dependency on natural resources, especially mineral resources. Many studies by political scientists and political economists suggest that natural resource dependence is associated with the weakening of democratic institutions and higher prevalence of civil conflicts. A series of authors have presented empirical evidence to underpin these claims in the form of case studies and, more recently, cross-country comparative studies. However, a few authors have recently published contrary evidence that call these correlations into question. It is worth providing a brief review of this debate.

Explanations of the political impacts of resource dependency are generally classified as:

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104 Auty, Sustainable Development, supra note 90.
105 Nicolas Di Boscio, “Taking the Lead: Mining and the Challenges of Economic Development” (Paper delivered at the International Mining Seminar 2004), [unpublished].
cognitive or behavioral; societal or interest group; and mixed or state-centered explanations.\footnote{108}{Ross, “The Political Economy”, supra note 101.} The literature also points to higher levels of corruption as another political risk associated with resource-dependency.\footnote{109}{Carlos Leite & Jens Weidmann, “Does Mother Nature Corrupt? Natural Resources, Corruption and Economic Growth” in George T Abed, Sanjeev Gupt, eds, Governance, Corruption and Economic Performance (Washington, DC: International Monetary Fund,1999) See Leonard Wantchekon “Why do resource dependent countries have authoritarian governments?” Yale University Leitner Center Working Paper No 99-12 (2002).} Political economist Leonard Wantchekon examined data related to 141 countries between 1950 and 1990 and found that a one percent increase in natural resource dependence, as measured by the ratio of primary exports to GDP, increased the probability of authoritarian government by nearly 8 percent.\footnote{110}{See Nathan Jensen & Leonard Wantchekon “Resource Wealth and Political Regimes in Africa” (2004) 37:7 Comparative Political Studies 816.} Wantchekon also found that countries that were rich in natural resources were more likely to experience failed or slow transitions to democracy. The same author, writing with political scientist Nathan Jensen, presented similar findings in relation to Africa, concluding that resource–rich countries in this region were more likely to experience authoritarian rule and democratic failures after the democratic transition than their resource-deprived peers.\footnote{111}{Michael L Ross, “Does oil Hinder Democracy?” (2001) 53:3 World Politics 325.} The most authoritative research to date on the political impacts of resource-dependence had been a 2001 study by political scientist Michael Ross. Ross examined data from 113 countries between 1971 and 1997, finding that “a state’s reliance on oil or mineral exports tends to make it less democratic”.\footnote{112}{David L Epstein et al, “Democratic Transitions” (2006) 50:3 American Journal of Political Science 551; Jamy Uldefer, “Natural Resource Wealth and the Survival of Autocracies” (2007) 40:8 Comparative Political Studies 995.} Subsequent studies have confirmed Ross’s findings.\footnote{113}{Stephen Haber & Victor Menaldo, “Do Natural Resources Fuel Authoritarianism? A Reappraisal of the Resource Curse” (2011) 105:1American Political Science Review 1, online: SSRN <http://ssrn.com/abstract=1545103>.}

At variance with this literature, political scientists Stephen Haber and Victor Menaldo published an influential study in 2008 questioning the correlation between resource dependency and regime type (authoritarianism or democracy).\footnote{114}{Stephen Haber & Victor Menaldo, “Do Natural Resources Fuel Authoritarianism? A Reappraisal of the Resource Curse” (2011) 105:1American Political Science Review 1, online: SSRN <http://ssrn.com/abstract=1545103>.} Using a long-run time series they found that regime types are not determined by the presence or absence of natural resource wealth. They argue that methodological shortcomings tainted the evidence from previous research claiming such a
correlation. In an earlier study, political scientist Michael Herb\textsuperscript{115} used a cross-regional comparative analysis and also found no negative effect of dependency on oil rents on democratic development. Pauline Luong is another scholar who questions the correlation between resource-dependence and political authoritarianism. In fact, Luong does not directly contest the correlation between resource wealth and lower rates of growth and/or political authoritarianism. Luong\textsuperscript{116} acknowledges there is evidence linking a group of resource-rich developing countries with weak economic and political performance. For Luong the reason for these results is not the abundance of natural resources per se, but rather the concentrated structure of ownership over these resource proceeds. In an upcoming book entitled \textit{Oil and Democracy Revisited}, Michael Ross uses improved measures and dataset to cover all oil-rich countries from 1960 to 2002. Ross finds that:

\begin{itemize}
  \item[a)] oil wealth strongly inhibits democratic transitions in authoritarian states;
  \item[b)] oil’s anti-democratic effects seems to vary over time and across regions”.\textsuperscript{117}
\end{itemize}

There is, therefore, no strong academic consensus on the existence of a correlation between resource-dependence and weak democracy.

The existence of a link between resource dependency and civil conflict has also been the topic of long-standing academic debate. Economists Paul Collier and Anke Hoeffler from Oxford University examined a sample of 98 countries and found that natural resource dependency was a strong determinant of the onset of civil war.\textsuperscript{118} In a different study the same authors found that resource dependency also increased the risk of both secessionist and non-secessionist civil wars.\textsuperscript{119} Economist Martha Reynal-Querol analyzed a sample of 138 countries, finding that from 1960 to 1995 natural resources dependency increased the incidence of non-ethnic civil wars (but

\textsuperscript{117} Ross states that the effects grow stronger over time and do not apply in Latin America, but in Africa and the Middle East. Michael Ross, “Oil and Democracy Revisited” Working Paper (2009), online: <http://www.sscnet.ucla.edu/polisci/faculty/ross/workingpapers.html> [Ross, “Oil and Democracy”].
did not find a correlation with ethnicity-related wars). Collier and Hoeffler and Ballantine also found a positive correlation between resource dependency and the longer length of civil war. Sherman has found that in Africa control over diamond mines has become a primary objective for rebels seeking income to finance civil wars. The higher occurrence of grievances in producing regions that may lead to secession attempts is also noted in the literature. At variance with this literature, Ross found only very modest support for this correlation in an analysis of 13 civil wars. He found that in only two cases did natural resources affect the intensity of the conflict.

Although the debates over the existence of a connection between natural resource dependency and negative political effects are on-going, there is a growing literature proposing explanations for this linkage. In the case of resource-dependence and conflict, some of the proposed motives are: greed (control of revenues) or grievances (feelings of ethnic or political marginalization); weakened links between state and society (due to the lack of taxation); and lack of internal trade networks (trade being an incentive to peaceful relationships). In relation to the negative correlation between resource-dependency and democracy, Ross asserts that the proposed explanations are generally divided into three approaches: cognitive or behavioral, interest group

121 Collier & Hoeffler, “Economic Consequences”, supra note 119.
126 Collier & Hoeffler, “Greed and Grievance”, supra note 120.
or societal, and state-centered or mixed approaches.\textsuperscript{129}

The cognitive or behavioral approach centers on the behavior of political elites, influenced by the easy reliance on, and certainty of resource rents. Behavioral theories argue that this certainty may lead to lazy or reckless behavior both in economic policy and in institutional building.\textsuperscript{130} Ross finds, nevertheless, that despite their intuitive appeal, behavioral explanations are not corroborated by empirical evidence and contradict case studies that show that state actors do have access to a large amount of information about resource curse risks and existing remedies. The interest group or societal approach considers that the failure of political actors to adopt the necessary measures to avoid the consequences of resource dependency is not reckless, but rather intentional behavior. Certain interest groups within and outside the state that greatly benefit from a dysfunctional system would purposely maintain the status quo. Instead of reckless behavior it is rational, utility-maximizing behavior.\textsuperscript{131}

For the proponents of the state-centered or mixed approach, however, it is the special characteristics of dependency on rents generated by exports (external rents) that facilitates the incidence of a complex interaction of economic, political and sociological effects that results in the undermining of institutions. It combines behavioral, sociological and political economy aspects to explain how characteristically dysfunctional institutions are shaped in resource dependent countries. I will present the theories relating rent seeking behavior to the resource curse in more detail in chapter 2. Basically these theories argue that the possibility of easily appropriating high rents independent of economic policies lead officials from rentier states to behave with a mix of reckless, self-interested and risk-averse behavior towards the state

\textsuperscript{129} Ross, “The Political Economy”, supra note 101.

\textsuperscript{130} According to Michael Ross, cognitive explanations have a long history, starting with early theorists such as Machiavelli, Montesquieu, Adam Smith and John Stuart Mill. Ross, “Civil War”, supra note 125.

economy. Besides, since there is no need to tax other economic sectors to support the state budget, there is also a lack of social pressure and accountability and information that are traditionally associated with tax bureaucracies.

Expanding on the theory of rentier states, authors such as political scientist Terry Lynn Karl and economists Humphreys, Sachs and Stiglitz add an external dimension. Karl argues that the great value and strategic importance of mineral commodities such as oil has meant that both foreign corporations and governments have historically attempted to exert high levels of external political intervention in exporter states, reinforcing the rentier nature of the state, or hampering democratic changes that would threaten their interests. Humphreys, Sachs and Stiglitz call attention to another problem: the huge technical and political advantages possessed by extractive multinational corporations, with whom resource-rich small developing countries have to negotiate concession agreements. This imbalance means that the terms of agreements are often not truly beneficial to the host country. Critics of the correlation between resource-dependency and negative political outcomes theory claim there is no sound empirical evidence behind it. Ross acknowledges that despite the correlation being repeatedly confirmed, “most of the proposed causal mechanisms either lack statistical support or are logically unpersuasive”.

It is possible that a combination of these different factors may explain the resource curse. Jeffrey D. Sachs, in the foreword of “Escaping the Resource Curse”, attributed the lower growth rates and the worse social indicators of resource-rich developing countries over time to three overlapping influences: the deterioration of other economic sectors like manufacturing and

132 Mahdavy, supra note 93.
137 Ross, “Oil and Democracy”, supra note 117.
138 Humphreys, Sachs & Stiglitz, supra note 136.
agriculture caused by the “Dutch disease”;\textsuperscript{139} the volatility of commodity prices; and the negative effects of resource abundance on fragile political institutions. In sum, although the effects of resource wealth on political outcomes are still debated in the resource curse literature, it seems that there is general consensus that resource wealth tends to promote worse economic and other development indicators in the long run. The systematic study of the economic and political impacts of resource-dependency is a modern preoccupation. There is another area of overall consensus in the literature of resource-led economies that is in fact much older than the consensus on the economic impacts of resource-dependence. This literature establishes the fact that resource-led economies are at greater risk of negative environmental and social impacts (such as human rights violations and forced displacements) as compared to other types of economies. This long-established fact adds to the perception that resource exploitation may in some cases be a “curse” disguised as “blessing”, while it adds explanatory power to why having a sound governance system is even more important for resource-rich developing countries than for other developing countries. I turn to these increased social and environmental negative impacts of resource-led economies next.

1.4.2. Environmental and social impacts of resource exploitation

The exploitation of non-renewable resources is by nature a disruptive activity, provoking significant negative externalities.\textsuperscript{140} The concern over and resistance to the negative social, environmental, economic and political externalities of the exploitation of natural resources is by no means a modern phenomenon. These concerns have, nevertheless, been amplified in the last fifty years, as countries around the globe have become more industrialized following an

\textsuperscript{139} Dutch Disease is the decline in traditional economic sectors caused by a marked currency appreciation resulting from the economy receiving significant levels of external rents. In the case of minerals and oil industries this is compounded by a pull effect in financial and human investments to the high earning extractive sector.

\textsuperscript{140} According to the John Black, Nigar Hashimzade, and Gareth Myles, externality is “a cost or benefit arising from any activity which does not accrue to the person or organization carrying out the activity. Negative externalities cause damage to other people or the environment, for example by radiation, river or air pollution, or noise, which does not have to be paid for by those carrying out the activity. Positive externalities are effects of an activity which are pleasant or profitable for other people who cannot be charged for them, for example fertilization of fruit trees by bees, or the public’s enjoyment of views of private buildings or gardens.” John Black, Nigar Hashimzade & Gareth Myles, \textit{A Dictionary of Economics} (Oxford: Oxford University Press, 2009).
economic model based on intensive resource exploitation. Some of the negative externalities associated with resource extraction are quite straightforward and have long been recognized. The more reliant a country is on the natural resources sector, the more severe the environmental and social externalities such as the degradation of visual landscape, the production of significant amounts of hazardous wastes that can pollute water and air, the displacement of communities to give way to new resource exploitation, local and regional conflicts around alternative use of land and distribution of revenues, etc.

The social and environmental effects of natural resource extraction comprise complex areas of study and the body of technical and theoretical research is enormous and growing quickly. This sub-section does not intend to offer a detailed review of all this literature, but rather to provide a broad overview of the main issues of concern relating to the negative environmental and social externalities of resource extraction. The objective is to emphasize how significant the potential risks and impacts involved in resource exploitation are. Although each of the following negative externalities is serious in itself, it is the high probability of occurrence and the combination of all them in one sector that make resource-based economies a special focus of concern.

In 1530 Georgius Agricola in his seminal book *De Re Metallica* characterized mining as “one of the most ancient, the most necessary and the most profitable [arts] of mankind”. The author was emphatically affirming the important role that mineral exploitation and use had already acquired in human social and economic life at that time. In making these strong statements at the outset of what would be the first – and for 180 years the leading - comprehensive technical guide

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141 Heated debates on the economic and social consequences and risks of unbridled resource exploitation and resource scarcity can be traced back to British classical economists Thomas Malthus and David Ricardo writing under the influence of the sweeping social and economic transformations deriving from the Industrial Revolution. Theses debates have waxed and waned, following each period of marked industrial growth. The current industrialization of emerging economies such as China and the resource boom in the least developed countries are provoking a new wave of heated debates on the social and economic implications of resource scarcity, with optimists arguing that human inventiveness and regulation can enable sustainable growth of the world’s growing population, while pessimists predict growing conflicts and economic disruption over dwindling resources. See Jeffrey D. Sachs, *Common Wealth: Economics for a Crowded Planet* (New York: Penguin Press, 2008); Collier, *The Plundered Planet*, supra note 1; and Moyo, *supra* note 1.

142 At the time minerals were the only significant non-renewable natural resources being exploited, since oil and gas would be discovered as useful energy suppliers much later.

143 Agricola’s text-book was the first comprehensive guide to miners and metallurgists on mining operations, and would remain the leading work in this area for other 180 years. Georgius Agricola, *De Re Metallica* translated by Herbert Clark Hoover & Lou Henry Hoover (New York: Dover Publications, 1950)
to miners and metallurgists, Agricola was building his case for the recognition of resource exploitation as a desirable, useful and honorable economic activity. At that early time Agricola already acknowledged that one of the elements that places natural resources exploitation apart from other economic activities was the strong social resistance to the negative externalities inherent in the extraction of natural resources. This is why Agricola made the point of dedicating the whole first chapter (Book I) of his technical metallurgist guide to respond to the various charges made against mining activities. In Agricola’s words:

Since there has been the greatest disagreement amongst men concerning metals and mining, some praising, others utterly condemning them, therefore I have decided that before imparting my instruction, I should carefully weigh the facts with a view to discovering the truth in this matter.\(^{144}\)

He then goes on to refute the arguments of those who accused resources extraction of being an unprofitable, inutile, dishonorable and wicked occupation. For those claiming the economic instability of mining activities due to the expected exhaustion of a mine’s resources, for example, Agricola contends that this is balanced by its high productivity, and emphasizes the longevity of various mines. Agricola also addresses what he calls “the strongest argument of the detractors”, i.e. the environmental and social impacts of mining, which would cause “greater detriment than the value of the metals which the mining produces”.\(^{145}\) Here Agricola skillfully chooses not to directly challenge the claim that mining can cause great disruption to the environment and to communities and their socio-economic activities such as agriculture, breeding, fishing and hunting. He chooses instead to downplay the disruptions and to emphasize the advantages of mining, highlighting the necessary trade-offs. He claims that mining is almost exclusively undertaken in otherwise unproductive mountains and valleys, or that after the cutting of woods the new fields can be used to produce rich crops, or that with the revenues from selling the

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\(^{144}\) Agricola, \textit{supra} note 143, Book I at 4.

\(^{145}\) In Agricola’s words: [T]he strong argument of the detractors is that the fields are devastated by mining operations, for which reason formerly Italians were warned by law that no one should dig the earth for metals and so injure the very fertile fields, their vineyards, and their olive groves. Also they argue that the woods and groves are cut down, for there is need of an endless amount of wood for timbers, machines and the smelting of metals. And when the woods and groves are felled, then are exterminated the beasts and birds, very many of which furnish a pleasant and agreeable food for man. Further, when the ores are washed, the water which has been used poisons the brooks and streams and either destroys the fish or drives them away. Therefore, the inhabitants of these regions, on account of the devastation of their fields, woods, groves, brooks and rivers, find great difficulty in procuring the necessaries of life, and by reason of the destruction of their timber they are forced to greater expense in erecting buildings. Thus it is said, it is clear to all that there is greater detriment from mining than the value of the metals which the mining produces. \textit{Ibid.}
minerals “birds without number, edible beasts and fish can be purchased elsewhere and brought to these mountainous regions”.

Agricola’s writings show how ancient are both the importance of natural resources to human life and the resistance to the disruptive externalities of the economic exploitation of natural resources. The importance of natural resources to human survival and economic development has only grown over time. As the world experiences increased levels of population and economic growth, it requires mounting quantities of resources to provide energy and to produce our everyday products like food, medicines, construction materials, machinery, appliances, etc. Every technological innovation requires long-used and new minerals as components. Although the world has undergone profound social, economic and political changes since 1530, a large body of current literature regarding the exploitation of natural resources still revolves around what Georgius Agricola long ago called “the strongest argument of the detractors”: the socially and environmentally disruptive impacts of resource extraction.

The extraction of oil, gas and mining resources is in most cases an activity based upon continued territorial expansion and compounding impacts and risks to the environment and communities living in or adjacent to mining or oil and gas sites. A vast literature has documented the environmental and social impacts and risks of natural resources extraction. A report commissioned by the mining industry, called *Breaking New Ground*, for example, gave an overview of the challenges faced by the sector, recognizing:

> It is hard to argue that mineral extraction, processing, and use generally benefits the local ecosystems concerned or makes them more productive. [...] Overall, the ability of local ecosystems to provide biological benefits has often been seriously impaired by mining and

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146 This research will not deal with indirect environmental and social impacts such as climate change, since I am more concerned with the impacts directly associated with mining exploitation in developing countries and climate change results from certain forms of mining exploitation and mineral use more generally speaking. There is however a solid body of literature arguing that climate change due to global forms of mineral exploitation may have a serious and disproportional negative developmental impact in the poorest countries.

As a result of this recognition international institutions such as the United Nations Environment Program (UNEP), the World Bank, the Organization for Economic Cooperation and Development (OECD), have all created special forums, guidelines and mechanisms to deal with these challenges. The World Bank, for example, states that:

Mining may cause environmental issues ranging from waste rock and tailing disposal, land disturbance, dust and noise, to water use and pollution. If not managed well, any of these could adversely affect the health and livelihood of the poor and vulnerable groups living near mining operations.  

The environmental impacts of natural resources exploitation are often subdivided for convenience into four categories: the effects of the mine itself, the disposal of mine wastes, the transport of the mineral, and the processing of the ore (which often involves or produces dangerous materials). These activities may take place at the same site, in which case the impacts are concentrated there, or considerable distances may separate them. All of them present significant disruptive effects. The recent environmental, social and economic devastation caused by the oil spill in the Gulf of Mexico, after the explosion of the British Petroleum (BP)’s Macondo offshore well, is but an extreme example of the risks in the exploitation site. Another infamous example has been the continuous environmental degradation provoked by oil exploitation in the Niger Delta in Nigeria. Nevertheless, because of the scale of the dangers caused by the production and disposal of mining wastes I will highlight this aspect of environmental impacts, as an illustration of the extent of the challenges presented by these externalities.

Waste and tailing disposal

By its very nature the extraction of mineral resources produces a vast quantity of waste. It

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150 According to the European Environmental Agency in 2002 over 400 million tones of materials, mining and quarrying were produced in Europe alone, representing 29% of total wastes and the largest stream of waste generated by the members of the European Union. See Elaine Baker et al, Vital Waste graphics, online: UNEP
involves materials that must be removed to gain access to the mineral resource, such as topsoil, overburden and waste rock, as well as tailings remaining after minerals have been extracted from the ore. The quantity of waste varies according to the type of mineral extracted, as well as the nature and size of the mine. For example, gold and silver are among the metals producing most quantities of waste: around 99 percent of the ore extracted becomes waste. By contrast, iron mining is less wasteful, with approximately 60 percent of the ore extracted processed as waste. According to the United Nations Environment Program (UNEP), for example, a single gold wedding ring containing a mere 5 grams of gold can often leave 3 tons of waste behind. The average quantity of minerals needed to produce a personal computer can produce as much as 1.5 tons of waste.

Often it is necessary to extract large quantities of earth material and to use a series of physical and chemical processes to obtain a small proportion of the desired mineral. The amount of waste material and chemicals increases as the metal rates per ore decreases. The impacts are often more pronounced for open-pit mines than for underground mines, because the latter often produce less waste, even though the quantities are still considerable. These vast amounts of waste occupy large territorial spaces, disfiguring the landscape and affecting local habitats. Where toxic wastes are released in coastal areas additional environmental impacts can be expected on sensitive coastal resources. Corals and other forms of marine life, for example, generally require clear water for growth, and are easily affected by metals and chemicals.

Mining waste is a very serious safety hazard, besides causing the loss of land productivity and erosion. Most mining wastes contain highly dangerous substances such as acids and metals that can be spread by the wind or water. This pollution can cause serious health and ecosystem problems and can produce long-lasting consequences for the environment and societies surrounding the site, being “extremely difficult and costly to address through remedial


151 Ibid.
152 See Baker, supra note 150.
measures." The technique mostly used to avoid these risks is the channeling of the waste resulting from the mining physical and chemical processes into tailing of contaminated water and earth materials.

Nevertheless, the management of tailings is also an intrinsically risky activity, often involving residual processing chemicals and elevated levels of metals. In many cases tailings are stored on heaps or in large ponds, where they are retained by means of dams. There is still no safe technique to fully contain these tailings. According to the non-governmental organization World Wildlife Fund (WWF), tailings dams’ failures have accounted for around three-quarters of all major mining-related environmental accidents worldwide since 1975. In Europe, successive mining waste spills – at the rate of more that one per year in the period 1998-2000 – have shown the high social, environmental and economic risks associated with mining waste management. According to the WWF, even the so-called non-hazardous inert mining and quarrying wastes (e.g. silts and coal ashes, fines from quarries) can be detrimental to aquatic fauna and flora, for instance, by damaging fish or by blanketing streambeds to such an extent that plant photosynthesis becomes impossible. Indeed, the degradation of aquatic ecosystems and receiving water bodies can be among the most severe potential impacts of badly managed tailings or other forms of disposal of mining waste.

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153 *Breaking New Ground, supra note 13.*

154 Famous examples of tailings accidents in Europe were Aberfan (Wales, 1966), Stava (Italy, 1985), Aznalcóllar (Spain, 1998), Baia Mare and Baia Borsa (Romania, 2000). Studies showed that two mine structure accidents have occurred per year on average over the last 6 years. Approximately 31 tailings incidents have been recorded in the decade from 1992 to 2002, of which nearly 40 percent resulted in loss of life or property. See Miranda et al, *supra* note 150.

155 For example, the toxic spill from the Boliden-Apirsa pyrite mine “Los Frailes” in Aznalcollar in 1998 (Spain) had long lasting disastrous environmental and socio-economic consequences for the Donana wetland ecosystem and local communities. In 2000, in “Baia Maré” (România), a tailings pond burst in a gold mine led to enormous amounts of cyanide and heavy metals being released into the Lapus river, then traveling downstream before entering the Danube river, killing 1,242 tones of fish and causing severe consequences for the health of the local populations and their livelihoods. Since then accidents have also happened, - at a smaller scale – in Greece, the UK and Sweden. Miranda et al, *supra* note 150.

156 There is currently, for example, a legal action against Simplot company in the USA for the selenium pollution of two rivers resulting from its open pit phosphate ore mining in Utah. Phosphate is a general term that describes naturally occurring rock containing a high concentration of phosphate minerals. The phosphate is usually used to produce fertilizers, herbicides and animal feed supplements. The USA has 7% of world known reserves of phosphate. China and the African continent have the largest reserves of phosphate. See website of Caribou Clean Water Partnership, with information about this and other legal actions related to water contamination in Caribou Country, in Idaho and Wyoming, *Hidden Children: Caribou Clean Water Initiative*, online: Hidden Children <www.hiddenchildren.org>. According to the US Environmental Protection Agency (EPA) the maximum contaminant levels of selenium for water is 0.05 parts per million (ppm). Even though selenium is an essential
Wastes from the exploitation of non-renewable resources have to be properly managed in order to ensure the long-term stability of disposal facilities and to prevent or minimize any water and soil pollution arising from drainage and leaching of heavy metals. Thus, safely disposing of such large quantities of hazardous waste presents enormous challenges for the mining industry and also for host governments. The United Nations Environment Program (UNEP) considers that the normal waste management instruments are incapable of ensuring adequate treatment of high quantities of dangerous waste. Therefore, special systems of waste management have to be created to deal with mining waste. All developed countries have enacted regulations to ensure the safe management of mining waste. Section 2 has shown that the last decades have witnessed a marked rise of natural resource exploitation in developing countries. The question is: will these countries also be able to formulate and enforce the same levels of protection against these serious environmental risks?\textsuperscript{157}

**Human rights violations and impacts on local communities**

The exploitation of extractive resources often causes significant social impacts, ranging from health and safety hazards, to large waves of migration to the sites of operations, to the displacement of communities and to human rights violations. It is important to note that these impacts are especially relevant when inflicted on indigenous communities. Despite the seriousness of these impacts, it is widely recognized that there is still a dearth of systematic research in this area.\textsuperscript{158}

human rights violations linked to economic activities. In 2005 John Ruggie, the special representative of the Secretary General of the United Nations on the issue of human rights and transnational corporations, undertook a series of consultations with governments, civil society organizations, international institutions and corporations in order to assess the types and implications of corporate activities for human rights.\footnote{As part of the survey the Special Representative analyzed sixty-five documents containing allegations of corporate abuse reported by NGOs. John Ruggie, “Report of the Special Representative of the Secretary-General (SRSG) on the issue of human rights and transnational corporations and other business enterprises” (UN A/HRC/4/035), online: Business & Human Rights Resource Centre <http://www.business-humanrights.org/Documents/RuggieHRC2007>.} His Interim Report to the UN Secretary General stated that:

The extractive sector – oil, gas, and mining – utterly dominates this sample of reported [human rights] abuses [by corporations], with two-thirds of the total. […] The extractive industries also account for most allegations of the worst abuses, up to and including complicity in crimes against humanity, typically for acts committed by public and private security forces protecting company assets and property; large-scale corruption; violations of labor rights; and a broad array of abuses in relation to local communities, especially indigenous people.\footnote{The report stated that the foods and beverages industry is a distant second, followed by apparel and footwear, and the information and communication technology sector. Ibid. The higher occurrence of human rights violation in the extractive sector may be a result of the fact that extractive corporations are more present in countries with weak governance systems. This is one of the reasons Ruggie appointed for his findings: “The higher incidence of human rights abuses in the extractive sector could be explained by two factors: first its inherent “enormous and intrusive social and environmental footprint”; second because the corporations operating in the extractive sector were more likely than others to engage in countries with weak or corrupt governments.}

The Fafo Institute for Applied International Studies has collected further evidence of the linkage between the extractive sector and serious violations of international law. This think tank based in Norway maintains a research project aimed at documenting crimes against humanity, war crimes and torture involving corporations worldwide. The Fafo Institute found that the majority of lawsuits initiated in the US judicial system through the United States Alien Tort Claims Act (ATCA) relate to multinational corporations operating in the exploitation of natural resources in various conflict zones around the globe.\footnote{The corporations are accused of being accomplices rather than direct perpetrators of the crimes See Business and International Crimes, The Project, online: FAFO <www.fafo.no/liabilities/project-descr.htm>.}

Besides gross human rights violations and serious crimes against international law, other negative social impacts of resource exploitation are on the rise. When stocks of minerals are identified in places that are heavily populated, the exploitation of the mines requires the
displacement of whole communities. Sometimes it is not the mine itself, but the need to construct the necessary infrastructure - such as dams to provide energy for the extraction or processing of the ores, or roads to transport the products - that require the displacement. The lack of effective mitigation of the impacts of this forced displacement can lead to impoverishment, social unrest, environmental degradation, and loss of cultural diversity.¹⁶²

For these reasons the United Nations has declared development-induced displacement a prima facie violation of fundamental human rights, and has issued various declarations and guidelines requiring that development-induced displacement be avoided in principle. In the cases where it must go forward, the UN guidelines propose a series of measures to address its impacts and risks.¹⁶³ International financial institutions such as the World Bank, the Asian Development Bank, and the International Finance Corporation have also adopted policies to ensure rehabilitation and compensation of people facing displacement. Despite these guidelines and policy changes, studies have increasingly found that communities have seldom become better off than they were before resettlement (the favored goal). Even the goal of rehabilitation remains exceedingly difficult to achieve. Displaced communities are generally left more impoverished and vulnerable than before. Inadequate financing and underestimation of social costs of large-scale projects continue to be key components of this failure. As the exploitation of natural resources expands in developing countries more cases of potential displacement of communities will have to be addressed.

Other significant social impacts occur when medium and large-scale mining activities attract huge waves of migration from other parts of the country or even from abroad. The migrants may have a very different set of cultural values from those of the surrounding population. This most often causes problems for existing communities in the area.¹⁶⁴ Although the impacts can vary greatly, some common factors observed by social scientists are: irreversible disruption of local


¹⁶³ Ibid.

social and cultural organizations; large changes to traditional values, as for example the way some indigenous communities relate to land and the environment; introduction of cash values in communities that have shared ownership of material products; conflicts between traditionalists and developmentalists, inside the communities, regionally and sometimes nationally.\footnote{Ibid.}

This section reveals a growing consensus on two issues: (1) resource-dependence leads to lower economic growth and worse development indicators in the long run; (2) resource-led economies are at greater risk of serious environmental and social disruptions. It also shows that resource-rich developing countries may also be at greater risk of developing authoritarian regimes, political violence and civil conflicts than their resource-poor peers, although there are ongoing debates on this point. Several resource-led economies such as Canada, Australia and Norway, but also developing countries’ economies such as Botswana and Chile, are proof that the resource curse is not inevitable. These countries were able to manage most of the negative externalities of resource dependency. What makes some developing countries fall prey to the resource curse, and not others?

There is another growing consensus in the literature that proposes to answer this question. This consensus argues that the primary explanation for why some countries fall prey to the resource curse while others do not, lies in one key variable: the existence of sound governance systems. I will turn to this theory next.

1.4.3. Governance deficit and the resource curse

As described in previous sections, the literature has tried to uncover which distinctive economic, political, social and environmental characteristics of resource-dependent economies may explain why resource-rich developing countries tend to exhibit worse development outcomes than their resource-poor peers in the long run. A recent body of the resource curse literature has tried to approach the same conundrum from a different perspective. Instead of asking what elements lead most resource-rich developing countries to fall prey to the resource-curse, this literature focuses on what elements explain why some resource-rich developing countries are able to escape the curse. Scholars employing this different research perspective have shed new light on the
importance of domestic governance systems for development, linking institutions to the phenomenon of the resource curse.

In fact, this line of research began in policy circles. Following numerous criticisms of its support for mining, oil and gas projects in developing countries, in 2001 the World Bank (WB) commissioned an *Extractive Industries Review Process* to analyze the Bank’s engagement with this sector. The WB released the resulting Report *Striking a Better Balance* in 2003. This report is the best existing analysis of the crucial importance of a sound governance framework to address the significant risks and impacts of resource extraction. After engaging various relevant stakeholders (governments, nongovernmental organizations/NGOs, indigenous peoples’ organizations, affected communities and community-based organizations, labor unions, industry, academia, international organizations) in a long consultation process, *Striking a Better Balance*\(^\text{166}\) affirmed that

The key difference between resource-rich states that do well and those that do poorly is the quality of government institutions and government policies. When governments are not corrupt, act decisively to prevent current overvaluation, enact countercyclical policies, manage windfall revenues properly, and promote the needs of the poor, the revenues from the development of oil, gas and mineral resources can contribute to poverty alleviation.

Recently a group of economists and political scientists have also published studies where they concur that weak institutions are the crucial link between resource wealth and the negative economic and social (heretofore meaning political, social and environmental) outcomes attributed to it. Melhum, Moene and Torvik measure institutional quality using data from Political Risk Services on: “a rule of law index, a bureaucratic quality index, a corruption in government index, a risk of expropriation index and a government repudiation of contract index”\(^\text{167}\). They find that institutions are decisive for the resource curse: resource wealth undermines economic development in weak institutional environments, while boosting economic growth in sound ones. Wantchekon and Jansen find that in sub-Saharan Africa, where countries

\(^{166}\) As part of the review process regional workshops were held in Brazil, Hungary, Mozambique, Indonesia, and Morocco. It also included six research projects, visits to four project sites and informal consultations with stakeholders worldwide. World Bank Group, *Striking a Better Balance – The World Bank Group and Extractive Industries Review (EIR) – Final Report*, 2004.

possess weak institutions, the abundance of natural resources tends to make both the transition to, and the consolidation of, democracy less likely.\textsuperscript{168} Humphreys finds strong support for the thesis that weak state structures caused conflict in resource-rich countries.\textsuperscript{169} Ross, in his upcoming study, finds that the presence of oil has undermined democracy, but only in poor countries; and that oil increases the likelihood of war within poor or middle-income states (which tend to have weaker institutions), but not within high-income ones.\textsuperscript{170}

Indeed, the negative externalities of natural resource extraction happen in developed and developing countries alike. However, developed countries have generally adopted measures to address these externalities. For example, all developed countries have enacted and are enforcing increasingly stringent regulations to address the environmental impacts of resource extraction. In order to deal with the toxic waste problem, for example, the European Union has created a comprehensive framework for the safe management of waste from extractive industries.\textsuperscript{171} In Canada, a resource-rich developed country, laws and regulations have been enacted both by the provinces and at federal level to deal with the management of mining waste\textsuperscript{172}. Reported accidents have been decreasing in developed countries, accordingly. However, many environmentalists claim the situation in developing countries is quite different. Environmental


\textsuperscript{169} Humphreys, supra note 128.

\textsuperscript{170} Ross, “Oil and Democracy”, supra note 117.

\textsuperscript{171} The European system of mining waste management comprises a reference document on best available techniques for the management of tailings and waste-rock in mining activities; and an amendment of the directive (Seveso II) to include in its scope mineral processing of ores and, in particular, tailings ponds or dams used in connection with such mineral processing. See P Charbonnier, Management of Mining, Quarrying and Ore-processing Waste in the European Union (BRGM, 2001) online: EU <http://ec.europa.eu/environment/waste/studies/mining/0204finalreportbrgm.pdf>; see also EC, Commission Directive 2006/21/EC on the management of waste from the extractive industries (the mining waste directive) [2006] OJ, L 102, online: EU <ec.europa/environment/waste/mining/index.html>.

\textsuperscript{172} The Canadian Federal Ministry of the Environment has created legislation on effluents generated by mining waste. The main points included in the Canadian legislation are: prohibition to dump certain substances; establishment of limit values on quality of the effluents; determination of limit contents authorized in terms of chemical compounds present in the materials stored; geotechnical stability of disposal sites; pollution control in the different environments; environmental impact of disposal, management, remediation and redevelopment operations, etc. The standards drafted at the federal level in Canada represent maximum basic values and the local environmental agencies must define the specific values for the sites concerned, values that may be lower than the nationwide values. The regulations on water management are based on controlling releases and in this sense they reinforce the responsibility of the mine operators in the management and treatment of the waste within the geographic limits of the mine. Mine operators are required to use “the best technique at the optimal economic level”.
regulation tends to be much weaker, and, even when adequate regulation exists, it is seldom enforced.

In 2005 the World Resources Institute (WRI)\(^{173}\) published a report called *Mining and Critical Ecosystems: Mapping the risks*, resulting from a 2-year research effort aimed at identifying environmentally and socially vulnerable areas at risk from mining. The WRI Report also included case studies of mining operations in Papua New Guinea (PNG) and the Philippines. Those case studies are illustrative of the extent of the impacts and risks of mining exploitation in contexts of weak regulatory systems. One case study focused on the Ok Tedi copper and gold mines operated by Australian corporation BHP Billiton in PNG. Claiming that seismic instability made the construction of tailing disposal systems to manage the waste in PNG impossible, BHP disposed of toxic waste directly into rivers. The disposal from the Ok Tedi mine resulted in significant negative impacts on the river and surrounding local communities, including: the loss of fish in the entire 480 km\(^2\) watershed; declines in local wildlife populations; loss of agricultural land; the degradation of more than 2,000 km\(^2\) of forests; and declines in coastal fish stocks.\(^ {174}\)

Approximately 50,000 residents in 120 villages have been affected by the 70 million tones of waste. In addition, more than 60 percent of the tailings and waste rock were deposited in another river, the Jaba, which were carried out to sea, affecting aquatic species in the upper tributaries that were unable to migrate to the sea to spawn.\(^ {175}\) In 2002 BHP divested itself of the Ok Tedi mine, leaving management to a government-owned subsidiary. BHP’s behavior was only possible because PNG legislation gives companies large exemptions from meeting water quality standards in discharge areas known as “mixing zones.” Few places in the world still allow the direct disposal of toxic mining wastes in rivers.

Like environmental impacts, the occurrence of human rights violations related to natural resource operations has been linked to weak governance. The 2006 Interim Report of the UN

\(^{173}\) WRI is an environmental think tank, see more information on WRI, *World Resources Institute*, online: WRI <http://www.wri.org/>.


Special Representative on Business and Human Rights (John Ruggie) emphasized that the alleged human rights abuses by extractive corporations occurred mainly in low income countries, two-thirds of them emerging from or still in conflict, and characterized by “weak governance”:

On a “rule of law” index developed by the World Bank, all but two [out of 27] fall below the average score for all countries […] On the Transparency International Corruption Perceptions Index – where “zero” is labeled “highly corrupt” and “ten” is described as “most clean” – their average score is 2.6. And on the Freedom House index of political systems – where “not free” is ranked as one, “partially free” two, and “free” three – their average is 1.9.

The 2003 World Bank’s Extractive Industries Review analyzed projects of resource exploitation supported by the Bank in Peru, Tanzania and Indonesia. The Review found that the projects had in fact increased social antagonism and conflict, exacerbated macroeconomic imbalances, had not been translated into revenues flows to locally affected communities, and had failed to address important market failures that were harmful to the poor, the environment and the economy. Regarding the environment, it found that overall the Bank’s activities of environmental mitigation “have been unable to offset the overall increase in environmental degradation associated with the expansion in exploration and production”. Regarding social costs and impacts such as workers’ health and safety and forced displacements, the Review found that the WB’s safeguards had been unable to ensure that “no harm is done” due to deficiencies in the policies and to poor implementation. The Report also noted allegations of human rights violations by military personnel engaged in protecting the security of extractive operations, or by private security personnel hired by corporations.

Striking a Better Balance concluded that there was a role for the WB in the natural resources sector in developing countries, but proposed that the WB’s engagement should be conditioned on a comprehensive assessment on the existence of three main “enabling conditions” in the country which would host the project. These conditions are:

- Pro-poor public and corporate governance, including proactive planning and management to maximize poverty alleviation through sustainable development;
- Much more effective social and environmental policies; and
- Respect for human rights.

The report went on to explain more specifically that the building blocks of governance required for extractive industries projects would include a requirement that:
Governance should be strengthened until it is able to withstand the risks of developing major extractions. [...] Similarly, when the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) consider investing in an oil, gas, or mining project, they need to specifically assess the governance adequacy of the country as well as the anticipated impacts of the project and then only support projects when a country’s government is prepared and able to withstand the inherent social, environmental, and governance challenges.\footnote{Development economist Paul Collier also concurs with this growing consensus. In *The Plundered Planet*, Paul Collier presents two equations:}

\begin{align*}
1) & \quad \text{Nature} + \text{technology} + \text{regulation} = \text{prosperity}. \\
2) & \quad \text{Nature} + \text{technology} - \text{regulation} = \text{plunder}; \\
\end{align*}

Collier argues that the revenues from natural resource exploitation can have a powerful transformative impact on LDCs’ economies, “dwarfing any conceivable flows of aid”.\footnote{Collier, *The Plundered Planet*, supra note 1.} However, this positive potential depends on the existence of a sound governance framework. Otherwise, he argues, the historical evidence indicates that revenues will be wasted in corruption and consumption without improving development indicators for the majority of the population.

Despite the solid consensus that resource wealth + governance deficit = the resource curse, the reality is that the recent boom in natural resource exploitation is happening in countries that have very weak governance systems.

In 2005 the environmental think tank World Resources Institute (WRI) published a report called *Mining and Critical Ecosystems: Mapping the risks*, resulting from a 2-year research effort aimed at identifying environmentally and socially vulnerable areas at risk from mining. Researchers compared the aggregate governance indicators developed by Kaufmann et al (2002)\footnote{The authors of the study only excluded regulatory burden from the six indicators of governance. Miranda et al, *supra* note 150.} to the information on existing relevant mining projects. They found that:

\begin{flushleft}
\footnote{\textit{The report adds: “The criteria of governance adequacy should be developed transparently and with the involvement of all stakeholders. It should include minimum core and sectoral governance criteria, such as the quality of the rule of law; the absence of armed conflict or of a high risk of such conflict; respect for labor standards and human rights; recognition of and willingness to protect the rights of indigenous peoples; and government capacity to promote sustainable development through economic diversification.” Striking a Better Balance, *supra* note 166.} }
\end{flushleft}
- Nearly one quarter of active mines and exploration sites are located in countries with weak governance;
- Nearly one third of the countries for which data are available rank poorly in both governance and capacity for informed decision-making, indicating that mining may be less likely to improve the human development of citizens in these countries;
- Nearly one third of countries with high watershed stress also rate poorly in governance, reducing the likelihood of sound water resource management.
- Approximately 4 percent of active mines and exploration sites face multiple vulnerabilities, including seismicity, watershed stress, and ecological value.

According to Paul Collier, 29% of people in the bottom billion currently live in resource-rich developing countries, most of them lacking an adequate governance framework to successfully address the resource curse risk. These are the people and the countries that face the bleak prospects of diverging more and more from other developing countries, let alone developed ones.

1.5. Conclusion

Resource-rich and governance-poor developing countries currently experiencing a resource boom face a significant risk of falling prey to the resource curse, and if they do, they will end up with worse development outcomes in the long run than their resource-deprived peers. What needs to be done? There is widespread consensus in the academic literature that governance matters for development, and this is particularly relevant for these resource-rich countries if they are to avoid the resource curse. Thus, domestic and foreign actors concerned with this risk need to find ways to successfully promote improvements in domestic governance systems, or to find functional equivalents to key missing domestic governance mechanisms in resource-rich and governance-poor countries. Can this be done? How? These are the questions that will be addressed in the next chapter.

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179 Collier, The Bottom Billion, supra note 4.
Chapter 2
“Double Trapped”

The sobering story of our limited success in encouraging economic development in sub-Saharan Africa and in Latin America suggests that we have some distance to travel before we can have confidence in our institution building to improve performance.

Douglass North*

2.1. Introduction

Chapter 1 showed that unless resource-rich and governance-poor countries improve their domestic institutions, many of them are currently on a path towards the long-term adverse development outcomes associated with the resource curse. This chapter shows that despite massive efforts and significant resources invested in development assistance to promote domestic governance reform in the last years, many developing countries, and resource-rich countries in particular, still present acute governance deficits (section 2). Why is this the case? This chapter argues that resource-rich and governance-poor countries face a significant challenge as there are major obstacles to domestic governance reform in these countries, and we still do not understand how to promote domestic governance reform effectively. For some resource-rich and governance-poor countries, improving domestic governance systems is an Augean endeavor, because they are caught in a double trap.¹ This chapter explains the two main trapping mechanisms behind the resilient dysfunctional paths of resource-rich developing countries, and discusses possible avenues of escape.

The first trapping mechanism occurs because the dysfunctional governance systems these countries have developed over time have become “sticky” or resilient to reform as explained by path dependence theories (section 3). The second trapping mechanism occurs because resource-rich and governance-poor countries face a significant contemporary obstacle to governance

reform: rent-seeking behavior (section 4). As a consequence, improving governance systems in resource-rich developing countries is an extremely intractable problem, and the strategy of promoting governance reform through development assistance has proven insufficient to break the weak governance curse, as I illustrate with the case of failed attempts to promote reform in Chad (section 5). The second part of this chapter draws insights from recent path dependence literature to argue that a way to overcome these obstacles may lie in forms of global regulatory mechanisms other than development assistance (sections 6 and 7). The conclusion of this chapter is that there is reason for cautious optimism regarding the potential for other forms of global regulatory mechanisms to help breaking the double trap in which resource-rich countries are enmeshed.

2.2. The elusive quest to promote domestic governance reform in developing countries

This section begins with an overview of the massive efforts to promote governance reform in developing countries in the last decades (section 2.1), and then moves on to show how the results of these efforts have so far been largely disappointing (section 2.2).

2.2.1. The rise of governance related initiatives in the development field

Beginning in the mid 1990s, Western donors, International Financial Institutions (IFIs) and private foundations adopted the promotion of domestic governance reforms as the primary strategy to improve development outcomes in developing countries in the long run. This trend is evidenced by a gradual, yet significant rise in external assistance for governance reform after the end of the Cold War. This rise has been spurred by both: a supply side, with aid donors (both multilateral agencies and bilateral development agencies from developed countries), policy makers and civil society organizations advocating and providing financial support for projects aimed at improving governance systems; and a demand side, with many developing countries having themselves incorporated the idea that improving governance systems was in their interest.

One reason for this trend was the rise of the “governance matters” consensus in academic circles and in the development discourse, as described in chapter 1. David Trubek argues that besides the “governance matters” consensus, the decades-old human rights movement has also contributed to governance reform becoming the primary strategy to spur positive development
outcomes in less developed countries from the mid-1990s on. Human rights advocates had long pressed for increased international assistance to translate the post World War II international human rights standards into effective domestic protection of human rights, beyond the merely official, lip service recognition by many developing countries. The mechanisms thought necessary to achieve this goal were the promotion of, inter alia: strengthened democratic institutions and processes; increased access to justice and rule of law protection for the population in general and for disadvantaged groups in particular; and greater accountability of state and non-state actors for human rights violations.

Institutional theories of development and the human rights movement provoked different, if complementary, strands of governance reform activities. While the former placed more focus on the necessary institutions to enable private economic activity, such as protection of property rights and enforcement of contracts through independent and non-corrupt courts, the latter has focused on governance reforms to ensure more socio-economic inclusion and democratic participation in developing countries. Private foundations such as the Ford Foundation, the Open Society Foundations (OSF), the Heinrich Boll Foundation, Avina, etc., have sought to support and/or strengthen the domestic demand for sound governance systems by funding or providing technical assistance to domestic civil society organizations and think tanks. Private foundations’


3 Ibid.

4 I will address the specific efforts to promote rule of law reforms in chapter 3. Thomas Heller, focusing on the analysis of rule of law reforms, argues that in fact there were different waves since WWII. The first wave happened in the 1960s, under the “old” law and development movement in American academia. The second wave happened in the 1970s and 1980s, and was characterized by the efforts to promote the internalization of international human rights standards in constitutions and legal systems throughout the developing world. Finally, a third wave was characterized by the efforts to build institutional foundations to enable efficient market activities that began in the 1980s and remains strong. Thomas C Heller, “An Immodest Postscript”, in Erik Jensen & Thomas Heller, eds, Beyond Common Knowledge: Empirical Approaches to the Rule of Law (Stanford: Stanford University Press, 2003). Michael Trebilcock and Kevin Davis also give a general overview of the various theoretical perspectives on law and development. Kevin Davis & Michael J Trebilcock, “What Role do Legal Institutions Play in Development?” (Paper delivered at the International Monetary Fund’s Conference on Second Generation Reforms, 8-9 November 1999), [unpublished]. David Trubek and Alvaro Santos talk about three moments in the international promotion of law and development reforms. The first moment focused on reforms to enable state intervention in the economy. The second moment involved governance reforms to reduce state intervention in the economy and provide an enabling environment for market economies. The third moment involves the expansion of governance reforms to correct market failures and to improve development outcomes beyond economic growth. In this third moment governance became not only a tool, but also an objective for development policies in itself. David Trubek & Alvaro Santos, eds, The New Law and Economic Development: A Critical Appraisal (Cambridge: Cambridge University Press, 2006).
support aims to enable these organizations to undertake studies, to monitor institutional shortcomings that contribute to widespread inequality and human rights violations, and to support their advocacy efforts to reform weak - or build new- institutions that contribute to human rights protection and to more accountable governments.\(^5\)

One illustrative example is the Open Society Foundations’ project called *Africa Governance Monitoring and Advocacy Project (AfriMAP)*, launched in 2004 to “monitor the compliance of member states of the African Union (AU) with selected standards of good governance, democracy, human rights and the rule of law.” The stated strategy is to partner with civil society groups and private research centers in Africa to produce independent research on governance issues, “using a framework linking respect for human rights to progress in development”.\(^6\) *AfriMAP* has chosen to focus initially on three areas: the justice sector and the rule of law; political participation and democracy; and effective delivery of public services.\(^7\) From 2005 to 2009 the various OSF projects in Africa have invested more than 180 million dollars in a range of initiatives besides *AfriMAP* to support civil society organizations; fight racial and gender discrimination; improve access to education and health; promote media independence; and foster more democratic and accountable governments in Southern, Eastern and Western Africa.\(^8\) In 2006 an African magnate created another private initiative to invest in governance improvements. The Mo Ibrahim Foundation was founded to “support good governance and great leadership in Africa”.\(^9\) This foundation seeks to encourage governance reforms by measuring the quality of governance in the African continent and by rewarding African leaders that have

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\(^5\) Ford Foundation, for example, describes its work as promoting institutional change:

> We are on the frontlines of social change around the world, working with visionary leaders and organizations to change social structures and institutions – so that everyone has the opportunity to achieve their full potential and have a voice in decisions that affect them. Ford Foundation, *About Us* (2012) [emphasis added], online: Ford Foundation <http://www.fordfoundation.org/>.


contributed to significant governance improvements in their countries. MO Ibrahim Foundation
gives these African leaders a “prize for Achievement in African Leadership.”
There are many similar projects to encourage or promote governance reform in other developing countries in
Latin America, Asia and the Middle East.

Multilateral financial organizations’ initiatives represent the major source of funds for
governance reform projects. Governance reform initiatives from these organizations, also known
as International Financial Institutions (IFIs), have grown to become quite significant in the wake
of the emergence of the “governance matters” consensus at the forefront of development studies.
In the last two decades the promotion of domestic governance reform in developing countries has
become embedded in IFIs from the Bretton Woods system, such as the World Bank and the
International Monetary Fund (IMF). In 1996 the IMF officially declared: “promoting good
governance in all its aspects, including by ensuring the rule of law, improving the efficiency and
accountability of the public sector and tackling corruption, [are] essential elements of a
framework within which economies can prosper”. In line with this view, the IMF has
significantly changed the initial concept of conditionalities, by requiring commitments to
governance reform from borrower countries.

10 The Ibrahim Governance Index compiles 86 indicators grouped into 14 sub-categories and four overarching
categories to measure the effective delivery of public goods and services to African citizens. The Ibrahim Prize is
“awarded to a democratically elected former African Executive Head of State or Government who has served their
term in office within the limits set by the country’s constitution, has left office in the last three years, and has
demonstrated excellence in office”. The award consists of a stipend of US$5 million over 10 years and US$200,000
annually for life for the outgoing African leader. The Foundation may also consider granting a further US$200,000 per
year, for 10 years, “towards public interest activities and good causes espoused by the winner.” Mo Ibrahim

11 Rittich argues that social concerns have been incorporated in the mainstream agenda of market reform and
economic development advanced by IFIs, when these multilateral institutions incorporated a broader concept of
development based on Amartya Sen’s idea of development as freedom. She calls these reforms “second-generation”
or “post-Washington Consensus. She argues, however, that there is still a strong emphasis on governance reform to
promote a “market-friendly” governance framework. In this way she seems to indicate that IFIs governance reform
initiatives still do not focus as much on directly promoting social objectives. See Kerry Rittich, “The Future of Law
and Development: Second-Generation Reforms and the Incorporation of the Social” in David Trubek & Alvaro
Santos, supra note 4, 203.

12 International Monetary Fund, The IMF’s Approach to Promoting Good Governance and Combating Corruption -
13 IFIs, such as the IMF and the World Bank, have originally created conditionalities to address the risk of non-
compliance with loans, thus protecting their financial integrity. Conditionalities were initially restricted to measures
such as monetary and fiscal policies or micro, sector-specific policies. Conditionalities were the only alternative of
A study shows that from 1997 to 1999, forty percent of the IMF’s conditionalities in the form of quantitative performance criteria, and seventy two percent of the more loosely-defined conditionalities to countries in sub-Saharan Africa were governance-related.\(^{14}\) In 2009 the United Nations Conference for Trade and Development (UNCTAD) found that, despite opposition to some forms of conditionality having provoked a heated debate about their effectiveness and legitimacy, lending conditionalities linked to governance reform projects continued to be important.\(^ {15}\) Indeed, in 2009 almost half of the structural conditions in IMF’s programs aimed at improving governance systems.\(^ {16}\)

The World Bank has also fully embraced the “governance matters” mantra. According to Carlos Santiso:

> Since 1996, the World Bank has begun over 600 governance-related programs and initiatives in 95 countries and is involved in supporting significant programs of governance and public sector reform in 50 countries (Development Committee 2000). Between 1987 and 1998, the Bank carried out 169 civil service reform programs in 80 countries. Since the early 1990s, it has supported legal and judicial reform and decentralization around the developing world. In 1996, the fight against corruption became a priority and the Bank began supporting programs aimed at strengthening other accountability institutions such as ombudspersons and parliamentary oversight bodies.\(^ {17}\)

IFIs to deal with the risk of non-compliance, since its public purpose precluded them from using standard market mechanisms such as higher risk premia, shorter duration agreements, etc. Devesh Kapur & Richard Webb, *Governance-related Conditionalities of the International Financial Institutions*, G-24 Discussion paper series no 6, (New York: UN 2000).

\(^{14}\) Ibid at 11.


\(^{16}\) The IMF has also created a guide on governance reform specifically for resource-rich countries, called “Guide on Resource Revenue Transparency”, and provides capacity building and technical assistance for countries willing to follow their guidelines on governance-related transparency initiatives in the extractive sector, *IMF – A Guide, supra* note 12.

In 2010 alone the World Bank provided 6 billion USD in loans (10% of its portfolio) to: “help countries improve the performance and accountability of their core public sector institutions and rule of law”.\textsuperscript{18} It is difficult to measure the exact amount of resources that has been invested in governance reform in developing countries. By all accounts it has been a massive sum.\textsuperscript{19} According to David Trubek, whose analysis focuses on only one dimension of governance reform, the “rule of law”:

At the twentieth century’s end, if all the current ‘rule of law’ portfolios of the World Bank, regional banks, major nongovernmental organizations and foundations, the US Agency for International Development (USAID), and other bilateral aid institutions and local counterparts were added up, it would equal several billion dollars worth of assistance funds being spent on law projects.\textsuperscript{20}

Developed countries have also embraced the “governance matters” mantra in their bilateral aid practices. In 1995 the OECD created the Network on Governance (GovNet), an international forum of all ‘Development Assistance Committee (DAC)’ donors and multilateral aid agencies to discuss analytic tools to assess governance and aid effectiveness, and to share experiences and good practices on governance reform in developing countries.\textsuperscript{21} In 2004 the United States government created the Millennium Challenge Corporation. This new aid agency was made independent of the traditional United States Agency for International Development (USAID), to provide additional funds for those countries that adopt sound governance policies.\textsuperscript{22}


\textsuperscript{19} See Mariana Prado & Michael Trebilcock, “Path Dependence, Development, and the Dynamics of Institutional Reform” (2009) 59(3) UTLJ 341 at 1. See also David M Trubek, “The Rule of Law in Development Assistance: Past, Present and Future”, in David Trubek & Alvaro Santos, supra note 4, at 3.

\textsuperscript{20} Trubek, supra note 2.

\textsuperscript{21} The Development Assistance Committee (DAC) is a forum of the largest aid donors, created by OECD to facilitate discussion of common concerns and to promote cooperation among donors. DAC has currently 24 members: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States and the European Commission. OECD, Development Assistance Committee, Development Assistance Committee (DAC), online: OECD <http://www.oecd.org/document/1/0,3746,en_2649_33721_46662849_1_1_1_1,00.html>.

development assistance donors have incorporated governance reform as an important objective of their bilateral development assistance.

This trend seems to be part of a broader historical shift in development assistance from Western donor countries, which have long been moving away from traditional government-to-government forms of official development aid (ODA).\(^{23}\) There has been a clear focus on building the conditions required to replace official assistance with private foreign direct investment. The United Nations Commission for Trade and Development (UNCTAD), for example, claims that in the case of LDCs, official development assistance has been clearly diverted from support for the creation of infrastructure, and increasingly invested in promoting governance reform that aims to build a better business environment or to help developing countries construct systems to provide basic social services to compensate for market failures.\(^{24}\)

Official government-to-government development assistance from Western developed countries to developing countries began a steady decline in the early 1990s, which lasted for a whole

\(^{23}\) The OECD defines official development assistance (ODA) as: flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent (used a fixed 10 percent rate of discount. By convention, ODA flows comprise contributions of donor government agencies, at all levels, to developing countries (“bilateral ODA”) and to multilateral institutions. ODA receipts comprise disbursements by bilateral donors and multilateral institutions. Lending by export credit agencies – with the pure purpose of export promotion – is excluded. OECD, *Glossary of Statistical Terms*, online: OECD <http://stats.oecd.org/glossary/>. Kazuo Takahashi explains the context in which post WWII official development assistance by industrialized countries to the developing ones has risen and fallen. According to Takahashi industrialized countries created institutions to provide development assistance for three main reasons, the altruistic ones being quite secondary. The first one was a belief that widespread poverty had been one of the main roots of the world wars. The second was to address the inauspicious situation of most of the former colonies, which were enabled to function as sovereign states on their own. The third was the fierce fight for ideological allegiances that marked the cold war era. Until the 1980s official development assistance, financed by tax payers money from industrialized countries, dominated aid to developing countries. With the end of the cold war, and the liberalization of private financial flows, official development assistance has experienced a general declining trend. Kazuo Takahashi, “Reversing the Decline of ODA: How Effective is the Current Policy Agenda?” in UN Department of Economic and Social Affairs, Division for Sustainable Development, *Finance for Sustainable Development: Testing New Policy Approaches* (New York: UN, 2000) 69.

\(^{24}\) The 2009 UNCTAD’s Report on LDCs suggested some priorities for institutional reform to build developmental State capabilities for “good development governance.” Development governance is understood as: “governance oriented to solve common national development problems, create new national development opportunities and achieve common national development goals. This is not simply a matter of designing appropriate institutions, but also a question of policies and the processes through which they are formulated and implemented.” For the authors of the Report the governance reform agenda which has prevailed in the last years was too biased towards market mechanisms and neglected key reforms to strengthen governments’ capabilities, while also neglecting principles such as participation, fairness and accountability. LDC Report 2009, *supra* note 15.
This was due not only to the marked ascendancy of the discourse hailing FDI as a more effective engine of development than official development assistance. Aid fatigue and civil society pressures against waste of official aid through corruption and inefficiency also provoked a diversion of funds to civil society actors instead of governmental agencies. Initially, this had a compounding effect in reinforcing the governance reform agenda. Countries that still heavily relied on aid, like many LDCs, began to embrace the governance discourse, in order to respond to this new political economy scenario. The fact that most developing countries, including resource-rich LDCs, have officially assimilated the governance reform agenda, even if only its discourse, is illustrative of the force of this shift.

In 1999 Festus Mogae, then Botswana’s President, said in a meeting among African finance ministers:

In the face of declining official development assistance, there is a realization and acceptance among African countries that individual countries will have to justify their case for additional assistance. This must be on the basis of high performance on the issues of good governance, observance of the rule of law and zero tolerance for corruption.26

That same year, when African leaders decided to terminate the Organization of African Unity, OAU, and create a new organization, the African Union, the “governance matters” consensus was already strongly established in development circles. In 2001 a group of African leaders presented an innovative proposal to the forum of eight developed countries known as the Group

25 This declining trend has been reversed in the late 1990s, early 2000s, with ODA inflows to developing countries rising again, however in a much slower pace than FDI flows. Besides, a significant share of the increase in ODA has been to finance debt relief and emergency assistance, while ODA for core development programs has seen a more modest increase. On the declining trend of ODA since the 1990s, see Takahashi, supra note 23. On the reversal of the declining trend see International Development Association (IDA), Aid Architecture: An overview of the Main Trends in Official Development Assistance Flows (2007), online: World Bank <http://siteresources.worldbank.org/IDA/Resources/Seminar%20PDFs/73449-1172525976405/3492866-1172527584498/Aidarchitecture.pdf>. See also Simon Burall, Simon Maxwell & Alina Rocha Menocal, “Reforming the International Aid Architecture: Options and Ways Forward” (2006) Overseas Development Institute Working Paper No 278. The slow rise of development assistance lost even more steam with the global financial crisis in 2008, with developed countries set to fail the commitment of increasing the percentage of ODA per GNI undertaken at the Gleneagles Summit in 2005. See UN Department of Economics and Social Affairs, World Economic Situation and Prospects 2012 (New York: UN 2012), online: UN <http://www.un.org/en/development/desa/policy/wesp/wesp_current/2012wesp.pdf> [World Economic Situation].

of Eight (G-8), which together provided the bulk of assistance for development to the continent. African leaders committed to strive to improve governance standards in exchange for increased development aid. This commitment led African leaders, with the support of G8 members, to launch NEPAD, the New Economic Partnership for Africa’s Development. According to John Akokpari:

NEPAD represents a form of moral contract between African countries and the G8. While the former strive to improve governance and promote democracy by undertaking political reforms and market-friendly economic policies, the latter undertakes to assist those African countries committed to good governance, the promotion of human rights, poverty eradication, and economic growth.

In the founding charter of NEPAD African leaders committed to pursue the path of sustainable development in the continent by following the principles of peace, security and good governance. NEPAD was heavily influenced by the “governance matters” theory. According to Alex de Waal, “at the heart of NEPAD lies a recognition that African governments must establish effective and democratic governance”. Membership in NEPAD is conditional on meeting certain standards of governance and economic management. NEPAD’s inclusion of the African Peer Review Mechanism (APRM) represents another indication that, at least in theory, African leaders were willing to endorse the “governance matters” mantra. African

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27 Forum of originally seven developed countries, formed in 1975 under the leadership of France, and which by 2010 was comprised of eight countries: France, Germany, Italy, United States, United Kingdom, Japan, Canada and Russia. For research on the G8’s history and activities see G8 Research Group, G8 Information Centre at the Munk School of Global Affairs, online: University of Toronto <http://www.g7.utoronto.ca/>.


countries would volunteer to go through a peer review of their governance standards and to strive to bridge their own governance deficits. In return, G8 donor countries committed to offer ‘enhanced partnership’ – meaning higher levels of development assistance – to those African countries whose policies reflect NEPAD’s commitments.

NEPAD, being an African initiative that covers most of the currently poorest countries worldwide, and has the backing of the major aid donors, is a striking illustration of the various on-going efforts and initiatives to promote governance reform in the countries that are considered to be in most need of institutional improvements for development. These efforts have now taken place over 15 years. How successful have these initiatives been in improving governance indicators in the least developed countries?

2.2.2. Disappointing results

Notwithstanding all the resources and activities devoted to improving governance systems not only in Africa, but in all governance-poor developing countries, the results so far are not very encouraging. In 2009 Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, the authors of the Worldwide Governance Indicators (WGI) annual reports, published an assessment of the evolution of indicators during the decade of their existence. Despite emphasizing that improvements in governance indicators can and did occur in individual indicators in specific countries throughout the world, the report presented sobering evidence of how difficult achieving significant improvements in governance systems worldwide has proven to be. Despite the increased awareness of the importance of good governance to development, the official commitment by developed and developing countries alike to pursue it, and the sizeable

32 The APRM in fact involves four distinct reviews. First a country commits to undertake a self-assessment, creating an independent board what will make public consultations and identify governance gaps, while proposing a plan of action to address those gaps. In a second stage a team of eminent African academics, diplomats, business and civil society experts will analyze the self-assessment and plan of action and issue the “APRM Country Review Report” with recommendations for governance improvements. In the third stage the APRM Report is submitted for discussion before NEPAD’s forum of heads of state. Finally the country under review commits to present annual reports to NEPAD to communicate progress on implementing the plan of action. See Ross Herbert & Steven Gruzd, The African Peer Review Mechanism: Lessons from the Pioneers, revised ed (Johannesburg: South African Institute of International Affairs, Jan Smuts House, 2008).


investments in governance reform, there was no evidence of significant improvements in the average quality of governance around the world in the last ten years. In fact, most countries (both developed and developing ones) experienced only minor average changes, for the worse as well as for the better.

In 2008 Michael J. Trebilcock and Ronald J. Daniels showed that developing countries in general were having difficulties implementing governance reforms to guarantee even a “thin”, or procedural form of the rule of law, encompassing only the essential elements of the concept.\(^\text{35}\)

This poor record is even more accentuated if one takes only resource-rich countries with low development indicators into account. Trebilcock and Daniels noted that the 2002 World Governance Indicators (WGI) showed that only six out of 47 countries in Sub-Saharan Africa, home of most resource-rich LDCs, registered positive rule of law ratings. None of these countries (Botswana, Cape Verde, Mauritius, Namibia, Seychelles and South Africa) were among the low development indicators countries that rely on minerals or oil exports.\(^\text{36}\)

In fact, more recent WGI data shows that in 2010 most resource-rich countries in the list of low development indicators still scored very low, and well below the world’s average ratings not only in the rule of law (chart 1),\(^\text{37}\) but also in government effectiveness (chart 2), regulatory quality (chart 3), control of corruption (chart 4), political stability (chart 5), and voice and accountability (chart 6). The evolution of the World Governance Indicators over the last decade, presented in the 2010 report, shows how the low levels of governance indicators in developing countries have endured, despite the massive investments in governance reform.\(^\text{38}\)

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35 The procedural values the authors include in the “thin” concept of rule of law are process values (transparency, predictability, enforceability, stability), institutional values (independence and accountability), and legitimacy values. Michael J Trebilcock & Ronald J Daniels, Rule of Law Reform and Development: Charting the Fragile Path of Progress (Cheltenham: Edward Elgar 2008).

36 Both South Africa and Botswana are significant mineral exporters, and Botswana’s economy is heavily reliant on its diamond exports, but their development indicators place them among the medium human development countries. Although Equatorial Guinea is also ranked as medium human development, this country’s socio indicators are still very weak, and poverty levels still very high, as compared to the average medium development countries. EG is not ranked among the low human development countries only due to its extraordinary levels of GDP per capita. United Nations Development Programme (UNDP), International Human Development Indicators, (2011), online: Human Development Reports <http://hdr.undp.org/en/statistics/>.

37 See charts in the appendix section in the end of this dissertation. The charts include the world average for comparison.

Yet the WGI 2010 report also finds that around 35% of the ranked countries did experience a significant change (improvement or deterioration) in at least one of the six dimensions of governance during this time. This proves that institutional change is difficult, but not impossible. Why has governance reform proven so elusive? Some authors blame the lack of governance improvement on the rising importance and influence of development assistance and foreign direct investment from emerging economies to the least developed countries. According to this hypothesis, emerging economies’ donors and investors, especially from China, do not emphasize good governance and sustainable development by recipient countries. China arguably provides unconditional financial support to developing countries with the poorest governance records such as Zimbabwe, Sudan, etc.\(^{39}\)

The impact of rising ODA and FDI flows from emerging economies on the domestic governance systems in recipient developing countries is hard to measure and so far there are no analytical studies available on the topic. The hypothesis about the deleterious effect of emerging donors and investors in the global efforts to improve governance indicators in developing countries is the subject of a heated and on-going debate. Many analysts argue that this type of veiled criticism against emerging economies has been overplayed for many reasons, including: (1) the aid and investment policies of both developed and emerging economies are more nuanced than usually depicted;\(^ {40}\) (2) the influence of developed donors and capital exporting countries in the least developed countries is still significantly greater as compared to emerging ones;\(^ {41}\) (3) the


\(^{41}\) In 2011, for example, estimates were that aid flows from emerging economies to less developed countries was still around 10% of global aid flows. Despite a marked rise in FDI flows from emerging economies to other developing countries in the last 10 years, in 2011 their share of global FDI outflows was still 28%. See World Economic Situation, supra note 25.
influence of developed countries’ conditionalities and other donor strategies in fostering governance improvements in developing countries had remained unproven in the first place.  

Regardless of these diverse views, one fact is clear: despite significant efforts and resources from developed countries and - at least declared - commitment by a number of governance-poor countries, improving governance indicators has proven elusive in the last 15 years. This reality has led to a rich body of scholarship investigating the reasons why reforming dysfunctional institutions is such an intractable enterprise, which I briefly review next.

2.3. The trapping mechanisms behind the weak governance curse

There is an extensive body of literature investigating potential explanations of the fact that the massive amounts of capital and time dedicated to governance reform have apparently failed to generate significant results in most cases. In a recent paper focusing specifically on the rule of law, Michael Trebilcock identifies four obstacles that impede developing countries from effectively implementing rule of law reforms: (1) resource constraints (including lack of financial, technical and human capacity) would prevent reforms; (2) socio-cultural-historical constraints (related to values, norms and attitudes that are adverse to the rule of law) would impede formal reforms from becoming effective; (3) political economy constraints (including lack of domestic demand for reforms and supply-side vested interests) would derail or obstruct reform attempts; (4) legal origins would determine the subsequent performance of legal institutions.  

This classification is extremely useful, and can be extended beyond rule of law reforms, to governance reform in general. For the sake of simplicity, and to highlight the main points of this dissertation, however, this section will adopt a different approach. I will use an expanded concept of path dependence – encompassing legal origins, socio-cultural-historical constraints, 

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42 See for example Ngaire Woods, “Whose Aid? Whose Influence? China, Emerging Donors and the Silent Revolution in Development Assistance” (2008) 84:6 International Affairs 1205. Mariana Prado and Michael Trebilcock also argue that the mixed record of success in promoting democratic reform and rule of law reform led from the 1990s “euphoria” with institutional reform programs to a more subdued view of the prospects of reform attempts, which takes into consideration the many obstacles to governance reform that will be discussed in the following section. Prado & Trebilcock, supra note 19.

43 Trebilcock, “The Holy Grail”, supra note 38. See also Trebilcock & Daniels, supra note 35.
and political economy constraints explanations as defined by Trebilcock – to argue that most resource-rich but governance-poor countries have inherited dysfunctional governance systems, which were reinforced over time, and are now “locked in”. In other words, promoting effective governance reform has become intractable, and these countries are currently “trapped” in a weak governance curse. This section assumes that lack of resources is not the biggest challenge due to the massive amounts of external resources invested in governance reform, and also the potential domestic financial resources available for resource-rich countries (that could finance technical and human capacity at least in the long run).

2.3.1. Path dependence as a major obstacle to governance reform

As discussed in Chapter 1, in the last three decades institutionalist scholars in various disciplines have embarked on the quest to better understand the mechanisms of institutional formation and institutional change. Economics and political science scholars have concluded that institutions are resilient to change due to path dependence. The concept of path dependence illuminates how past choices and events have both determined how current governance systems were originally shaped, and possibly created significant obstacles to institutional reform. According to Vladimir Balaz and Allan M. Williams, “path dependence exists when the outcome of a process depends on its past history, on a sequence of decisions made by agents and resulting outcomes, and not only on contemporary conditions”. Or, in the words of Paul David, “a dynamical process whose evolution is governed by its own history is “path dependent”.

44 The idea that the concept of path dependence could illuminate the dynamics of how social institutions were formed and evolved was originally introduced by Paul David three decades ago. See Paul A David, “Path Dependence: a Foundational Concept for Historical Social Science” (2007) 1:2 Cliometrica 91 [David, “Path Dependence”]; see also Vera Zamagni, “What is the Message of ‘Understanding the Process of Economic Change’ for Economic Historians” (2010) 21 Structural Change and Economic Dynamics 157. For another overview of the path dependence theory see Pierson, “Increasing Returns”, supra note 51. Some authors such as Adrian Kay argue that path dependence is not a theory, but rather “a concept which can be used to label a certain type of temporal process.” Adrian Kay, “Path Dependency and the CAP” (2003) 10 Journal of European Public Policy 405 at 406; see also Daron Acemoglu & James A Robinson, Why Nations Fail: The Origins of Power, Prosperity and Poverty 1st ed (New York: Crown, 2012) [Acemoglu & Robinson, Why Nations Fail].


46 David, “Path Dependence”, supra note 44 at 92.
Besides being strongly determined by past events and decisions, path dependence also means that a certain path, once initiated, becomes ‘locked in’ and resistant to change. This is because previous investments and repeated routines in a certain institutional path end up raising the costs and the stakes of changing course in a progressive and cumulative way. Consequently, despite institutions being dynamic rather than static, the direction of change tends to follow its past trajectory. As Douglass North puts it:

Path dependence will occur because the direction of the incremental institutional change will be broadly consistent with the existing institutional matrix … and will be governed by the kinds of knowledge and skills that the entrepreneurs and members of organizations have invested in.  

The first scholars to identify and propose the path dependence concept were economists trying to understand why some technologies that were clearly inferior not only had prevailed and expanded, but also why over time it became ever more difficult to switch from these inferior technologies to more optimal alternatives over time. Their insight was that once a path was chosen or taken at a certain critical juncture, if there was significant initial sunk costs and/or increasing returns due to collective learning and large-scale adoption of this system (network effects), this path would prevail even in the presence of superior options. One illustrative example, taken from many cases discussed by Brian Arthur in his seminal “Competing Technologies, Increasing Returns, and Lock-In by Historical Events” is the prevalence of light-water nuclear reactors in the USA.  

According to engineering literature gas-cooled nuclear reactors are, in the long run, technically superior to light-water ones. However, in 1954 the first American nuclear submarine used a light-water reactor as a propeller. The U.S Navy played an active role in all nuclear industry

47 Douglass C North, Understanding the Process of Economic Change (Princeton: Princeton University Press, 2005) at 62; see also Zamagni, supra note 44.

48 The concept of critical junctures, meaning exceptional moments in history where sweeping institutional changes place a country’s institutional arrangement into new paths, was in fact introduced by the historical institutionalism literature, where it is an essential element. The idea of critical junctures as starting analytical points for and one of this discipline’s most important contributions to the theories of path dependence. See Giovanni Cappocia & R Daniel Kelemen, “The Study of Critical Junctures: Theory, Narrative, and Counterfactuals in Historical Institutionalism” (2007) 59 World Politics 341.

contracts at the time, and its expertise and experience with light-water technology led it to favor this option in future reactors. With increasing investments in research and development and construction experience of light water reactors, it became ever more difficult to abandon this path and change to gas-cooled technology. As a consequence, light-water nuclear reactors ended up dominating 100% of the American nuclear industry, despite its technological inferiority in the long run.  

Even if a reform to favor the most effective technology was attempted at this point, with so many resources invested in terms of capital, knowledge and production systems in light-water nuclear technology, changing courses would be extremely costly. Besides, reform attempts at this stage could open up space for wasteful rent-seeking behavior. Individuals and groups that are currently deriving benefits from the economic exploitation of light water technology would strongly resist change, requiring investments in counter-lobbying.

The same insights can be applied to social and political institutions. Paul Pierson presents a metaphor that helps to illustrate the advantage of using path dependence insights to analyze institutional change. According to Pierson, many attempts to promote governance reform fail because reformers take only a snapshot picture of a governance problem, instead of a moving picture of the problem in its historical and contextual settings. A snapshot analysis of the inferiority of light water reactors would simply lead to recommended reforms, due to the superiority of gas-cooler technology in the long run. Only a moving picture analysis of the dynamic, historical process could shed light on the complexity of the current institutional matrix and the potential switching costs of the desirable reform.

Once a certain institutional path is taken, and sets a self-reinforcing dynamic due to increasing returns, it becomes progressively more stable and more difficult to change over time. Many individuals or groups will have learned how to derive benefits from this institutional design. Those individuals or groups will resist any change that could jeopardize them receiving these

50 Ibid.
52 For a more detailed analysis of the path dependence related concepts of self-reinforcing mechanisms and switching costs see Prado & Trebilcock, supra note 19.
benefits. The dysfunctional institutions also become embedded in broader sets of informal social rules and cultural values that are adverse to exogenous reform strategies. According to Douglass North:

The institutional structure inherited from the past may reflect a set of beliefs that are impervious to change either because the proposed changes run counter to that belief system or because the proposed alteration in institutions threatens the leaders and entrepreneurs of existing organizations.

This process is likely to happen independently of the capacity of this institutional choice to generate positive outcomes, however defined. Trying to reform this institution in order to bring a system from a dysfunctional path onto a functional path, without paying attention to these self-reinforcing mechanisms and switching costs, will most probably result in failure. A successful reform strategy would then require developing a detailed understanding of how the institution was formed and its main self-reinforcing mechanisms and switching costs, including vested interests that have formed over time. It is important to note that most proponents of the path dependence theory have not used it prospectively, i.e. to recommend strategies that would allow people and societies to escape a bad equilibrium. The main purpose of these theories is to explain why it is so difficult to do so. In this sense, the literature allows us to explain why attempts at promoting governance reform have proven so elusive, but it does not offer lessons on better ways for moving forward. One example can illustrate how these insights can be applied to illuminate the challenge of promoting governance reform in resource-rich but governance-poor countries.

Equatorial Guinea ranked at the very bottom of control of corruption indicators in 2009. This low ranking is usually a platform used to promote governance reform, composed of model

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53 This can also be characterized as vested interests against reforms, a type of political economy explanation for why some institutions are difficult to change. Sometimes it becomes difficult to distinguish between path dependence related obstacles from other political economy explanations of resistance to institutional change, and for this reason this chapter will include political economy obstacles as one of the features of path dependence, as stated in the introduction to section 3.
54 Prado & Trebilcock, supra note 19.
55 North, Understanding, supra note 47.
mechanisms designed to curb corruption, such as the creation of a law criminalizing corruption, another requiring governmental officials to declare their assets, yet another mandating that public agencies publicize governmental spending, etc. Pierson’s insights suggest that this simplified snapshot view recognizing that current institutions are dysfunctional, and the consequent attempt to simply transplant an alien model governance mechanism, is likely to fail because it ignores the complex ways in which such dysfunctional institutions interact with other features of the system and become entrenched through a series of feedback effects. In this sense, it is not hard to predict that the new transplants will interact with such features in complex ways and will certainly set up a new equilibrium, but probably not the one that was initially expected, i.e. an equilibrium with reduced levels of corruption.

Path dependence insights suggest that history matters and reformers should take historical factors into careful consideration when designing reforms. In other words, path dependence insights imply that, in order for reformers to effectively address the challenges of transforming current dysfunctional institutions, history matters in three different ways. First, because each country and society has a very unique governance path, there are no optimal strategies of governance reform that will be effective in all places at all times. Second, and related, each country needs to identify its own specific set of reinforcing mechanisms and consequent switching costs of governance reform. Third, governance change is most often a long-term, gradual process. The first lesson is especially relevant. Because domestic governance systems were formed and remain currently embedded in diverse social, political, institutional and cultural contexts, what constitutes good governance, or a beneficial set of domestic institutions in developed countries, may not engender the same results in the very different settings that characterize most developing countries.

The path dependence scholarship challenges the usefulness of devising a universal set of good governance models and, even more, of attempting to transplant them into a foreign polity. The

57 With the exception of critical junctures, when windows of opportunity may be opened to more sweeping institutional change. Critical junctures are special historical contexts that enable the opening of new pathways towards different institutional directions. Paul Pierson, Politics in Time (Princeton: Princeton University Press, 2004). In chapter 5 Pierson argues that scholars working on “institutional development” should take path dependence insights into consideration. See also James Mahoney, "Path Dependent Explanations of Regime Change" (2001) 36:1 Studies in Comparative and International Development 114.

58 Prado & Trebilcock, supra note 19.
literature has widely recognized that one-size-fits all strategies for governance reform are unlikely to generate positive results.\(^5^9\) Dani Rodrik and Sharun Mukand, for example, argue:

There is growing evidence that desirable institutional arrangements have a large element of context specificity, arising from differences in historical trajectories, geography, political economy, or other initial conditions […] This could help explain why successful developing countries – China, South Korea and Taiwan among others – have almost always combined unorthodox elements with orthodox policies. It could also account for why important institutional differences persist among the advanced countries of North America, Western Europe and Japan – the role of the public sector, the nature of the legal systems, corporate governance, financial markets, labor markets and social insurance mechanisms, among others.\(^6^0\)

Therefore, when governance reform projects rely on standards of good governance that are dissociated from the context and the history of specific countries, the most likely result is failure. This was also the conclusion of a consortium of research organizations and think tanks from France, Ghana, Niger, Uganda, the United Kingdom and the United States, called Africa Power and Politics Program (APPP), who united in 2008 to discuss and promote effective governance reform in the continent. They “share[d] the view that standard prescriptions for ‘good governance’ fail because they are not properly anchored in local realities: they do not ‘work with the grain’ of the host societies.”\(^6^1\)

With these insights in mind, it is worth reviewing a recent literature that proposes that European colonization has marked a critical juncture that inaugurated new institutional paths for many contemporary developing states, including resource-rich LDCs. This literature seeks to explain

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59 See Francis Fukuyama, “Development and the Limits of Institutional Design”, in Natalia Dinello & Vladimir Popov, eds, Political Institutions and Development: Failed Expectations and Renewed Hopes (Cheltenham: Edward Elgar, 2007). For a specific analysis of the diverse context where legal rules arise and develop see Erik G Jensen &Thomas C Heller, eds, Beyond Common Knowledge: Empirical Approaches to the Rule of Law (Stanford: Stanford University Press, 2003). See also Jessica Cohen & William Easterly, eds, What Works in Development? Thinking Big and Thinking Small (Washington, DC: Brookings Institution Press, 2009). Trebilcock and Daniels also argue that external actors should adapt their strategies for promoting rule of law reform in developing countries depending on their political context. They present an idealized spectrum of three different types of states, with Type 1 being states where there is broad political and popular demand for rule of law reform, Type 2 being states where there is demand from the leadership, but strong vested interests against reforms, and Type 3 being states that are unequivocally opposed to governance reform. See Trebilcock & Daniels, supra note 35.


the reasons why the institutional paths of former European colonies have been so divergent, and why some of them became so dysfunctional.

2.3.2. On institutional origins and dynamics

The institutional development literature has recognized that the various periods of European political, economic and demographic expansion - first with the settlement and colonization of the new world in the sixteenth and seventeenth centuries, followed by the imperial colonization of Africa, Southeast Asia and the Pacific in the late nineteenth and twentieth centuries - have marked critical institutional junctures for many developing countries. These critical junctures have inaugurated new, different institutional paths that later evolved to form the governance frameworks that nowadays characterize societies that were directly colonized or indirectly controlled by European powers. In other words, the institutional paths forcibly imposed on many developing countries at such crucial geopolitical junctures have influenced the current socioeconomic outcomes of former colonies to this day.

However, there is strong variation in the governance structures and socio and economic outcomes of former European colonies. One can wonder why the United States, Canada, Australia, New Zealand, Chile, Brazil, Peru, Bolivia, Ghana, Botswana, Sudan, Chad, all former European colonies, have such distinct institutional features. Many theories have been proposed to explain this puzzle. One theory argues that cultural, and more specifically legal, origins may offer a sound explanation. The legal origins theory claims that common law - and its associated background cultural values - is generally more conducive to economic growth than

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62 Some authors also emphasize how the unprecedented growth in the Atlantic slave trade, provoked by the European capitalist expansion in the sixteenth century, significantly disrupted the social and economic institutions inside the African continent. One could say that despite most African countries being colonized in a later period, for many African societies the critical juncture had also been in the sixteenth century. See Acemoglu & Robinson, Why Nations Fail, supra note 44.

Ronald J. Daniels, Michael J. Trebilcock and Lindsey D. Carson explain that this scholarship credits the association of common law to positive development outcomes because common law traditions would favor: “[…] economic freedom, judicial independence, limited government, efficient lawmaking, or interest group constraints […]” more than other legal traditions.

Therefore, this theory proposes that former British colonies that inherited common law legal traditions have in general developed rule of law institutions that were more conducive to economic development than former Portuguese, Spanish and French colonies that inherited civil law systems. This would explain, for example, why former colonies such as the USA, Canada, Australia and New Zealand are now among developed nations, while all Latin American former colonies have lagged far behind. While this theory has achieved a good deal of prominence, there is strong disagreement over whether the rule of law is effectively a pre-condition to achieve economic growth and other positive development outcomes. The literature has generally highlighted two important incongruences of this theory with empirical facts. First, the theory fails to explain the significant divergence of governance systems and development outcomes among the members of a same legal family. Why, for example, are Zambia, Sierra Leone and Yemen, all former British colonies that inherited common law systems, still among the LDCs? Furthermore, this theory fails to explain the rise of Asian economies, despite many not having common law traditions.

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64 This scholarship is strongly associated with the earlier work on the sociology of law initiated by Max Weber. Weber claimed that unique cultural and legal features in Western Europe proved the most conducive to the rise of industrial capitalism in this region. See David Trubek, “Max Weber on Law and the Rise of Capitalism” (1972) 3 Wis L Rev 720.


67 Some Asian economies such as Hong Kong, Malaysia and India inherited common law traditions. Japan chose to draw from French and German sources to modernize its legal system and repel foreign pressure, and the Japanese legal model would later be transferred to Taiwan and to South Korea. Asian countries would later borrow from very different Western legal sources to build their unique legal systems, which also had the peculiarity of often formal legal rules being superseded or ignored in favor of Asian concepts of authority. Katharina Pistor & Philip A Wellons, The Role of Law and Legal Institutions in Asian Economic Development: 1960-1995 (New York: Oxford University Press 1999).
Daron Acemoglu, Simon Johnson and James A. Robinson also correlate current development outcomes in developing countries to critical junctures imposed by European colonization. They propose that, instead of looking at legal origins, one should look at the impact exerted by the very different colonial strategies employed by European powers on the quality of institutions. The authors maintain that the strategies used by European conquerors towards their colonies worldwide differed widely according to how conducive the initial environment was for settlement. In places where conditions such as low settler mortality favored the establishment of larger communities of European immigrants, either European metropoles promoted the creation of early institutions that protected private property and provided checks and balances against governmental power, or settlers organized to fight for these institutions. Finally, the authors found a strong correlation between early conducive institutions and the strength of current governance systems in these settlement colonies.

Acemoglu et al. argue that the colonies that presented high rates of settler mortality were subjected to a very different strategy. In these cases European metropoles created institutional structures with the primary goal of enabling the generation of the highest possible rates of economic rents to the colonizers. Or, in the authors’ words: “colonial powers set-up authoritarian and absolutist states with the purpose of solidifying their control and facilitating the extraction of resources”. According to this theory, the institutions created in these “extractive states” did not offer protection of private property or checks and balances against government expropriation. Even though the authors have focused on private property and risk of expropriation, one can also conclude that other institutions providing checks and balances against other forms of

69 The authors use date on mortality rates of soldiers, bishops and sailors between the seventeenth and nineteenth centuries. Acemoglu, Johnson & Robinson, supra note 68 at 1370.
70 Ibid at 1371.
71 Ibid at 1378.
governmental abuse, or granting protection of individual rights, or providing collective goods, were also largely absent.

These so-called “endowment” theories of legal origins and colonial extractive strategies offer important hypotheses to explain the significant divergence of institutional evolution experienced by developing countries that were formerly European colonies. However, taking path dependence insights seriously, the main weakness jeopardizing the explanatory success of “endowment” theories lies in their insistence on a snapshot view of initial legal – and governance – strategies adopted by European colonizers at a certain critical juncture. The theories take past colonial history into account in their attempts to explain current development outcomes. But they fail to investigate the moving picture, i.e., the dynamics of how and why these inherited legal and governance systems have subsequently developed in remarkably different ways. Other scholars have addressed this challenge.

Katharina Pistor, Daniel Berkowitz and Jean-Francois Richard, for example, have proposed that rather than investigating the potential lasting impact of substantive European legal institutions in the colonies (as the legal origins theory propose), a more fruitful and adequate enterprise would be to investigate the iterative, dynamic way in which the transplanted European institutions (based on civil or common law alike) have or have not been harmonized with existing institutions in the colonies.72 Pistor et al claim that transplanted institutions that have been appropriately adapted to local conditions, or that have echoed existing local principles and customs, have gained legitimacy and became socially embedded and therefore efficient. Curtis Milhaupt also subscribes to this iterative analytical approach. He adds another dimension, that of local demand for sound institutions:

Countries do not appear to be locked for all time in the legal framework provided long ago by conquerors or colonizers. But the significance of legal change depends almost entirely on whether local constituencies demand it, and whether that change is carefully designed to have traction within the existing institutional set up of the legal system.73

The idea that the demand side of the reforms is as relevant as the supply side is further developed by Milhaupt and Pistor in a recent book regarding convergences and divergences in corporate governance structures around the world. The authors argue that exogenous factors such as an economic or political crisis or the entry of a new market [or political] actor can undermine the institutional equilibrium and enable significant changes.

Stanley Engerman and Kenneth Sokoloff have proposed that instead of looking primarily into initial colonial strategies due to settler mortality or resource endowment, as Acemoglu et al do, the explanation for the very different institutional outcomes lies in the different ways in which these initial strategies have evolved to provoke or to mitigate inequalities in the distribution of wealth, human capital and political influence in the societies they encountered. For example, Spanish and Portuguese Americas were not only richly endowed in natural resources, but their pattern of economic resource exploitation was based on the large “import” of slave labour and extreme concentration of land and capital in the hands of a few elite members. These extreme inequalities that characterized the first economic cycles of Latin American countries were reflected in their institutions.

Ronald J. Daniels, Michael J. Trebilcock and Lindsey D. Carson add to this evolving iterative scholarship on path dependence and development. They analyze concrete case studies to investigate the more specific institutional mechanisms that could explain why eight former colonies that inherited institutions based on the same British common law legal system have

75 Ibid at 179. Besides, all their case studies are either in developed countries such as the USA, Germany and Japan, which have already a strong overall governance framework, and where dysfunctional governance systems are more isolated, or in emerging economies such as China, Russia and South Korea, which also do not suffer from the level of governance weakness of the countries object of this dissertation.
yielded markedly different governance frameworks and development outcomes. They found that:

[W]hile the original cultural, physical, economic and institutional endowments of the colonized areas influenced significantly the initial governance models and choices selected by the crown, it was the subsequent and intentional reactions (or inactions) of the British – and the resultant institutional arrangements – that ultimately and most significantly affected their modern rule of law outcomes.

Daniels, Trebilcock and Carson analyze two specific elements of a sound rule of law system: (1) the degree of indigenous representation in formal colonial legislative bodies; and (2) the degree to which indigenous and British common law courts and background values were integrated in widespread local formalized mechanisms of conflict resolution. They argue that in the cases where there was greater indigenous representation in law-making, and greater integration among transplanted and local dispute settlement systems, the consequent increased social legitimacy served to support the long-term development or preservation of strong rule of law values and systems. On the other hand, in the cases where there was weak indigenous representation in law-making bodies, and weak integration of transplanted and local dispute settlement systems, formal institutions suffered from a widespread lack of legitimacy that have undermined existing governance systems or inhibited the creation of sound ones.

As Daniels et al note, their thesis does not discount the theories of Acemoglu et al, which call attention to the impact of different initial European powers institutional strategies in the development of colonial institutions in the various colonies; or Engerman and Sokoloff’s, which claims that the way these strategies interacted with the existing social and economic structures was more or less conducive to the creation of a sound governance framework. There is as yet no consensus in the literature whether legal origins or natural endowments are a stronger initial determinant of how subsequent institutional paths evolved according to different conditions. Scholars have recently emphasized the need to go beyond investigating the original intentionality of colonizers’ strategies or the original legal system transplanted. It is important to also

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77 The eight former British-controlled colonies that Daniels, Trebilcock and Carson analyze are: Barbados, Jamaica, Botswana, Nigeria, Kenya, India, Burma and Singapore. Daniels, Trebilcock & Carson, supra note 65.
78 Ibid at 126.
79 Ibid.
investigate the dynamic way in which these intended strategies were shaped by existing social structures; the reactions or inactions by both indigenous peoples and European settlers during colonial times; and the iterative way in which these institutions were shaped by later events after independence.

Of these two lines of theory – legal origins and “extractive institutions” - the second theory seems more compelling as an explanation of why developing countries that were former colonies from European states of different legal traditions are nowadays among those with the weakest governance systems and the lowest human development indicators. The “extractive institutions” endowment theory is more in line with recent rent-seeking theories that seek to explain significant long-term development divergences among resource-rich countries and their resource-poor peers in very similar historical and current conditions, which I will address in section 2.3.4. As I discuss next, if the endowment and iterative theories are correct, most of the resource-rich and governance-poor countries that are currently experiencing a resource boom have developed resilient dysfunctional governance systems. Virtually all resource-rich and low development countries have been European colonies with high settler mortality rates that attracted low number of European settlers and that mainly inherited extractive institutions that were detrimental to long term economic growth and social development. They also likely experienced many of the non-conducive subsequent interactions indicated in the literature.

2.3.3. The paths of resource-rich countries with low human development indicators

In Chapter 1 I showed that from the 46 countries that the United Nations classifies as having low human development indicators, 26 were currently experiencing a marked growth in resource exploitation. I listed these countries in table 2.1 below, adding Equatorial Guinea. Despite Equatorial Guinea not being listed in the low development indicators group of countries due to its high GDP per capita, the country still presents extremely low development indicators in all other categories such as health, education and poverty levels.

80 Because of its extraordinary oil wealth, Equatorial Guinea has now one of the highest levels of GDP per capita in Africa, estimated in 15.397 dollars, or 20.000 if calculated per PPP. This is higher than some European Union member countries. This high GDP per capita is, to a large extent, what places EG outside the list of low development indicators. However, estimates are that despite this GDP, over 70% of Equatorial Guinea’s population
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<th>Country</th>
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<td>DRC</td>
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<td>Cote Ivoire</td>
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<td>Niger</td>
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<td>Mozambique</td>
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<td>Malawi</td>
<td>UK</td>
<td>Timor Leste</td>
<td>Portugal/Indonesia</td>
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<td>Kenya</td>
<td>UK</td>
<td>Sao Tome Prince</td>
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<td>Equatorial Guinea</td>
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Section 2 in this chapter showed that these countries have weak governance systems, some well below the world average. According to path dependence theories, these dysfunctional governance systems have likely been initiated at a previous critical juncture, and have likely “locked in”, making governance reform an intractable enterprise in these countries. Virtually all still falls below the poverty line. See The World Bank, *World development Indicators*, online: World Bank <http://data.worldbank.org/data-catalog/world-development-indicators>.  

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**Table 2.1**

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these now resource-rich countries fell under direct or indirect colonial control by European states at different moments between the sixteenth to the late nineteenth century, as indicated in table 1. Colonization has been widely recognized as a critical juncture for the formation of institutional paths.

It is beyond the scope of this dissertation to propose a full and complete analysis of the colonial strategy and subsequent institutional evolution of each and every one of these 27 countries. Institutional and legal historians are undoubtedly those with the capacity to undertake the kind of detailed empirical work needed to effectively perform this task. The anecdotal evidence that I present next is intended only to paint a general picture of how in all likelihood most of the countries in this group were extractive colonies. They also likely lacked some of the mitigating elements that helped other former colonies to develop less dysfunctional governance systems over time, such as high settlement rates, harmonization of transplanted institutions with local principles and customs, and significant indigenous representation in colonial legislative and dispute settlement institutions. The anecdotal evidence should also illuminate how challenging it is to promote governance reform in countries that inherited such dysfunctional governance paths that became ever more dysfunctional over time.

Angola, for example, was a Portuguese colony for almost five centuries, beginning in 1575.81 As late as 1845, however, there were fewer than 2,000 Portuguese settlers living in the colony, mostly exiled convicts or adventurers seeking fortune and a way back to Portugal.82 A similar picture could be drawn in relation to Mozambique and Sao Tome. Gerald Bender, who studied the Portuguese settlements in colonial Angola in-depth, explains that few free Portuguese were interested in settling in the African colonies, which were associated with hardship and death. The numbers and the type of Portuguese settlers in Angola, Mozambique and Sao Tome were never

82 For a very long period most of the Portuguese settlers in African colonies were “degredados”, meaning those that were sentenced to forced exile by the criminal justice system. In Bender’s words: “for over four centuries the dungeons of Portugal were the most important source of white settlers for Angola.” Gerald J Bender, Angola Under the Portuguese: The Myth and The Reality (Berkeley: University of California Press, 1978). See also Kenneth Robert Redden & Linda L Schlueter, eds, Modern Legal Systems Cyclopedia (Buffalo: WS Hein, 2005) at 6.

Australia was also a colony where early settlers were mainly ex-convicts, and Acemoglu et al argue that it came to develop more conducive institutions due to the pressure of these settlers for political rights. Acemoglu, Johnson & Robinson, supra note 68.
in any way similar to “new Europe” colonies such as Canada or the USA, or even to Latin American colonies. Bender describes the settlement process in Angola as follows:

During the past five centuries and especially since the end of the transatlantic slave trade, Portugal attempted to secure its hegemony [in Angola] through government-sponsored settlement schemes utilizing Portuguese peasants and unskilled workers. Throughout most of this period the overwhelming majority of the settlers were drawn from among the most undesirable inmates of Portuguese prisons. After [1926] they were replaced by free Portuguese whose level of education and skills barely exceeded those of the degredados [forced exiles]. After the expenditure of more than $100 million to settle a few thousand Portuguese in rural Angola, the most notable legacy of planned settlement was the introduction of racial competition and conflict over land and production. Not surprisingly, all but a few of the colonos and their families fled Angola during the battles prior to and following independence.

Likely because of high levels of settler mortality, colonial strategies for most of the resource-rich but poor countries were mainly extractive and controlled by small elites, which created structures to more effectively exploit natural resources and cash crops. DRC (former Belgian Congo), Chad (former Ubangui-Shari) and the Central African Republic, for example, were subjected to the system of European concessionary companies. The companies were offered concessions to exploit all natural resources (some minerals excepted) over large parts of the territory. Sierra Leone also experienced decades of rule by corporate concession. The Sierra Leone Company was incorporated in London and received authority from the British Crown to explore large portions of land and to “make laws until the settlers were capable of making their own”. Many other current resource-rich but poor countries had high levels of settler mortality and became

83 Gerald Bender argues that: [b]y the final quarter of the nineteenth century, when over half a million Portuguese were in Brazil, only three thousand were in Angola and even fewer in all the other African colonies combined (Sao Tome, Cape Verde, Guinea [Bissau] and Mozambique). Bender, supra note 82 at XXVI. While from 1900 to the outbreak of WWII Brazil, Argentina and the USA attracted more than one million Portuguese immigrants, less than 35,000 Portuguese chose to move to Angola. While America attracted upper and middle class Portuguese settlers, Angola attracted mostly poor rural peasants and unemployed or sub-employed urban Portuguese, with almost no skills. Bender, supra note 82 at 98.
84 Ibid, at 131.
85 Acemoglu et al argue that DCR was an extreme case of extractive colony, citing Bogumil Jewsiewicki assertion that policies in DRC during King Leopold’s colonial times were “based on the violent exploitation of natural and human resources.” Acemoglu, Johnson & Robinson, supra note 68 at 1375.
86 See Redden & Schlueter, supra note 82. Acemoglu et al argue that “in the first year of the Sierra Leone company 72% of the European settlers died.” In a second expedition all the European settlers that went to work for the company died. Acemoglu, Johnson & Robinson, supra note 68 at 1374.
“extractive states” dominated by their European colonizers. However, this initial critical juncture is not the only factor explaining the resilience of dysfunctional governance systems in this group of countries.

Political science Professor Richard Sandbrook, who has extensively researched the political roots of economic stagnation in African countries, argues that when European institutions were transplanted from metropolises to many African colonies, they were not socially embedded. And with continued colonial exploitation they remained strongly dissociated from society. Gradually, these uprooted institutions adapted to their function in the new environment. The result, according to Sandbrook, was the consolidation in Africa of patrimonial states, with political and social regimes based on “personal rule”. One may say that most of the African resource-rich and governance-poor countries fell into this category of patrimonial states, subjected to regimes of “personal rule”. To be sure this is a general view, which does not take into account cases such as Botswana, for example, which is a resource-rich Sub-Saharan country that was able to develop reasonably functional institutions. Yet, the exception of Botswana does not invalidate the general rule.

Many of the non-African resource-rich and governance-poor countries also had tumultuous colonial histories that have resulted in patrimonial states as well. The European colonization of Timor-Leste happened in an earlier period than the formal colonization in Africa. The region had in fact been controlled by descendents of Portuguese and other Western soldiers with local women, known as “Topasses”, and later by governors appointed by the Portuguese metropolis that were established in Macau, China, from the early seventeenth century. In the nineteenth century Portugal increased its presence in the eastern part of Timor Island, fearful of increased disputes over political and economic influence with the Netherlands, which had control of West

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87 Acemoglu, Johnson & Robinson, supra note 68.
89 For explanations of special conditions that made Botswana acquire a governance framework conducive to development see Daniels, Trebilcock & Carson, supra note 65; see also Acemoglu, Johnson & Robinson, supra note 68.
Timor. The strategy was to exploit production and trade of sandalwood and later coffee in Timor Leste. The region was again invaded and occupied in 1976, this time by Indonesia. Timor Leste only regained formal sovereignty in 2002.

Being strategically located, at the southern entrance of the Red Sea, Yemen has undergone various forms and phases of invasion, occupation and colonization. The Ottoman Empire controlled the region where Yemen is situated for years, and this control remained over what is now North Yemen until the end of WWI. South Yemen had a different history. In 1839 Britain occupied the port of Aden, which was strategic for its access to India. The port became even more important after the opening of the Suez Channel in 1869. The colony of South Yemen, created around the Aden port, was ruled from India until 1937, when it became a crown colony. Settlement was negligible in Yemen. Britain ruled primarily by signing treaties with tribal leaders in exchange for military protection.

In terms of European colonizers intentionally integrating European institutional models into preexisting or traditional systems of maintaining social order, it seems that this was not a common feature in most of the 27 resource-rich but poor countries. In French Equatorial Africa, for example, two very different legal codes were in use. French citizens were subject to the French legal code, regardless of color. Indigenous peoples were subject to customary law, but this law was administered not by local authorities, but by French representatives. Similarly, in Angola there were two types of colonial courts, ordinary and special. The special courts heard cases involving Portuguese settlers. The ordinary courts, presided over by a colonial administrative official, heard cases involving “indigenas”, meaning those Angolans considered

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92 Ibid.
93 Ibid.
95 Kritzer, supra note 81.
unassimilated and uncivilized. Until 1961, 99% of all native Angolans were officially classified by the Portuguese government as unassimilated and uncivilized.\footnote{96}{Redden & Schluerter, \textit{supra} note 82.}

Therefore, the colonization of resource-rich but poor countries marked critical junctures that inaugurated the dysfunctional path of their current institutions. Many resource-rich countries that are currently experiencing a resource boom have generally inherited governance frameworks that lacked legitimacy among most of the population, that were patrimonialist, and non-conducive to local development, governmental accountability or political participation. Colonialism, and later the capture of institutions by autocratic leaders in most of these countries after independence, compounded by the rivalries of the cold war, all are factors that have contributed to the emergence of extremely dysfunctional governance frameworks. As a result, the challenge of reforming these institutions is daunting. Therefore, it is true that path dependence can help us understand where these dysfunctional systems came from. The question is whether path dependence insights can also help us determine how these systems can move forward, as I will discuss in section 5.

Yet, besides all these historical factors that contributed to the stickiness of dysfunctional governance systems in many resource-rich but poor countries, there is another element that makes governance reform even more intractable in their case. Due to the availability of significant amounts of natural resource rents, rent-seeking behavior\footnote{97}{The Oxford Dictionary of the Social Sciences define rent-seeking as: Nonproductive activities pursued by economic agents in the effort to obtain economic rents (above average profits) for themselves. Usually rent-seeking refers to attempts to use government regulation to create barriers to competition, or to secure favored status such as exclusive production rights. Lobbying for trade protection and making campaign contributions to secure government contracts are examples. Rent-seeking activities are distinguished from other profit-motivated behavior in that they do not add to the economic pie, but rather seek to secure a larger slice at someone else's expense. (A counterexample is research that leads to patentable processes, which would generate rents but also add to productive activity.) Thus any resources spent on rent-seeking are wasted in aggregate economic terms. Craig Calhoun, ed, \textit{Dictionary of the Social Sciences} (Oxford: Oxford University Press, 2002).} may serve as a major contemporary factor that is “locking in” already dysfunctional governance systems in these countries. Although not much discussed in the path dependence literature, the idea that significant natural resource rents may cause perverse distortions in a country’s institutions and
development strategies is not new. This idea is addressed in another body of literature that has developed since the 1970s, the rentier state literature, which I discuss next.

2.4. Rent-seeking behavior: the contemporary trapping mechanism

Chapter 1 explained that the resource curse literature is still divided over whether countries that have significant natural resources endowments tend to be less democratic or to experience more civil conflicts than resource-poor countries. There is, however, a long line of studies affirming that rent-seeking behavior, a phenomenon associated with significant resource rents, has a deleterious impact on political institutions. I use these studies to suggest that rent-seeking behavior can be considered as yet another trapping mechanism that is ‘locking in’ already dysfunctional governance systems in resource-rich but poor countries. This dimension of the problem is especially relevant if one considers that the demand side of reforms is as relevant as the supply side.\footnote{See previous discussion and citations to Law and Capitalism and other works by Curtis Milhaupt in section 2.3.3.}

In 1970 an Iranian economist, Hossein Mahdavy, introduced the theory of the rentier state.\footnote{Hossein Mahdavy, “The Patterns and Problems of Economic Development in Rentier States: The Case of Iran,” in MA Cook, ed, Studies in the Economic History of the Middle East from the Rise of Islam to the Present Day (London: Oxford University Press, 1970).} Rentier states are countries that receive substantial amounts of economic rents from abroad, on a regular basis. These can be rents from exports of minerals, oil and other natural resources, or even aid. In these states significant income and wealth derive from chance or situation, instead of resulting from labor and constant capital investments.\footnote{Douglas A Yates, The Rentier State in Africa: Oil Rent Dependency and Neo-colonialism in the Republic of Gabon (Trenton: Africa World Press, 1996), at 21.} The theory argues that this certainty of unearned rewards causes a rentier mentality in leading political and economic actors. They have few incentives to advance or to accept important institutional reforms favouring productive activities and collective prosperity. When Mahdavy first advanced the theory of the rentier state he was analyzing the economic and political impacts of the vast amounts of foreign revenues and credit that had been flowing into the budget of the Iranian government due to oil exports after the nationalization of the oil industry in that country in 1951. After Algeria and Lybia copied Iran
and nationalized their oil industries in 1971, most oil producing developing countries followed suit. By 1976 almost all had at least partially nationalized oil production. A similar, though less accentuated, trend happened in large scale mining countries.

In the 1980s, with the rise in oil prices during and after the Arab oil embargo of 1973, oil countries were benefiting from windfall revenues from oil and gas. With the significant number of countries potentially becoming rentier states, the theory gained momentum. Scholars such as Giacomo Luciani and Hazim Beblawi further developed the theory of the rentier state. Beblawi, for example, proposed that rentier states were characterized by four features:

a) They possess a rentier economy, meaning one where rents predominate to the detriment of productive activities;

b) These rents originate in external economic sources;

c) Only a small number of economic actors and society are directly or even indirectly involved in the activities generating rent;

d) The government is the primary recipient of external rents.

The rentier state literature claims that ruling elites in states that exhibit these features become divorced from and unaccountable to the country’s citizens. Because there is no need or incentive to tax other economic sectors to support the state budget, there is also a lack of social pressure and information, which reinforces the lack of accountability. According to this theory, the rentier state presents some characteristics that facilitate rent-seeking behavior and undermine institution building in rentier economies. First, the rentier “state becomes the main intermediary between the oil [or mineral] sector and the rest of the economy.” Second, access to substantial rents allows state actors to buy off opposition and to repress any contestation of authority. Third,


102 Luciani however, argues that the most important feature was the reliance on external rents, which liberated the rentier state from extracting income from the national economy. Hazim Beblawi & Giacomo Luciani, eds, The Rentier State (London: Croom Helm, 1987).


105 Abdel Fadil, cited in Yates supra note 100, at 24.
Rentier states acquire revenues in a distinctive way, as compared to other countries. They do not need to build tax systems in order to capture resources. Rentier states have very weak tax systems, if any. A tax bureaucracy has been historically associated with facilitating flow of information, strengthening social and political pressure and providing incentives to institutional building. \(^\text{106}\)

More recently, political scientist Terry Lynn Karl has produced new research on rentier states by undertaking comparative studies of contemporary oil states. Karl argues: “oil revenues are the catalyst for a chronic tendency of the state to become over-extended, over-centralized and captured by special interests”. \(^\text{107}\) In 2010 Kurt Weyland also suggested that the rentier state theory can explain the divergent policy paths of recent political leadership in Latin America. Weyland claims that resource-rich countries in Latin America such as Venezuela, Bolivia and Ecuador are adopting radical leftist and increasingly authoritarian policies, diverging from the trend in the region of more moderate changes (towards leftist policies or towards rightist policies) negotiated within democratic institutions. \(^\text{108}\) For Weyland: “Bolivia’s move from leftist moderation to radicalism, which occurred soon after the discovery of huge natural gas reserves, provides striking evidence for this novel twist on rentier state arguments.” \(^\text{109}\)

Despite this rich body of literature on the rentier state, only very recently scholars concerned with governance reform in resource-rich countries have begun to analyze the implications of rent-seeking for the dynamics of already dysfunctional governance systems. In 2006 Mehlum, Moene and Torvik investigated whether there was a systematic difference in institutional arrangements between the growth winners and the growth losers among a group of 82 resource-rich countries. They found that what made resource-rich countries fall prey to the resource curse was primarily the way resource rents were distributed according to institutional arrangements:

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107 Karl, supra note 106.
109 Ibid.
“the resource curse applies in countries with grabber friendly institutions but not in countries with producer friendly institutions”.

They argue that when institutions are friendly to rent-seeking, “resource abundance attracts entrepreneurial resources out of production and into unproductive activities.”

In 2006, in their editorial for a collection of essays analyzing why many promising transitions to democracy which had started in the 1990s ended up slowing down, reversing or collapsing, Michael Dauderstadt and Arne Schildberg affirmed: “Authoritarian rentier economies are often the root cause of [the] lack of transition [to democracy] and of subsequent underdevelopment, conflict and terrorism.” In a 2007 study Richard Auty argues that the perverse incentives of high rents were the main explanation for diverging development paths among developing countries. In his words “high rent tends to nurture predatory political states that benefit the elite, which capture and redistribute the rent, by force if necessary.” Auty affirms that high rents create incentives to state capture “because it confers immediate personal and political benefits”. In contrast, wealth creation (via manufactures, for example) is a long term process, whose revenues may benefit others down the line and not current actors. The captured rents are diverted from the competitive economy and invested in inefficient state bureaucracy and national


111 Ibid.

112 Michal Dauderstadt & Arne Schildberg, eds, Dead Ends of Transition: Rentier Economies and Protectorates (Frankfurt: Campus Verlag, 2006), at 7.

113 This was a change from his earlier conclusions on the same question. In 1998 he presented rent-seeking as one among six concurrent explanations for the resource curse. Three were external factors, including Dutch disease and volatility. Three were internal ones. Besides rent-seeking, he included the use of rents to perpetuate inefficient import substitution; and lack of incentives to build human resources. Richard Auty, Resource Abundance and Economic Development, Improving the Performance of Resource-Rich Countries, 1998.

industries, or are stolen by elites.\footnote{115}

In 2006 Pius Fisher claimed that even though many factors contributed to explaining why Sub-Saharan countries remained poor, despite decades of intensive development assistance, “a great number of the problems can be reduced to a very basic phenomenon: rent-seeking behavior”. In a case study, Fisher analyses the difficulty of implementing institutional reforms in Tanzania, concluding that: “rent-seeking is probably the main impediment to economic development in general and to reforming economic policy in particular”.\footnote{116} His findings in relation to Tanzania, which is included among the resource-rich and low-development countries, reinforce the arguments that rent-seeking has perverse effects in attempts to reform the governance systems of countries which receive significant rents from natural resources.

Resource-rich and low-development countries are therefore facing two distinct trapping mechanisms, because their dysfunctional governance systems originated in the past and became dependent over time, and now rent-seeking behavior is reinforcing the system. Rent-seeking makes these governance systems even more resilient by creating an important incentive for contemporary political and economic actors to prevent attempts to steer the governance systems towards a more functional path. The fact that these trapping mechanisms make governance reform in rentier states with a long path of dysfunctional governance systems so intractable does not mean that it is impossible to shift paths in the future. One avenue that may open this possibility is a new critical juncture, as we have recently seen inaugurated by social revolutions in the Middle East, although the long-term outcomes of the 2011 Arab Spring are by no means

\footnote{115}Auty clarifies that the more concentrated the rent flow, the more prone it is to short-sighted political capture. He claims that developing countries in general, not only resource-rich ones, normally exhibit higher levels of rents as a proportion of GDP than developed countries. These rents would include development aid (which he calls geopolitical rent), artificial rents created by state interventions (which he calls contrived rents). However, resource-rich developing countries tend to present the higher amount of rent flows to GDP from all developing countries. Auty further argues that weak checks and balances left more room for artificially created rents and natural resource rents. He concludes that “a critical policy objective is to steadily channel rent away from patronage-driven redistribution into broad-based wealth creation. However, he did not specify the institutional mechanisms that could help achieving this goal. \textit{Ibid.} Mushtaq Khan and Jomo K.S, also affirm that while rent-seeking is endemic in both development and developing countries, in the latter rent-seeking “can be more extensive, can include illegal forms and is more often damaging for growth.” Mushtaq H Khan & Jomo KS, eds, \emph{Rents, Rent-Seeking and Economic Development: Theory and Evidence in Asia} (Cambridge University Press, 2000).

\footnote{116}Fisher defines rent-seeking behavior as “the ability of individuals to capture incomes without producing output or making a productive contribution”. Pius Fisher, \emph{Rent-seeking, Institutions and Reforms in Africa: Theory and Empirical Evidence for Tanzania} (Zurich: Springer 2006).
clear. Are revolutionary critical junctures the only way out of these trapping mechanisms? Before I address this question in section 6, I will briefly describe the case of Chad, to further illustrate the challenge of reforming governance systems in many of the resource-rich and governance-poor countries in normal times.

2.5. The double trap in action: the illustrative case of Chad

The discovery of significant deposits of oil in Chad in the 1990s and the failed attempts to promote governance reform in this country provide an extremely illuminating opportunity to use path dependence insights to analyze the challenges of institutional reform in countries that possess extremely dysfunctional governance paths. It also illuminates how the rent-seeking factor poses a serious contemporary obstacle to governance reform.

Chad’s path of dysfunctional institutions is age-old. The region where Chad is located had been subjected to continuous slave raids by neighboring and local Muslim groups (based in North Chad) throughout the early nineteenth century. Mario Azevedo attributes the social organization of the Sara, the leading ethnic group in the region where Chad is now located (especially in Southern Chad), to the constant social dislocation and demographic instability caused by these raids. The basic social unit was the extended family, or clan, with men being generally polygamous, with an average of 4.7 women per men. Groups of extended families lived in villages, under the leadership of a chief, called mbang. The mbang, assisted by a group of advisors, was responsible for administering justice and coordinating economic and social activities. Trade was negligible. The mbang also collected tributes in kind to provide for the sick, the disabled and the orphans in normal times. Tributes in kind were also used to respond to incidents that caused social devastation, like environmental disasters or slave raids.

At the end of the nineteenth century Chad came under Sudanese control. In 1910 the territory of Chad became part of French Equatorial Africa, together with the territories of Central African Republic (then Oubangui-Chari), Gabon, and Republic of Congo (then Middle Congo). There was very scant European settlement during colonial times. In 1910, when the formal colony of French Equatorial Africa was finally officially established after decades of indirect rule, the

important town of Bangui had a European population of one hundred settlers.\textsuperscript{118} Chad became a distinct territory in 1920, when it was placed under a civil administration that promoted the cultivation of cotton in the South, which presented more conducive climatic conditions. Due to its generally difficult climatic conditions and lack of significant natural resources, France considered Chad one of the least attractive areas of the French Equatorial Africa colony.\textsuperscript{119} The colony was largely neglected in terms of investment by the French colonizers. In the North, there was only “indirect rule”, which meant no investment other than in basic maintenance of a few colonial representatives.\textsuperscript{120}

France applied French civil law as the general law in its territories. However, pre-existing customary and Islamic laws were allowed to remain in effect.\textsuperscript{121} There was a mixed court system. French settlers were tried in French courts under French law. Africans were tried by district courts using customary or Islamic law, or by customary courts. The use of very different customary laws in the North and in the South was an impediment to constructing a national legal system for Africans.\textsuperscript{122} During colonial times Chadians did not have voting rights, and were subjected to a form of forced labor (indigenat corvee). In order to avoid the forced labor and acquire rights a Chadian could apply for the status of “assimilated”. S/he had to prove able to perform basic habits based on French culture: dress, education, religion, language and mannerisms. It was mostly people from Southern Chad that acquired this status. The Northern Islamic groups remained culturally and politically segregated.\textsuperscript{123}

After independence in 1960, Chad followed the pattern of many sub-Saharan African former colonies, becoming a patrimonial state, disputed by different factions. Conflicts between Muslim populations in the North and Christian populations in the South provoked two decades of

\begin{itemize}
\item\textsuperscript{118} Redden & Schlueuter, \emph{supra} note 82.
\item\textsuperscript{120} Ulrich Sturzinger, The Introduction of Cotton Cultivation in Chad: The Role of the Administration, 1920-1936.
\item\textsuperscript{121} Redden & Schlueuter, \emph{supra} note 82 at 6.130.12.
\item\textsuperscript{122} Ibid at 6.130.13.
\item\textsuperscript{123} Ibid at 6.130.12.
\end{itemize}
intermittent civil war and many armed insurrections. These conflicts were followed by almost three decades under a centralized and militarized state controlled by a despotic leader named Hissene Habre under a one-party regime. During this time, Chad’s economy consisted basically of subsistence agriculture, with some livestock in the North, and some cotton production in the South. Cotton was the main export cash crop. The economy was heavily reliant on direct state production and controlled agricultural marketing boards. The despotic regime of Hissene Habre came to an end only in 1990. In 1994 Chad’s annual per capita income was only 190 dollars. The civil conflicts had destroyed all infrastructure and institutions. In 1995, William Miles wrote:

[O]nly habit or convention can justify speaking of a ‘state’ of Chad. Functionally, there are two of them: that part of the juridical state which remains linked, however tenuously, to the government in the capital; and a second Chad which includes territories and populations, northern and southern, operating beyond the control of N'Djamena. According to this 'two-Chad' model, democracy cannot take hold except in a formalistic and constricted way. Lack of security has rendered democracy elusive and democracy alone cannot restore security.

At the end of the 1990s prospecting revealed vast deposits of oil in the Doba region, in Southern Chad. The financial and political costs of exploiting these deposits were, however, immense. Chad is landlocked, and an entire pipeline would have to be built through Cameroon to reach the nearest port, in Kribi. There was virtually no infrastructure. The history of political conflicts and mismanagement was dismal. And yet the oil sector in this country was to benefit from the “largest single private sector investment in Sub-Saharan Africa”.

Initially, private corporations Exxon and Petronas were reluctant to invest in oil exploitation in Chad, and in the necessary Chad/Cameroon pipeline, due to the enormous political and reputational risks. The project was only able to move forward when the World Bank and IFC assumed a significant share of the risks. The World Bank had begun capacity building projects to strengthen governance in Chad soon after oil was discovered in late 1990s. The Bank conditioned its loans and participation in the enterprise on Chad enacting a Revenue Management Program that addressed some of the main governance concerns. For example, large

parts of the royalties were earmarked for investments in five poverty-reduction sectors such as health, education and social services, infrastructure, environmental and water resources and rural development. This was designed to avoid corruption and to ensure resources were allocated to these key social sectors.  

The program also established an offshore stabilization fund to avoid the risks of the Dutch Disease (high revenues volatility, current appreciation, etc). In addition, it included a Future Generation’s Fund to ensure future Chadians would have access to part of the country’s non-renewable resource wealth. For many, the World Bank’s Chad-Cameroon Petroleum and Pipeline Governance Project was the test case of the capacity of external actors to promote governance reform in an LDC with extremely weak governance systems that suddenly became attractive for significant oil exploitation.

The Chadian government approved the Program, and the World Bank loans and the private investments went ahead. The case of Chad was initially heralded as a successful example of how engineering governance reform and poverty reduction in a resource-rich LDC was possible. In 2005, however, when the entire financial investment had been made in the successful physical construction of the wells and pipelines, the Chadian government announced that it would change the Revenue Management Law. It abolished the Future Generation’s Fund, added three other areas as priority for investments – security, justice and territorial administration, and increased the share of royalties for non-earmarked funds from 13.5 to 30%, among other changes with negative impacts for governance.

References:


129 There were severe criticisms by scholars, human rights and environmental activities against this project from the start. Pegg, “Policy Intervention”, supra note 126.

130 Ibid.
Seven years have passed since Chad began receiving large amounts of oil revenues.\textsuperscript{131} Its GDP per capita has increased to 1,477 due to oil sector development. However, Chad has not experienced any significant positive improvements in social indicators. For example, the Human Development Indicators in Chad have remained below the regional average for Sub-Saharan Africa. In 2011 the country still ranked in the bottom five in terms of human development indicators. Despite the measurement difficulties due to lack of reliable data, estimates are that 35.7\% of Chadians in 2009 still suffered from severe deprivation, and were not expected to survive to age 40. Most tellingly, since 2003 Chad has experienced deterioration in all 6 of the WGI indicators of governance.\textsuperscript{132}

An independent evaluation of the Petroleum and Pipeline project commissioned by the Bank stated that:

\begin{quote}
The fundamental development objective of WBG support for the Chad-Cameroon oil development and pipeline construction program begun in 2000 was to reduce poverty in Chad and improve governance through the best possible use of the oil revenue, in an environmentally and socially sustainable manner. Despite the technical and financial success of the pipeline project, linked largely to the high price of oil, this fundamental objective has not been achieved. Indeed, the oil revenue windfall was associated with a resurgence of civil conflict and a worsening of governance. The evaluation concludes that the principal reason for this disappointing outcome was the lack of government ownership, with repeated violations of the basic agreements. Actual outcomes might have been better with a more flexible program design, suited to the fluid circumstances and political economy of Chad. However, no alternative program design or closer supervision would have allowed to achieve the program’s development objectives in the absence of government commitment.\textsuperscript{133}
\end{quote}

The difficulties of improving governance systems in Chad should not come as a surprise. By assigning blame to deficient leadership the independent evaluation conclusion seems to disregard the complexity revealed by path dependence scholarship. In fact, due to Chad’s long path of dysfunctional institutions and, more importantly, due to the strength of rent-seeking behavior, the prospects of successfully promoting governance reform were not good in the first place. Does

\textsuperscript{131} Oil production in Chad began in 2003.
that mean that there is absolutely no way out for most or some of those countries? I turn to this question next.

2.6. Is there a way out?

Path dependence theory provides useful analytical tools to help us understand why resource-rich and low-development countries have developed bad governance systems, and why these systems have become so resilient to reforms. However, most of the literature on path dependence has been used to describe past events. In other words, the scholarship describes what has happened and helps us understand how we got to the present point in time. This section asks whether we can also use path dependence as a tool to move forward. Prado and Trebilcock and other authors have recently departed from the mainstream literature in proposing the use of path dependence theories as a framework to guide domestic governance reforms in developing countries. I ask whether their insights are applicable to the main research question of this dissertation: can global regulatory mechanisms serve as tools to open avenues of escape from the path dependence and rent-seeking traps that hamper governance reforms in resource-rich but governance-poor developing countries?

2.6.1. Path dependence as a descriptive enterprise

The path dependence literature has presented compelling explanations as to why and how governance systems change and as to why and how they become stable and resilient to change. The concept of a critical juncture is key to understanding this process. An initial extraordinary event happens that destabilizes the existing system by provoking dramatic shifts in domestic payoffs, thus opening the way to significant institutional change. This critical juncture enables the inauguration of a new governance path, which gets reinforced and stabilizes over time, becoming resilient to change. The same critical juncture can create a path that is functional in one system and dysfunctional in another, depending on the circumstances. Thus, there is no

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134 Prado & Trebilcock, supra note 19.
135 Daron Acemoglu and James Robinson argue, for example, that the Black Death that plagued Europe constituted a critical juncture that inaugurated very different institutional paths in Western Europe and in Eastern Europe. The shortage of labour resulting from the Black Death led to more balanced power relations between workers and elites in more urbanized settings in Western Europe, opening the way for more inclusive institutions. The same shortage of
guarantee that a critical juncture will produce a determinate outcome. This helps us understand when current governance systems in different countries have begun to follow their overall functional (in the case of most developed countries) or dysfunctional (in the case of most developing countries) paths. The notion of self-reinforcing mechanisms explains why current governance equilibriums are stable and resilient to change.

Path dependence theory may seem quite deterministic, indicating that there is not much hope for successful reforms in normal times. Critical junctures are, after all, rare and largely unpredictable and unmanageable events. However, a significant number of path dependence scholars recognize that in normal times the institutional path is not completely frozen. There is gradual change in normal times, even if constrained. Indeed, there are factors that can disrupt the mechanisms of reproduction that bind evolution to a certain direction. As Douglass North put it:

At every step along the way there [are choices]- political and economic- that provide [...] real alternatives. Path dependence is a way to narrow conceptually the choice set and link decision making through time. It is not a story of inevitability in which the past neatly predicts the future.

The idea that there is gradual change during normal times has been originally used in the scholarship to explain past events, i.e., to explain how gradual changes have occurred despite the self-reinforcing mechanisms, institutional interdependencies and switching costs that reinforce a
stable path dependent equilibrium. Nevertheless, some scholars have more recently asked if the insights offered by these path dependence concepts can be used to illuminate strategies for institutional reform. This is the forward-looking perspective that has not been widely used or explored in the literature yet and will be discussed next.

2.6.2. Path dependence as a prospective enterprise

Most of the literature on path dependence seeks to account for how institutional change occurred in the past in order to explain existing outcomes. In other words, it is descriptive and retrospective. The mainstream path dependence literature considers that it is not possible to predict how exactly a future governance path will evolve. This literature does not believe it is possible to predict, let alone provide guidance, for example, as to how countries that are currently caught in the double trap of path dependency and rent-seeking behavior could eventually find their way out. Indeed, many exponents of the scholarship may strongly resist such possibility, as it seems to contradict some of the most basic assumptions of the theory. Nevertheless, some scholars have recently proposed that path dependence insights could also illuminate how one could make present policy interventions more effective in shaping new, desired paths.\(^{139}\) For this group of scholars, path dependence scholarship can be prospective, and as such it could provide guidance for reformers on the ground.\(^{140}\)

The prospective path dependence literature is still controversial, because it goes against the long-held belief that social sciences is a scholarly field that is averse to probabilistic prediction. Bernstein and colleagues have however suggested that despite not being possible to make accurate predictions, social sciences disciplines such as International Relations could still use the method of “forward reasoning” to propose future alternative scenarios. Based on existing explanatory and theoretical work, social science scholars can indicate which scenarios are unlikely to occur, and which scenarios are more likely to occur.\(^{141}\) Following the same line of


\(^{140}\) See, for example, Crouch & Farrell, supra note 137. See also Levin et al, supra note 139.

thinking, Prado and Trebilcock propose to use path dependence insights to illuminate which rule of law reform strategies would likely be more feasible than others.

While Prado and Trebilcock acknowledge that no one-size-fits-all strategy will suit each country’s unique institutional path, they argue that it is possible to investigate which rule of law reforms should be prioritized for specific countries or group of countries, depending whether reforms are taking place in normal times or at critical junctures. On the one hand, they argue that in normal times all-encompassing reforms would likely not be feasible because they are likely to be very disruptive to the institutional status quo, to provoke significant switching costs and to invite major resistance from vested interest groups. On the other hand, they caution that isolated reforms risk neglecting self-reinforcing mechanisms and institutional interdependencies. Attempts to change only one institution that functions in combination with others that remained dysfunctional is unlikely to generate overall positive results either. Therefore, Prado and Trebilcock conclude, based on the path dependence literature, that in moving forward both isolated reforms and all-encompassing reforms are likely to face significant challenges to be effective in normal times.

Is any reform possible in normal times, under a path dependent framework? Prado and Trebilcock argue that a series of gradual reforms, if sequenced properly, can allow reformers to achieve desired outcomes. Benefiting from the lessons learned from path dependence, reformers can identify one institution that is amenable to change, try to predict how that reformed institution will provoke positive feedback effects in interdependent institutions, and implement it with a view to facilitating future reforms. The idea of sequencing, in this regard,

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142 Prado & Trebilcock, supra note 19.
143 The exception is when there is one stand alone institution that proves to be detached from the rest of the institutional matrix. Prado & Trebilcock, supra note 19.
144 Ibid.
145 Although this theory arguing that sequencing and timing matters in the micro-level of domestic governance reform processes draws from macro-level institutional theories that have long emphasized the importance of sequencing and timing for successful institutional change, this scholarship has developed quite separately and sometimes in opposition to the macro-level sequencing theories. In one of the last iterations of the macro-level sequencing theory, Douglass North et al argue that contemporary developed countries went through a sequence of institutional stages, from closed to open societies, and that developing countries will probably go through the same sequence of institutional evolution. This type of macro-level sequencing theory has recently come under attack. Michel Trebilcock and Paul-Erik, for example, argue that because developing countries have very different
assumes that initial reforms will set up a different path that will later be strengthened by other reforms, which will in turn serve as self-reinforcing mechanisms.

However, sequenced reforms can also produce unexpected results. For example, one initial reform may provoke unintended consequences, such as creating political economy resistance to future reforms. This may happen, for example, when initial reforms strengthen certain interest groups that may later oppose further reforms that will weaken their newly-acquired power. This is what Prado calls a “reform trap”.\textsuperscript{146} Acknowledging this, the most recent development literature on policy reforms to combat global poverty has advocated for a great deal of experimentation and trial and error reform strategies in the micro-level. Such strategies aim at addressing the enduring uncertainties of development theories and the risks of one-size-fits-all reform strategies. This literature favours empirical studies of how specific development projects play out in practice,\textsuperscript{147} and comparative case studies.\textsuperscript{148} In other words, no model development institutional histories and current dynamics, it is not possible to predict that developing countries will evolve through progressively improved neat macro categories or stages of institutional development, in the same way that the theory that developing countries would progressively go through different stages of growth (according to Rostow’s theory) proved misleading. In their words:

\begin{quote}
However, path dependent does not mean that societies are stuck in a phased trajectory and that they will not be able to evolve unless they follow all the steps in a prescribed sequence. […] A core element of path dependence is that there is no linearity: societies are complex, and change will be unpredictable. Thus, I do not subscribe to the sequence North, Wallis, and Weingast offer (basic natural states, mature natural states, open-access societies) because there are likely to be multiple equilibria, and progress will not be as linear and predictable as the authors suggest.”
\end{quote}

In the micro-level, however, North and all do accept that incremental micro-changes are possible and desirable:

\begin{quote}
[T]he institutional evolution necessary to get to the doorstep of open access type societies is instead the product of “thousands of incremental changes” that are ad hoc, practical responses to a variety of different problems encountered over time.”
\end{quote}


\textsuperscript{147} A group of leading development economists has promoted the use of randomized trials of specific policy interventions to assess what is working and what is not working in practice. At MIT, for example, the \textit{Abdul Latif Jameel Poverty Action Lab} (J-PAL), founded by Esther Duflo, Abhijit Banerjee and Sendhil Mullainathan in 2003, has since been implementing this strategy. For an account of this new scholarship see Abhijit Banerjee and Esther Duflo, \textit{Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty} (New York: PublicAffairs, 2011). Other development economists are following in the footsteps of the J-PAL team, and producing micro-level randomized studies of policy initiatives on the ground. See, e.g. Jessica Cohen and William Easterly, eds, \textit{What Works in Development? Thinking Big and Thinking Small} (Washington DC: Brooking Institution Press, 2009); and
project should be expected to ensure successful development outcomes in all contexts. Each option has its challenges, its limitations and its unintended effects. This is an assumption that the present dissertation shares with this emerging literature. No single policy strategy should be expected to ensure successful reforms in dysfunctional governance paths in normal times.

2.6.3. Path dependence and global regulatory mechanisms

How does this discussion apply to global regulatory mechanisms? Using the concepts offered by the path dependence literature, there are potentially three ways to conceive of possible interactions of these mechanisms with domestic legal systems. First, these mechanisms can be used to provoke an external shock in a stable governance system. This may destabilize the system and create a critical juncture that will set up a new governance path. Paul Pierson argues that in cases where the institutional path seems so locked-in that all internal strategies have proven insufficient to break the bad equilibrium, only external shocks will be effective in promoting change.149 Thus, one could argue that external mechanisms may be used in this way in cases where internal change is exceptionally constrained.

A second possibility is to conceive of global regulatory mechanisms as helping foster gradual internal changes. This idea is based on two assumptions. The first assumption – as suggested by Kathleen Thelen -- is that institutional changes do not depend on external shocks. Internal dynamics, even in bounded paths, are still fluid, and change is always occurring, however small.150 The second assumption is that external mechanisms can help foster such internal changes. Thelen argues that it is always possible to find endogenous avenues to provoke

148 According to Trebilcock and Prado “while empirical evidence will confirm or not whether a certain claim is true or is able to be generalized, case studies are likely to illuminate why that claim is not true or cannot be generalized.” Michael J. Trebilcock and Mariana M. Prado, What Makes Poor Countries Poor? Institutional Determinants of Development (Cheltenham: Edward Elgar, 2011), at 272.
feedback effects in stable dynamics. Collin Crouch and Henry Farrel expand Thelen’s theory, arguing that often there are potential but dormant endogenous alternative mechanisms that can open new paths or that may provoke feedback effects to disrupt the dynamics of a dependent path. I argue, differently from these authors, that exogenous global regulatory mechanisms can operate in the same fashion that these endogenous mechanisms operate, offering an innovative avenue of escape that domestic actors may or may not take in an attempt to set a new path in the domestic sphere. While the first assumption above – that there are always dormant endogenous mechanisms to provoke change - is solidly grounded in the literature, the second one is not. The idea proposed here, that exogenous institutional mechanisms can serve as key options to provoke feedback effects in dysfunctional governance paths that have proved extraordinarily resilient, is grounded in a combination of Pierson’s and Thelen’s theories, and therefore requires further elaboration.

Through which avenues will a global regulatory mechanism possibly interact with a dysfunctional domestic scenario? One possibility is that such external mechanisms are simply conceived of as bypasses of dysfunctional domestic institutions. Prado offers the concept of institutional bypass to suggest that in some cases it is possible to identify potential new institutions that would seek to achieve similar goals or provide similar services as existing dysfunctional institutions, bypassing the resilient governance path. While Prado discusses this in the domestic scenario, one could ask what is likely to happen if the bypassing institution was placed outside of the domestic system instead. This bypass will clearly avoid the political economy resistance and switching costs of trying to reform dysfunctional domestic paths, but it is not clear whether such institutions would have positive feedback effects in the domestic scenario. Tom Ginsburg, analyzing how foreign investors and developing countries use arbitration clauses in bilateral investment treaties (BITs) to bypass deficiencies in domestic

courts, argues that BITs signatory countries ended up experiencing declines in domestic governance indicators over time.\textsuperscript{152}

Ginsburg hypothesizes that allowing the use of international arbitration as a bypass to dysfunctional domestic courts reduces the number of constituencies pressing for domestic reforms, therefore decreasing the likelihood that they may take place in the near future. The same question is investigated by Kevin Davis, who assesses the possible advantages and disadvantages of using foreign anti-corruption institutions as substitutes – or bypasses – for missing domestic institutions in countering corruption in developing countries.\textsuperscript{153} Davis draws from Albert Hirschman’s claim that allowing constituencies to exit a dysfunctional system reduces their incentives to exercise their voices towards change, arguing that this is a risk of transnational anti-corruption bypasses.\textsuperscript{154} Davis adds that using foreign institutions as bypasses may prevent domestic institutions from learning-by-doing, further inhibiting endogenous reforms.\textsuperscript{155} Davis does not conclude that foreign anti-corruption mechanisms necessarily undermine domestic institutions, pointing to the lack of empirical evidence to draw conclusions at this point. He indicates that in fact there are positive signs that these external institutions are having deterrent effects on corruption levels in the case of some developing countries, and also that sometimes these mechanisms are being used not as substitutes, but rather as complements to domestic anti-corruption efforts.

Davis’ argument that international institutions may be used as complements to - or as tools to provoke positive feedback effects in - dysfunctional domestic governance systems, rather than


\textsuperscript{154} Albert O Hirschman, Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States (Cambridge: Harvard University Press, 1970).

\textsuperscript{155} Davis explains the premise behind the learning-by-doing as “local institutions [may] improve by experience, rather than as a result of pressure from vocal constituents.” Davis, supra note 153 at 17.
bypasses or substitutes, is much less explored in the literature. It is not clear, for example, whether the positive effects of global mechanisms on reducing corruption levels mentioned by Davis are due to improved domestic institutions or not. This is, however, another way in which global regulatory mechanisms may interact with domestic governance systems. Domestic actors may choose to use global regulatory mechanisms not to exit the system, but rather to open a new course of action within the system, an action that was unavailable in the absence of the external mechanism. The difference is crucial: while in the first case the mechanism offers an exit option, in this second case the mechanism serves as a tool to strengthen the capacity of domestic actors to exercise their voices towards change within the system. The other crucial difference is that global regulatory mechanisms may serve as a vehicle for outside constituencies to exercise their voice towards change in foreign domestic governance systems when they have a stake in the process. How exactly this may operate in the case of resource-rich and governance-poor countries is a central issue in this dissertation.

In addition to promoting a shock in the system, undermining the system by exiting, or gradual changes, there is yet a fourth possibility: global regulatory mechanisms will have no effect. If the mechanism is conceived as an external shock, it will operate as such regardless of the agreement or consent of domestic actors. In contrast, if the mechanism is conceived as a choice (either as a choice to exit or as a choice of tool to strengthen the voice of internal pro-reform actors) it may be the case that domestic actors may decide not to use it, or may not be able to seize the opportunity to use it. Similarly, these mechanisms may offer external actors an option to exercise their voice in the system, but they may choose not to do so. Therefore, the mechanism will be ineffective.

In articulating these three possibilities according to which external mechanisms can affect domestic systems, I am adopting the assumptions of those who believe that path dependence theory can be used prospectively. Nevertheless, I do not believe that it is possible to predict whether an ideal global regulatory mechanism may ignite a virtuous sequence of domestic governance reforms. I also do not think it would be fruitful to engage in a search for an optimal sequence of reforms, as Prado and Trebilcock do for reforms in the domestic scenario. I argue that the rich variety of institutional starting points, subsequent dynamics and current socio-political and cultural contexts in resource-rich developing countries makes it impossible to predict how any given global regulatory mechanism may possibly affect existing dysfunctional
governance paths. Each global regulatory mechanism may be used to enhance internal voice and increase the likelihood of domestic change in some resource-rich governance-poor countries, or be used as exit options in other countries, or sometimes not produce any effects at all in yet other countries.

Therefore, instead of asking which may be the best external mechanism to ignite reforms, and which possible sequencing of reforms may be most productive for resource-rich and governance-poor countries as a group, I believe that the larger the number of global regulatory mechanisms that are potentially available, the more opportunities foreign and domestic actors will have to pick and chose those that best suit them in specific cases. Empirical analysis of specific strategies for specific countries could then illuminate how effective the particular policy mix proves to be in practice.

2.7. Global regulatory mechanisms as escape routes

Both the explanatory and retrospective path dependence literature, and the emerging prospective path dependence literature that are seeking to illuminate how countries have been able to break free from, or may be able to break free from a dysfunctional governance path, have so far disregarded the possibility that global regulatory mechanisms may in fact interact with internal dynamics, provoking feedback effects in a dysfunctional equilibrium. Pierson’s theory that in some cases external interventions have proven the key to forcefully disrupting the dysfunctional governance trap seems as compelling as Thelen’s theory that internal dynamics are never totally locked in, and that endogenous avenues have often been responsible for breaking the dysfunctional path. One theory does not exclude the other.

The argument of this chapter, which will be further developed in the balance of this dissertation, is that there is yet another alternative dynamic that has so far been ignored. External factors such as global regulatory mechanisms should be more thoroughly investigated as factors that can explain how some governance weak countries have been able to break extremely resilient dysfunctional governance paths, even in the absence of a major external shock. And these external mechanisms should be taken into consideration by outside and internal reformers searching for ways to escape from the complex trapping mechanisms that keep dysfunctional domestic governance paths locked in.
To be sure, the intuition behind the idea proposed in this chapter – and articulated in the following chapters -- is not completely new. Indeed, the case that global mechanisms interact with – and may have significant implications for - the internal dynamics of domestic governance paths seems to be similar to that which guides the analysis of Pistor and Milhaupt in their book “Law and Capitalism.” Pistor and Milhaupt argue that domestic governance structures, including legal systems that are the focus of their study, experience a highly interactive process of action and strategic reaction with global institutions and actors. In four out of six cases that the authors investigate in their book, the exposure of a domestic governance regime to international markets and practices has proved to be a prominent catalyst for change, even in the absence of a major external shock.

For Pistor and Milhaupt, external investors demanding better governance in capital-importing countries explain the spread of laws protecting individual property rights in countries that apparently lacked sufficient internal demand for property rights reform. They argue that in a globalized world, key constituencies of domestic governance systems are no longer predominantly insiders. The question is why and how the participation of outsiders has enhanced the protective function of law in some of the cases they analyze. Although they do not address the issue, apparently in some cases external investors felt that using global regulatory mechanisms to bypass missing domestic legal systems did not provide enough protection. The authors argue that outsiders demand better governance in foreign capital importing countries because they do not have easy access to internal networks of relations and the informal protections that privileged insiders rely on. Pistor and Milhaupt also point to a second reason why outsiders, rather than insiders, promote mechanisms to influence foreign domestic systems: because sometimes outsiders have the political leverage to promote institutional mechanisms that domestic actors lack.

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157 Ibid at 192.
158 According to Pistor and Milhaupt law can perform multiple functions, and they differentiate domestic systems which privilege the protective function law provides to individual property rights, from domestic systems which privilege the coordinating function of law. They argue that centralized systems tend to be coordinating whereas decentralized systems tend to be protective. Ibid at 7.
159 Ibid at 194.
Pistor and Milhpaut also explain why external constituencies rely on the interaction with domestic constituencies to obtain better results. Despite their greater leverage to propose institutional mechanisms, external constituencies often lack the legitimacy to use these mechanisms to advance their own interests. The combination of the leverage of outside constituencies and the legitimacy provided by internal constituencies is key for the external mechanisms to ignite internal change. In the authors’ words:

> When players within the system make use of new legal tools or governance practices, they can be potent forces for challenging prevailing assumptions about how the world should operate, because their actions cannot be written off as the work of an outsider. [...] Thus, the uncoordinated but cumulative efforts of foreign and domestic actors appear to make a powerful combination for inducing institutional change in an increasingly globalized world.\(^{160}\)

To be clear, Pistor and Milhpaut’s study focuses on domestic governance systems that serve to support market-oriented economic activity, and therefore their emphasis is mostly in how external constituencies that have a stake in this economic activity have influenced domestic dynamics. I propose that their insights are, however, extremely useful for investigating whether external mechanisms could serve as tools to enable this combination of leverage of external constituencies and legitimacy of internal constituencies to break the resilient dysfunctional path in resource-rich but governance-poor countries that hamper their development outcomes. Because my research is concerned with governance systems that may ensure broader development outcomes, my study will include potential external constituencies that are concerned with social and moral values as well as economic interests.

Another difference between Pistor and Milhpaut’s study and the inquiry proposed in this dissertation relates to the academic discussion over descriptive versus prospective and normative value of path dependence scholarship. Pistor and Milhpaut are very clear that their study of how domestic legal systems are influenced by global economic interactions is descriptive, not normative.\(^{161}\) Their work is not intended to serve as a guide to policy-making, but rather to understand why some countries made certain institutional choices in the past and to predict what choices may be open in the future. However, siding with those that think that path dependence

\(^{160}\) Ibid at 194.

\(^{161}\) Ibid at 10.
insights can also be used in a prospective and prescriptive manner, I argue that global regulatory mechanisms should also be seen strategically as institutional choices beyond existing endogenous avenues that reformers could use to provoke feedback effects in governance systems that are caught in complex trapping mechanisms, such as the case of most resource-rich and governance-poor countries. My theory is that in some cases global regulatory mechanisms may be intentionally harnessed as tools to ignite or to strengthen internal processes of change, by enabling the interaction of external and internal pro-reform constituencies.

2.8. Conclusion

This chapter has argued that despite massive efforts and investments, there has been little or no significant improvement in governance indicators in resource-rich and governance-poor countries, placing them at great risk of experiencing the negative development effects of the resource curse. The chapter proposed that two trapping mechanisms – path dependence and rent-seeking behavior – explain why these countries are locked into this “weak governance curse”. I suggested that path dependence insights should be used in a forward looking manner to provide guidance for those actors that are seeking to devise mechanisms to help reformers in these countries to escape this double trap. I sided with those in the path dependence literature that believe that a dysfunctional path, however resilient, is still dynamic, open to internal mechanisms that enable gradual change, and therefore are often not completely dependent on external shocks to escape the trap. I however proposed that in intractable cases such as those faced by resource-rich but governance-poor countries, external institutional mechanisms that enable a combination of the leverage of external pro-reform constituencies and the legitimacy of internal pro-reform constituencies may offer crucial missing choices for pro-reform actors to break dysfunctional paths.

As noted above, I am not proposing that a global regulatory mechanism will always be successful in provoking internal change in dysfunctional dynamics in resource-rich developing countries. In fact development assistance, which is one form of global regulatory mechanism, has proven insufficient in most cases. I am proposing that different types of global regulatory mechanisms may expand the very limited choices internal reformers currently face. My hypothesis is that in some cases exogenous mechanisms may interact with existing endogenous mechanisms, or reformers could use global regulatory mechanisms in their attempts to
destabilize the dysfunctional equilibrium from the inside. External mechanisms would therefore reinforce a trend or force already present in internal dynamics. External mechanisms can also be used to bring new actors into the internal dynamics, creating a new path for change. In other cases, however, exogenous mechanisms may prove ineffective, provoking no change at all in internal dynamics. Whether an external mechanism will be effective or not is largely unpredictable. Much depends on the characteristics of the governance path and current situation in each country: the political economy obstacles to reform, the different endogenous levels of demand for reform, the various political and technical capacities of internal actors, etc.

Finally, I argue that it is not possible to predict beforehand which global regulatory mechanism may prove the most efficient tool to allow the combination of the leverage of external constituencies and the legitimacy of internal constituencies to increase the chances of breaking a dysfunctional governance path. It may be possible to investigate a ranking of global regulatory mechanisms to address a domestic institutional deficit if those mechanisms were seen as tools to bypass the governance deficits in developing countries. However, this would not be feasible if one considers global mechanisms as potential strategies to provoke positive feedback effects in domestic governance systems. One global mechanism may function well in country A, while not functioning well in country B, and not functioning at all in country C. Much would depend on the particular internal circumstances of each country. In this case, it is better to have as many external options as possible available, so that reformers could explore which mechanism may work better in certain countries in certain moments in time.
Chapter 3
The Next Frontier: Law and Development Meets Global Governance

3.1. Introduction

As the previous chapters have explained, after many years of intense academic debates and political disputes, a strong consensus seems to have emerged around the pressing need for good governance in resource-rich countries (Chapter 1), and yet promoting governance reform has proven to be an intractable problem due to path dependence and rent-seeking behavior (Chapter 2). This dissertation’s central question is whether and how global regulatory mechanisms (international hard law, soft law initiatives and extraterritorial home-country regulations) have the potential to serve as escape routes from this “weak governance curse”, by disturbing stable equilibria that have become path dependent and by addressing rent-seeking behavior in resource-rich developing countries. The second part of this dissertation – chapters 4, 5 and 6 - seeks to illuminate various existing potential global regulatory alternatives, asking how some came to be selected over others, what exactly they are trying to accomplish, and to what degree they have been successful or not. Before developing the analysis of specific strategies and mechanisms, however, this Chapter will explain why this question is relevant and the framework that I will be using to evaluate these instruments.

There is a rich body of interdisciplinary literature on the interface between institutions and development.¹ This is the institutional development literature, which includes a sub-field known as “law and development” (L&D) studies. The L&D literature can inform my analysis of the attempts to use external mechanisms to address the governance deficit in developing countries, including resource-rich countries. The L&D literature focuses on whether and how reforming dysfunctional domestic governance systems can affect development outcomes in developing countries. Nevertheless, recent strands of the L&D literature seem to have glossed over many non-domestic instruments, such as international law, extraterritorial jurisdiction statutes and

¹ For a recent comprehensive review of this literature see Michael J Trebilcock & Mariana Mota Prado, *What Makes Poor Countries Poor?: Institutional Determinants of Development* (Cheltenham: Edward Elgar, 2011).
transnational soft-law, that may be relevant to promoting domestic governance reforms.

The mainstream L&D literature does not deny that external actors can play a role in this process, but the scholarship is primarily focused on illuminating how external actors can recognize and overcome domestic obstacles in order to promote domestic governance reforms more effectively. There is therefore a great deal of emphasis on endogenous institutional structures and processes. At the most, this literature has indicated how external actors can use conventional international coercive measures - such as conditionality on loans and foreign aid, or trade sanctions - or incentives – such as direct funding, technical assistance and capacity building - to press or encourage developing countries to promote domestic reforms. This emphasis on domestic institutional structures, however, overlooks the possibility of global regulatory mechanisms being also used to affect or constrain the domestic reform process in much more complex, and perhaps effective, ways than the conventional methods proposed thus far.

This inward-looking perspective (i.e. this focus on domestic institutional structures) is not exclusive to the L&D literature, but can also be recognized in the broader field of development studies from the 1990s onward. Since the second half of the 2000s, however, a group of development economists and development political scientists have begun to devote more attention to the complex interactions between global regulatory mechanisms and domestic governance deficits. These scholars conceive external institutions as potential mechanisms that can trigger, foster or help promote changes in the domestic sphere, in addition to having a life of their own. With very few exceptions, contemporary L&D scholars seem not to have engaged with this important movement towards looking at global regulatory mechanisms and towards a more comprehensive view of the complex interactions between external and internal mechanisms for reform.

Therefore, my starting point is that the L&D literature could benefit from looking at potential answers to the governance deficit conundrum that are not brought about by domestic initiatives, or are not designed purely as mechanisms to change domestic governance structures.

In sum, this chapter proposes that the L&D scholarship should draw from global regulation studies in order to adopt an expanded approach that takes into consideration the various endogenous and exogenous mechanisms that affect domestic governance reform and how they interact. This chapter will be divided as follows. Section 2 argues that the L&D literature has adopted a predominantly inward perspective, focusing on domestic governance processes and structures. Section 3 argues that most of the global governance literature has considered external mechanisms as tools to bypass the governance deficit in developing countries. Section 4 describes the nascent global governance literature that is investigating the interactions between global mechanisms and dysfunctional domestic governance systems in developing countries, which should inform an expanded L&D perspective on domestic governance reform.

3.2. L&D literature: the inward perspective

Since the end of WWII, scholars and policymakers have consistently engaged in activities designed to address the development divide between rich and poor nations. These concrete development efforts have generated many moral, analytical and normative challenges that have inspired a broad range of academic investigations in several disciplines. These academic investigations are collectively known as development studies. Development studies encompass heterogeneous scholarly fields in, inter alia, economics, political science, and law. These academic fields have influenced each other over the years in such complex and reciprocal ways that it is sometimes difficult to disentangle one from the others. Recognizing this difficulty, this dissertation will adopt the vantage point of the still emerging sub-field of development studies known as “law and development” (L&D) scholarship, while also making reference to the broader development studies field.  

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3 That L&D is indeed a field of legal studies or just a “movement” is still hotly debated. Thomas Carothers, Kevin Davis and Michael Trebilcock argue that a significant level of ambiguity still surrounds most of the main premises that would justify the existence of such a scholarly L&D field: 1) whether legal rules play a significant role in development; 2) whether it is possible to promote meaningful law reforms; 3) whether it is possible for outsiders to identify the reforms needed for development in a foreign developing country. Thomas Carothers calls this “the problem of knowledge” in L&D studies. Instead of dismissing the possibility of L&D becoming a solid academic field, Carothers, Trebilcock and Davis take the stance that these ambiguities “makes law and development a ripe field for academic research.” Mariana Prado also cautions that even today L&D cannot be considered a cohesive field of study, with a unified set of assumptions and concepts. The fact is that L&D studies have already produced a rich body of literature, still growing, and there are several law schools considering this a field established enough to hire professors to work in this area, and several professors auto-define themselves as law and development scholars. Thomas Carothers, ed, Promoting the rule of law abroad: in search of knowledge (Washington, DC: Carnegie
David Trubek and Alvaro Santos have divided the L&D literature into two historical moments, for analytical purposes. These two ‘moments’ are the first L&D movement that emerged in the American legal academy in the 1970s, and the second L&D movement, also known as the “Rule of Law” movement, that began in the 1990s. I will adopt their division for the purpose of showing that L&D has not – for the most part -- investigated how external institutional mechanisms may affect domestic “rule of law” reforms. The only exception was a brief moment in the 1980s, when legal scholars examined how international mechanisms could impact development, although this still does not qualify as looking into the interaction of external mechanisms and domestic governance reform in the way I propose in this chapter.

3.2.1. The rise and fall of the first L&D movement

The first attempts to institutionalize L&D as a defined field of legal scholarship occurred in American law schools in the 1970s. At the time, economic development studies, spurred by modernization theories, was already a thriving field in economics faculties. Development economists in the 1970s believed that economic convergence between poor developing nations and Western industrialized countries was a question of smart planning and time. The scholarship focused on which domestic policy measures developmental states could adopt to bring about this
convergence. In parallel, political scientists were conducting systematic investigations of the social and political factors that could bring about social and economic development. Legal scholars joined the enterprise somewhat later, in order to investigate the specific relationship between formal legal systems and social, political and economic change in developing countries.

According to David Trubek and Marc Galanter, the L&D research agenda at this time developed in close partnership with legal reformers in the field. The research was largely instrumental, with the main objectives of justifying and guiding the legal development activities already occurring in practice. The main research challenge was to identify the “legal changes needed to achieve some specific developmental goals.” L&D scholars investigated, for example, the deficiencies hampering the proper functioning of legal institutions in developing countries, and whether and how these institutions could be fixed or adapted to function in a similar way as in developed countries. As in the other development studies fields, there was a strong emphasis on the role of effective state regulation in steering the market economy in the right direction. The idea was that political democracy and social development would naturally follow economic growth.

There was a sense that legal systems in developing countries were still rudimentary, or too concerned with empty legal formalities instead of focusing on concrete policy goals. A set of studies centered on how to support the improvement of legal education in Africa, Asia and Latin America, as this was expected to be the most effective way to foster the long-term modernization of the legal systems in developing countries. Other areas of focus were on how to promote access to justice, which then meant mainly including access to formal courts, and on how to provide

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7 See discussion on theories of development in Chapter 1.
9 Trubek & Galanter, *supra* note 6 at 1074.
10 Ibid.
11 Trubek, *supra* note 5 at 75.
12 Trubek, *supra* note 5.
subsidized professional legal services to the poorest sectors of society.\textsuperscript{13} All of these studies were concerned with how external reformers could contribute to the modernization of public law and administration and to the legal profession in developing countries by using their knowledge, their technical capacity and their capital to transplant model legal institutions from developed to developing countries. The focus was therefore on domestic institutions only.

The 1970s L&D reform efforts were thus motivated by the same assumption underlying modernization theories: that the ideal response to the development divide was to help developing countries to shape their legal, economic and social practices and institutions according to liberal-democratic models similar to those developed countries had arguably successfully used to achieve their high development outcomes. By the time legal scholars began to catch up with the post-WWII economic and political science branches of development studies, however, scholars from these other disciplines were already recognizing the failure of policies based on modernization theories to deliver significant development results on the ground.

The disappointing results of two decades of external attempts to promote development led David Trubek and Mark Galanter to declare the early demise of the L&D scholarly project in their leading 1974 article, “Scholars in Self-Estrangement.”\textsuperscript{14} For Trubek and Galanter the whole concept of transplanting liberal-democratic legal institutions from developed to developing countries as an ideal and feasible tool to promote development had been naïve and ethnocentric.\textsuperscript{15} Brian Tamanaha argues that the demise of the first L&D movement was in fact an American academic crisis, since at its core was the growing mistrust of the democratic

\textsuperscript{13} Trubek & Galanter, \textit{supra} note 6 at 1076.
\textsuperscript{14} The disappointing results of two decades of external attempts to promote development efforts led Trubek and Galanter to expose a very cynical view not only of the 1970s L&D efforts, but of the whole development enterprise.
\textsuperscript{15} One valid question is why did Trubek and Galanter so readily dismiss the possibility of using the lessons from failed attempts to transplant Western legal models to inform the transformation of the L&D efforts into a project more attuned to the reality of developing countries. The two authors were convinced that the first L&D paradigm was inextricably rooted in implicit liberal presuppositions about the nature of the state and the role of law in society that came under attack in developed countries themselves. These models were deemed thoroughly incompatible with the reality in developing countries. In Scholars in Self-Estrangement Trubek and Galanter discuss these fundamentally flawed presuppositions in detail. The authors basically conclude that: 1) it is not possible to assume that any state will utilize the control and coercive powers granted by society to further individual and collective welfare; 2) the fact that legal rules are the main vehicle used by the state to advance welfare was a fallacy, and this was even more so in developing countries where states are captured by elites and social control is exercised primarily through informal norms. This analysis reflects the profound debates about role of the state and formal legal rules happening in American academic circles at the time. Trubek & Galanter, \textit{supra} note 6.
credentials of the American liberal legal model, both domestically and in foreign affairs. Yet this American academic crisis was also informed by an ideological crisis of international proportions. The demise of the first L&D movement happened amidst charged global debates on neocolonialism, dependency theories, a new international economic order, etc. The idea that L&D specifically, and modernization development theories more generally, were ethnocentric projects and potential instruments for interference in the internal affairs of developing countries echoed much beyond American academic circles.

Tamanaha rightly argues that this crisis, whatever its dimensions may have been, did not affect the practice of development assistance in general and legal development assistance in particular. There was enough endogenous demand by legal practitioners in developing countries to sustain an interest in L&D. The UN, private foundations and bilateral aid agencies provided a sufficient supply of development assistance projects to keep the law and development enterprise alive and well amid the fundamental transformations in the perceptions of state-society relations. As the American L&D academic movement lay dormant due to the self-inflicted legitimacy blow, versions of the academic drive to understand the relationships between legal rules and development began to flourish elsewhere. Academic circles in France, the UK and in developing countries kept L&D studies alive, albeit largely marginal and non-institutionalized.

The central point to be made here is simply that this first L&D movement was largely concerned with and focused on domestic reforms. Foreigners, who were perceived to have the expertise and the resources to conduct such enterprises, promoted a great deal of the reform efforts. But this does not change the fact that the focus was on domestic mechanisms and domestic reforms, as opposed to international mechanisms.

### 3.2.2. L&D’s sojourn in international law

In the 1980s, while L&D scholarship lay dormant, the discussion about the relationship between

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18 Tamanaha, “The Lessons”, supra note 16.
legal rules and development did not disappear completely from legal studies. These debates were in fact displaced to international law scholarship, under a very different research agenda, rarely concerned with the intricacies of domestic legal systems.\(^\text{19}\) Inspired by dependency theories, many developing countries strove to provoke a 180-degree shift in the academic focus on the relationship between law and development outcomes. The main idea was that instead of focusing on the developmental effects of developing countries dysfunctional domestic governance systems, academics should be investigating the negative developmental impacts caused by colonization and perpetuated or aggravated by an unequal international economic and political structure.

One important strand of international law scholarship, for example, critically followed the efforts to institutionalize a “right to development” as one of the most important tools to advance a New International Economic Order (NIEO).\(^\text{20}\) Many scholarly debates were initiated to discuss whether and how current international legal norms and political economy structures, inherited from colonial times, were affecting the possibilities of developing countries advancing their development interests at the international and national levels.\(^\text{21}\) International law and constitutional law scholars at this time were also developing another rich body of literature to investigate how international human rights law was impacting constitutional design and legal reform in developing countries.\(^\text{22}\)

This was a first instance whereby legal scholars concerned with development engaged with international and transnational mechanisms, instead of focusing only on domestic institutional structures. This legal strand of development scholarship was also very removed from the instrumental approach that characterized the first L&D movement. Academic discussions on human rights in general, and the right to development in particular, were largely deontological. Several scholarly works on the right to development, for example, had as their main objective to

\[^{20}\text{Jack Donnelly, “In Search of the Unicorn: The Jurisprudence and Politics of the Right to Development” in Carty, supra note 19.}\]
\[^{21}\text{Tamanaha, “The Lessons”, supra note 16 at 477.}\]
“unreservedly accept the extent to which the West [during past colonial periods] have torn apart the political and economic structures of Third World societies and used their legal systems to do so.”23 The heated debates revolved around questions such as whether this history had generated a current legal responsibility by developed countries to rebuild the social fabric of developing nations, and how this responsibility would play out against developing countries’ own current responsibilities towards their own citizens and their own development.

Similarly, the human rights movement strove to institutionalize the moral responsibility of states towards the well-being of their own citizens worldwide. Investigating the obstacles to translating states’ formal recognition of human rights into further domestic institutional and social change was largely outside the research agenda of human rights scholars at that time. The furthest the human rights literature went was investigating the gap between recognition and implementation of human rights international standards, and the focus was on how international instruments could evolve to promote state compliance. It was assumed that once states recognized human rights, societies in developing countries would be able to press for the creation of domestic institutions to have these rights protected and respected.24

Furthermore, the scholarly discussions on the incorporation of international human rights standards into the legal and political systems in developing countries were not primarily concerned with development as understood by the first L&D movement. While L&D was more concerned with a functional legal system, the human rights movement was focused on the individual, and its ultimate goal was to promote individual civil, political, social and economic

23 Carty, supra note 19 at xiii.
24 Later studies would bring awareness of how this assumption was dissociated from reality, since international human rights treaties proved insufficient to significantly reduce the level and number of cases of human rights violations. Oona Hathaway, for example, investigated the impact of countries’ commitments to human rights treaties and concluded that international human rights legal commitments were more meaningful when domestic institutions allowed actors to hold the government into account. When a country had no domestic institutions that could enforce the treaties, formally binding international human rights treaties were often ignored. Hathaway attributed this lack of compliance to weak enforcement mechanisms. More puzzling, Hathaway found that if the country was nondemocratic, ratifying international human rights treaties such as the Torture Convention and the International Convention of Civil and Political Rights (ICCPR) led to higher levels of human rights violations. Oona Hathaway, “Why do Countries Commit to Human Rights Treaties?” (2007) 51:4 J Conflict Resol 588; Oona Hathaway, “Do Human Rights Treaties Make a Difference?” (2002) 111:8, Yale LJ 1935. But see, for a more optimistic position on the impact of human rights treaties, Beth A Simmons, Mobilizing for Human Rights: International Law in Domestic Politics (Cambridge, UK: Cambridge University Press, 2009); and Victor Abramovich, “From Massive Violations to Structural Patterns: New Approaches and Classic Tensions in the Inter-American Human Rights System” (2009) 11:6 Sur International Journal On Human Rights 7.
rights. Whether and by which mechanisms these individually recognized rights would be translated from the constitutional and legal orders into actual development outcomes on the ground was outside the focus of the human rights scholarship.

Anthony Carty also describes a series of academic discussions on the interface between international law, the international economic order and development that were occurring in France, Netherlands and the UK at this time, as well as the USA.\textsuperscript{25} The research agenda of this literature revolved around issues such as the disproportionate political and economic influence of Western-based multinational corporations and the unbalanced power of Western industrialized countries in international economic structures. Proposed solutions included preferential treatment for developing countries in trade rules, renegotiation of foreign debts, technology transfers and some form of international control over multinationals. While these proposals are slightly closer to what I am calling here an outward-looking perspective, they do not go so far as to acknowledge the complex interaction between these international elements with domestic institutions. This literature seemed to assume that changing international investment and trade rules that were biased in favor of developed countries, and taming multinationals internationally, would automatically generate positive development outcomes in developing nations.

In other words, the literature on international law and development did not question whether developing countries would possibly need a set of domestic reforms if they were to take full advantage of the potential benefits of a different set of international trade and investment rules. The same deficiency applies to taking full advantage of the potential benefits flowing from a politically recognized international right to development.\textsuperscript{26} Therefore, although the literature on international law and development and the literature on international human rights law at the time were focusing on external mechanisms as tools to influence legal systems in developing countries, they were not sharply focused on understanding the avenues by which these mechanisms could possibly enable the transformation of dysfunctional domestic legal systems in developing countries. At best, it was assumed that respect for human rights and a fair

\begin{itemize}
\item \textsuperscript{25} Carty, \textit{supra} note 19.
\item \textsuperscript{26} For Tamanaha, while “there is no denying that developing countries suffer from serious disadvantages in the current world economic system”, the answer to this problem is not legal, although laws could help to implement political solutions that have been agreed or decided by others. Tamanaha, “The Lessons”, \textit{supra} note 16 at 480.
\end{itemize}
international economic order would naturally generate positive development outcomes.

In sum, despite a concern with international and transnational mechanisms, this strand of academic scholarship in the 1980s did not go far enough to analyze and explain how these instruments would interact with domestic institutional structures. Therefore, they fall short of qualifying as what I call “outward-looking”.

3.2.3. The second L&D movement

The end of the Cold War in the late 1980s would mark a new moment of optimism in the capacity of external actors to identify and promote legal reforms that were expected to generate economic development in developing countries. However, profound political economy transformations at the global level and in major developed economies had provoked a marked shift in the focus of academic thinking about development. Neoliberal theories and policies had gained political prominence and legitimacy in the UK, USA and Germany, while the world was becoming much more economically integrated. Some developing countries, especially in East Asia, that had invested in export-led growth and free trade had achieved much higher rates of economic success than those that had adopted import-substitution and protectionist economic policies. A new consensus was formed that instead of state-led economies, it was free markets, privatization and foreign direct investment that were the key elements to the economic development of developing countries. This was the political-economy conjuncture in which the second L&D movement emerged.


In this book, economists, historians and political scientists proposed to use the insights of the evolving literature in New Institutional Economics (NIE) to illuminate how domestic institutional constraints in developing countries were hampering development efforts. The focus was brought back from international law and global structures to domestic systems in developing countries. The research agenda of NIE was

27 David Trubek gives a new name for this second movement, the “Rule of Law” (ROL) movement, to differentiate from the first movement Galanter and himself had declared dead in the 1970s. Trubek & Santos, supra note 4.

therefore primarily inward-looking: it provided insights into how domestic institutions were created, how they evolved over time, and how existing institutions influence economic development. The emphasis of this literature, following the liberal mantra of its time, was on domestic institutions that would specifically enable the effective functioning of a market economy.

The development literature based on NIE centered on providing guidance to those external and internal actors willing to engage developing countries in domestic reforms to improve their levels of economic growth in the existing global political economy context. As the institutional perspective became mainstream in the development scholarship, the raging political debate on a new international economic order was relegated to the margins of academic studies.\textsuperscript{29} The main idea of NIE inspired development theories was that, in order to help developing countries to achieve economic development, external actors should promote the strengthening of domestic property rights, contract law and judicial guarantees against indiscriminate state interference with markets. Legal scholars were thus brought back to the forefront of studies investigating institutions and economic development. In parallel, legal scholars involved in promoting international human rights law recognized that international human rights standards and enforcement mechanisms were insufficient to guarantee effective protection without a more structured project of changing domestic institutions beyond the constitution.

The research agenda of this second L&D movement closely followed the agenda pursued by legal reformers on the ground. It was wide-ranging and covered investigations on virtually all aspects of the legal system: legal education, efficient administration of justice, access to justice, legal reforms, judicial independence, etc.\textsuperscript{30} In terms of substantive research areas, the literature initially centered on understanding the links between property rights and contract law to economic development. As the critiques pointing to the failure of the Washington Consensus and its limited focus on economic growth to ensure positive development outcomes grew stronger, however, the mainstream agenda of development studies gradually expanded. Studies of property

\textsuperscript{29} Although critical scholars have continued to emphasize that the political and ideological neutrality of development theories – alleged or assumed – is a myth, and should always be object of debate. See Trubek & Santos, \textit{supra} note 4; Aram Ziai, ed, \textit{Exploring Post-Development: Theory and Practice, Problems and Perspectives} (Abingdon, Oxon: Routledge, 2007).

\textsuperscript{30} See Trebilcock & Daniels, \textit{Rule of Law Reform, supra} note 2.
and contract law continue, but the literature now includes investigations as to how legal reforms can directly influence social and political outcomes.\textsuperscript{31} There has also been a gradual expansion towards understanding how informal norms interact with formal legal rules to impact development outcomes. This has brought L&D into closer contact with other disciplines in the broader development studies field.\textsuperscript{32}

The research agenda of mainstream development studies has more recently focused on questions such as: 1) what are the main formal and informal domestic institutions, also referred to as governance systems, that may facilitate positive development outcomes?;\textsuperscript{33} 2) how did many developing countries develop chronically dysfunctional governance systems in the first place?;\textsuperscript{34} and, 3) what are the domestic obstacles that may hamper governance reforms promoted by external and internal actors alike?\textsuperscript{35} The debate on how to promote governance reform more effectively is now at the forefront of L&D studies.\textsuperscript{36} There are still many unresolved questions in this debate, such as 1) should institutional reforms be ends in themselves or means to an end?;\textsuperscript{37} 2) among the alternatives of classic reforms focused on judiciary and law enforcement; reforms

\textsuperscript{33} A substantial body of the new institutional economics literature has, for example, concentrated in identifying governance indicators that can inform reform strategies for specific countries. This literature also aims to enable cross-country analysis of the correlation and causation of the various dimensions of governance and development. Daniel Kaufmann & Aart Kraay, “Governance Indicators: Where Are We, Where Should We Be Going?” (2008) 23:1 World Bank Research Observer 1. For a recent account of the history and a comprehensive critical analysis of governance indicators, see Kevin Davis et al, eds, Governance By Indicators: Global Power Through Classification and Rankings (Oxford: Oxford University Press, forthcoming August 2012).
\textsuperscript{34} As discussed in chapter 2, the historical institutionalism literature in political science has delved into the dynamics of institutional origins and institutional change in politics to understand how dysfunctional governance systems came into being, and how they became path dependent. Paul Pierson, “The Limits of Design: Explaining Institutional Origins and Change” (2000) 13:4 Governance 475; James Mahoney & Kathleen Thelen, Explaining Institutional Change: Ambiguity, Agency, and Power (New York: Cambridge University Press, 2009).
\textsuperscript{35} Anne O Krueger, Political Economy of Policy Reform in Developing Countries, (Cambridge, UK: MIT Press, 1993); Trebilcock & Davis, supra note 3.
\textsuperscript{36} See chapter 2 for a detailed discussion on path dependence and other obstacles to governance reform.
concentrating on poverty alleviation;\textsuperscript{38} civic and professional education;\textsuperscript{39} or reforms focused on social justice, which are the most conducive to development?\textsuperscript{40}

In sum, the new L&D scholarship has so far cultivated an inward-looking perspective, focusing at how domestic governance systems are formed, why they are resistant to change, and how best to promote governance reform. The literature has remained largely oblivious to how current global regulatory mechanisms may interact with domestic systems. There has been, however, a recent change in the scholarship. Development scholars in economics and in political science are leading the way in a movement to bring international institutional systems back into the equation of domestic development.

This recent trend is different from the movement in the 1980s. There has been no major shift of responsibility for changing development outcomes from domestic institutions to international institutions, as seemed to be the case during the dependency theory era. The main focus of this literature remains at the domestic level. A few current studies, however, are beginning to investigate for the first time how transnational institutional mechanisms can interact with domestic institutional systems. They are asking whether these external mechanisms can either fill a critical domestic governance deficit, or provoke feedback effects that may shift the balance of power, thus facilitating the implementation of successful domestic reforms. This is exactly what I am calling here an outward perspective. The recent trend indicates that the literature may be moving in a promising direction, although scholars have yet to articulate this move according to the framework I am proposing here.

Before describing these recent developments in the literature and their limitations, however, I will provide an overview of the global regulation literature, which has traditionally analyzed transnational and international mechanisms. This literature is relevant because recent developments in the L&D literature, which I explore in section 4, have begun to converge and


\textsuperscript{40} Trubek & Santos, \textit{supra} note 4.
intersect with recent studies conducted by global regulation scholars.

3.3. The global governance literature: the outward perspective

The prolific literature on global governance, or global regulation, encompasses scholarships in international relations, political science and international law. Global governance (GG) scholars investigate why and how, in an anarchic world without a centralized government, key state and non-state actors cooperate to form international regimes to regulate some issue-areas. GG scholars seek to understand, for example, in what relative measure key state and non-state actors are motivated by power, interests and/or ideas. GG scholars also investigate the causes and implications of the increasing movement of regulatory authority from the national level to the global level, and from public mechanisms to private and hybrid forms of regulation. A complete overview of this wide-ranging GG literature is beyond the scope of this dissertation. I am interested, however, in identifying whether this literature can guide an L&D analysis of the possibility of policy actors’ attempts to use global mechanisms to address the governance deficit in developing countries, especially in resource-rich countries.

When one attempts to use this lens to assess the GG literature, some characteristics become immediately evident. First, a large number of GG studies seek to analyze the creation and evolution of transnational mechanisms to deal with all kinds of global problems at the same time. This literature usually does not differentiate those initiatives created to address issue-areas that escape the regulatory power of both developed and developing countries alike, such as climate change, from initiatives designed to address issue-areas related specifically to the governance deficit in developing countries, such as the resource curse.

Another aspect in which this literature tends to conflate developed and developing countries is on

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41 There are several definitions of issue-area. Keohane and Nye, for example, define issue areas as sets of problems or issues regarded by policymakers as closely interdependent and dealt with collectively. Issue areas can thus be identified according to their policy substance for analytical purposes, although different issue areas may vary substantially in terms of their functional linkage. Keohane and Nye clarify that it is not always possible to identify issue areas’ boundaries with precision. Robert O Keohane & Joseph S Nye, Power and Interdependence (Boston: Little, Brown and Co, 1977); See William C Potter, “Issue Area and Foreign Policy Analysis” (1980) 34 International Organization 411. For Mathew Evangelista the definition of an issue-area depends on the perception or belief of actors involved, as well as on the purposes of the investigator. The investigator can deduce the existence of an issue-area to the extent that a group of state and non-state actors regard sets of issues as closely interdependent and treat them collectively. Mathew Evangelista, “Issue Area and Foreign Policy Revisited” (1989) 43:1 International Organization 147.
the impact of internationalization. For example, there is literature on how governments harmonize their domestic policies with other jurisdictions in order to compete in or to ensure an international level playing field in a globalized economy, and how international standard setting initiatives play an important role in this process of policy convergence. These sub-sets of the GG literature are relevant to an expanded L&D perspective in the way I am proposing, to the extent that they pay more attention to how global regulations affect or are affected by domestic governance systems. However, they need to account for developing and developed countries differences in order to better capture the development dimensions of such discussions.

A recent sub-set of the GG literature, which I review in section 4, is taking the institutional deficit of developing countries into account. Some authors, for example, draw from regulation studies that discuss how the “shadow of hierarchy” (shadow of the state) is important to ensure the effectiveness of “new governance” types of global initiatives, which have become increasingly common in the last three decades. This literature still looks primarily for non-

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43 One recent branch of the literature on regulatory diffusion in a globalized world has already began to pay more attention to how regulatory models originating in the North may have a different impact when adopted by “Southern” developing countries with very different political economy contexts. This literature, known as the regulatory state of the South, does not specifically investigate regulatory models designed to promote development. Navroz K Dubash & Bronwen Morgan, “Understanding the Rise of the Regulatory State of the South” Regulation and Governance [forthcoming in 2012] online: Wiley Online Library <http://onlinelibrary.wiley.com/doi/10.1111/j.1748-5991.2012.01146.x/abstract>.


45 Abbott and Snidal argue that policy actors are increasingly relying on what they call “transnational new governance” mechanisms in the global arena. These new governance mechanisms are characterized by the central role of private actors in rule-making and rule-implementation, with different levels of collaboration by states depending on the initiative; by reliance on dispersed expertise; and by reliance on voluntary norms. In contrast, “international old governance” mechanisms rely primarily on states and state-centered institutions to create and implement rules; rely on centralized bureaucratic expertise; may – or may not – rely on mandatory rules instead of only voluntary norms. Kenneth W Abbott & Duncan Snidal, “Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit” (2009) 42 Vand J Transnat’l L 501.
domestic (either public, private or hybrid) solutions, but asks whether global regulatory mechanisms could constitute functional equivalents to the shadow of state hierarchy. In this sense, they fall short of promoting the expanded perspective that I am proposing here, which focuses on possible interactions between domestic and global mechanisms.

Another recent strand of GG scholarship is examining more closely the marked difference in results when global regulatory models interact with well established national governance systems in Western developed countries, and when global regulatory models interact with developing countries with weak or missing domestic institutional capacity. This emerging literature, known as “The Regulatory State of the South”, proposes a research agenda to investigate how the particular characteristics of national governance systems in developing countries, and their specific developmental needs, affect: (i) the objectives that should be pursued by global regulatory mechanisms that seek to promote policy convergence; and (ii) which results should be expected from the interactions between certain global regulatory models and weak national governance systems. This promising literature is concerned with how global norms interact with weak governance systems, but it still falls short of providing helpful guidance for the research problem that is the object of this dissertation for two reasons. First, this literature has so far adopted a very narrow focus on specific forms of national governance systems: independent regulatory agencies in the infrastructure sector. Second, it does not specifically investigate whether and how global mechanisms may be harnessed to enhance the success of domestic governance reforms for development.

In sum, while analyzing global regulatory mechanisms, the mainstream global governance literature still fails to take seriously how the complex interactions between domestic and non-domestic instruments may affect attempts to promote governance reform. Thus, they are still falling short of what I call an outward perspective: rather than being located inside developing countries looking out, their analysis lies entirely outside of developing countries. There is, however, a small number of studies that are beginning to investigate more specifically how

46 Dubash & Morgan, supra note 43.
47 For example, this literature emphasizes how in order to devise strategies to successfully influence domestic reform in developing countries, issues such as multistakeholder politics have to become central tenets of the analysis. Dubash & Morgan, supra note 43.
transnational regimes can help to bridge the governance gap in developing countries. These will be discussed in section 3.4 below.

3.3.1. In the Mainstream: literature overlooking the governance deficit

The 1990s witnessed the beginning of a pronounced policy shift in many Western industrialized countries from a top-down, public approach to regulation towards an increasingly horizontal and hybrid interaction of public and private regulations. The state was expected to steer private activity to secure social (including health, safety, environmental and anti-discrimination) and economic objectives, instead of trying to secure these goals directly. There was also a move towards the use of non-legal control mechanisms and non-state institutions, such as relying on business self-regulation or voluntary agreements between business and other civil society organizations. One of the characteristics of private and hybrid forms of regulation is their capacity to cross borders more easily than conventional forms of international regulation. Therefore, the move towards private and hybrid forms of regulation has become deeply enmeshed with the move of regulatory authority from the national to the global level.

Western scholars concerned with the evolution of domestic regulation followed behind these policy trends, by shifting the focus of their studies from investigating the potential and the limitations of state regulation to investigating “a wider range of norms and mechanisms through which [regulatory] control is asserted or achieved, however indirectly.” Prolific bodies of literature exist on the “regulatory state” and on the “new governance model of regulation”.


50 Scott, supra note 49 at 145. See also the rich academic discussion on the “instrument-choice” perspective on public policy and administration, where authors focused on which policy instruments were more adequate to translate policy ends into practical reality in complex societies. See Pearl Eliadis, Margaret M Hill & Michael Howlett, Designing Government: From Instruments to Governance (Montreal: McGill-Queen's University Press, 2005).

Regulation scholars began to draw from the rich scholarship in international relations, which had already begun investigating how states managed to address world problems without a centralized, hierarchical global government.

Conversely, the international relations scholarship also expanded its scope from focusing on states as the primary sources of global regulation to include the investigation of the mushrooming horizontal, non-legal regulatory mechanisms that were being created or encouraged by state and non-state actors alike. In the social sciences scholarship that focused on the national level, this wide-ranging shift towards collaborative, “hybrid” regulatory forms became known as “governance without government”. In the global governance scholarship this new set of regulations was named “transnational new governance”, in contrast to the “international old governance” form, where states and international institutions were the only norm-makers and norm-implementers.

Some areas of legal studies have also been heavily influenced by these trends. Legal pluralism, for example, gained momentum as a framework to make sense of the mushrooming of overlapping sites of normative authority inside the nation-state and in the global arena.

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54 According to Tamanaha: “In the past two decades, the notion of legal pluralism has become a major topic in legal anthropology, legal sociology, comparative Law, international Law and socio-legal studies, and it appears to be gaining popularity.” Brian Tamanaha, “Understanding Legal Pluralism: Past to Present, Local to Global” (2008) 30 Sydney Law Review 375; see also Ralf Michaels, “Global Legal Pluralism” (2009) 5 Ann Rev Law Soc Sci 243.
Complete fields of legal studies have developed, if uncomfortably, at this intersection between the national and global levels, such as transitional justice and environmental law. Scholars have proposed different methodologies, analytical frameworks or approaches to study this multilayered and complex web of public and private, national and international normative arrangements. Transnational law, for example, is proposed as a perspective to bridge the separate research agendas from national pluralist legal studies and global governance.\(^{55}\) Hard law X soft law is proposed as a framework to investigate the characteristics and efficacy of different regulatory mechanisms.\(^{56}\) Global administrative law seeks to examine the normative foundations of global regulations with a more focused objective to investigate whether global regulations suffer from an accountability deficit, and whether insights from state administrative law could ensure greater accountability and legitimacy to global norms.\(^{57}\)

Several of the scholars engaging in these global regulation studies came to consider the “retreat of the state” from many traditional regulatory realms as a defining feature of many national governance systems and also of the global governance system in the 1990s.\(^{58}\) Scholars have offered many explanations as to why this occurred. For example, there was a general understanding that with economic and technological globalization several elements of the


\(^{57}\) In 2004 Benedict Kingsbury, Nico Krisch and Richard Stewart initiated a research project at NYU to investigate whether and how administrative law principles such as transparency, participation, review and accountability, primarily associated to national governance systems, could and should also apply to global governance mechanisms. For a seminal article on the global administrative law project see Benedict Kingsbury, Nico Krisch & Richard Stewart, “The Emergence of Global Administrative Law” (2005) 68 Law & Contemporary Problems 15; for a detailed bibliography of scholarship related to global administrative law until 2005 see “A Global Administrative Law Bibliography” (2005) 68:3/4 Law & Contemporary Problems 357. For more recent scholarly work related to the “global administrative law” research project see IILJ, Institute for International Law and Justice at the New York University School of Law, online: IILJ <http://www.iilj.org/gal/bibliography/default.asp>.

regulatory process that in the past were debated and resolved at the national level had “migrated to international or transnational actors in areas as diverse as trade, finance, the environment and human rights.” A considerable number of scholars concluded that national states had lost regulatory capacity to deal with cross-border issues effectively without the cooperation of other states and, increasingly, without the cooperation of non-state actors.

It is important to note, however, that the role of states in influencing national and global regulation has remained a debated academic topic. There are in fact three main approaches in the global governance literature with respect to how the role of the main actors behind transnational regulations has evolved over the years. Several authors contend that private actors have come to increasingly dominate global governance, while state authority in global regulation has weakened significantly. A second position argues that in fact powerful states still hold the upper hand in influencing global regulation. According to this second view, first the USA, and

59 Walter Mattli & Ngaire Woods, eds, The Politics of Global Regulation (Princeton: Princeton University Press, 2009) at 1; see also Callies and Zumbansen, proposing the use of transnational law as a methodology to investigate global regulation: “The starting observation is that today law has become distinctly and irreversibly transnational”, Callies & Zumbansen, supra note 55 at preface. The global governance literature is concerned with understanding the ways in which changes in the nature of regulation and the globalization of the regulatory process have challenged long-used dichotomies such as public international law versus private international law, or created new dichotomies such as “old governance” regulatory initiatives versus “new governance” regulatory initiatives. There is increasing recognition that the international order has become highly regulated when one takes into consideration the new governance forms that transcend the classic state-centered, top-down mandatory regulation. See for example the literature on regulatory capitalism, inaugurated by John Braithwaite. John Braithwaite, Regulatory Capitalism: How it Works, Ideas for Making it Work Better (Cheltenham: Edward Elgar, 2008).

60 Saskia Sassen argues that the retreat of the state from conventional forms of top down regulation does not constitute a complete retreat from regulation nor the weakening and powerlessness of the state, but rather a seminal change in how states exert authority in the national and global arenas. Saskia Sassen, The Global City (Princeton: Princeton University Press, 2002); Saskia Sassen, Territory, Authority, Rights: From Medieval to Global Assemblage (Princeton: Princeton University Press, 2006). Sol Picciotto also argues that rather than a retreat of the state there was a profound transformation of states’ role in the regulation of the public and private spheres. This process led to a blurring of boundaries between private and public regulation. Sol Picciotto, “Regulatory Networks and Global Governance” (Paper delivered at the WG Hart Legal Workshop on ‘The Retreat of the State: Challenges to Law and Lawyers, Institute of Advanced Legal Studies’ at the University of London, 2006); Sol Picciotto, Regulating Global Corporate Capitalism (Cambridge, UK: Cambridge University Press, 2011). According to Levi-Faur: “Regulation, though not necessarily directly by the state, seems to be on the increase despite efforts to redraw the boundaries between state and society.” Faur, supra note 42 at 12.

61 John Braithwaite and Peter Drahos offer a broad and detailed description of case studies of global business regulation across various issue-areas as evidence that global regulation has so far been a history of domination by Western industrialized states. Although various weaker states and also non-state actors have promoted the creation of transnational regulatory mechanisms, sometimes successfully, the results have been very uneven. Braithwaite & Drahos, supra note 42. This position is also supported by Beth Simmons, who analyzed the evolution of global financial regulation. She shows how in this regulatory issue area the USA has unilaterally decided to use extraterritorial regulation first, while subsequently mobilizing pressure to create transnational mechanisms to
then the European Community, have been by far the most influential actors behind a significant number of global regulations. A third position, advanced by Walter Mattli and Ngaire Woods, among others, calls for a more nuanced approach. They hold that the level of influence by powerful and weak states and also by non-state actors varies across different issue-areas.

According to this more nuanced approach, powerful states may exert disproportionate influence in the design of favorable global regulation in some issue-areas when their stakes are very high, when there is a more pronounced power imbalance among countries and/or when they can more easily start with unilateral regulation and then either disregard divergence or promote global convergence. In all other cases, however, the influence of weaker states, international institutions and non-state actors in the emergence and evolution of global regulation would gain in relevance and become essential to explain regulatory trends. I believe Mattli and Woods’ theory best reflect the wide diversity of global regulatory mechanisms.

The types of global regulation that I intend to analyze in this dissertation fall into Mattli and Wood’s third category where powerful states would not have strong self-interested incentives to build global regulatory mechanisms. Generally speaking, the negative effects of the governance deficit that leads to the resource curse are felt in developing countries themselves. They are the countries at risk of experiencing reverse development outcomes in the long run. The negative effects in Western capital exporting countries are only indirect, such as reputational costs or higher business risks. They do not have a high stake in resolving the governance deficit in resource-rich developing countries. That is, when investigating the emergence and evolution of encourage or coerce foreign countries to adopt similar regulations, in order to counter significant negative externalities to the USA. Beth Simmons, “International Politics of Harmonization: The Case of Capital Market Regulation, (2001) 55 International Organization 589.

Braithwaite and Drahos attribute this disproportional influence to the superior capacity of powerful states to control and use knowledge, and their greater capacity to use coercion mechanisms. Braithwaite & Drahos, supra note 42. Daniel W Drezner, in his influential “All Politics is Global”, also argues that powerful states such as the USA and the European Union still exert disproportionate influence in global regulation. Drezner adds “great power concert is a necessary and sufficient condition for effective global governance.” On the other hand, Drezner argues that the values and interests of international organizations and weaker states, and the values and interests of transnational corporations and non-governmental organizations and epistemic communities can only be translated into global regulatory mechanisms if powerful states’ acquiesce or support. Daniel Drezner, All Politics is Global: Explaining International Regulatory Regimes (Princeton: Princeton University Press, 2007).

Mattli & Woods, supra note 59.
global regulation to deal with the governance deficit in developing countries and its developmental effects, there is a greater need to take into consideration the role played by weaker states and non-state actors. Which strategies are these actors adopting? What are their motivations and their assumptions when choosing some institutional choices over others? How effective have their choices been to date? The global governance literature should offer some guidance as to how to answer these questions.

One shortcoming of the mainstream global governance literature, however, is the fact that, for the most part, it does not differentiate between the global regulation was motivated by a problem that involves high stakes for powerful developed countries, or when the global regulation was motivated by the need to deal with the developmental effects of the governance deficit in developing countries themselves. Global regulations to address climate change or international organized crime, which directly affects Western industrialized states, is discussed jointly with global regulations to address degrading labour in the production of, e.g., rugs, which affects only developing countries directly. Global regulations to encourage sustainable forestry practices or to deal with corruption, which are common concerns in developed and developing countries alike, is analyzed together with global regulations to address conflict diamond production, which affects only resource-rich fragile states directly.

Because the global governance literature is focused on investigating whether and how transnational policy options can contribute to addressing these social and economic problems, independent of where they occur, the specific problem of the acute governance deficit in some developing countries has often been overlooked in the mainstream literature. Yet, there should be a marked difference between devising global regulations to achieve social and economic objectives that escape the regulatory capacity of any single national public institution, and

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64 Degrading labour in developing countries affect Western based corporations only when there is consumer and social pressure that impact on their reputation. There is however a valid argument that business actors may also push for ways to prevent and address degrading labour due to ethical considerations, and not only when motivated by “the business case”. Some business sectors may consider that there are high stakes in addressing this issue resulting from the governance deficit in developing countries. The question remains whether this would count as high stakes for developed countries in international relations parlance.

65 Abbott and Snidal, for example, argue that the plethora of global regulatory standard setting mechanisms that have been created since the 1980s aim to fill perceived gaps in state and international regulation, without qualifying the possible different underlying causes of the national governance deficits. Abbott & Snidal, supra note 45.
devising global regulations to address social and economic problems that exist primarily due to the acute governance deficit in developing countries.  

The most obvious difference is that in the second case one potential strategy for global regulators is to address the governance deficit, instead of focusing directly on solving the social and economic challenges faced by resource-rich, governance-poor countries. The second difference, as mentioned before, is that when the social and economic problems are concentrated mostly in developing countries, Western developed countries will have only an indirect interest in the global regulation of these problems. This requires special analytical attention to the role of actors other than developed countries in explaining the emergence and evolution of global regulations.

Because the mainstream global governance literature does not differentiate between the two cases, however, one cannot find sufficient guidance on how the various external actors have tried to use global regulation to address the specific developmental problems generated by the governance deficit in developing countries.

Due to this lack of analytical nuance, one can only infer some hypotheses on how external actors have approached the question of the governance deficit in developing countries over the years. Although global governance authors do not ostensibly say so, most studies from the 1990s to mid-2000s were noticeably not concerned with investigating whether and how transnational institutional mechanisms could in any way help bridge the governance deficit in developing countries. Most policy actors who examined global mechanisms as potential tools to address social and economic problems in developing countries at this time were adopting the strategy of bypassing, rather than bridging, the governance deficit in developing countries. They were pressing multinational corporations and their capital-exporting home countries to create mechanisms to directly deal with these social and economic problems.  

Because non-state

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66 Or that are greatly aggravated by this deficit. One of the main implications in this case is the potential legitimacy, democratic and accountability deficits of global regulations that are accentuated in the context of acute domestic governance deficits. See supra note 57 on the global administrative law research project.

67 There are some possible explanations as to why several outside actors have apparently decided to focus on regulations to bypass, rather than to bridge, the governance deficit in developing countries as the main regulatory strategy in the global level for such a long time. First, based on the premise that Western industrialized countries and their private interest groups have disproportionate influence in the design of global regulations, one may ask what would be their position towards the best way to address the governance deficit in developing countries. Let us assume that their main motivation was not necessarily to deal with the governance deficit that caused or aggravated social and economic externalities that were primarily affecting foreign societies, and not directly affecting them.
actors were already exercising a similar regulatory role in Western developed countries under the “governance without government” trend, this strategy was assumed either to be unproblematic, or to benefit from insights from the evolving mainstream regulatory debates.

As experiences with national and transnational new governance mechanisms to bypass the perceived governance deficits in national and international law began to accumulate, however, it became evident that they were showing very different results when implemented in Western developed countries than when they were implemented in developing countries. A branch of the global governance literature has thus emerged to understand this divide. I turn to this literature next.

3.3.2. At the forefront: literature confronting the governance deficit

As the implementation of “new governance” forms of regulation intensified, it became evident that their results were mixed in terms of both effectiveness and legitimacy. A central debate emerged as to whether there were pre-conditions for these mechanisms to work effectively, or whether there were issue-areas that were more amenable to this type of regulation than others.

Most relevant for the purposes of this chapter, comparative empirical studies on regulatory practices in the European Union and Eastern Europe showed that horizontal governance mechanisms were “mostly likely to be effective if a strong state looms in the background which

Their goal was simply to respond to the mounting social pressure (consumers, NGOs, investors) that was affecting their “social license to operate” in developing countries. In this case the best option for private Western interest groups was not necessarily to engage in the complicated business of bridging the governance deficit in far away, complex developing societies. Rather, the best option could be to find ways to directly address some of the most egregious social and economic externalities resulting from this governance deficit, thus responding to the reputational costs of doing business as usual. Another factor that may help explain the “bypass over bridge” trend in practice and theory was the fierce political resistance by developing countries to any idea of external institutional mechanisms that would interfere with their sovereignty. The alternative was therefore to avoid the charged political divide that permeated existing international institutions following decolonization and the Cold War, by simply trying innovative mechanisms to directly address some of the worst environmental and social impacts of global production. The bypass over bridge strategy may also have been facilitated by the existence of almost a cartel of capital-exporting countries and their TNCs operating in these governance-poor countries from the 1990s to mid-2000s. These capital-exporting countries and TNCs experienced somewhat similar social and political backgrounds. Under similar or potentially similar levels of social pressure to address the impacts of global production in governance-poor countries, they had more incentives to promote global regulations to directly address social and economic problems in far away governance poor countries, thus levelling the playing field and ensuring fair competition.
sees to it that non-state actors contribute to the provision of collective goods.”

The literature on regulation at the national level has concluded that in developed countries, public and private actors engaged in different forms of hybrid regulation almost always negotiate under a “shadow of hierarchy”. This shadow of hierarchy provides incentives for non-state actors to cooperate to create and implement governance mechanisms. For example, the state threatens – explicitly or implicitly – to impose binding rules or laws on private actors in order to change their cost–benefit calculations in favor of a voluntary agreement closer to the common good, instead of pursuing only their self-interests. Besides, the literature concluded that new governance mechanisms required a minimum level of social demand or market incentives to function efficiently.

Translating this conclusion to the global arena, the GG literature has also acknowledged that supranational regulatory initiatives are only likely to be effective when anchored in the governance capacities of sovereign states. A significant number of studies in the mainstream GG literature in fact implicitly examine the effectiveness and legitimacy implications of the different scales and combinations of “new governance” initiatives when they are employed specifically in the context of one type of state, the strong state.

Despite the fact that the mainstream academic debate on the effectiveness and legitimacy of “new governance” initiatives has remained mostly focused on modern industrialized nation-states, since the second half of the 2000s a group of scholars has begun to investigate the implications of using these governance models in countries lacking this shadow of state

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68 Borzel & Risse, supra note 44.
hierarchy. In other words, there has been a recent separate branch of the literature that recognizes the domestic governance deficit as an important research variable when analyzing the best available regulatory strategy to address a social or economic problem. Part of this new literature is focusing on whether new forms of regulation could work effectively in the case of governance-poor countries, where there is no credible shadow of state hierarchy.

The idea is to explore whether external mechanisms could serve as functional equivalents to the shadow of the strong state hierarchy in governance-poor countries. The question thus becomes what kind of mechanisms could effectively perform this role in societies that present different combinations of governance weaknesses. These studies form part of the emerging sub-set of global regulation studies that are beginning to systematically investigate the interaction between transnational institutional mechanisms and dysfunctional domestic governance systems in developing countries. I discuss these new studies next.

3.4. Global regulation studies and development studies: the nascent intersection

Some of the most pressing social and economic problems generated by the domestic governance deficit in developing countries are fuelling demand for scholarly guidance as to how best to approach this deficit. Development scholars have only very recently started to investigate whether and how global regulatory initiatives might help addressing the governance deficit in developing countries. Meanwhile, global regulation scholars have also initiated investigations on how to adapt existing transnational mechanisms to situations where the shadow of state is missing, that is, when there is a significant domestic governance deficit.

For example, in 2006 Thomas Risse and Ursula Lehmkuhl have initiated a research program at the Freie Universitat Berlin on new modes of governance in what they called “areas of limited statehood”. See the inaugurating working paper for this project: Thomas Risse & Ursula Lehmkuhl, “Governance in Areas of Limited Statehood: New Modes of Governance? The Research Program of the Research Center (SFB) 700” (2006) 1 Working Paper Series 1. The literature on how different regulatory models function in states with significant national governance deficits is still sparse and uncoordinated, with each scholar using a different terminology.

In the research project at Berlin Risse articulates as lead question: “how can effective and legitimate governance be sustained in areas of limited statehood? The idea is to identify the regulatory challenges emerging under these specific conditions. Ibid.

For Borzel and Risse this question should be answered in the positive: both international mechanisms and social norms in the local, national and international levels could serve as functional equivalents to the shadow of the state. Risse & Bozel, supra note 44.
To be clear, the authors of the studies I review in this section seem often to implement this change in analytical perspective, from looking into global regulations as stand-alone mechanisms to how they interact with domestic systems, unreflectively. I argue that their studies constitute a consequential shift in the global governance literature, one that may serve to inform the L&D scholarly efforts to solve the complex puzzle of how to disrupt the equilibrium of dysfunctional governance systems in certain developing countries, enhancing the chances of successful domestic governance reforms. However, they have rarely explicitly or implicitly acknowledged or suggested that this was their intention.

It is also important to note that the emerging studies that I will briefly review in this section are still sparse and scholars are largely working independently from one another. The authors are using concepts that are similar, but not exactly the same. They are also approaching the problems from different perspectives, some of them from a development perspective, some of them from an environmental perspective, some of them from an international security perspective. Finally, these authors do not explicitly acknowledge that they are departing from the mainstream scholarship in their respective academic fields. When one proposes to translate unstated scholarly trends into an analytical theory there is the inevitable risk of generalizing and oversimplifying. I believe, however, that it is important to illuminate these new trends in both development studies and global regulation studies, because they have sufficient explanatory power to help us to understand the recent evolution of foreign policy actors’ strategies for dealing with the chronic governance deficit in developing countries.

A few scholars in both development studies and global regulation seem to be following the insights from the shadow of state hierarchy literature, and examining how transnational mechanisms could help to promote governance reform in developing countries. Stephen Krasner, an international relations scholar, has focused on the almost-failed states, trapped in chronic political chaos and violence, which pose a security threat to other nations, now or in the future. In 2004, Krasner argued that international society (foreign policy actors) needed to transcend conventional rules, such as sovereignty, in order to promote “better domestic governance in
badly governed, failed, and occupied polities.”\textsuperscript{75}

Krasner argued that some countries that enjoy international sovereignty and even Westphalian sovereignty from other states were clearly failing in the sphere of domestic sovereignty. In these cases, Krasner argues, conventional mechanisms available to foreign policy actors – such as governance assistance and transitional administration - are not feasible or sufficient. For Krasner, there is a great need to expand the menu of policy options. He proposes two forms. In the case of completely failed states, such as Somalia, he proposes trusteeships. Trusteeships basically would be a formal recognition by the international society that a specific country had lost international legal sovereignty. Krasner admits that this option is politically unlikely, although he claims it happens in practice.\textsuperscript{76} The second policy option would be what Krasner calls “shared sovereignty”. In his words:

Shared sovereignty would involve the engagement of external actors in some of the domestic authority structures of the target state for an indefinite period of time. Such arrangements would be legitimated by agreements signed by recognized national authorities.\textsuperscript{77}

While the principle of autonomy in international affairs would be compromised, the country would still exercise its sovereignty by signing the voluntary agreement, and by being able to exit at any time. Krasner cautions that a better expression, for political and policy purposes, may be to call these arrangements “partnerships” instead of shared sovereignty. In other words, Krasner is advocating the creation of international mechanisms to serve in the domestic scenario as

\textsuperscript{76} The most substantial barrier to a general international treaty codifying a new form of trusteeship or protectorate is that it will not receive support from either the powerful, who would have to implement it, or the weak, who might be subject to it. \textit{Ibid.}
\textsuperscript{77} Krasner, “Sharing Sovereignty”, \textit{supra} note 75, at 108. A polemic idea based on the same concept of shared sovereignty and temporary external governance of specific regulatory domains in a foreign governance-poor country was introduced by economist Paul Romer with his charter cities’ project. Romer argues that governance-poor developing countries should explore the option of creating new cities from scratch, in previously uninhabited pieces of land. The new inhabitants of these new cities would accept to abide by a series of governance rules under a charter, which would be monitored and enforced by external authorities. The idea is that these well-governed charter cities would attract foreign financial and human capital and spur development within these countries, hopefully having a spill over effect in other parts of the country over time. For information on the charter cities project see Charter Cities, \textit{Charter Cities}, online: <http://www.chartercities.org/>; See Kee-Cheok Cheong, “Charter Cities – An Idea Whose Time has Come or Should Have Gone?” (2010) 47:2 Malaysian Journal of Economic Studies 165; Barrett Sheridan, “The Best Development Plan in the World Originated With … The British Empire?” \textit{Newsweek} (12 August 2009); See Rory Sutherland, “More Canada” \textit{The Spectator} (12 May 2012).
functional equivalents to missing governance systems, maybe permanently. Krasner does not explore how exactly these external bypass mechanisms would interact with embryonic domestic governance systems or even whether they potentially could be designed in a way to foster the creation of a self-sufficient domestic governance system over time.

In his 2009 book *Wars, Guns and Votes*, development economist Paul Collier asks why, despite a large turn to formal electoral democracy amongst developing countries, several of the world’s most impoverished countries (that he calls the “bottom billion” in his 2008 book) are still not showing evidence of real economic or political development. His conclusion is that when only cosmetic political and economic reforms are undertaken by developing countries with weak domestic governance systems, the result is increased political violence, social instability and widespread poverty. Collier argues that the bottom billion countries will not escape this political violence trap by themselves, or even with conventional external development assistance focused on promoting governance reform. The reason is that these countries lack basic political security and governmental accountability that are pre-conditions for governance building. Collier also does not believe that top-down international treaties are the best way forward, at least initially.

Like Krasner, Collier argues that these complex cases require a complete rethinking of the concept of national sovereignty. In the case of countries experiencing chronic political violence, Collier’s proposed solution is to use foreign mechanisms to provide security and accountability, until the bottom billion countries can escape the political violence trap. Collier is therefore also proposing that transnational mechanisms be used as domestic functional equivalents to the missing domestic governance structures that provide security and

78 Krasner argues: “external efforts to influence the authority structures of other states is arguably the central foreign policy challenge of the contemporary era”. Krasner’s research interests are not necessarily focused on how to improve development outcomes in those countries *per se*, but rather how to manage the risks they pose to global security, since they may become havens for terrorists, drug traffickers and other forms of organized crime. In these cases one may argue that influential developed countries may have more incentives to discuss and promote global regulation. A different question arises if one is focusing on governance-poor countries that do not present this global threat. Their threat is primarily to their own societies and to their own environment. How would transnational cooperation to create mechanisms to serve as functional equivalents to the shadow of the state occur in these cases? Krasner, *supra* note 75.


80 Collier, *Wars, supra* note 79; Collier, *Bottom Billion, supra* note 79.
accountability, which he argues are pre-conditions to building further political governance systems. In other words, he suggests a temporary bypass for the missing domestic institution. Collier does not detail, however, how exactly these external governance mechanisms would open the way to domestic equivalents over time.

Other scholars are already posing this question of what are the potential feedback effects of existing global governance mechanisms – which are far less intrusive in countries’ sovereignty -- in the dysfunctional domestic governance system in developing countries. In his 2009 article “Does the Globalization of Anti-Corruption Law Help Developing Countries?” L&D scholar Kevin Davis analyzes whether the emerging transnational anti-corruption regime formed by international conventions and home-country anti-bribery regulations are affecting corruption levels in developing countries. Davis does not explore, however, the potential positive feedback effects of these mechanisms on domestic governance reforms. Yet Davis includes a brief discussion of potential ways in which these transnational anti-bribery norms may have unintended effects. He suggests that if these norms try to bypass or replace the domestic system, they may undermine incentives to strengthen domestic governance mechanisms to fight corruption in developing countries.

Also in 2009, David Brown, a social anthropologist and senior researcher at the think tank Overseas Development Institute, made a critical assessment of the European Union’s growing practice of using demand-side pressures such as “Voluntary Partnership Agreements (VPAs)” in their bilateral trade agreements with forestry-rich and governance-poor countries. Brown argued that VPAs had the objective of promoting governance reform in forestry-rich and governance-poor countries. Brown found mixed results. On the one hand, he saw the potential of VPAs to encourage the development of mandatory forestry standards in the long run. He also saw potential for the mechanism to reduce the volume of illegal timber in the international market, and to improve transparency in the international forestry sector. However, based on his field analysis, Brown was more skeptical about the impact of VPAs in terms of encouraging domestic governance reform by developing countries.

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Some of the new literature on the interface between transnational mechanisms and domestic governance deficits in developing countries is aimed at finding possible solutions to the resource curse conundrum. In his 2010 book *The Plundered Planet*, Paul Collier builds on his earlier argument about the lack of capacity of some governance-poor countries to escape some development conundrums without external help. This time Collier addresses the case of resource-rich and governance-poor countries trapped in the resource curse. Collier explains that while resource-rich countries need good governance more than resource-poor nations, the very existence of abundant resource rents makes it rather difficult to “build the needed institutions [...]”\(^8^2\)

In *The Plundered Planet*, Collier is more evasive than he was in *Wars, Guns and Votes* on how external actors can approach the problem. He advocates the creation of a natural resources charter to guide good governmental decisions, for increased transparency in the extractive sector, and for developing a critical mass of informed opinion through social networks and social pressure. This charter, which includes 12 principles to guide the sound management of natural resources, has in fact been created in 2009 by a group of independent development experts.\(^8^3\) Collier has not explained whether, and exactly how, soft law mechanisms such as the charter would fulfill the role of missing governance systems, and how they would interact with attempts to promote domestic governance reform.

In 2011, Gilles Carbonnier, Fritz Brugger and Jana Krause assessed several voluntary multistakeholder initiatives created to deal with the resource curse and influence development outcomes in resource-rich but fragile states, with special emphasis on the Extractive Industries Transparency Initiative (EITI), a transnational public private partnership that I will discuss in chapter 6.\(^8^4\) The authors analyze the behavioral pathways, including market incentives and regulations, which may influence the decisions of public and private actors. They argue that the main pathway in which EITI is expected to influence the domestic balance of power in developing countries is through the encouragement of civil society participation in governance.

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83 See website of the Natural Resources Charter project online: http://naturalresourcecharter.org/
systems. The authors conclude that in many instances civil society is still not strong enough to live up to these expectations.

Each of these authors still needs to focus on the positive or negative feedback effects of the potential international mechanism they are analyzing in dysfunctional domestic governance systems in resource-rich countries. This is a very important research agenda, which is still nascent. One needs also to acknowledge that the feedback effects may run the other way, with domestic regimes affecting or influencing global regulatory mechanisms. In sum, there is much work to be done to understand the mechanisms according to which non-domestic and domestic instruments interact and how we can make better use of international and transnational mechanisms to promote domestic reforms.

In the specific case of a complex problem such as the resource curse, the analysis of the feedback effects of one global mechanism in isolation from other existing ones may not be sufficient. The resource curse results from a governance deficit that has developed over time, and has become entrenched. As a consequence, dealing with the deficit requires modifying multiple aspects of a country’s governance system that not only are interconnected with each other, but also are sustained and maintained through feedback effects with social-historical and cultural aspects of a particular country. Besides, rent-seeking behavior associated with the significant rents that characterize a resource-led economy is a major contemporary obstacle to any type of governance reform in these countries. This multi-faceted and interconnected aspect of the governance deficit problem in resource rich countries makes it rather unique. This uniqueness is characterized by a level of complexity that defeats any attempt to try to identify a single point of departure for reforms, or to conceive how to strategically design an effective way of tackling the problem.

3.5. Conclusion

The starting point of this dissertation is that the lack of good governance in resource-rich countries is an intractable problem. In order to address such an intractable problem there is a need to consider, simultaneously, the full constellation of potentially appropriate mechanisms that could be combined on a “policy mix” to provoke feedback effects in a stable dysfunctional governance system in a certain resource-rich country. By initiating a wide range of global regulatory mechanisms, reformers are opening up the possibility for different countries to benefit from different mechanisms, depending on their own particular circumstances. In other words,
some instruments might prove effective in one resource-rich country, but not in another. Moreover, some instruments may prove more effective in combination in certain cases. Thus, instead of trying to decide which problem to tackle first, and which mechanism is more effective to tackle a certain governance problem, reformers should create options that reformers inside those countries can use or not, depending on their own circumstances and judgment.

The assumption that bridging the governance deficit in resource-rich and governance-poor countries is an intractable problem explains why this dissertation is not focused on one specific mechanism. Instead, the following chapters will seek to advance the idea that a better understanding of the possible ways of dealing with these countries’ governance deficits requires a full picture of the menu of options available to them. What has been the evolution of external attempts to deal with the resource curse? What is the range of policy options available to create feedback effects on dysfunctional domestic governance systems? How did they come into being? What were the assumptions of the actors behind their creation? How are they being used? In trying to answer these questions this dissertation suggests where the research on L&D should focus in the future, if it seeks to tackle effectively the problem of the resource curse in developing countries.
Chapter 4
Global Regulatory Mechanisms and Domestic Governance Reform: An Overview

4.1. Introduction

Promoting governance reform through development assistance has proved especially intractable in resource-rich developing countries, as discussed in chapter 2. In addition to path dependence, these countries also face a significant contemporary obstacle to reform: rent-seeking behavior. While the previous chapter focused on the academic literature dealing with these problems, this chapter will discuss which potential global regulatory mechanisms policy actors may use to address these problems on the ground. Besides development assistance, are policy actors using any other global regulatory mechanism to influence the process of domestic governance reform, thus helping resource-rich developing countries to overcome these obstacles? If they are, which institutional types of global regulation are they choosing, and why? These are the three questions that this chapter tries to answer.

I argue that policy actors have expanded the menu of institutional types of global regulation used to influence domestic governance systems, including extraterritorial regulations and soft law mechanisms not conventionally used for this specific goal. To develop this argument, the chapter will be structured as follows. Section 2 presents a typology of global regulation mechanisms, which is partially based on a typology used in the academic literature. My analysis, however, proposes a more nuanced distinction to better capture the dynamic evolution of global regulation. Sections 3 and 4 present this modified typology. Section 5 discusses how policy actors are now using extraterritorial home-country regulations and soft law public-private partnerships to promote governance reform.

4.2. Global regulatory mechanisms: a typology

Global regulatory mechanisms are extremely diversified in terms of their objectives, the subjects
they intend to regulate, and their institutional type.\(^1\) Although there is already a rich literature investigating the different institutional types of global regulatory mechanisms, Benedict Kingsbury, Nico Krisch and Richard Stewart rightly emphasize that there is still much work to do before we can fully understand all the nuanced characteristics of existing and emerging global governance mechanisms, which makes this topic a relevant area for future research.\(^2\)

Kingsbury et al offer a contribution to this research agenda by systematizing global governance mechanisms in three main categories, according to the subjects they intend to influence and the objectives they seek to achieve:

1) Global regulations intended to influence how states behave towards other states;

2) Global regulations intended to influence the behavior of private actors (individuals, NGOs, companies); and

3) Global regulations intended to influence how states behave towards distinct groups of individuals, private market actors or social interests.\(^3\)

Although the typology of global regulatory mechanisms according to their targeted subjects offered by Kingsbury et al was only intended as an initial exercise, and is still not fully developed, I believe it offers a helpful framework to investigate which institutional types of global regulatory mechanisms may be used to influence the reform of dysfunctional domestic governance systems in resource-rich countries.

The global regulatory mechanisms to address the weak governance curse seek to influence state behavior towards its social interests in its own territory, and would therefore fall into the third

\(^1\) Benedict Kingsbury, Nico Krisch and Richard Stewart, “The Emergence of Global Administrative Law,” (2005) 68 Law & Contemp Probs 15. For scholarly work related to the “global administrative law” research project see the website of the Institute for International Law and Justice at the New York University School of Law, online: http://www.iilj.org/gal/bibliography/default.asp.

\(^2\) Kingsbury et al, supra note 1.

\(^3\) For Kingsbury, Krisch and Stewart there are many different frameworks that may facilitate further inquiry in this area. They also discuss, for example, another typology of global administration mechanisms according to who is the primary source of regulatory authority: formal international organizations; transnational networks of national officials; distributed administration officials implementing global administration in the national level; hybrid intergovernmental-private schemes; and private institutions. Kingsbury et al, supra note 1.
category as proposed by Kingsbury et al. Yet, in order to identify more accurately which global mechanisms may be relevant to achieve this specific purpose, I argue that we need to divide this category into two different sub-categories, according to the relationships the global mechanism intends to influence. Some global regulations seek to primarily influence the relationship between the state and its own citizens (e.g. human rights treaties). Some regulations seek to influence the relationship between the state and any actor (national or foreign) that may be affected by its domestic governance system (e.g. World Bank mechanisms to promote “good governance” or environmental standards). The focus of this dissertation is on global regulations falling into this second sub-category. Table 4.1 represents the typology I am proposing:

Table 4.1

<table>
<thead>
<tr>
<th>Subject</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) States</td>
<td>- To influence the behavior of states towards other states</td>
</tr>
<tr>
<td>2) Private actors</td>
<td>- To influence the behavior of private actors</td>
</tr>
<tr>
<td>3) States</td>
<td>- To influence the behavior of states in their own territory:</td>
</tr>
<tr>
<td>3.1)</td>
<td>- To influence the behavior of states towards their own citizens</td>
</tr>
<tr>
<td></td>
<td>(e.g. human rights treaties)</td>
</tr>
<tr>
<td>3.2)</td>
<td>- To influence the behavior of states towards any actor, domestic or foreign</td>
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Any typology is ultimately an arbitrary simplification of complex realities. I recognize that the boundaries between the different categories, and especially between the two sub-categories I am proposing, are blurred in practice. Human rights norms such as labour rights, for example, may also benefit foreign corporations operating in that country. This working typology is intended to shed light on the particular characteristics of global regulations to promote governance reform for development, which seek to influence how states construct domestic systems that will ultimately directly affect not only their own populations, but also any foreign public and private actors that are subject to the effects of state regulatory actions within that state’s jurisdiction. Making this distinction is important in order to understand exactly what types of global mechanisms are potentially available in this category, which of those mechanisms are effectively
being used, and why.

In order to provide a full picture, I will briefly sketch the two first categories of global regulation according to their target subjects as proposed by Kingsbury et al – those intended to influence how states behave towards each other, and those intended to influence private behavior (section 3), before proposing that the third category should be sub-divided (section 4).

4.3. Global regulation to influence inter-state behavior or to influence private actors

Traditionally, global regulation was equated to hard international law mechanisms designed to influence the behavior of states towards each other, or to facilitate inter-state cooperation. States were the only subjects of traditional international law. A contemporary definition of global regulation now includes both international law in its modern embodiment – law that deals with the conduct of states and of international organizations, as well as with some of their relations with private actors - and private and hybrid forms of regulation. Yet the goal of influencing how states coexist and cooperate with each other remains the primary objective of a substantial part of global regulation through international law.

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4 I use traditional international law here to mean the set of legal rules that emerged in the seventeenth century, after the Peace of Westphalia, to be used as instruments to regulate the behavior of sovereign states towards each other or to facilitate inter-state cooperation. This system lasted until the end of WWI, which saw the creation of the modern system of international law. See Antonio Cassesse, *International Law in a Divided World*, (Oxford: Clarendon, 1988). Some authors rightly argue that a series of non-state global regulatory mechanisms (known as “the Law Merchant” or “Lex Mercatoria) were in place since the eleventh century, therefore before traditional international law existed, to influence the behavior of private merchants towards each other. Yet, by the seventeenth century states’ domestic legal systems had evolved to exert regulatory authority over both domestic and transnational business activities, and states had gained sole authority to regulate global affairs. See Bruce L. Benson, “The Spontaneous Evolution of Commercial Law” (1989) 55:3 Southern Economic Journal 644. As sovereignty -- meaning the exclusive control of public and private activities occurring within (or affecting) a delimited geographic area -- became the most important diffuse principle in international relations, states became the primary regulators of private actors under their jurisdiction. Stephen Krasner, “Structural Causes and Regime Consequences: Regimes as Intervening Variables” (1982) 36:2 International Organization 185, at 18. For a detailed history of traditional international law see Arthur Nussbaum, *A Concise History of the Law of Nations*, revised ed (New York: Macmillan, 1954). For a contemporary critical analysis of the origins and expansion of international law see Martti Koskenniemi, *The Gentle Civilizer of Nations: The Rise and Fall of International Law, 1870-1960*, (Cambridge; New York: Cambridge University Press, 2001).


6 Buergenthal & Maier, *supra* note 5 at 2.
In this category we find past and contemporary global mechanisms designed to regulate warfare and international security, for example. We also find the various global regulations which are designed to facilitate the coordination of activities, or the resolution of problems, that have cross-border or global effects, in areas as diverse as international communication, transportation, environment and commerce, to name a few. In all of these cases the objective of the global regulation is clearly to influence states’ behaviour that impact other states’ interests.\(^7\)

Immediately after WWII an international consensus formed over the need for a significant overhaul of international law and international relations in order to help mediate political and economic conflicts and promote peaceful settlements. Under the leadership of the new hegemonic power, the United States, the international community proceeded towards the increasing institutionalization of international law and international relations as the main framework to regulate cooperation among nation-states.\(^8\) This movement led to the creation of global institutions such as the various United Nations agencies, regional institutions such as the European Union and the Organization of American States, and multilateral institutions such as the OECD.

The same can be said of specialized global or regional institutions to facilitate cooperation in certain specific issue areas such as the GATT and later WTO to facilitate international trade, and NATO to defend national security. Inter-state global regulations created under the auspices of

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\(^7\) In this chapter I will often conflate the term international law with global regulation, since many international law authors have recognized global regulatory mechanisms that are not state-centered as part of the broad contemporary international law umbrella.

\(^8\) John Ikenberry offers a compelling theory of why the United States has opted to pursue a strategy to promote the creation of formalized inter-governmental institutions of an unprecedented nature and in such a systematic way. He traces the move to international institutions to an earlier period. He argues that since the Vienna settlement among European powers in 1815 (which set the boundaries of that continent after Napoleon’s defeat), followed by the settlement of World War I in 1919, and the settlement of World War II in 1945, “leading states made increasingly elaborate efforts to institutionalize the postwar security relations between the major powers. Rather than simply relying on balance-of-power strategies or preponderant power, they sought to restrain power, reassure weaker potential rivals, and establish commitments by creating various types of binding institutions”. The fact that the USA exercised such an asymmetric dominance over all other states in 1945 made it appealing for this hegemonic country to trade its immense raw military and economic power for a beneficial set of institutionalized rules that would lock in its economic and political advantages in a more long-term and legitimate way. Its immense dominance has also facilitated the concretization of this strategy. For weaker states, the idea was appealing as well, since it appeased fears of raw dominance or abandonment by the only superpower. John Ikenberry, *After Victory: Strategic Restraint, and the Rebuilding of Order After Major Wars* (Princeton, Princeton University Press, 2001), Chapter one, the problem of order, at 8. See also David Kennedy, “The Move to Institutions”, (1987) 8:5 Cardozo L Rev 841.
multilateral institutions still prevail in the areas of warfare, international security, trade and diplomatic relations, for example. This is also the case with regard to various inter-state regulations whose object is to coordinate the way states manage problems that have cross-border or global effects, such as the Convention on the Law of the Sea, or the 1992 UN Framework Convention on Climate Change (UNFCCC). Another example is the international regime formed by principles and international treaties designed to ensure the protection of foreign nationals against state abuse. In sum, after WWII multilateral treaties and international institutions became the conventional form of global regulation to influence the behavior of states towards each other, or to facilitate inter-state cooperation to protect and promote states’ interests.

Despite this move to multilateral institutions, states did not relinquish the use of bilateral treaties as another traditional form of global regulatory mechanism to coordinate inter-state behavior towards shared goals or interests, or to protect their own self-interests. One example is the plethora of bilateral disarmament agreements signed during the Cold War, followed by arms control agreements and, more recently, non-proliferation agreements. Sometimes states resort to bilateral treaties when the multilateral avenue does not offer a feasible option to defend their interests. For example, there has been a proliferation of bilateral investment treaties (BITs) and preferential trade agreements, despite the multilateral apparatus created to facilitate trade and investment. Kenneth Vandevelde argues that the first bilateral investment agreements were signed by European states and “were dedicated exclusively to the protection of investment”, since facilitation of trade and free investment flows was already being negotiated under GATT

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and later WTO. European countries, and later the USA, resorted to BITs after attempts to create multilateral mechanisms to directly protect foreign investors proved politically impossible.

Global regulations have long expanded beyond the goal of influencing the behavior of states towards each other. As Kingsbury et al emphasize, today there are also global regulatory mechanisms with the objective of directly influencing the behavior of the same subjects of domestic law, namely private individuals and private collectivities such as corporations. These mechanisms come in many forms: inter-state international mechanisms, private mechanisms and hybrid public-private mechanisms. Exceptionally, a few international mechanisms directly regulate private actors. One example is the Kyoto Protocol’s Clean Development Mechanism (CDM), which directly certifies corporate projects that reduce emissions. However, the use of international treaty law to directly regulate private actors is still very limited, and it does not totally circumvent the need for host states’ implementation measures to take effect. States have strongly resisted the idea of expanding the scope of this type of regulation, preferring to retain the authority to regulate private entities at the domestic level, as proven by the failed attempts to create international treaty mechanisms to directly regulate transnational corporations. When

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14 Kingsbury et al supra note 1.

15 The Kyoto Clean Development Mechanism (CDM) has a voluntary nature, only applying to those companies that accept to participate. The incentives for corporate participation are the possibility of reducing carbon emissions at a lower cost in certain countries, and earning credits that can offset their obligations to reduce emissions at a higher cost in other countries where they operate. Axel Michaelowa & Frank Jotzo, “Transaction Costs, Institutional Rigidities and the Size of the Clean Development Mechanism” (2005) 33 Energy Policy 511.

16 The Kyoto CDM, for example, has to be approved by the host institutions. Michaelowa & Jotzo, supra note 15.

states undertook initiatives to influence corporate behavior, they were in the form of voluntary guidelines, in contrast to binding inter-state multilateral and bilateral treaties to influence state behavior towards each other.  

Since the 1980s there has been a mushrooming of types of global mechanisms other than international treaty law to directly regulate private actors. These include corporate codes of conduct such as Body Shop’s Community Trade initiative to help protect labour rights and the environment, NGO-sponsored standard-setting mechanisms such as Amnesty International’s Human Rights Principles for Companies, NGO-Firms joint certification initiatives such as the Forest Stewardship Council, and public-private partnerships such as the Apparel Industry Partnership’s Agreement. For some this movement was a result of the political economy obstacles of creating direct international law mechanisms to influence corporate behavior, while for others it is a result of states’ lack of capacity to effectively regulate corporate activity in a complex world, especially when this activity occurs across borders. Whatever the reason, the fact is that today there are various types of global regulatory mechanisms designed with the objective of promoting global standards to influence how private actors such as corporations


The most famous examples being the OECD Guidelines for Multilateral Enterprises and the Basle Principles on Money Laundering Practices.


behave when participating in transnational activities. The other option is for a state to use extraterritorial jurisdiction to regulate the activities of its transnational corporations operating abroad, such as in the case of the USA Foreign Corrupt Practices Act (FCPA). There have been increasing calls for home-countries extraterritorial regulations to play a more active role in influencing the behavior of multinational corporations operating in host countries with weak governance systems.

It is important to emphasize that many global mechanisms have been designed to influence the way national states regulate private actors’ behaviour under their jurisdiction. In these cases private actors are indirect, not direct subjects of global regulation. One example is the Vienna Convention for the Protection of the Ozone Layer and its Montreal Protocol, which requires states to enact domestic measures to control, limit, reduce or prevent private activities that may affect the ozone layer. Another example is the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs Agreement) under the WTO, which requires states to adopt international norms to protect holders of intellectual property rights. Indeed, a fair number of contemporary international treaties are designed with the objective of encouraging states to adopt domestic measures to regulate private behavior, and to facilitate inter-state coordination for that purpose, such as the OECD Anti-bribery Convention. However, because these global mechanisms seek to influence state behavior within its own territory, they fall into category 3, which I discuss next.

4.4. Global regulation and state behavior within their own domestic sphere: two sub-categories

According to Kingsbury et al, besides global regulations aiming to influence how states behave

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24 See, e.g. Georgette Gagnon, Audrey Macklin and Penelope Simons, arguing that at least in respect to fundamental human rights there is a moral obligation or moral right for home states to act in order to prevent – or demand accountability from - their corporations perpetrating or being complicit in human rights violations abroad. Georgette Gagnon, Audrey Macklin and Penelope Simons, Deconstructing Engagement: Corporate Self-Regulation in Conflict Zones – Implications for Human Rights and Canadian Public Policy (Ottawa: Social Sciences and Humanities Research Council: Law Commission of Canada, 2003).
25 Kingsbury et al, supra note 1.
27 Kingsbury et al, supra note 1.
towards each other, and global regulations aiming to influence how private actors behave in the transnational space, there are also global regulations aiming to influence how states behave towards distinct groups of individuals, private market actors or social interests within their own domestic jurisdictions. Until WWII there was virtually no global regulation in this category. The principle of state sovereignty, meaning that states have final authority to regulate their domestic affairs, was considered the fundamental principle of international relations. During the critical juncture after WWII, besides other seminal changes in international law and relations such as the move to formal multilateral institutions, the concept of sovereignty experienced a significant transformation. Issues that up to that point were considered exclusive domestic problems of sovereign states came to be considered legitimate concerns of the international community. This opened the way for the existence of a third category of global regulations: to influence the behavior of states within their own territories.

I propose that this category should be divided in two sub-categories: global regulations to influence how states behave towards their own individual citizens specifically; and global regulations to influence how states interact with any private and public actor, national or foreign, in their own territory. In this section I argue that despite their similarities, these two sub-categories are distinguishable and have evolved in different ways over time.

### 4.4.1. Influencing the relations between states and their own citizens

After WWI socialist policy actors reacted to the deterioration of workers’ conditions by promoting international conventions to protect minimum workers rights, and an international organization, ILO, to promote those rights. Faced with the mass abuses and mass murders of

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28 One exception was the treatment of national citizens by foreign states, which was regulated by international conventions, but this can be seen as global regulations influencing the behavior of states towards other states. On a discussion of different aspects of sovereignty, see Stephen Krasner, *Sovereignty: Organized Hypocrisy* (Princeton: Princeton University Press, 1999).

29 In fact international human rights laws protect the rights of each and every individual from state abuse and neglect, independent of her/his nationality. While nationality is relevant under the law of state responsibility, it is irrelevant under human rights law. Describing human rights norms as instruments to influence the behavior of states towards their own citizens has been used to emphasize the fact that this new set of inter-state laws was different from earlier concepts of international law, which treated domestic affairs as exclusive sovereign domains of host states. Anne-Marie Slaughter & William Burke-White, “An International Constitutional Moment” (2002) 43 Harv Int’l LJ 1 [Slaughter & Burke-White, “Constitutional”]. Other seminal change that the human rights regime provoked in traditional international law was to recognize individuals as subjects of international law, to give a voice for NGOs and social movements at the international stage, etc. David Kennedy, “Reassessing International Humanitarianism: The Dark Sides”, at Anne Orford, *International Law and its Others* (Cambridge: Cambridge University Press 2006).

30 Cassesse, *supra* note 4. Trebilcock and Howse argue that the notion of using international labour standards to protect workers rights has an even earlier pedigree, having first been advanced by European social reformers in the
ethnic and religious groups during the Nazi rule in Germany but also elsewhere, the Allies promoted the creation of an international regime that had the main objective of influencing how states behave towards the human rights of their own citizens.\textsuperscript{31} This regime was based on multilateral treaties that created international human rights and humanitarian standards, and international organizations to uphold these standards.

Human rights treaties identify a set of clear prohibitions on government behavior as related to a series of civil and political rights, as well as a set of positive aspirations toward economic, social and cultural rights.\textsuperscript{32} When human rights treaties were first created the idea was that even when states accepted being bound by international human rights treaties, they would remain in charge of implementation at the national level. There was therefore a compromise between states’ sovereignty in their own territories and the concerns and values of the international community.\textsuperscript{33} Human rights treaties inaugurated the practice of using international law to affect domestic governance systems in sovereign states through encouraging states to internalize sound governance standards in specific human rights areas.

Over time, states have agreed to create international enforcement mechanisms to ensure compliance with human rights norms, with various levels of intrusiveness of international laws in the domestic sphere of states. Some human rights enforcement mechanisms merely require states

\begin{footnotesize}
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\item first half of the 19\textsuperscript{th} century. They argue that earlier concerns with labour standards were rooted in international trade competition. Robert Howse and Michael J. Trebilcock, “Trade Policy and Labour Standards”, (2005) 14 Minn J Global Trade 261.
\item The international human rights regime is normally described as the advent of international rules to protect the rights of individuals against the abuse or neglect from their own state. For the purposes of this chapter, however, I emphasize that the subject of the regulation is the state, and the objective is not to regulate inter-state behavior, but behaviour of the host state within their own territory.
\end{itemize}
\end{footnotesize}
to regularly report on national measures to comply with the treaty. In other cases there are human rights courts that can receive individual complaints and require states to pay compensation for victims of human rights violations and to adopt policy measures to prevent similar violations in the future. Yet human rights treaties enforcement mechanisms are still not coercive in the same way as domestic legal systems, working through moral and political pressure instead.

There is a second way in which international human rights law has opened the way for global regulations to affect states’ behavior in their own territory. When multilateral treaties create autonomous bodies to gather information received from governments and from private actors, to produce investigations, analysis and reports, and to receive complaints and adjudicate conflicts related to a sovereign country’s misconduct against its own citizens, it potentially causes positive feedback effects in domestic systems. Examples are UN human rights committees and courts, which have allowed civil society organizations and opposition groups to make certain illegitimate state practices visible; to open domestic political spaces for discussions and participation that were previously closed; and to gain domestic political leverage they did not have before.

Extraterritorial regulations have also been used to influence the behavior of states towards the human rights of their own citizens, although less often. The United States has for example used its trade laws to impose trade sanctions on countries that show a persistent pattern of violations of workers rights. 34

4.4.2. Influencing the relations between states and all actors affected by their domestic governance system

In their typology of global regulatory mechanisms Kingsbury et al argue that World Bank regulations, which apply conditionalities to development assistance in order to promote good governance and rule of law in developing countries, are examples of regulations falling into the category of global mechanisms to influence how states behave towards distinct groups of individuals, private market actors or social interests within their own territory. 35 While it is true that good governance is expected to affect market actors and promote social interests of host countries, global regulations to influence governance reform for development are different from

34 Trebilcock & Howse, supra note 30.
35 Kingsbury et al, supra note 1.
regulations to protect the rights of a country’s citizens in several ways.

First, governance reform for development potentially reaches a broader number of actors that may be affected by the domestic governance system of a given country. These actors can be citizens of the host country, domestic private actors, but they can also be foreign investors. Second, there are important variations in the institutional types of global regulation commonly used in the two sub-categories, as will be discussed in section 5. Third, while a general consensus over many human rights norms have existed for several decades, the growing consensus on the important role of domestic governance systems in fostering national development and global security and welfare has been more recent and it is still more contested than most human rights norms. Consequently, it is possible that host states that stand to lose by compromising their sovereignty while adhering to global regulations in this sub-category may offer more resistance than in other less contested fields.36

While there has been no scholarly discussion on the difference between these two sub-categories, some scholars have recognized that recent types of global regulation are interacting with domestic governance systems in ways that are different from international human rights norms. Anne-Marie Slaughter, for example, argues that while traditional international law was designed to influence the behavior of states towards each other, and modern international law expanded to also influence the conduct of states toward their own citizens, today “international legal rules seek actively to shape not only domestic law but also the domestic political environment to enable and enhance domestic government action.” Slaughter argues that these new international rules are “far more invasive and potentially at least, far more transformative” than the norms that arise from the international human rights regime created post WWII.37 In a similar fashion Francis Fukuyama argues: “[T]he issue of how to promote governance of weak states, improve their democratic legitimacy and strengthen self-sustaining institutions [has] become the central project of contemporary international politics.”38

36 It is true that human rights norms may also benefit foreign citizens and investors, as for example when improvements in human rights in one country prevent flows of political or economic refugees to other countries, or when improvements in labour rights benefit transnational corporations operating in that country. It is also true that some human rights norms are still highly contested, as the case of some economic and social rights. As I mentioned previously, in practice the boundaries of these two sub-categories are blurred, and some mechanisms can overlap the two sub-categories. Still, I believe that for analytical purposes it is important to make this distinction in order to better understand the variation of global regulatory types.
37 Slaughter & Burke-White, “Future”, supra note 32.
Both Slaughter and Fukuyama argue that global concern with the domestic governance deficit in many developing countries is rising because today’s security threats are no longer limited to the behavior of rogue states that should be constrained by conventional inter-state regulations. Today’s security threats are increasingly intrastate in origin, and only strong domestic governance systems would be able to address these challenges. For these authors, policy actors are creating global regulations to influence how states behave within their own territories in order to address the increasing domestic roots of the most serious contemporary global problems.

I argue that these authors are revealing only one part of the puzzle. The converse is also true. The roots of some domestic problems such as the resource curse are to be found not only at the national level, but also embedded in international systems (in this case in the transnational economic exploitation of mining, oil and gas). The implication is that to offer an effective response to domestic challenges that have international roots, such as the weak governance curse in resource-rich countries, domestic and foreign actors could potentially harness global regulatory mechanisms in pursuit of domestic objectives.

The starting point of the second part of this dissertation is the proposition that domestic and foreign policy actors are already harnessing global regulatory mechanisms to pursue the objective of addressing the weak governance curse in resource-rich countries. In section 5 I investigate which institutional types of regulation are being used for this goal, and why.

4.5. The choice of unconventional types of global regulation to promote domestic governance reform

International relations scholars have studied the behavioral phenomenon known as “forum shopping”, meaning the practice of state and non-state actors employing strategic selection of global regulatory mechanisms from among a menu of available options, in order to advance their policy objectives. IR scholarship seeks to explain when, why and how policy actors use forum shopping, and which are the consequences of this practice for policy making. Joseph Jupille and Duncan Snidal have recently expanded the concept of “forum shopping” under a new name:

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39 A narrow definition of forum shopping from legal scholarship considers it as the strategic selection from a menu of available judicial jurisdictions. Here I use the broader definition from institutional international relations, where “forum” or “venue” includes institutions where rules are negotiated and designed, besides potential implementation mechanisms. Antonio Ortiz Mena, "Forum-Shopping in International Trade: A Tradeoff between Scope and Flexibility? Evidence from the Mexican Case" 101st Annual Meeting of the American Political Science Association, Washington, DC, 2005.
“choice of international institutions”.

For Jupille and Snidal, when existing institutional mechanisms to address a certain cooperation problem in the global arena are not conducive to advancing their policy objectives, policy actors are inclined to: a) promote changes in existing institutional venues so they can serve as tools to advance their policy objectives; b) create new institutional arrangements more closely aligned with their policy objectives.

In fact, policy actors make strategic choices among global institutional mechanisms to influence the different subjects and to pursue the different objectives discussed in section 2, not only to address cooperation problems. Policy actors also make strategic choices among global mechanisms to influence private behavior and to influence states behavior within their own territory. This is possible because the various institutional types of global regulation such as treaty laws, soft law mechanisms and extraterritorial regulations are malleable, and their use to influence specific subjects evolves over time. In this section I will first sketch the different institutional types of global regulation, in order to argue that there has been an expansion in the number of institutional types used to influence governance reform for development in resource-rich countries.

### 4.5.1. Institutional types of global regulation

Global regulatory mechanisms can come in myriad institutional types: multilateral inter-state treaties, bilateral inter-state treaties, extraterritorial regulations, transnational public-private partnerships, governance networks, private governance mechanisms, etc. One method that global regulation and legal scholars have used to analyze this variety of institutional types has been to classify them as hard or soft law, according to their levels of obligation, precision and delegation, and/or according to the role that states and other actors perform in these

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41 Jupille & Snidal, supra note 40.

mechanisms. Although the definition of hard and soft law is highly contested, and varies significantly across different disciplines and scholarly theories, the concept of hard and soft law is broadly used because it does offer important analytical tools to illuminate the study of regulatory forms.

According to Abbott et al global rules present different shades of legalization, depending on the presence and degree of three attributes: obligation (meaning that states or other actors are bound by a [legal] rule or commitment or by a set of [legal] rules or commitments” that imply external scrutiny of their behaviour); precision (meaning that the rule unambiguously defines behaviour that is proscribed, required or authorized); and delegation (meaning that third parties are given the authority to implement, interpret and resolve disputes concerning the rule). The presence of high levels of the three attributes means that the rule is highly legalized. This ideal form corresponds to hard international law. Examples of highly legalized mechanisms are most of the European Community’s regulations, and most of WTO agreements. At the other extreme one finds the ideal type that presents a complete absence of the three attributes: soft law. Abbott et al argue that rule systems such as “balance of power”, which rests on customary law, represent this ideal soft law type.

In the book Hard Choices, Soft Law, John Kirton and Michael Trebilcock define the ideal type of hard law in a different way:

[A] regime relying primarily on the authority or power of the state – ultimately its legitimate monopoly on the means of coercion – in the construction, operation, and implementation, including enforcement of arrangements at international, national or subnational level.

For Kirton and Trebilcock the ideal type of soft law, on the other hand, relies “primarily on the

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45 WTO agreements tend to be extremely detailed, legally binding and rely on supra-state bodies to enforce its rules. Abbot et al supra note 42 at 405.
46 Kirton & Trebilcock supra note 43.
participation and resources of non-governmental actors in the construction, operation and implementation of a governance arrangement.”

The authors of both definitions of hard global regulations and soft global regulations agree that instead of a dichotomy between hard law and soft law, the types of global governance mechanisms are better described as falling along a continuum.\textsuperscript{47} For Kirton and Trebilcock at one extreme of this continuum are mandatory mechanisms such as international law (multilateral and bilateral treaties or agreements) and extraterritorial regulations, both types relying primarily on states’ authority to create and enforce its rules. At the other extreme of the continuum are the “voluntary” governance initiatives relying primarily on the authority, participation and resources of non-state actors, such as private codes of conduct. For Abbott et al there is a multidimensional continuum where rules can present any combination of attributes at different levels. Using a combined approach drawing from both frameworks one may say that the ideal hard law type should present high levels of obligation, precision and delegation and rely primarily on the authority of the state to create and enforce its rules. The ideal soft law type should present low levels of the three attributes and rely primarily on private actors as sources of authority.\textsuperscript{48}

It is important to note that the authors proposing these analytical distinctions are not arguing that hard law mechanisms are necessarily more effective than soft law mechanisms in terms of influencing the behavior of states or private actors. In fact the idea is to provide analytical tools to understand when and how policy actors seek to create different types of regulation along the continuum hard to soft law, in order to respond more effectively to concrete problems, under existing political economy circumstances.

Under this framework, multilateral and bilateral inter-state mechanisms and extraterritorial regulations tend to be closer to the hard law ideal type, while corporate codes of conduct and NGO certification schemes tend to be closer to the soft law ideal type. Transnational public-

\textsuperscript{47} Ibid.
\textsuperscript{48} To be clear IR scholars don’t usually consider the source of authority of a regulation – state or non-state actor – when analyzing whether the norm is closer to the hard or to the soft law ideal. IR scholars rely more on the strength of authority, based on how binding and enforceable the norm is, independent of its source. Yet, whether and how the state participates or not in rule-making and rule-enforcement can usually provide at least indications of the different levels of obligation, precision and delegation one may expect from the rule. For this reason I am using this combined approach here.
private mechanisms are usually placed somewhere in the middle of the continuum. Although one may identify which institutional types of regulation are more conventionally used in each one of the three categories of regulations discussed in the previous sections, “forum shifting” means that at any time policy actors may decide to explore a different institutional type to advance their policy objectives. Next I discuss which institutional types of global regulation have been conventionally used to influence state behaviour within its own territory.

4.5.2. Multilateral and bilateral treaties: the conventional regulatory mechanisms to influence state behavior

Inter-state multilateral and bilateral treaties with higher to medium levels of precision, obligation and delegation are the conventional forms of global regulation in seeking to influence state behavior, both towards each other (category 1) and within its own territory (category 3). States remain the primary source of authority to create and enforce the rules in these institutional regulatory types. In contrast, states have generally resisted the idea of using highly legalized multilateral and bilateral agreements in category two, that is, to directly influence private behavior.

One example of states using multilateral treaties in category 1 is the 1963 Treaty Banning Nuclear Weapons Tests in the Atmosphere, in Outer Space, and Under Water. This treaty relies on high levels of obligation and precision to prevent the expansion of nuclear activities that present global security threats. The 1949 Geneva Conventions provide other example. Geneva

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49 Global regulations are malleable, changing over time within the continuum between the ideal types, usually from soft to hard law.
50 In the case of multilateral mechanisms to influence corporations, for example, there are only the ones with a explicitly voluntary nature. For example, attempts to create a minimally legalized United Nations code of conduct for multinational corporations beginning in the 1970s have failed, while OECD members opted for the voluntary Multilateral Guidelines for Multinational Enterprises. In the 1990s there was a widespread perception that domestic systems on many developing countries were incapable of protecting human rights and the environment, despite normal adherence to international human rights and environmental treaties. Faced with this scenario, civil society organizations tried to encourage the creation of international treaty law mechanisms to protect human rights and the environment by directly regulating the behavior of transnational corporations operating in developing countries, thus bypassing host countries, but largely to no avail. Powerful developed countries, which have more leverage to sponsor global regulations, had little interest in this kind of regulation. Besides, resistance by TNCs and by developing host countries themselves hampered all attempts in this direction. The exception in category two is the creation of international criminal courts to directly try individuals responsible for war crimes and crimes against humanity, as mentioned previously.
51 Abbott et al, supra note 42, at 404.
Convention rules present high levels of precision and obligation, besides providing an advanced enforcement system which includes the right of any contracting state to “search for, arrest and bring to trial” any person accused of breaching the treaty.\textsuperscript{52} In the first sub-category of category three – global regulations to influence how states treat their own citizens – multilateral treaties also come in many different combinations of obligation, precision and delegation. While many human rights treaties were originally created with low levels of obligation and delegation, over time there has been a tendency for these mechanisms to evolve towards harder forms of regulation.\textsuperscript{53}

States have advanced some multilateral treaties that could be included in the sub-category of mechanisms to influence how states shape their own domestic governance systems to affect a broad number of actors, national and foreign. This is the case for example of international conventions to fight corruption. In the specific case of mechanisms to address the weak governance curse that undermines development outcomes in resource-rich countries (the topic of this dissertation), there is currently no international treaty with high levels of obligation, precision and delegation. Despite long-standing international discussions, there has been no consensus to create a treaty to formally consider development as a human right and what could potentially make it more precise and obligatory over time.\textsuperscript{54} International conventions such as

\textsuperscript{52} Cassesse, \textit{supra} note 4.


the United Nations Convention Against Corruption (UNCAC) can be considered as an important tool to help tackling rent-seeking behavior. When UNCAC first entered into force in 2005 it did not have a strong implementation mechanism, leaving states to “decide if and how far to incorporate the Convention into national law.”\(^{55}\) In 2009 a Conference of States Parties to that Convention adopted a peer review mechanism to assess implementation with UNCAC, strengthening the delegation attribute of this mechanism.\(^{56}\) UNCAC deals with corruption in general, though, and does not address the special circumstances of resource-rich countries. There is currently no international convention specifically designed to address the resource curse in governance-poor developing countries. For this reason I will only discuss international treaty law mechanisms in the remainder of this dissertation indirectly.

The other conventional form of global regulation to influence state behavior is a bilateral treaty. Sometimes when states cannot reach a multilateral agreement to influence how other states behave towards each other (category 1), they may resort to bilateral agreements. This has been the institutional choice adopted, for example, by capital-exporting countries unable to advance a multilateral binding treaty to influence how host states behave towards capital-exporting countries’ private investors. Expropriating the property of foreign investors without compensation is not considered a serious humanitarian violation or a global security threat, and there are no grounds for capital-exporting countries forcefully interfering in a sovereign state that decides to take such a measure.

Leading capital-exporting countries have however used bilateral investment treaties to create autonomous international mechanisms to protect foreign investors from potential misconduct by sovereign developing countries, thus opening important institutional avenues to influence how

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states behave towards foreign investors. This is a powerful tool because it provides real commercial incentives for countries to adopt certain internal policies or to adhere to international arbitration that may impose sanctions in cases of non-compliance.  

Until recently bilateral agreements were not used as a global regulatory mechanism to influence how states behave towards their own citizens. Attempts to promote human rights norms by including human rights clauses in bilateral investment treaties have been strongly resisted by developing countries, which accuse developed countries of using this strategy to disguise trade protectionism. Bilateral agreements to provide development assistance, which present lower levels of obligation, precision and delegation than BITs, were the only avenues to influence how a foreign country treated its own citizens, in sub-category 3.1. In a similar way, bilateral agreements to provide assistance for governance reform for development more generally, in sub-category 3.2, have until recently been the only global regulatory mechanism used to influence how states behave towards anyone under their jurisdiction.

One important discussion in the literature on bilateral investment treaties has been the potential unintended effects of BITs protecting foreign investors in domestic governance systems. Although disputed, some authors argue that the reliance on external arbitral tribunals to resolve investor-states disputes is undermining domestic governance systems by reducing incentives for undertaking governance reform domestically, or by causing a chilling effect on domestic regulations to protect social interests and the environment when they are in conflict with investors interests. A new generation of BITs is seeking to minimize these potential deleterious effects in domestic governance systems by including interpretative provisions and exception

57 As discussed previously, various authors argue, nevertheless, that one unintended effect of BITs’ provisions protecting foreign investors has been to provoke negative feedback effects in host countries attempts to reform their domestic governance systems to enhance environmental and social protection. Tom Ginsburg, “International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance”, (2005) 25 Int’l Rev L & Econ 107. David Schneiderman, Constitutionalizing Economic Globalization: Investment Rules and Democracy’s Promise (Cambridge, UK: Cambridge University Press, 2008)


clauses to establish a balance between the legitimate interests of host states and investors.\textsuperscript{60} BITs continue to evolve, and since the 2000s policy actor began to use these regulatory mechanisms not only to protect the policy authority of host countries, but also to promote domestic governance reform.

In 2003 the European Union launched a new initiative called “Forest Law Enforcement, Governance and Trade” (FLEGT). The initiative was a response to failed attempts to promote sustainable forestry practices in certain timber-rich developing countries through bilateral aid. The purpose of the initiative is to avoid the importation of illegal timber into the European Union by strengthening governance systems in exporting countries. The most important mechanism in this initiative is the “Voluntary Partnership Agreement” (VPA).\textsuperscript{61} By signing VPAs, timber-rich countries agree to verify and certify the legality of the timber it exports, and to submit to periodic independent evaluation of the certification process. They also agree to enter into dialogue with non-state actors, such as civil society organizations, to discuss how to improve sustainable forestry practices.\textsuperscript{62} VPAs, however, have not been used in the case of countries that are rich in minerals, oil and gas, which are the focus of my doctoral thesis. For this reason I will not directly address bilateral treaties in the remainder of this dissertation.

Besides bilateral assistance for development, the other form of state-centered mechanism that has been conventionally used to influence governance reform for development since the 1990s has been the international agreements between states and international institutions such as the World Bank, to promote economic and social development. World Bank agreements are considered low in obligation and low in precision as compared to the ideal hard law global mechanism. Despite the use of conditionalities to press for compliance, implementation of states’ commitments with the World Bank is ultimately left to host countries themselves. In chapter 2 I addressed the


\textsuperscript{61} The term “voluntary” in the title is misleading because once a VPA is signed it constitutes a legally binding bilateral agreement between the European Union and the timber exporting country.

\textsuperscript{62} More recently, the USA also began to include clauses prohibiting illegal timber imports in its bilateral trade agreements, such as the US-Peru free trade agreement.
mixed to weak record of success of World Bank and bilateral assistance for governance reform. Alone, these types of global regulation will not be able to effectively influence the weak governance curse in resource-rich countries. The question becomes whether there are other forms of global regulation that could reinforce the conventional forms.

4.5.3. Using extraterritorial regulations and soft law to influence state behavior in their own territory

Extraterritorial regulations and transnational soft law initiatives have been primarily used in category two – to influence the behavior of private actors. While multilateral regulations were created to respond to failures of state laws to address transnational issues, the bulk of extraterritorial regulations and transnational soft law initiatives were a response to the perceived inadequacy of both conventional mechanisms of global regulation and the domestic governance system in many foreign countries to deal with externalities provoked by private actors operating abroad.63

When the behavior of private actors operating abroad affected important interests of home countries, and they could not rely on international law or on other states to influence corporate behavior, powerful states created extraterritorial regulations. For example, in 1977 the American Congress enacted the Foreign Corrupt Practices Act (FCPA), an extraterritorial anti-bribery regulation, to address perceived threats posed by foreign bribes paid by American corporations abroad to American investors and to American foreign policy. Over time, extraterritorial regulations evolved. Instead of being used exclusively to protect the interests of home countries, they have also been used to promote and protect internationally recognized human rights, by for example enabling states to prosecute and try national and foreign individuals and corporations that have been accused of committing serious human rights violations abroad. Examples are the American Alien Tort Statute, or the plethora of national regulations that were created to implement the commitments of universal jurisdiction clauses in treaties such as the UN Torture Convention.

Another case of states employing extraterritorial regulations to directly influence the behavior of

private actors abroad was the USA use of its environmental laws to ban shrimp imports from countries which allowed private actors to use fishing nets that endangered sea turtles. In this case a WTO Appellate Body issued a landmark decision on the ability of states to use extraterritorial regulations to affect the environment beyond its own borders. However, these mechanisms fall into category two, since the objective is to bypass the domestic governance system in host countries and directly regulate private actors.

The mainstream strategy of many key policy actors in the 1990s became the creation of soft law mechanisms to directly influence private actors to control their own negative externalities, and to respect human rights and the environment. The plethora of corporate social and environmental code of conducts, and the certification processes by industry and/or NGOs, for example, formed part of this strategy, which was an important driver of the international movement for corporate social responsibility. Some argue that the move to voluntary initiatives was a second best option, deriving from recognition of the difficulties of achieving consensus on more legalized international regimes. Others claim that the move to soft law can be explained as a preemptive strategy by transnational corporations and home-countries to diffuse calls for international binding regulations. A third view is that soft law initiatives are more efficient means to influence corporate behavior than command and control measures. Whatever the reason, the fact is that various forms of soft law regulation were created in category two.

In principle, one should not expect to find many extraterritorial regulations or soft law mechanisms to influence state behavior, either in category one or in category three. However, policy actors have apparently inaugurated a movement that is gradually promoting the expansion of extraterritorial regulations and soft law initiatives to reach category three - to influence the behavior of states within their own territories. The challenge of addressing the weak governance curse in resource rich countries seem to be the perfect research area to illustrate this shift. Soft law mechanisms such as the Extractive Industries Transparency Initiative (EITI), for example, have apparently been created with the primary objective to influence how resource-rich countries shape their domestic governance systems in the extractive sector. EITI will be discussed in chapter 6. Extraterritorial securities disclosures regulations, although still targeting corporations, have apparently been designed to complement other efforts that aim to influence resource-rich

countries to increase transparency in their extractive sector. These extraterritorial regulations will be discussed in chapter 5.

4.6. Conclusion

The types of global regulatory mechanisms used to influence how states shape their own domestic governance systems beyond protecting the human rights of their own citizens have clearly evolved over time. Historically, policy actors relied only on conventional strategies which included: the use of conditionalities and/or incentives through foreign aid programs (such as direct funding, technical assistance, capacity building); and promoting the domestic implementation of international treaties such as the United Nations Convention Against Corruption.

Today there is more diversity in the types of global regulatory mechanisms and strategies to influence how countries shape their own domestic governance systems, which includes using extraterritorial regulations and soft law initiatives. If this is true, the implication is that the external influences on how states shape their own domestic systems beyond protecting the human rights of their own citizens is gradually becoming more institutionalized. According to Robert Keohane, variations in the degree of institutionalization exert substantial effects on state behavior. Therefore, if given the expansion in the number and forms of global institutions to influence how states shape their own domestic governance systems, at least potentially this constellation of global regulatory mechanisms can exert more effects on state behavior in this arena.

The remainder of this dissertation will investigate whether, why and how policy actors are choosing extraterritorial regulations and soft law initiatives as global regulatory options to influence how resource-rich countries shape their weak domestic governance systems.

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Chapter 5
Extraterritorial Regulations’ New Objective: To Influence States’ Behavior in Their Own Territory

5.1. Introduction

There are many reasons why home countries may avoid investing their national resources to regulate extraterritorially. It is difficult for regulators in home countries to manage activities that occur beyond their borders, since information is hard to obtain and they have limited leverage on foreign domestic systems. Host countries that are affected by extraterritorial regulations usually resent this kind of foreign intervention. This is especially the case with developing countries, which have labeled many extraterritorial regulations from Western developed countries as protectionism or neo-imperialist interventions in disguise. Besides, since foreign constituencies do not vote in the home country, there is no political gain at home if positive benefits of extraterritorial regulation are felt primarily in foreign countries.

Nevertheless, guided by significant self-interests, powerful states will sometimes use their own domestic laws to bypass international and host country regulatory systems and unilaterally regulate private actors operating abroad, as discussed in chapter 4. States have historically not relied on extraterritorial regulations to influence the behavior of other states in their own territories. Recently, however, the USA has created unilateral extraterritorial securities disclosure regulations that have as their primary purpose the promotion of transparency in resource revenues flows from multinational extractive corporations listed on its stock exchanges to resource-rich and governance-poor developing countries. Hong Kong has adopted similar regulations, and the European Union is also discussing whether to do the same. Despite targeting corporations directly, these extraterritorial regulations were unmistakably part of a broader global movement designed to address rent-seeking behavior in foreign resource-rich and governance-poor developing countries. There is an argument to be made, therefore, that policy actors are using this type of global regulatory mechanism as one more instrument to provoke

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feedback effects in a foreign governance system. How did extraterritorial home-country regulations become a global regulatory option to provoke feedback effects in domestic governance systems in resource-rich but governance-poor countries?

This chapter argues that this unconventional use of home-country extraterritorial regulations became possible, in the late 1990s and early 2000s, due to a confluence of values and interests. This confluence induced public and private actors in both developed and developing countries to accept the idea that anti-bribery and anti-money laundering extraterritorial regulations, that had been originally created to protect home-countries’ self-interests by directly targeting corporate behaviour, could also serve the objective of influencing the chronic corruption that undermines development outcomes in host countries. In other words, this chapter reveals how extraterritorial home-country regulations went from being a tool used by powerful developed countries to bypass the domestic governance systems in host countries and protect their self-interests, to a potential tool to be exploited by public and private actors that are attempting to find entry points to provoke feedback effects in dysfunctional domestic governance systems in resource-rich host countries.

I argue that this change in how the international community perceives the legitimate objectives of extraterritorial regulations is important because nowadays they are considered as part of the constellation of potential global regulatory mechanisms to address the resource curse in resource-rich and governance-poor countries. To be clear, I am not arguing that this change has happened surreptitiously, as one more example of a hidden agenda by powerful developed countries seeking to impose their values and interests on weaker countries. This chapter argues that the change was organic and only occurred due to the convergence of interests and values by several

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2 This chapter confirms the accounts by global regulation scholars that the US is the leading actor behind the creation of global regulatory mechanisms in order to advance their interests and values, followed by other OECD countries. Braithwaite and Drahos, for example, argue: “The US state has been by far the most influential actor in accomplishing the globalization of regulation. Today the EC is beginning to approach US influence. When the US and EC can agree on which direction global regulatory change should take, that is usually the direction it does take. Japan’s influence is remarkably weak.” John Braithwaite and Peter Drahos, Global Business Regulation (Cambridge, UK; New York, NY: Cambridge University Press, 2000) at 27. See also Daniel Drezner, All Politics is Global (Princeton, NJ: Princeton University Press, 2007). This chapter also confirms accounts that powerful countries leadership is not sufficient to explain the globalization of regulation. The evolution of most global regulatory mechanisms can only be properly explained by looking into how other policy actors – developing countries and non-state actors – have participated in and transformed these global regulatory mechanisms into instruments to advance a myriad of other interests and values. See Walter Mattli and Ngaire Woods, eds, The Politics of Global Regulation (Princeton, MA: Princeton University Press, 2009).
state and non-state actors. Despite the fact that this change in discourse and practice related to extraterritorial regulations has been ostensible, it has remained largely absent from academic discussions in both the global governance and the law and development literatures. It remains unclear whether this type of global regulatory mechanism can effectively promote the social interests of foreign countries, and what limitations and possible unexpected negative externalities they could have in pursuing this objective.3

The chapter will be structured as follows. Section 2 describes the tortuous historical process that enabled the creation of extraterritorial anti-bribery regulations4 first to bypass the domestic governance system in foreign countries and protect home countries interests, then to fight transnational corruption, and finally to combat corruption in developing countries. Section 3 demonstrates that the spread of home-country anti-money laundering legislations also originated and evolved due to developed countries’ concerns with international organized crimes such as drug trafficking and terrorism. The application of anti-money laundering legislation to tackle rent-seeking behavior by ruling elites in foreign sovereign countries was a later development, due to extraterritorial regulations being transformed to pursue objectives other than protecting the self-interests of home countries. Section 4 examines the very recent extraterritorial regulations that require corporations listed in stock exchanges to disclose all resource revenues paid to resource-rich foreign developing countries, and how they were more specifically created to primarily address problems affecting foreign constituencies. Section 5 illustrates how these mechanisms are being used to address rent-seeking behavior in resource-rich countries, but highlights the significant obstacles and inherent limitations that hamper the capacity of home-

3 Some scholars, although not discussing this shift, are already beginning to analyze its potential consequences, as the case of recent studies on the implications of “borrowing” developed countries’ more developed law enforcement systems to fight corruption in developing countries. See Kevin E. Davis, “Does the Globalization of Anti-Corruption Law Help Developing Countries?” (2009) New York University Law and Economics Working Papers, Working Paper 203.

4 It is important to note that international treaties addressing foreign bribery and money laundering do not create international mechanisms to directly address transnational corruption, organized crimes and money laundering schemes. As Guy Stessens noted well, these international treaties serve to encourage the enactment of domestic legislation, “but this does not alter the principal fact that it is still domestic criminal [and civil] law that is being enforced”. For this reason I will borrow Stessens terminology and refer to the emerging anti-bribery, anti-money laundering and revenues disclosure regimes as international law enforcement regimes. Stessens defines this special kind of regime as ‘a global arrangement among governments to co-operate against particular transnational crimes’. The predicate ‘international’ only pertains to the international co-operation in the enforcement of municipal criminal law. Guy Stessens, Money Laundering: A New International Law Enforcement Model, (Cambridge, UK: Cambridge University Press, 2000) [Stessens, Money Laundering].
country’s anti-bribery, anti-money laundering, and financial disclosure regimes to constitute autonomous mechanisms to efficiently address rent-seeking behavior abroad.

5.2. The tortuous rise of the international anti-bribery law enforcement regime

This section will first describe the extraordinary path that led the USA, against all odds and expectations, to create an extraterritorial regulation to fight bribery of foreign officials in 1977, a period marked by extreme polarization in international relations (2.1). It will also describe how the self-interest of the hegemonic economic global power was insufficient to guarantee the dissemination of home country extraterritorial anti-bribery regulations worldwide. It was not until there was a marked change in knowledge and values about the effects of corruption in development, but also a convergence of interests from a number of other countries, that extraterritorial regulations to address the bribery of foreign officials were considered a legitimate mechanism to promote the social interests of host countries (2.2). Today extraterritorial regulations have become accepted global regulatory mechanisms to help combating corruption in foreign developing countries (2.3).

The account of the evolution from the FCPA to an international anti-corruption regime in this chapter largely builds on the 2002 article by Kenneth W. Abbott and Duncan Snidal, “Values and Interests: International Legalization in the Fight Against Corruption”. However, while the authors analyze all the global regulatory mechanisms that were created to address transnational and national corruption together, this chapter focuses on the extraterritorial anti-bribery home-country regulations. The intention is to illuminate how this specific type of global regulatory mechanism has evolved over the years in two respects. First, extraterritorial anti-bribery regulations evolved from clearly protecting the interests of home countries, to promoting values and interests of foreign countries alongside the interests of home countries. Second, extraterritorial anti-bribery regulations evolved from bypassing foreign host countries governance systems, to an ambiguous position that may both seek to bypass and help to bridge governance deficits in foreign countries.

5.2.1. The accidental and reluctant lonely boy scout

In the 1970s newly independent developing countries in Asia, Africa and the Middle East had joined Latin American former colonies to press for a New International Economic Order (NIEO) at the United Nations. Developing countries argued that formal political independence should be followed by real economic independence. Sovereignty was fiercely defended. Developing countries were not alone on this front. European industrialized countries strongly resented and resisted US Courts extraterritorial application of American anti-trust and securities laws, which they considered a dangerous effect of the expansion of American TNCs in Europe during and after WWII. This was clearly not a conducive context for the USA to create a domestic legal regime to enable American law enforcement institutions to investigate and prosecute individuals and corporations committing certain activities abroad. And yet this is exactly what happened in 1977. In that year the United States of America enacted the first ever home-country law aimed at discouraging American transnational corporations from paying bribes to foreign officials in exchange for business opportunities.

The Foreign Corrupt Practices Act (FCPA) adopted two sets of provisions that affected all American corporations engaged in international business, as well as all corporations registered with the Securities and Exchange Commission (SEC). The accounting standards provisions

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amended the *1934 Securities Exchange Act* to require all registered corporations to maintain “books, records, and accounts which, in reasonable detail, accurately and fairly reflect the [financial] transactions [with foreign officials]”.\(^9\) The anti-bribery provisions prohibited American corporations\(^11\) and all registered corporations alike from offering, promising or paying anything of value to a foreign official, political party or a person whom the corporation has reason to know will influence a foreign official or party, in order to assist in obtaining or retaining business. Failure to comply with any or both sets of provisions would result in civil and criminal liability.

The FCPA was also unusual since it marked a shift from the traditional approach to corruption at the time, which was to consider it an eminently domestic concern and responsibility. Just a few years before, the USA and other industrialized countries had reaffirmed this approach. In 1972, following the scandal provoked by *International Telephone and Telegraph (ITT)*’s collusion with the CIA to influence the Chilean elections, which included paying illegal campaign contributions, the US Congress was pressed to discuss the potential implications of transnational corporations (TNC)’s bribes to foreign officials.\(^12\) In reaction to the ensuing pressure by developing countries for international regulations to address the impact of TNC’s bribes on their domestic political system, together with other negative impacts of FDI, OECD countries (including the USA) reaffirmed the existing standard notion that active and passive corruption were mainly domestic concerns. Each country should take responsibility for regulating the occurrence of bribes in its own territory. It was well known that the use of bribes in international business was widespread at the time.

Despite maintaining the prevailing approach to corruption, OECD countries responded to developing countries concerns with TNC’s illegally bribing government officials and often also

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\(^9\) Officially named “issuers” in the legislation.

\(^10\) FCPA also stated that: “No person shall knowingly circumvent or knowingly fail to implement a system of international accounting controls or knowingly falsify any book, record, or account […]” The complete text of the Foreign Corrupt Practices Act can be found on-line at *The Foreign Corrupt Practices Act USC tit 15 §78m* (1998), online: US Department of Justice <http://www.justice.gov/criminal/fraud/fcpa/docs/fcpa-english.pdf>.

\(^11\) Officially named “domestic concerns” in the legislation.

\(^12\) At the time the Senate Investigative Commission was concerned with the potential undue influence of private corporations in American foreign affairs. See Anthony Sampson, *The Sovereign State: The Secret History of ITT* (London: Hodder and Stoughton, 1972).
members of opposition parties, by including provisions on foreign corruption among the non-binding OECD Guidelines for Multilateral Enterprises adopted in 1976. However, until 1977 binding extraterritorial legislation to address bribes paid to foreign officials seemed unthinkable. Why did American legislators unilaterally break this tradition of treating bribes and corruption as a host-country internal problem, and the soft law international approach? Why did they decide to apply domestic legislation extraterritorially to discourage the use of bribes in international business? The enforcement of this legislation would undoubtedly bring many risks. It could cause serious conflicts with foreign nations, as the example of the extraterritorial application of anti-trust and securities regulations clearly showed; it could threaten the competitiveness of American corporations abroad; and it would undoubtedly present significant law enforcement challenges and costs.

Opinion was extremely divided at the time on the reasons why US legislators approved this groundbreaking extraterritorial act. Some authors equated FCPA’s enactment to “at worst, a unilateral disarmament by economic leaders who project a long-term vision, undaunted by the consequences of competing against cheaters.” A related, yet more cynical, view equated the “do gooders” minds behind FCPA, who believed that it would improve business ethics and fair competition worldwide, to “Don Quixote tilting at windmills”. On the opposite side of the spectrum were those affirming that the extraterritorial application of FCPA amounted to just another example of the old American moral imperialism. In hindsight, the particular circumstances that generated the unanimous approval of FCPA by the American Congress in 1977 seem to indicate a more banal explanation, however: something more along the lines of an accidental domestic occurrence that snowballed out of control.

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Kenneth W. Abbott and Duncan Snidal examined the particular circumstances relating to the enactment of the FCPA and they argue that the creation of FCPA was a result of American domestic concerns, resulting from an exceptional upsurge in moral values among American citizens and politicians caused by the Watergate scandal. Among the many forms of misconduct revealed by the 1977 Watergate investigations were the instances whereby American TNCs had used “slush funds” to channel illegal contributions to the Nixon presidential campaign. It was then revealed that these same “slush funds” were used by TNCs to bribe foreign officials in pursuit of business opportunities abroad.

The most infamous bribery cases revealed by the Watergate investigations had not occurred in developing countries, but rather involved significant bribes paid by the American corporation Lockheed to the Italian government, to the then Japanese Prime Minister and to Prince Bernhard of the Netherlands. The strident national public outcry provoked by these revelations spurred the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS) to open an in-depth investigation to assess the extent to which American TNCs were engaged in wrongful conduct abroad. Following a voluntary disclosure program where they were encouraged to reveal how they conducted business in foreign countries, over 400 American transnational corporations admitted to maintaining “slush funds” and to routinely bribing foreign officials. With the extent of the problem unveiled, the American public demand for regulatory responses intensified.

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19 SEC investigations of illegal campaign contributions in the USA indicated the existence of large numbers of “slush funds”, and yet often only a small part of these funds were used for campaign contributions, the rest being used to make undefined payments abroad, which SEC suspected was to pay bribes to foreign officials. Taking into consideration the impossibility of initiating enforcement cases for each and every instance of suspected questionable payment abroad at the time, officials at SEC decided to promote a voluntary disclosure program which although not promising immunity signaled that if a cooperating corporation undertook their own investigations on potentially
Therefore, what made the FCPA bill not only possible, but rather inevitable was the American public outrage against corruption, domestically and internationally. Yet, it is granted that not only value-based arguments (rooted on the moral drive to fight corruption), but also interest-based arguments were used to promote the advancement of the FCPA bill in the American Congress. These interest-based arguments were not related to concerns with the welfare of citizens in foreign countries, however. According to Laura Longobardi, American congressmen supporting FCPA used primarily domestic interests as arguments for the bill’s approval. Interest-based arguments included: the need to insulate US foreign policy from private interference; the need to protect stockholders by impeding TNCs’ illegal and risky operations abroad; the need to protect a truly competitive free-enterprise system; the need to protect the integrity and reputation of American TNCs. Independent of the mixed motivations, Longobardi argues that the main purpose of the FCPA was clear: “to prevent United States Corporations from bribing foreign officials”.

The focus of the Act was therefore first and foremost the supply side of corruption, and in no way did the American Congress adopt FCPA to address the negative developmental impacts of political corruption and rent-seeking in less developed countries. In fact, in 1977 corruption was not even considered an important hindrance to development. The American Congress had also illegal procedures and disclosed to SEC, this corporation would be given the chance to “fix” their procedures without having to pay fines. See Wallace Timmery, “Overview of the FCPA, A Symposium: The Foreign Corrupt Practices Act: Domestic and International Implications” (1982) 9 Syracuse J Int’l L & Com 235. Supra note 18. See also Nicole Y. Hines, “Cultural Due Diligence: The Lost Diligence That Must be Found by US Corporations Conducting M& A Deals in China to Prevent Foreign Corrupt Practices Act Violations” (2007) 9 Duq L Rev 19. The argument here was that allowing private transnational corporations to maintain “slush funds” was also dangerous because sometimes the funds were used to finance opposition groups and individuals, increasing their chances to gain political advantage against incumbent groups. If successful, these politicians were expected to advance the corporation’s interests in return. This interference with foreign political dynamics could sometimes be in opposition to official foreign policy strategies.

Longobardi, supra note 18.

no intention to use American law enforcement institutions as tools to provoke positive feedback
effects in the dysfunctional domestic governance systems that facilitated corruption and rent-
seeking in foreign developing countries.  

FCPA can be better considered as a tool to bypass the
governance deficit in foreign countries that led to increased chances of acts that affected relevant
American values and interests, similar to the international investment regime discussed in
chapter 4. In the case of the international investment regime the USA and other OECD
countries agreed that domestic institutions in many developing countries could not be trusted to
offer protection to foreign investors, and an international system was advanced in order to bypass
this perceived governance deficit and directly protect investors rights or interests.

In sum, the FCPA resulted from a very conducive critical juncture where American citizens,
deluged with information about misdeeds by American TNCs, both nationally and abroad,
showed significant concerns about the domestic implications of widespread corruption and
illegal financial transfers. The fact that foreign domestic systems could not be trusted to
prevent and fight corruption by American corporations, and should therefore be bypassed, was
assumed. The implications of such a break with the prevailing idea of non-intervention in
domestic governance systems were taken for granted. Both Houses of the American Congress
approved FCPA without a single dissenting vote.

23 Recall that the most infamous cases of foreign bribes had happened in other OECD countries, not in developing
countries, as mentioned above. See also Hines, “Cultural”, supra note 19.
24 See Davis, supra note 3 at 2.
25 There is of course a huge debate on the motivation behind the creation of the international investment regime,
with some arguing that since its inception the idea was to advance the interests of developed countries over and
above the interests of developing countries. Many controversial decisions by arbitral tribunals on investor disputes
with host governments do give rise to arguments that at the very least the regime has been captured by investors
interest groups. Whatever the intention, what I want to highlight here is that the strategy was to bypass the
governance deficit and directly protect investors rights or interests, and not to provoke positive feedback effects in
domestic governance systems.
26 Abbott & Snidal, “Values”, supra note 5.
27 Henry H. Rossbacher & Tracy W. Young, “The Foreign Corrupt Practices Act Within the American Response to
Domestic Corruption” (1997) 15 Dick J Int’l L at 509. The sometimes forgotten original motivation behind
the creation of FCPA explains why this Act was not restricted to the most famous set of provisions prohibiting
American corporations and issuers from paying bribes to foreign officials (anti-bribery provisions). Stuart H.
Deming notes that during the Watergate scandal it became clear that improper accounting methods and the lack of
internal accounting controls had greatly facilitated the engagement of American corporations in illegal payments
to the Nixon campaign and to foreign governments. For this reason the FCPA created obligations to issuers in the USA
to maintain records that accurately reflected transactions, and also to create sound systems of international
accounting controls. These “accounting provisions” have a more expanded scope than the anti-bribery provisions,
As should be expected, some key actors that felt they would be negatively impacted by the Act voiced strong opposition. Other developed countries affirmed that this was another “arrogant attempt by the United States to export its morality and enforce its laws extraterritorially.”

Developing countries condemned the initiative as one more instance of moral imperialism of developed countries towards developing countries. However, the most outspoken opponents of the Act were American corporations, which affirmed that FCPA would make them lose competitive advantage in a world where foreign bribery was still an “accepted” practice. Yet, this realpolitik-type argument was not very well received at the height of the legitimacy crisis that plagued American corporations during and after the Watergate scandal.

President Jimmy Carter allegedly assured disgruntled American TNCs that FCPA would be followed by similar regulations in other developed countries, due to its moral force. When this proved wrong, US corporations fiercely lobbied against the Act, pressing for it to be reversed or weakened. Kenneth Abbot and Duncan Snidal argue that repealing or weakening FCPA proved politically difficult, since it would appear that the American Congress was “endorsing” corruption of foreign officials. They claim that when American corporations felt themselves inevitably constricted by FCPA, they opted for lobbying their government to sponsor international rules to encourage other countries to create FCPA-like legislation, thus leveling the

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28 Longobardi, supra note 18 at 442. They were referring to the practice by US Courts to apply US anti-trust and securities laws extraterritorially.

29 Deming, Foreign Corrupt Practices Act, supra note 27.

30 Ibid.


32 Longobardi affirms that attempts to weaken the legislation continued for years. American Congressmen had continuously proposed amendments to the FCPA throughout the first decade after its approval. From 1980 to 1987 twelve bills had been presented to that effect, Longobardi, supra note 18. See also Abbott & Snidal, “Values”, supra note 5.
playing field. The attempts by American policymakers to disseminate extraterritorial anti-bribery regulations were therefore initially based on self-interest, and there was virtually no mention of values such as combating corruption to promote development abroad at the time.

Abbott and Snidal affirm that early on (1979) the US government tried to advance a multilateral convention at the United Nations, but the negotiations at the ECOSOC were very problematic due to the strong North/South divide. They note that developing countries wanted to discuss the regulation of international bribery together with the other international rules regarding transnational corporations, which were highly contested. Abbott highlights, however, that American corporations were more concerned with spreading FCPA-like regulations among its leading competitors in Europe and Japan, since this would suffice to guarantee a level playing field. The US lobbying efforts to overcome existing resistances were thus concentrated on the creation of anti-bribery rules in the OECD, and not in global multilateral bodies such as the WTO or the United Nations.

Yet the American government would also face fierce resistance from the industrialized countries. Mark Pieth et al affirm that developing countries were not the only countries opposed to the draft UN agreement on “illicit payments” based on the FCPA model sponsored by the United States. Industrialized countries also evinced strong opposition to what they saw as “another US effort to extend a unilateral policy choice extraterritorially.” Pieth et al note that the context of mutual distrust provoked the abandonment of the initiative in 1979. The US government would nevertheless insist in discussing the issue at the OECD.

In order to avoid accusations of exporting American moral principles abroad, the Carter Administration used primarily interest-based arguments when trying to negotiate an OECD agreement on foreign bribery. The primary argument was that curbing bribery of foreign public

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officials collectively would improve efficiency at the global economy level.\textsuperscript{37} However, corruption was still considered an eminently domestic political issue at this juncture, without significant development repercussions.\textsuperscript{38} Besides, having already passed FCPA unilaterally, the USA now lacked diplomatic leverage to pressure European countries and Japan into following their example.\textsuperscript{39}

The effects of FPCA on the competitiveness of American corporations at this stage are much disputed. In fact the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ), organizations responsible for FCPA enforcement, would only open a few cases against corporations in the decade that followed.\textsuperscript{40} From 1979 to 1988 the DOJ filed ten actions against American corporations for violations of the anti-bribery provisions of FCPA. None of the corporations had a high profile.\textsuperscript{41} The primary motive for the lack of enforcement, according to Laura Longobardi, was the heavy burden of discovery placed on the governmental agencies that did not have sufficient resources, and could not count on the cooperation of foreign institutions. Besides, the SEC and DOJ would have to investigate instances of international bribery at the risk of offending foreign officials and harming the interests of American corporations and the American government. The chilling effect was however very real. American corporations continued to fiercely condemn the Act.\textsuperscript{42} Despite the continuous lobby by major American TNCs, and the disproportionate American economic and political influence in the global arena, it would take twenty years before the first serious multilateral initiatives addressing anti-bribery in foreign business came into being.

In 1994 John Kimelman used the expression “the lonely boy scout” to illustrate the overall perception regarding the unilateral enactment of FCPA by the United States, and its subsequent

\begin{footnotesize}
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\item \textsuperscript{37} Abbott & Snidal, “Values”, \textit{supra} note 5.
\item \textsuperscript{38} \textit{Ibid} at 162.
\item \textsuperscript{39} \textit{Ibid} at 162.
\item \textsuperscript{40} Longobardi, \textit{supra} note 18.
\item \textsuperscript{41} Six of these actions related to illicit payments by several American companies to obtain contracts with PEMEX, the Mexican national oil company. The other four were bribes paid in Qatar, Cook Islands, Mexico and Nigeria. Longobardi, \textit{supra} note 18 at 478.
\item \textsuperscript{42} American corporations voiced particular opposition against what they saw as the dangerous vagueness of some of the Act’s provisions.
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insistence in promoting international norms to outlaw foreign bribes.\textsuperscript{43} This account shows that
if the USA was a lonely boy scout, it was certainly an accidental and very reluctant boy scout. The enactment of extraterritorial anti-bribery legislation in the USA resulted from exceptional historical circumstances. And the USA would have to wait until the international perception regarding corruption and its economic and social impacts had significantly changed to be able to form its own “anti-foreign bribery club”.

5.2.2. Values and interests shape new anti-corruption global mechanisms

The late 1980s and early 1990s witnessed the beginning of what would prove to be a marked change in international knowledge and perceptions about corruption. It was around this time that economists, development scholars and social activists began to argue that systemic corruption matters to economic and social development.\textsuperscript{44} The change in perception was reflected in a 1989 World Bank study entitled Sub-Saharan Africa Long Term Perspectives Study.\textsuperscript{45} This Study’s final report stated:

Hundreds of millions of dollars have been siphoned off to private bank accounts outside Africa. The cost is not just the waste of funds, but also more seriously the profound demoralization of society at large. […]

Ultimately, better governance requires political renewal. This means a concerted attack on corruption from the highest to the lowest levels.\textsuperscript{46}

The Study listed the elimination of excessive government controls on the economy, government transparency (especially procurement procedures), adequate accounting systems, and investigation and sanctioning of corruption as important mechanisms to promote economic development. It also highlighted that donor governments had the responsibility to sanction their

\textsuperscript{44} Glynn et al, supra note 43. See also Abbott & Snidal, “Values”, supra note 5.
\textsuperscript{45} Abbott & Snidal, “Values”, supra note 5 at 159.
corporations engaged in corruption in international business, and added: “regrettably so far the United States is the only developed country that has outlawed such practices”. 47

Indeed, at this time the legal systems of most industrialized countries still treated foreign bribes as tax deductible. 48 Not only did most industrialized countries allow tax deductions for foreign bribes, some of their foreign agencies also funded or insured their corporations for these costs. 49 The significant public outcry that followed a series of high-profile corruption scandals in Europe and Asia would nevertheless show that corruption was not a problem exclusive to developing countries, and that there was more than “boy scout” moralization in the American initiative to address corruption in foreign business. According to Patrick Glynn, Stephen J. Kobrin and Moises Naim, who examined the globalization of anti-corruption efforts:

[I]n the 1990s a host of nations in Europe and Asia – Germany, Italy, France, Korea, Japan, - have been experiencing an upheaval in many ways comparable to America’s Watergate experience 20 years ago. The politics of [corruption] scandal is no longer a peculiarly American preoccupation but a global political phenomenon. 50

It was not only the perception about corruption that experienced a marked change in the 1980s. The international context was also rapidly changing in favor of concerted collective actions against transnational crimes such as drug trafficking and money laundering, topics that will be covered in the next section of this chapter. The fight against transnational corruption would be incorporated into this new set of international concerns. 51 The world economy was also changing. The American fiscal and trade deficits relative to other industrialized countries

47 Ibid at 61. However, the change would come slowly. Include some info on how hard it was to mainstream anti-corruption in the World Bank and how it culminated with Robert’s Wolfenson policies.


49 Ibid.

50 Glynn et al, supra note 43 at 23.

51 Transparency International attributes this change to a confluence of several factors such as: the end of the Cold War, which removed the extreme use of the national security rationale by leading countries in both sides to tolerate corrupt leaders provided they were allies; post-Cold War agenda of democratization, transparency and accountability that made international development institutions focus on corruption as well; perception that corruption was on the rise, especially due to the wave of privatization and deregulation; increased competition among TNCs due to reduction of trade barriers (including here the American leadership to level the playing field). “When and Why Did Anti-corruption Conventions Came Into Being”, online: Transparency International <http://www.transparency.org/global_priorities/international_conventions/conventions_explained/history>.
experienced a substantial and unprecedented growth at that time. Deteriorating economic indicators led to fears that American corporations were losing competitive positions vis-à-vis corporations from Europe, Japan and even from the newly industrializing countries (NIC).

The second Reagan Administration implemented a much more aggressive international trade policy, which included significant interventions on exchange rates and stalwart promotion of US exports. The 100th American Congress approved the Omnibus Trade and Competitiveness Act (OTCA) in 1988, with the objective of advancing a comprehensive competitiveness and productivity growth strategy and revert the trend of deteriorating economic indicators. Since American corporations had long accused FCPA of impairing – or threatening to impair - their international competitiveness, an amendment to the Act was included in OTCA. The main intention was to clarify some of its provisions that were deemed too vague or too strict. The 1988 FCPA amendment, on the other hand, increased the penalties for the violation of accounting and anti-bribery provisions.

The 1988 amendment to FCPA also expressly stated that the President should negotiate an international agreement with OECD countries to level the playing field for American corporations. The President was required by law to report to Congress about the progress of the

52 If in 1971 US merchandise trade deficit was around 4 billion, by 1981 it had increased to 35 billion and in 1987 to 170 billion. The deficit in manufactured goods in 1985 had reached 100 billion, and bilateral trade balances with OECD members Japan, EC, Canada and Mexico were all negative by 1996. Susan Carol Schwab, Trade-offs: Negotiating the Omnibus Trade and Competitiveness Act (Boston, MA: Harvard Business School Press, 1994). See also Leonard Silk, “The United States and the World Economy” (1996) 65 America and the World 458.


54 Ibid at 254.

55 The Omnibus Trade and Competitiveness Act included extensions of fast track authority to allow the President’s negotiating free trade agreements, and provisions to enable the US Trade Representative to identify countries and practices that offered unfair trade barriers to USA exports, among others. See United Nations Economic Commission for Latin America and the Caribbean, “An Annotated Guide to the US Omnibus Trade and Competitiveness Act of 1988” (1989).

56 For example, facilitation payments (routine governmental action) were more clearly excluded from the Act, independent of who was the official; the amendment also changed the “reason to know” standard for liability, deemed too high. Defendants would only be convicted if they had actual knowledge of the bribes, or if knowingly violate accounting standards. Finally, the amendment excluded payments that were permitted under foreign law. See Earle, “FCPA”, supra note 14 at 554. See also Adam Fremantle & Sherman Katz, “The Foreign Corrupt Practices Act Amendments of 1988” (1989) 23 Int’l Law 755 at 760.
negotiations.\textsuperscript{57} This happened despite the fact that studies of the impact of FCPA on the competitiveness of American corporations were inconclusive at the time.\textsuperscript{58} George Bush senior’s administration did press the OECD to start negotiations on the topic. This time he succeeded in creating an “Ad Hoc Group on Illicit Payments” in the OECD to examine the issue.\textsuperscript{59} It would however take almost ten more years before a consensus on anti-foreign bribery was reached.

Mark Pieth argues that the characteristics of the 1989 OECD working group showed that OECD countries still resisted the initiative, even though they were not as vocal as before. European countries nominated officials of a very low ranking to comprise this group, and the work was extremely slow.\textsuperscript{60} First the group asked for a comparative review of different domestic legislation applying to bribery of foreign public officials in OECD countries. Then the group commissioned a series of “feasibility studies of possible substantive actions and procedural approaches”.\textsuperscript{61} A fair inference is that OECD countries were trying to prolong the discussions in the expectation that the issue would likely fade away.

Abbott and Snidal argue that the inauguration of a new Democratic Administration under President Bill Clinton in 1993 represented a new critical juncture that would change this state of affairs.\textsuperscript{62} They claim that two interest groups lobbyists the new Assistant Secretary of State for Economic and Business Affairs, Daniel Tarullo,\textsuperscript{63} for a push by the American government towards successful negotiations of international initiatives against bribes of foreign public

\textsuperscript{57} Ibid at 764.
\textsuperscript{59} Hatchard, supra note 31 at 5.
\textsuperscript{60} Pieth, International, supra note 33 at 11.
\textsuperscript{61} Ibid at 12.
\textsuperscript{62} Abbott & Snidal, “Values”, supra note 5.
\textsuperscript{63} Daniel Tarullo was a Professor of Law in Georgetown Faculty of Law, in Georgetown University, and an expert in international economic policy. Currently he is member of the Board of Governors of the Federal Reserve System.
officials. American corporations that had been sanctioned in the first high-profile cases under FCPA\(^64\) lobbied the government by presenting evidence of lost international business opportunities due the sanctions incurred under the FCPA.\(^65\) They insisted that it was imperative for them to have a level playing field with European and Japanese competitors. This time, however, a newly formed non-profit organization called Transparency International and other NGOs also lobbied the government.\(^66\) These organizations for the first time advanced normative or values-based arguments to justify the need for American leadership in this area, using the growing concerns with the negative developmental impacts of corruption to support their case.

The Clinton Administration pushed the internationalization of the anti-bribery regime on two fronts. One was the OECD,\(^67\) and the other the Organization of American States (OAS). With normative and interest arguments underpinning American efforts for the first time, both initiatives would prove successful. The OECD initiative would follow the same lines of the FCPA by focusing exclusively in the supply-side of corruption. The OAS initiative, on the other hand, would incorporate concerns of developing countries and would prove more receptive to the emerging international consensus on the importance of international cooperation to fight both the supply and the demand sides of corruption. In March 1994 the Clinton Administration sponsored a discussion within the Hemispheric Summit of Heads of States and Governments of the Americas on the problem of bribery in international transactions. During the discussions the Venezuelan government argued that the scope of the discussion in the Americas should be broader, claiming that the consolidation and preservation of democracy and the fight against

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\(^65\) They specifically cite General Electric, which had been prosecuted under FCPA and adopted internal policies to comply with the legislation in its global operations, presenting concrete evidence of lost business opportunities. Abbott & Snidal, “Values”, supra note 5 at 163. Abbott & Snidal, “Filling”, supra note 16 at 25.

\(^66\) 1993 was the year where Peter Eigen founded Transparency International, after leaving his job as a World Bank’s expert with extensive work in Latin America and Africa. This was the first transnational civil society organization dedicated exclusively to “mobilizing a global coalition to promote and strengthen international and national integrity systems”. Hongying Wang & James N. Rosenau, “Transparency International and Corruption as an Issue of Global Governance” (2001) 2 Global Governance at 31. The article presents an interesting account of how transnational non-state actors such as NGOs influence the global governance agenda, using the example of Transparency International.

\(^67\) Pieth, *International*, supra note 33 at 12.
corruption at the national and international levels were interlinked.\textsuperscript{68} This leadership from Venezuela can be explained by internal politics, since the country had undergone recent national corruption scandals involving major Venezuelan banks.\textsuperscript{69}

In June of 1994 the OAS General Assembly approved the creation of an initiative:

[To] develop within the OAS […] a hemispheric approach to acts of corruption in both the public and private sectors that would include extradition and prosecution of individuals so charged, through negotiation of a new hemispheric agreement or new arrangements within existing frameworks for international cooperation.\textsuperscript{70}

The Secretary General of the OAS, Cesar Gaviria, expressed the Organization’s full embrace of this normative approach in 1995 when delivering a statement entitled \textit{A New Vision of the Organization of American States}. The statement included the sentence: “corruption is a problem that seriously affects the legitimacy of democracy, distorts the economic system and contributes to social disintegration”.\textsuperscript{71} The “new vision” reflected how Latin American countries, many of which were still struggling to consolidate democratic institutions after long years of military dictatorship and civil wars, were showing increased concerns with democracy and human rights.\textsuperscript{72} In this context, Abbott claims that the desire by a significant number of reformist Latin American governments to bind their successors in office to rules against corruption and illicit

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\textsuperscript{68} Evelisse Helena Hernancesz Gorrin, “The Ethics and the Fight Against Corruption in the Public Administration: A View From The Offices Of The Comptroller General In The Andean Community Countries” (2001).
\textsuperscript{70} “Plan of Action, First Summit of the Americas, Miami, Florida”, (1994) at 6, online: First Summit of the Americas <http://www.summit-americas.org/i_summit/i_summit_dec_en.pdf>.
\textsuperscript{71} Cesar Gaviria, A New Vision for the OAS (Washington, DC: OAS, 1995).
\end{flushright}
enrichment, while diverting corrupt officials’ resentment to international bodies, can explain the strong support for the OAS convention. ⁷³

On March 29, 1996, twenty-one out of thirty-four OAS members meeting in Caracas signed the Inter-American Convention Against Corruption (IACAC). ⁷⁴ Leading Latin American actors used the opportunity opened by the Clinton Administration at the OAS to advance a different agenda from that pursued by the Americans. ⁷⁵ For this reason the OAS Convention was broader than FCPA, having as its main purpose to encourage and help member states to adopt national legislation to “prevent, detect, punish, and eradicate” official corruption and to facilitate cooperation among members to combat official corruption. ⁷⁶ This chapter will not present a detailed examination of the provisions regarding domestic corruption (when the demand and supply involve national actors) in the OAS Convention and other international instruments that followed its lead. Although this is an important subject, it is not the focus of this chapter. This chapter focuses on home-country initiatives designed to address governance deficits abroad, and some of its consequences. For this reason I will only survey the important elements of these provisions, but will concentrate the analysis on the specific provisions dealing with bribery in international business. Did the IACAC introduce new mechanisms in the fight against foreign bribery? How effective was this convention for these purposes?

IACAC was an innovation in that its provisions on domestic corruption included the supply side (the individual or the corporation offering the bribe), and the demand side (the public official or political party receiving the bribe). ⁷⁷ However, with respect to bribes in international business transactions it followed the FCPA model, and only covered active bribes, i.e. home countries

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⁷⁶ Low et al, supra note 74 at 246. “Certain articles are binding on states parties, others are conditional, still others are subject to progressive development, and a fourth category are aspirational.” ⁷⁷ Low et al, supra note 74. To address the demand side the Convention listed the acts of corruption that should be criminalized, which included solicitation or acceptance of a bribe, improper acts or omissions by public officials, fraudulent use or concealment of property, conspiracy and illicit enrichment.
were not expected to investigate and prosecute the foreign public officials who appropriated the bribe. Article VIII stated that parties should prohibit and punish bribes of foreign officials. There was however a “escape clause”, since the article added that “a state party’s obligation to enact foreign bribery measures is ‘[s]ubject to its Constitution and the fundamental principles of its legal system’. 78

In addition, States that decided not to criminalize foreign corruption would still be required to cooperate with other states parties in the enforcement of their foreign bribery laws, but only “insofar as [their] laws permit”. 79 Therefore, despite being the first multilateral convention to institutionalize the idea that FCPA-like legislation should be encouraged, IACAC left much room for member-states to avoid or postpone criminalizing foreign corruption. Besides, the IACAC did not include any mechanism for oversight or monitoring of compliance by member states. Implementation was left to their own discretion. 80 Members of the international community did not have much leverage beyond naming and shaming in cases where the treaty was signed but there was no compliance.

Assuming that all OAS members decided to criminalize foreign corruption after ratifying the Convention, the practical effects in addressing rent-seeking in developing countries would likely be negligible. The country home to most of the major TNCs in 1996, the USA, had already criminalized the conduct. Latin American countries did not have relevant TNCs at the time. The Convention could nevertheless encourage Canada to follow the American lead. In less than a year, however, Canada would ratify the OECD Anti-bribery Convention, and this treaty would make the IACAC’s provisions related to foreign bribery irrelevant. This is because all the significant economies in the Americas that were the home base, or that would become home base, of major TNCs were either OECD members (USA, Canada, Mexico and Chile), or would ratify the more important OECD Anti-bribery Convention (Brazil, Argentina). OECD also

78 This clause enabled States to ratify the convention without reservations and still postpone the criminalization of foreign bribery. The same clause would apply for criminalizing illicit enrichment, but not other acts of domestic corruption. Low et al, supra note 74 at 248.

79 Ibid at 249.

included all other industrialized countries, which were home countries to major TNCs potentially involved in foreign bribes worldwide in the 1990s.

For this reason the most significant development in terms of addressing the bribes of foreign officials would be an agreement among OECD members. As explained before, industrialized countries had fiercely resisted American attempts to promote their adoption of FCPA-type legislation. The Clinton Administration designated Daniel Tarullo, a law professor and skilled negotiator, to lead the new American efforts towards a multilateral agreement on the issue at OECD. This time negotiations developed differently. Tarullo approached the situation as a prisoners’ dilemma problem. TNCs faced commercial incentives to bribe, and home-countries had political incentives to support their TNCs. Tarullo was convinced that only a hard law mechanism, with binding norms and effective sanctions, would be able to overcome such strong self-interested incentives. However, he was also convinced that this outcome was not politically feasible, due to strong resistance from European countries and Japan. His strategy was therefore to gradually open the way by starting with soft law.

Abbott and Snidal claim that, besides the gradual approach, this time the American negotiators did not rely exclusively on interest-based arguments. Taking stock of the growing international recognition of the negative impacts of corruption, they also decided to use a values-based approach, focusing on the need to fight international corruption due to its social and moral implications. A series of concurrent events helped to make this strategy successful. One of them was the creation of a non-governmental organization in Europe dedicated to disseminating knowledge on the negative developmental impacts of corruption and to advocate for policy mechanisms to address corruption in developing countries.

In 1993 Peter Eigen, a German national and former World Bank program manager for Africa and Latin America, with over 25 years of experience in economic development, created a non-profit organization called Transparency International. TI would play the important role of

81 Abbott & Snidal, “Values”, supra note 5.
82 Ibid.
83 Fredrik Galtun and Jeremy Pope argue that Peter Eigen decided to retire early from the World Bank to found TI due to the resistance showed by the Bank’s legal department, senior and middle-management in the early 1990s to
systematically gathering and disseminating information on the ubiquity of corruption and its negative social and economic impacts, and promoting practical actions to address it. The organization decided to focus primarily on developing countries where corruption was systemic (demand side), and in developed countries whose corporations were fueling the supply side of systemic international corruption.\(^8^4\) Their members also lobbied parliamentarians and government officials from key European countries in favor of the OECD Convention, including France and Germany, the main opponents of the initiative up to that point.\(^8^5\)

Meanwhile, the Clinton Administration ordered CIA monitoring and reporting of foreign corporations that were bribing foreign officials to gain commercial advantage.\(^8^6\) The administration believed that this information would give them more leverage in the negotiations. In the mid-1990s a series of corruption scandals in Europe and Japan provoked a strong public outcry, strengthening the value side of the strategy, and finally paving the way for the adoption of the 1994 OECD “Recommendation on Bribery in International Business Transactions”.\(^8^7\) This Recommendation called upon OECD countries to “take effective measures to deter, prevent and combat the bribery of foreign public officials in connection with international business develop an anti-corruption agenda. It was deemed that addressing corruption would interfere with the Bank’s charter mandate to abstain from political considerations in lending decisions. Fredrik Galtung and Jeremy Pope, “The Global Coalition Against Corruption: Evaluating Transparency International”, in Andreas Schedler, Larry Jay Diamond & Mark F. Plattner, The Self-Restraining State: Power and Accountability in New Democracies (Boulder, CO: Lynne Rienner Publishers, 1999).

\(^8^4\) Even though the founding members of TI, including Eigen, recognized that corruption was also a problem in several developed industrialized countries, the rationale was that “countries of the North may be able to afford the luxury of corruption… those elsewhere cannot.” Originally TI was focused only in international corruption, but over time it broadened its scope to cover domestic corruption as well. Galtung & Pope, supra note 83 at 258.

\(^8^5\) TI was created in fact as a global network formed by national chapters that seek to identify and engage key national players in government, parliament, civil society, private sector and media in the fight against corruption. The International Secretariat was (and remains) headquartered in Berlin, and very soon TI had chapters established in various OECD countries (Australia, Belgium, Britain, Canada, Denmark, USA, France and Germany).

\(^8^6\) Kimelman, The Lonely Boy Scout, supra note 6. See also Klich, “Bribery”, supra note 48 at 141.

transactions”. It also instructed the creation of a working group to follow up on this recommendation.88

The OECD nominated a Swiss international law professor, Mark Pieth, to coordinate this working group. Pieth adopted a gradualist and participatory approach.89 He invited representatives of corporations and civil society organizations, including TI, to present information to OECD members. He also coordinated with World Bank and regional development banks that were beginning to discuss concerns with corruption and foreign bribery to participate in the working group. Finally, he also engaged prosecutors who worked on domestic corruption and money laundering issues and were invested in the fight against corruption in the activities of the working group.90 Following the gradualist approach, the OECD working group began preparing draft principles on corruption to be discussed by member-states in 1997. However, Abbott and Snidal claim that France and Germany, two of the main opponents of the process up to that point, radically changed positions and pressed for a binding treaty with a meaningful enforcement mechanism.91

There is speculation that France and Germany changed position for fear that a soft law could lead to irregular implementation. They were concerned that as their civil society organizations were more active than in other OECD countries, they would be under more pressure to adopt and implement legislation, while the same might not be true for all other OECD members. France and Germany allegedly felt they would have no leverage to address the potential free-riding by

88 Pieth argues that the 1994 OECD Convention, despite not having binding force, had an important political role in the future development of international mechanisms to deal with foreign bribery. “Its real significance has been to generate confidence within the OECD and within other organizations and NGOs that bribes could be overcome, provided states, the private sector, and civil society all co-operated. Pieth, International, supra note 33 at 13.

89 Abbott & Snidal claim that all main actors involved, Tarullo for the American government, Pieth for OECD and Eigen for TI, were firm believers in the gradual approach as a way to avoid stalemates. Abbott & Snidal, Filling, supra note 16.

90 For Abbott & Snidal this conjunction of value-based actors explain why the working group focused on criminalizing transnational bribery, instead of softer approaches such as disclosure and administrative penalties. Abbott & Snidal, Filling, supra note 16.

91 Abbott & Snidal, Filling, supra note 16. See also Pieth, International, supra note 33, who mentions that both countries wanted to make sure there was a real level playing field. France suggested that there should be negotiations in the WTO, while Germany wanted to immediately engage the United Nations. Pieth argues that after the G7 discussed the issue and was in favor of multilateral binding initiatives to deal with foreign bribes, the Convention was a done deal. This explains why the process was very fast, and not gradual.
other OECD countries, and their corporations would lose competitiveness. For these reasons they decided to support a binding treaty instead. Yet, the change had been so sudden that American officials suspected they might be trying to provoke stalemate in the process. American representatives agreed with the discussion of the binding treaty, yet asked for a deadline in negotiations. If by December 1997 there was no agreement on a binding convention, the guidelines would be approved instead. However, the negotiations for a binding treaty went smoothly. In December 1997 all 34 OECD states, plus five non-members, approved the text of the OECD Anti-Bribery Convention. It entered into force in 1999.

The OECD Anti-bribery Convention focused exclusively on foreign bribes. Twenty years after the enactment of FCPA, it marked the successful, if belated, multilateralization of extraterritorial anti-bribery regulations. The OECD Convention required state parties to enact domestic legislation criminalizing the conduct of their national individuals or corporations offering or granting bribes to foreign public officials in exchange for business advantages. Mark Pieth argues that the OECD Convention amounted to “collective unilateralism”, since its provisions were deployed to address bribes taking place mostly in countries that are not part of the Convention. Responding to the free-riding concerns of key industrialized countries, the OECD Anti-bribery Convention also included a strong monitoring and follow-up procedure. A

92 Abbott & Snidal, “Values”, supra note 5 at 167.
94 Brazil, Argentina, Bulgaria, Chile and Slovak Republic. Nowadays Chile and Slovak Republic are part of OECD.
96 The OECD Anti-bribery Convention was more limited than FCPA in a few areas. It did not include provisions on accounting and record keeping. For those countries that do not consider corporations as legal subjects in criminal law, the Convention required the creation of civil sanctions. However, according to Stuart Deming, the civil law threshold to prove sufficient knowledge required for civil liability is too high. Lastly, the Convention did not include payments to political parties. On the other hand, the OECD Anti-bribery Convention included two vital components: legal cooperation to address transnational bribery and a strong monitoring and follow up system. The Convention requires members to “give prompt and effective” assistance to other parties in connection with their investigations and legal actions. Parties should follow the “extradite or prosecute” rule with respect to foreign nationals in their jurisdiction. The Convention also removed bank secrecy domestic laws as a basis for declining investigative or legal assistance. For an examination of these limitations see Deming, supra note 29.
97 Abbott & Snidal, “Filling”, supra note 16 at 143. For a detailed analysis of the technical legal aspects of the Convention, ie, who is considered a foreign official, what constitutes bribe, etc, see OECD Convention, a Commentary. On this same issue see also Pieth, International, supra note 33 and Low et al, supra note 74.
permanent working group would periodically monitor both the implementation of domestic anti-bribery laws and their enforcement, as well as suggest remedial actions.

If the OECD Convention concentrated exclusively in the supply side of foreign bribery, European countries were also discussing regional cooperation mechanisms to address both the supply and demand sides of domestic and foreign corruption. The Council of Europe adopted the *Criminal Law Convention on Corruption* in 1998. This Convention was similar to the OAS Convention, although it expanded its scope in a few areas.\(^9^8\) For present purposes, the most relevant provision of the Council of Europe’s Convention was the criminalization of the demand side of bribery, meaning the criminalization of foreign officials that were recipients of bribes paid by foreign actors. The Council of Europe’s Convention asked member states to establish as criminal offences

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\text{“The request or receipt by any [...] public officials, directly or indirectly, of any undue advantage, for himself or herself or for anyone else, or the acceptance of an offer or a promise of such an advantage, to act or refrain from acting in the exercise of his or her functions”}.\(^9^9\)
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The demand side bribery provision also applies to members of public assemblies, officials of international organizations and assemblies, judges and officials of international courts.\(^1^0^0\) A second innovative aspect of the Council of Europe’s Convention was the creation of a strong monitoring system, based on the work of a *Group of States Against Corruption (GRECO)*, whose members are charged with analyzing periodic reports on implementation submitted by party members.

By the time the OECD Convention was finally approved, the geopolitical scenario was beginning to experience another change. Even though the TNCs from OECD countries still dominated foreign business, there were a few TNCs from emerging economies and newly industrialized countries (NICs), not part of OECD, experiencing growing commercial success globally. There was no Asian regional initiative addressing bribery in foreign business, leaving transnational


\(^1^0^0\) Webb, *supra* note 98.
corporations from newly industrialized countries like South Korean, Taiwan, Hong Kong, Singapore, and also from emerging economies like India and China completely unconstrained. Besides, as already mentioned, the OAS Convention did not include a strong enforcement mechanism, also leaving some Latin American corporations unconstrained. Finally, some South African TNCs were also competing with TNC’s from OECD countries for African business. Aware of this on-going - if gradual – shift, the OECD Convention included in its section III.2 a binding provision to “open negotiations promptly on an international Convention to criminalize bribery in conformity with the agreed common elements”. 101

When the 1990s came to a close, the anti-corruption movement was firmly established on the international agenda. 102 Besides the multilateral conventions already mentioned, the IMF, the World Bank, and other regional development banks, all had incorporated the fight against corruption in their activities, with varying levels of commitment and effectiveness. 103 These independent efforts culminated in the United Nations organizing an international conference against corruption in Durban in 1999. 104 This Conference revealed a high degree of congruent interests and values, indicating that a global agreement on corruption was possible at that moment. The United Nations General Assembly followed through and opened formal negotiations in 2000.

A United Nations Ad Hoc commission negotiated a draft convention during seven sessions between January 2002 and October 2003. 105 In December 2003, 95 states signed the United Nations Convention Against Corruption (UNCAC) in Merida, Mexico. This Convention reflected the different levels of international acceptance of issues related to corruption, as its provisions come in varying degrees, from hard, mandatory provisions, to optional provisions, to

102 In the regional level exceptions were African countries, which would discuss a regional treaty a while later, and Asian countries, which have historically tended to give a stronger emphasis to the principle of non-intervention. On this topic see John Funston, “Asean and the Principle of Non-Intervention – Practices and Prospects” (2000), online: <http://www.iseas.edu.sg/trends520.pdf>.
104 Abbott & Snidal claim that the fight against corruption became an end in itself. They argue that interests became values, and point to the change in rhetoric of some leaders of the anti-corruption movement as evidence. See Abbott & Snidal, “Filling”, *supra* note 16 at 160.
soft recommendations. The UNCAC also reflected the complex and dynamic nature of global law-making. Its mandatory provisions do include the criminalization of bribery of foreign officials, which was the main issue of concern for developed industrialized countries. However, the Convention also required member-states to criminalize both the supply side and the demand side of domestic corruption, including embezzlement of funds, laundering the proceeds of corruption and obstruction of justice related to corruption, showing that concerns first raised by developing countries at the OAS level had now become recognized as of universal concern.  

For the purposes of this chapter the landmark feature of UNCAC is the global coverage of its anti-bribery provisions. As the global economy evolves, TNCs from emerging economies are increasingly competing for business opportunities with TNCs from industrialized countries. This competition includes business in places where corruption is still widespread, such as resource-rich LDCs. With a very high ratification rate, UNCAC reaches countries such as China, which had been unconstrained in terms of criminalizing foreign bribery. There is therefore a level playing field in principle.

One interesting question is why China, a country plagued by systemic corruption, and which had so far maintained a strong “non-interference in domestic affairs” approach in international law, decided to support UNCAC. In the same way that OECD countries resisted US attempts to level the playing field, China could also have resisted attempts to curb this alleged competitive advantage. By all accounts a strong motivation and a few reassurances could explain China’s strong support to UNCAC. Margareth Lewis affirms that China was “an early and enthusiastic proponent of UNCAC”. She argues that the motivation sprang from a congruence of key UNCAC’s aims with Chinese government’s domestic concerns. Corruption scandals involving public officials have been a powerful fuel for domestic demonstrations of discontent that carry serious political risks to the Chinese ruling party. In order to avoid escalation, the Chinese government needs to demonstrate a strong resolve to investigate uncovered cases of corruption, and to sanction individuals engaged in corrupt behavior. Part of this effort should include the return of the often substantial assets from corruption stashed overseas, as well as the extradition

106 Deming, supra note 27.
of former officials or businessmen that have fled abroad in attempting to escape Chinese law enforcement.\textsuperscript{108}

China was strongly interested in international cooperation for the purposes of recovering assets from corruption transferred abroad and having accused individuals hiding in foreign countries extradited back to China.\textsuperscript{109} Asset recovery was also an important concern to the new governments of several developing countries who had got rid of long-time dictators who had diverted significant sums of money to bank accounts in developed countries or to offshore havens, a topic that will be addressed in the following section of this chapter. These countries supported China’s resolve to include provisions in UNCAC requiring states to cooperate in order to facilitate the recovery of assets related to proceeds from corruption that were transferred abroad, and the extradition of suspects. If China was a strong proponent of the asset recovery provisions and of international cooperation to jointly combat corruption, it still showed strong commitment to the non-interference in domestic affairs principle. It did so by fiercely resisting the creation of a meaningful system to monitor the implementation and enforcement of anti-corruption and anti-bribery domestic laws. Despite this resistance the UNCAC has approved a peer review mechanism in 2009, which raised the levels of delegation of this treaty’s enforcement mechanisms.\textsuperscript{110}

In the same year that the UNCAC was approved, the African Union also approved its Convention against Corruption. If effectively implemented, this convention could have an important impact on rent-seeking behavior in resource-rich LDCs. The African Union Convention requires countries to criminalize the supply and the demand side of domestic and international corruption, as under the OAS and UN conventions, but it includes criminalization of illicit enrichment and of concealment of proceeds. For the purposes of this chapter, however,

\textsuperscript{108} Lewis cites a case that became notorious in China, where one Chinese businessman, Lai Changxin, built an enormous smuggling empire by systematically bribing Chinese officials. Changxin escaped to Canada and legal battles for the recovery of his assets and for his extradition to face justice in China are still on-going. \textit{Ibid}.

\textsuperscript{109} For an account of the strong Chinese interest in the asset recovery provisions see \textit{ibid}.

the African Convention not only did not add anything to the existing framework of international conventions, and did not even include the criminalization of transnational bribes.\footnote{111}

Today, most countries that are home to extractive TNCs have criminalized foreign bribes in a more or less homogeneous way. Since the most effective review mechanism so far is that created by the OECD, I will focus on the record of its anti-bribery initiatives. All the 34 OECD State Parties and the four non-parties that signed the OECD anti-bribery convention have enacted legislation to criminalize foreign bribery.\footnote{112} This includes all the industrialized countries that are home to the most important mining, oil and gas TNCs, and also Brazil and South Africa, two of the emerging economies whose extractive TNCs have been recently expanding worldwide.

Other emerging economies such as Russia, India and China, that have an increasing presence in international business and especially in mining, oil and gas activities in developing countries, could still be free riders. In 2010, however, the G20 countries committed to adopting an Anti-Corruption Action Plan that included criminalizing foreign bribery.\footnote{113} Russia and China only approved domestic legislation criminalizing foreign bribery in May 2011.\footnote{114} India was drafting legislation in 2010. Yet, emerging economies are not the only countries that neglected the enactment of domestic anti-foreign bribery laws until very recently. The UK, home of leading extractive TNCs such as British Petroleum and Rio Tinto, took a very long time to enact domestic legislation. The UK Parliament only approved a new Bribery Act pursuant to the OECD Convention in 2010. This Act has just recently (July 1\textsuperscript{st}, 2011) come into force.\footnote{115}

\footnote{111}{The African anti-Corruption convention only recommended states parties to cooperate to prevent corruption in international business.}
\footnote{114}{Signing the OECD Convention is a requirement for accession to the OECD. Since 2009 Russia has started a process to become part of this organization, and enacting anti-bribery laws according to the convention was part of this process. OECD, Press Release, Russia Joins the OECD Working Group on Bribery” (26 May 2011), online: <http://www.state.gov/r/pa/prs/ps/2011/05/164438.htm>. On China see Renee Mark & Peter Bullock, “From May 1st New China Anti-corruption Laws Follow Long Arm Jurisdiction Trend” (30 May 2011), online: <http://thebriberyact.com/2011/05/30/from-may-1st-new-china-anti-corruption-laws-follow-long-arm-jurisdiction-trend>. Despite not being part of OECD China has been participating as ad hoc observer in the Working Group meetings since 2007.}
\footnote{115}{The Bribery Act has created the offences of active bribery, passive bribery, bribery of foreign officials and failure of commercial organizations to prevent bribery by an associated person. Besides UK citizens, UK residents and corporations established under UK law, non-UK companies that conduct business in the UK can also be held accountable for international bribes. Jon Jordan, “Practitioners Note: Recent Developments in the Foreign Corrupt}
As a result of this historical evolution of the international anti-foreign bribery law enforcement regime, virtually all countries that are home to extractive TNCs operating in resource-rich LDCs have the legal power to investigate and prosecute their nationals and their corporations engaging in bribes of foreign officials. European countries even have the legal power to investigate and prosecute foreign officials that accept bribes in transnational business transactions. Extraterritorial home-country regulations to combat the bribery of foreign officials therefore went from primarily protecting the self-interests of home countries to also serving as a tool to promote the interests of foreign populations that may have their development outcomes affected by transnational corruption. A similar trajectory occurred with anti-money laundering regulations, which I discuss next.

5.3. The international anti-money laundering law enforcement regime

Nowadays most countries that are home to important financial centers have extraterritorial laws and regulations designed to address money laundering related to proceeds of foreign corruption. The process leading to this international anti-money laundering law enforcement regime followed an analogous path to the process leading to the international anti-foreign bribery law enforcement regime. In a similar fashion, the first extraterritorial regulations were created in the USA to address domestic concerns. The USA was concerned with the abuse of bank secrecy in foreign countries to conceal white-collar crimes committed against the United States, or to evade American economic regulations. The USA also took the lead in promoting an international

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116 Money laundering is generally understood as including any procedures and techniques used to hide the illicit origin of assets or money, and to make the impression that it was acquired by legal means. Money laundering is usually divided in three distinct phases that normally follow chronologically (but not always). 1\(^{\text{st}}\) phase is called placement, and happens when assets acquired illegally are placed into a legitimate financial institutions. This is considered the most conducive phase for combating money laundering. 2\(^{\text{nd}}\) phase is called ‘layering’ and includes a series of transactions/movements of assets in between financial institutions in order to disguise the original placement. 3\(^{\text{rd}}\) phase is called ‘integration’ and happens when the financial assets are fully incorporated in the mainstream economy through for example the acquisition of real property and/or luxury goods, and securities assets. See Quentin Reed & Alessandra Fontana, “Corruption and Illicit Flows: The limits and possibilities of current approaches” U4 Issue (2011), online: <http://www.u4.no/publications/corruption-and-illicit-financial-flows-the-limits-and-possibilities-of-current-approaches-2>.

117 The justification for enacting extraterritorial legislation to deal with domestic concerns, breaking the traditional principles of jurisdiction (territory and nationality) was the “effects doctrine”. Despite happening in a foreign country the criminalized act produced relevant public policy effects in the United States. American legislators and law enforcement officials had used the same rationale when they approved and enforced antitrust and securities laws
regime to encourage the adoption of anti-money laundering legislation by other countries, and to facilitate cooperation in investigating and sanctioning transnational money laundering.

While the USA promoted the dissemination of extraterritorial anti-bribery regulations to level the playing field for American corporations, American policymakers had since the very beginning an additional motivation to promote the dissemination of anti-money laundering regulations worldwide. American policymakers became convinced that it was impossible to effectively fight transnational organized crime such as drug trafficking and white-collar crimes without strong international cooperation. Therefore, American policymakers had a strong interest in the internationalization of the anti-money laundering regime, beyond promoting a level playing field for American banks that had to comply with more stringent disclosure requirements under anti-money laundering regulations.

The other difference was that the USA faced much less resistance to its initiative to internationalize anti-money laundering legislation than in the anti-foreign bribery case. This time, most other industrialized countries were more receptive to the idea of adopting anti-money laundering legislation, since they were also concerned with the domestic impact of drug trafficking and other transnational organized crimes. Developing countries were mostly interested in anti-money laundering international cooperation in order to enable the recovery of assets leaving their jurisdiction through grand corruption. Only a specific group of countries, which had traditionally or strategically relied on stringent bank secrecy laws, such as Switzerland and the so-called tax havens, resisted the spread of initiatives based on financial disclosure.  

This section argues that it was feasible for countries like the USA to create the first extraterritorial regulations to tackle money laundering because they responded to important domestic concerns of home countries. It also argues that the international cooperation that enabled the creation of the anti-money laundering law enforcement regime resulted from the combination of unrelated interests from key developed and developing countries.

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There is an argument that bank secrecy is part of an entrenched right to privacy principle developed in continental Europe as a whole for centuries. “The individual right to privacy […] has perhaps greater significance in the countries of the European continent than elsewhere, because Europeans have been involved in a century-long struggle against the aggressions of authoritarian regimes […] It is undeniable fact that in Europe the secrecy duty has been an essential component of the banker/client relationship for centuries.” Werner de Capitani, “Banking Secrecy Today” (1988) 10 U Pa J Int’l Bus L 57.
5.3.1. **Self-interests prompt first extraterritorial money laundering regulations**

At the end of the 1960s the 90th US Congress and the 91st US Congress conducted extensive hearings on the use of foreign financial institutions by American individuals engaged in illegal or criminal activities. The findings showed how bank accounts in countries with stringent bank secrecy regulations such as Switzerland were being used to hide proceeds of crimes committed against the United States treasury. These crimes included tax evasion, violation of securities regulations, smuggling, etc. The same practice was being used to facilitate other crimes considered of a serious nature such as bribes and kickbacks to governmental and military officials and drug trafficking. American law enforcement officials alleged they were being prevented from effectively investigating and prosecuting these crimes by the widespread invocation of bank secrecy laws by key foreign countries where the financial assets – and the evidence – had been stored.

At that time the US Congress opted to create a domestic regulatory mechanism to facilitate the investigation of these types of criminal activity. According to James Kelly, the basic premise of the 1970 Bank Secrecy Act (BSA) was that:

> [I]f recording and reporting requirements are imposed on domestic banks, and if American citizens are unable to use domestic banks as conduits to move money secretly out of the country, then American investigators and prosecutors will no longer need to seek information protected by foreign secrecy laws.

One set of BSA’s provisions dealt with financial recordkeeping, and required all domestic financial institutions to maintain records indicating all transactions and the account holder’s

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120 Ibid at 240.

121 Both Kelly and Barry Schwartz argue that the enactment of BSA was in great part a response to several concrete cases where failure of legal cooperation by Swiss institutions based on bank secrecy laws had frustrated investigations of white-collar crimes. Kelly says that after negotiations with Swiss government to reach a bilateral treaty appeared unpromising, the House of Representatives decided to study the problem and potential unilateral domestic alternatives. See Ibid at 145. Kelly offers a very detailed account of the long-standing conflict between US and Switzerland over Swiss bank secrecy laws, starting in WWII when Nazi Germans were thought to use Swiss banks to conceal financial assets. The official name of the Bank Secrecy Act was in fact Currency and Foreign Transactions Report Act. Barry P. Schwartz, “Recent Swiss-American Treaty to Render Mutual Assistance in Criminal Law Enforcement (An Application of the Bank Secrecy Act): Panacea or Placebo, The Notes” (1974) 7 NYUJ Int’l L & Pol 103.

122 Kelly, supra note 119 at 246. See also Schwartz, supra note 121.
A second set required reporting of currency transactions over a certain threshold in order to signal possible unusual transactions and enable the combat of tax evasion and concealment of assets abroad. Both the financial institution and the account holder were required to file these reports with the Department of Treasury. American financial institutions were strongly opposed to the Act, claiming that its implementation would entail significant costs, placing them at a disadvantage with foreign peers. They would also challenge the constitutionality of the Act in American courts, unsuccessfully. They were however successful in their lobbying efforts to influence the subsequent rules that were needed to put the BSA into action. These rules ended up narrowing the scope of several provisions. In the first decade after its passage, BSA was not enforced and did not have much impact. The momentum to combat illicit finance schemes seemed to have waned. The anti-money laundering efforts would wax again during the Watergate scandal. As an illustration, the same events that led to the enactment of FCPA also marked the first time in which American law enforcement officials used the expression ‘money laundering’.

It is not my intention here to offer a detailed examination of the provisions of the BSA, but rather to give a general overview of the intended results. For a detailed analysis of BSA see Charles Thelen Plombeck, “Confidentiality and Disclosure: the Money Laundering Control Act of 1986 and Banking Secrecy” (1988) 22 Int’l Law 69. Kelly, supra note 119 at 248. He mentions a third set of provisions, related to margin requirements in securities transactions by American borrowers, that did not seem as relevant as the other two for present purposes. Read other source to double check. Schwartz, supra note 121. Matthew Morgan says that the effects of the BSA in the first decade and a half was minimal, due to lack of enforcement. Matthew S. Morgan, Money Laundering: The United States Law and Its Global Influence (London, UK: International Finance and Tax Law Unit, Centre for Commercial Law Studies, University of London, 1996) at 10. Cynthia Clark Northrup, ed, American Economy: A Historical Encyclopedia (Santa Barbara, CA: ABC-CLIO, 2003) at 446.

According to Friedrich Schneider and Ursula Windischbauer the specific expression ‘money laundering’ became popular among journalists during the Watergate scandal. It would only enter the American legal dictionary in 1982. In 1993 it would enter the international agenda in a UN Report. Friedrich Schneider and Ursula Windischbauer, Money Laundering: Some Facts, (2008) 26 (3) Eur J L & Econ 387. However, the origins of the expression are traced to early efforts to address domestic organized crime in the USA by targeting the finances of organized groups. During the 1920s and 1930s Mafia groups invested in legitimate laundry business with illicit assets obtained from bootlegging, gambling and prostitution. The legitimate laundry business helped to confound licit from illicit proceeds. David A. Chaikin, “Money Laundering: an Investigatory Perspective” (1991) 2 Criminal LF 467. In 1956 the American Congress passed the Laundering of Monetary Instruments Act, criminalizing the act of transferring assets illegally obtained, or concealing or disguising the illegal source of ownership. In 1957 the Monetary transactions in Property Derived from Specified Unlawful Activity Act was passed, to reinforce the previous one. See Jeffrey Robinson, The Laundrymen: Inside Money Laundering, the World’s Third Largest Business (New York: Arcade Publishing, 1996) [Robinson, The Laundrymen]. See William C. Gilmore, “Money laundering: the international aspect”, in David Hume Institute, Money laundering (Hume Papers on Public Policy, vol. 1, No. 2) (Edinburgh, UK: Edinburgh University Press, 1993) 1 at 2.
it seems that the public concern or outrage with money laundering at the time was not as strong as with foreign bribery, or maybe the lobby by financial institutions that were concerned with their competitiveness abroad was stronger than multinational corporations. The fact is that in 1978 instead of strengthening the Bank Secrecy Law or creating any extraterritorial regulation, the American Congress approved the Right to Financial Privacy Act, to protect individuals against possible abuses committed by law enforcement officials enforcing the Bank Secrecy Law.\footnote{See Plombeck, supra note 123. Plombeck explains this Act in details, but it is not clear how the balance of forces tilted so much to the side of financial institutions while other multinationals endured FCPA.}

The first extraterritorial home-country regulation to address money laundering related to criminal conduct abroad was not designed to address corruption or illegal campaign financing, but rather to combat the transnational trade in illicit drugs. In the late 1970s and early 1980s the consumption of illicit drugs in several developed countries, especially in North America and Europe, saw an exponential growth. This phenomenon raised existing concerns about both the serious public health problems caused by habitual drug use, and the economic and social costs of drug-related violent criminality.\footnote{David Whynes, “Illicit Drug Production and Supply-side Drugs Policy in Asia and South America” (1991) 22 Development and Change 3 [Whynes, “Illicit”].} The problem was particularly serious in the USA, which was at the time the main destination of cocaine and heroin produced abroad.\footnote{World Drug Report 1999, at 46. The USA also witnessed a significant increase in the consumption and illegal trade of amphetamine-type stimulants (ATS) like ecstasy and methamphetamine, starting in the 1990s. The production of ATS was however mainly domestic, and therefore the fight against the illegal traffic of this type of drugs did not involve transnational cooperation or extraterritorial legislation.} It was well known that organized criminal groups were responsible for the international supply of these drugs to the growing American market.

Organized crime and money laundering came to the forefront of the American domestic agenda in 1983. In July of that year President Ronald Reagan created the “President’s Commission on Organized Crime, The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering”. This Commission was entrusted with:

[M]aking a full and complete national and region by region analysis of organized crime; define the nature of traditional organized crime, as well as emerging organized crime groups, the sources and amounts of organized crime’s income …; develop in-depth information on the participants in organized crime networks; and evaluate Federal laws pertinent to the effort to combat organized crime.\footnote{See US, President’s Commission on Organized Crime, The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering (4-8) (Washington, DC: US President's Commission on Organized Crime, 1984). See also William Norman Thompson, Gambling in America: An Encyclopedia of History, Issues, and Society (Santa Barbara, CA: ABC-CLIO, 2001).}
The Commission gave special importance to examining money-laundering schemes, since they were considered effective instruments of - and powerful incentives for - organized crime. Forty-one American banks were investigated. In the most infamous case, the Commission found evidence that the Bank of Boston had “knowingly and willfully” allowed $1.22 billion in cash transfers to Swiss banks on behalf of clients who brought in large sums of money in paper grocery bags. Bank of Boston asked no questions about the origins of the money and made no reports about the transfers. The Commission’s findings revealed that this was not an exceptional case, as American financial institutions had in fact largely ignored the 1970 Bank Secrecy Act, especially its reporting provisions.\footnote{Robinson, \textit{The Laundrymen}, supra note 128.}

In October 1984, the Commission concluded its work by recommending that a new law be passed making money-laundering a federal crime, with significant fines for financial institutions and prison terms for individuals engaged in the criminal activity.\footnote{At the time illegal gambling had become highly conducive to money laundering activities, and legal casinos were also viewed as potential money laundering conduits. In 1985, regulations of the Treasury Department were amended so that casinos with revenues in excess of $1 million a year were to be considered banks for purposes of the 1970 Bank Secrecy Act. During the Commission’s work some Senators were very vocal on why money laundering should be considered a serious crime. They said money laundering was the “lifeblood” of international narcotics trafficking and traditional organized crime. Statements of senators Thurmond and Hatch at the President’s Commission, cited in Jimmy Gurule, “The Money Laundering Control Act of 1986: Creating a New Federal Offense or Merely Affording Federal Prosecutors an Alternative Means of Punishing Specified Unlawful Activity?” (1995) 32 Am Crim L Rev 823.} In 1986 the \textit{Money Laundering Control Act (MLCA)} established money laundering as a federal crime. The Act prohibited individuals from engaging in financial transactions with proceeds that were generated from certain specific crimes (so-called SUAs or specified unlawful activities). It also created the following money laundering offenses: a) deliberately avoiding reporting requirements under the BSA; b) knowingly aiding a criminal to launder money; c) knowingly engaging in a financial transaction in excess of $ 10,000 with proceeds from criminal activity.\footnote{\textit{Money Laundering Control Act of 1986}, MLCA §1956 & 1957 (1986) [MLCA]. Prior to MLCA financial institutions had under BSA to file currency transaction reports “CTRs” for any currency transaction above $10,000. Yet they evaded this obligation by performing multiple transactions below the threshold. MLCA closed this loophole, making it a criminal offense to intentionally performing multiple transactions to avoid reporting. Gurule, \textit{supra} note 134 at 825.}

Law enforcement officials had to demonstrate that the proceeds were linked to one of the crimes included in a laundry list as part of the Act. The crimes could have been committed abroad, giving the USA a tool to indirectly influence criminal behavior overseas. Most relevant to this Chapter’s purposes, this laundry list included “bribery of a public official, or the
misappropriation, theft or embezzlement of public funds by or for the benefit of a public official”.\textsuperscript{136}

However, the MLCA also included specific provisions prohibiting transnational money laundering.\textsuperscript{137} The Act proscribed the “transportation or transfer of monetary instruments or funds internationally with the intent to promote the carrying on of specified unlawful activities, or knowing that the monetary instruments or funds represent the proceeds of some form of unlawful activity, with the design to conceal or disguise the nature, location, source, ownership, or control of illicit proceeds”.\textsuperscript{138} Yet, maybe in order to minimize expected controversy surrounding the extraterritorial law enforcement of American laws, the Act limited the reach of the legislation to cases where the defendant was a US citizen or when the transaction occurred in whole or in part in the United States.

In 1986 President Ronald Reagan called for a “national crusade against drug use”.\textsuperscript{139} This ‘crusade’ was to be primarily based on suppressing the illegal drug trade, with his administration advancing domestic legislation to make penalties against drug traffickers more stringent and to increase funds for law enforcement programs. The American strategy to address the supply side of the illicit drug trade was based on the eradication of production, the disruption of drug flows, the criminalization of transnational trade of illicit drugs and the identification and recovery of illicit proceeds from drug trafficking.\textsuperscript{140}

A significant portion of drug trafficking occurs across borders,\textsuperscript{141} and most of the cocaine and heroin supplies to the American market come from outside the country. Therefore, the Reagan

\textsuperscript{136} Gurule, \textit{ibid}. See Morgan, \textit{supra} note 126 at 13.
\textsuperscript{137} MLCA, \textit{supra} note 135 at §1956(a)(2).
\textsuperscript{138} Gurule, \textit{supra} note 134 at 827.
\textsuperscript{139} Whynes, “Illicit”, \textit{supra} note 130.
\textsuperscript{140} Secretariat of the Commission, “Drugs and Democracy: Towards a Paradigm Shift, Statement by the Latin American Commission on Drugs and Democracy, Third Meeting of the Commission” (November 2009), online: <http://www.drogasedemocracia.org/English/DocumentosComissao.asp>.
\textsuperscript{141} In 2009, for example, there were estimated 12 to 14 million global heroin consumers, mostly in Europe and Asia. The heroin consumed by these individuals mainly made from Afghan opium. Similarly, most cocaine consumed in North America and Central and West Europe is produced in the Andean countries in South America. Conversely, cannabis consumption seems to be worldwide and its production is usually local or regional. Likewise, there seems to be worldwide markets for amphetamines-group substances, and the manufacture of these drugs is usually local, close to the market. However there has been lately increasing production of amphetamines in Africa, for consumption in East Asia.
Administration declared international drug trafficking a national security issue. President Reagan made the promotion of international cooperation to combat transnational drug trafficking a priority as well. Mathew Morgain claims that the USA had all the incentives to promote an international system to combat the transnational drug trade, and could also build on its own evolving experience with the domestic war on drugs, organized crime and money laundering. All this domestic legislative activity concerning money laundering, and the international lobby efforts that would follow, reflected the marked domestic concern with the need to attack organized crime, especially drug trafficking, by fighting money-laundering schemes. Up to this point, although anti-money laundering laws could also be used to address foreign corruption, this was not on any country’s agenda.

There is overall agreement that the international anti-money laundering law enforcement regime that exists today originated at this time out of growing international concerns with drug trafficking and related organized crime. There is also consensus that the United States provided strong initial leadership in the creation of the first international treaties that would form the backbone of this regime. I turn to this international regime next.

5.3.2. Values and converging interests enable international anti-money laundering regime

In 1986, the same year that Reagan declared the domestic “crusade” against drugs, the United Nations General Assembly purported to “mobilize the international community in an unprecedented global counteroffensive against the international drug menace”. Early on the

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143 Gilmore, Money Laundering, supra note 128. International concern with illicit trade in drugs can be traced in fact to 1961 Single Convention on Narco. North America (mainly the United States) houses 37% of the cocaine users worldwide. 1.9% of North Americans consumed cocaine in 2008, the highest prevalence rate in the planet. More than 40% of opioid users. See also Whynes, “Illicit”, supra note 130.
144 See Morgan, supra note 126.
145 Gurule, supra note 134.
147 Matthew Morgan affirms that the USA was active in the negotiation of the future 1988 Vienna Convention on Illicit Drugs that generated the first international provisions on money laundering, and its domestic laws are reflected in the document. See Morgan, supra note 126. Guy Stessens however emphasizes that the UK as early as 1986 created domestic legislation to confiscate proceeds of crime, reflecting similar concerns with drug related money laundering as in the US. See also Stessens, Money Laundering, supra note 4 at 20, stressing the instrumental role of the US in the UN 1988 Convention.
148 Whynes, “Illicit”, supra note 130 at 476.
actors engaged in these international discussions took the view that encouraging countries to identify and prosecute drug traffickers would not be enough. It was necessary for other countries to follow the American example by combating the laundering of money obtained as the proceeds of drug trafficking; and by identifying, freezing and confiscating the assets obtained via this illegal trade. Anti-money laundering regulations were considered an indispensable tool in the international fight against transnational drug trade. This led many developed and developing countries which were concerned about this issue to support the creation of international initiatives aimed at encouraging criminalization of money laundering domestically and facilitating international cooperation to fight transnational money laundering schemes.

As early as 1988 the American leadership achieved its first major breakthrough in the efforts to address the international drug trafficking problem. In that year most European countries, but also emerging economies such as China and Brazil, and several developing countries gathered in Vienna, all agreed to adopt the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances. For present purposes, the most relevant achievements of this Convention were: it required states to criminalize drug-related money laundering activities; it established mechanisms to facilitate cooperation with respect to confiscation of assets, mutual legal assistance and extradition of accused individuals between states; for the first time it affirmed that bank secrecy should not be used as an excuse for banks not disclosing information deemed relevant for investigations.

Despite questions about the effectiveness of the Convention, once created the regime gathered its own momentum. A change in consensual knowledge about money laundering regarded the practice not only as a tool to enable international drug trafficking, but also as an autonomous problem: the injection of vast sums of “dirty money” into legitimate domestic financial institutions was deemed to pose serious risks to their long-term legitimacy and stability. In addition, other countries quickly recognized that combating transnational money laundering could be an important tool to tackle other transnational crimes. Guy Stessens affirms, for example, that while Western developed countries seemed most concerned with mechanisms to

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150 The Convention entered into force two years later, in 1990.

151 Lisa Barbot, for example, affirms that the UN Convention was an important political and ideological first step, but its effectiveness in actually preventing or addressing money laundering was marginal. She claims that a provision allowing state parties to adopt measures only when consistent with their constitutional systems weakened the potential of the convention. She also questioned the narrow focus on money laundering related to international drug trafficking. Barbot supra note 146.
identify and control the domestic impact of the huge sums of “dirty money” related to drug trafficking, developing countries were primarily interested in anti-money laundering regulations as tools to help them addressing another concern: capital flight.

Capital flight, meaning the significant outflows of domestic private capital, had become a significant concern for several developing countries in the 1980s. Developing countries expected that anti-money laundering legislation in important financial centers could help them to identify the flight of assets related to illegal activities, and to provide tools to enable those assets to be repatriated.

Despite this convergence of interests among developed and developing countries, initially industrialized countries did not pursue an international treaty on money laundering. The consensus among industrialized countries was that the approach should be soft law, and that the private financial system could and should play an active role. This was in line with developed countries 1980s shift towards what came to be known as the “regulatory state”, where economic governance was to place “greater emphasis on institutional self-regulation”. In 1988 the “Basle Committee on Banking Regulations and Supervisory Practices”, which comprises representatives of Central Banks and Bank Supervisory Agencies from the Group of 10 most industrialized countries (G10), approved a Statement of Principles on Money Laundering

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152 Although there is to this day no consensus on a definition for capital flight, developing countries were concerned with the significant outflows of domestic private capital from their economies to foreign financial centers. Capital flight had been identified as an important factor hampering development, especially in countries that were already capital-scarce. There were many reasons for this flight. Some of these reasons are considered rational economic responses to market distortions, including the lack of confidence from domestic investors in the stability of their own financial markets, a perceived decline in returns, etc. In many cases, however, capital flight reflected the attempts by private actors to hide and secure assets that had been illegally obtained in developing countries through corruption, embezzlement, tax evasion, etc. See Donald R. Lessard & John Williamson, eds, “Capital Flight and Third World Debt” (Washington, DC: Institute for International Economics, 1987), especially the article by Into Walter. See also Arvind K. Jain, “Review of Capital Flight and Third World Debt by Donald R. Lessard; John Williamson”, 19(3) Journal of International Business Studies 506.

153 Guy Stessens argues that the option to soft law was: (i) speed, since developed countries wanted to avoid a long ratification process associated with hard law treaty mechanisms; (ii) and flexibility. Stessens, Money Laundering, supra note 4.

Practices (known as “Basle Statement” or “Basle Principles”). This non-binding code of conduct encouraged banks to put in place procedures to ensure that: all customers were properly identified; transactions that do not appear legitimate were discouraged; and cooperation with law enforcement was facilitated. Guy Stessens affirms that the “Basle Principles” was a pioneer initiative at the time, and would remain influential even after the adoption of binding initiatives.

One year later the “Group of 7 Leading Economic Countries” (G7 then, now G8), meeting at an economic summit in Paris, expressed collective concern with the potential negative economic impacts of drug-related money laundering on their banking and financial systems. They decided to create a Financial Action Task Force (FATF) to examine their existing domestic anti-money laundering regulations and to promote recommendations on how they could be improved to more effectively deal with the problem. Despite being a G7 initiative, the task force was opened to other interested participants that voluntarily agreed to have their domestic regulations examined. Besides the G7 members (Canada, France Germany, Italy, Japan, UK and USA) Australia, Austria, Belgium, Luxembourg, Netherlands, Spain, Sweden and Switzerland became part of FATF. Another 19 countries, including emerging economies such as Brazil,
China, India, Russia and South Africa, would later become FATF members a decade later.\(^{160}\) In April 1990 FATF issued a series of 40 far-reaching recommendations.\(^{161}\)

Despite being voluntary recommendations by a free-standing specialist body, they would prove highly effective and influential. This time the recommendations were not directed only to private financial institutions, but included measures to be adopted by states as well. For some they established high international standards for legislative and regulatory actions to address money laundering.\(^{162}\) Among them were recommendations encouraging states to criminalize the laundering of money related to any crime that generated a large sum of proceeds, and not only drug trafficking. The window for the spread of home-country regulations granting power to home-country law enforcement mechanisms to tackle money laundering related to foreign corruption was thus open. Another important recommendation was to strengthen international cooperation to facilitate the exchange of information on suspicious transactions, including the possibility of asking for the seizure and confiscation of proceeds of crimes. The stated objective of FATF recommendations was, nevertheless, clear: to combat the misuse of the financial systems by persons laundering money acquired through drug trafficking and other illicit means.\(^{163}\)

At the regional level, the European Community (EC) also approved an initiative on money laundering in 1990. The *Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime* expanded from the original concern with drug trafficking, and included “proceeds of all types of criminality, especially serious crimes, and in particular drug offences, arms dealing, terrorists offences, trafficking in children and young women […] and other offences which generate large profits”. Although requiring states to adopt legislative and administrative measures to fight money laundering, the European Council’s Directive

\(^{160}\) According to the 1998 FATF Annual Report the main strategy for expanding membership was to include “strategically important countries […] which are politically determined to make a full commitment with the implementation of the forty recommendations, and which could play a major role in their regions in the process of combating money laundering.” FATF 1998 Annual Report. See the full list of current members and observers at FATF, “Members and Observers”, online: <http://www.fatf-gafi.org/pages/aboutus/membersandobservers>.

\(^{161}\) These recommendations were later expanded in 1996 and 2003. Maira Rocha Machado & Guilhermo Jorge, “Anti-Money Laundering and Governance in Latin America”, (Workshop on Global Administrative Law Issues in Latin America, delivered at the University of San Andres, Buenos Aires, 9-10 March 2007).


“Prevention of the Use of the Financial System for the Purpose of Money Laundering” made clear that financial institutions should bear the burden of detecting money launderers.

In 1992 the OAS Inter-American Drug Abuse Control Commission issued the “model regulations concerning laundering offenses connected to illicit drug trafficking and related offenses”. These model regulations followed the lines of FATF recommendations, and were not legally binding. They encouraged financial institutions in all American countries to adopt “know your customer” policies and to keep their records for at least five years. Similar to the UN Convention, the focus of the OAS model regulations was initially focused on money laundering related to drug trafficking. States were encouraged to make it a crime to conspire, attempt, facilitate, or aid in money laundering; and to provide for the seizure and forfeiture of assets related to the drug trade. These regional initiatives became somewhat marginal in influence, however, since the FATF gained legitimacy and turned into the most important international anti-money laundering initiative, despite its soft nature. Virtually all the major financial centers joined FATF. The initiative also created a strong monitoring and review system that although voluntary proved to be influential.

However, these international and domestic initiatives were not free of conflict due to both self-interested and principled concerns. Financial institutions still resented having to bear most of the costs of preventing money laundering. On the other hand, individuals and corporations doing legitimate business resented the incursions in their privacy by ever more invasive recording and reporting measures. Offshore centers, financial havens and traditional bank secrecy jurisdictions

165 Based on the Basle Principles, the Directive recommended that financial institutions should do so by requiring the identification of customers (know your customer) whenever the transaction exceeded a certain threshold (15,000 Euros at the time, in one or several related operations). If the financial institution becomes suspicious of possible money laundering schemes, however, it should identify and record the identity of the customer, even if the amount is below the stated threshold. Records were to be maintained for 5 years. If there were suspicious transactions, financial institutions were required to inform authorities. Officers and employees should cooperate with authorities, and were not liable for doing so. See Barbot, supra note 146.
166 The OAS would later broaden the scope of the recommendations for anti-money laundering regulations to cover other illegal activities as well. Ibid.
167 See ibid at 175, 176.
168 See ibid.
169 This review system includes an annual report by each member describing the evolution of norms and law enforcement activities; and periodic critical examination by a team of FATF experts.
170 See Gilmore, Money Laundering, supra note 128 at 3.
such as Switzerland also fought for the preservation of strong bank secrecy rules, since this was key to their whole economies or some of their main economic sectors. They pointed to the fact that money launderers would simply move their assets to other financial jurisdictions with less strict rules. This tricky balance between the need for combating money laundering while respecting legitimate economic and privacy concerns would not prevent the enactment of anti-money legislation in many countries. It may however help to explain why a consistent record of implementation was not forthcoming.

Scandals of individuals laundering crime-related money through American, Swiss or offshore accounts continued to be recurrently reported, revealing that there were many obstacles preventing effective enforcement of the new anti-money regulations. The case of Bank of Credit and Commerce International (BCCI), which was serving to launder money from a range of different crimes, gained special notoriety for the number of countries involved.\(^1\) This case led to the creation of a Senate investigation in the USA.\(^2\) The investigation concluded, among other things, that national laws in the USA and other financial centers were still inadequate to address the problem of money laundering.\(^3\) The Senate Subcommittee included among its legislative recommendations:

> [T]he United States [should] develop a more aggressive and coordinated approach to international financial crime, and to move further against foreign privacy and confidential laws that protect criminals.\(^4\)

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\(^1\) Several investigations in various countries, including one by an American Senate Subcommittee, revealed a transnational scheme of money laundering, fraud and other illegal activities of huge proportions. BCCI was a transnational bank, chartered in Luxembourg but based in the Cayman Islands and London, with subsidiaries in 70 countries including the USA. Investigations showed how BCCI had continued to systematically evade regulations and launder money from drug trafficking, arms trade, terrorism, smuggling, tax evasion, foreign bribes and political corruption. Besides Colombian drug barons, smugglers and the CIA, BCCI had as its customers a group of political leaders of foreign countries such as Ferdinand Marcos (Philippines) and Manuel Noriega (Panama) that were accused of grand corruption in their home-countries. An initial investigation about suspected money laundering activities at BCCI’s Tampa branch in 1988 failed to uncover the extent of the problem, and resulted in a plea bargain in 1990. See US, Senator John Kerry and Senator Hank Brown, *The BCCI Affair: A Report to the Committee on Foreign Relations* (S Doc 102-140) (1992), online: <http://info.publicintelligence.net/The-BCCI-Affair.pdf> [The BCCI Affair]. See also Nikos Passas, “Structural Sources of International Crime: Policy Lessons From the BCCI Affair”, (1993) 20 Crime, L & Soc Change 293.

\(^2\) American authorities would open a more detailed investigation only after an investigative journalist published a story about BCCI. This investigation by the Justice Department unleashed a series of other probes in the USA, including a Senate investigation, and in several other countries such as UK, France, Spain, Switzerland and Luxembourg. *Passas, supra* note 171.

\(^3\) In the middle of the investigations, for example, the Bank of England allowed the BCCI to move its headquarters from London to Abu Dhabi, and there were no legal impediments for the Bank to do so. According to the American Senate report this has hampered the capacity of American law enforcement officials to investigate and prosecute BCCI’s financial crimes. *Passas, supra* note 171.

\(^4\) The recommendations from the Senate Subcommittee also included: “The Subcommittee recommends that the justice department reconsider the policies and practices that led to its ineffectiveness in investigating and
In 1992 the American Congress approved the *Annuzio-Wylie Anti-Money Laundering Act* (*Annunzio-Wylie Act*). This Act raised the stakes of violating anti-money laundering regulations by increasing criminal and civil penalties. Despite the fact that other countries were also enacting their own anti-money laundering regulations, American financial institutions argued that they would lose competitiveness and efficiency because the regulations were placing too much responsibility and too many costs on them. Only two years after the *Annunzio-Willie Act*, in 1994, the American Congress passed the MLSA (Money Laundering Suppression Act), allegedly to “soften” requirements on financial institutions.

Fifteen years after the FATF recommendations, it was clear that the leading country in domestic initiatives designed to address money laundering related to crimes considered of high national concern, the United States, was facing several obstacles to enforcing its regulations. Writing in 1995, Lisa Barbot concluded that money laundering and its related crimes were being rarely prosecuted in the USA. The number of successful prosecutions were negligible in light of the number of launderers who either go undetected or who, even if prosecuted, were required to pay fines that pale in comparison to their profits. She concluded that: “As a practical matter, anti-money laundering prosecutions have on the whole proven to be unsuccessful.”

The law enforcement challenges were compounded at this time by the marked liberalization and de-regulation of capital flows spurred by technological advances and the political momentum generated by the end of the Cold War and the rise of the Washington Consensus. Bruce Zagaris and Scott MacDonald argue that these technological - and political – developments would potentially jeopardize the gains made by domestic legislation and international regimes of anti-money laundering law enforcement cooperation:

175 The Act included what became known as the “death penalty”, meaning the potential termination of the financial institution engaged in money laundering activities, or the banning of convicted individuals from working in the financial industry. The American Treasury also required financial institutions to develop internal anti-money laundering programs, and to file ‘Suspicious Activities Reports’. See Matthew Morgan, supra note 126.

176 See Gilmore et al, supra note 147 at 190. Matthew Morgan explains that the objective was to simplify procedures and create exemptions so as to facilitate reporting and place the focus on really suspicious activities. See Matthew Morgan, supra note 126 at 35.

177 Barbot speculates that the complexity of money laundering operations (which raises investigation costs) and the difficulty of discovering evidence (either because they are protected in haven jurisdictions or the foreign country does not recognize money laundering as a crime and does not facilitate cooperation) may be among the causes of so few prosecutions. See Gilmore et al, supra note 146 at 193.
The very nature of open economies, growing interdependence, and the sheer instantaneity of financial transactions can be, and is being abused by those who intentionally seek to conceal the source of their earnings.\footnote{Zagaris & MacDonald, supra note 162.}

By the end of 1995 the Clinton Administration considered that it was still necessary to sponsor a series of international initiatives against organized international crime, which included strengthening anti-money laundering regimes, and decided to do so at the fiftieth anniversary of the United Nations.\footnote{Bruce Zagaris, “Constructing a Hemispheric Initiative Against Transnational Crime” (1995) 19 Fordham Int’l LJ 5 at 1888 [Zagaris, “Constructing”]. “Mr. Clinton explained that he had directed his Attorney General and the Secretaries of the Treasury and State to identify countries that help in money laundering and to notify them that, unless they adhere to the international standards set forth in the Financial Action Task Force’s forty anti-money laundering recommendations, the Administration would consider imposing sanctions that could prevent them from doing business in the United States and, more specifically, preclude them from making electronic transfers of money through banks in the United States. [Home states could do similar measures to deal with corruption, but the incentives are quite different].} The USA had domestic interests as their primary motivation. The Clinton Administration considered that fighting money laundering in key financial centers was a key piece in the strategy of protecting US national security against the threats of international drug trafficking and international terrorism.\footnote{According to Bruce Zagaris: “[Clinton’s discourse], while ostensibly made to the more than 130 world leaders at the United Nations, much of the rhetoric and initiatives seemed aimed at a US domestic audience.” Zagaris, “Constructing”, supra note 179 at 1888.} Frustrated by the lack of progress in international cooperation efforts, the USA opted for another unilateral move. In that year President Clinton signed an executive order authorizing the government to require US financial institutions to search and freeze accounts held in the names of persons or companies determined by the government to assist or have a significant role in transnational crimes.\footnote{The same order prohibited corporations and American officials trading with such persons or companies. Zagaris, “Constructing”, supra note 179 at 1890.}

This new unilateral move, which would soon be copied by other OECD countries, enhanced the power of home-countries to freeze or forfeit assets related to money laundering activities linked to international drug trafficking and other transnational crimes, thus bypassing foreign countries that were incapable or unwilling to fight money laundering related to organized crime. American policymakers were, however, aware of the limitations of acting unilaterally, bypassing other countries where the proceeds of crime could find sanctuary. In parallel to strengthening extraterritorial home country regulations, OECD countries decided to promote actions to enhance their capacity to influence other countries in creating domestic regulations to combat money laundering.
In 1998 FATF approved a program to: “establish a worldwide anti-money laundering network and spread the FATF’s message to all continents and regions of the globe.” The membership of FATF was expanded to include “strategically important countries” that should disseminate anti-money laundering domestic regimes in their regions of influence. The boundaries between strategies to bypass and strategies to bridge governance gaps in order to fight transnational crime became blurred. Besides, the issues of money laundering, asset recovery and corruption began to converge in international discussions and in international law-making initiatives.

The governments succeeding Ferdinand Marcos of the Philippines, ‘Baby Doc’ Duvalier of Haiti, and Sani Abacha of Nigeria were three cases in point. The efforts by these and other new governments to regain control of the assets embezzled by deposed former rulers would expose how far the evolving anti-money laundering regimes were from being an effective tool in the fight against foreign corruption, even when there was strong political will and interests from the developing country where the corruption and embezzlement took place. In September 1999, the new Nigerian President, Olusegun Obasanjo, who was battling to bring back vast sums of stolen assets transferred by former president Sani Abacha to Swiss bank accounts, made an address to the United Nations General Assembly calling for the creation of an international convention specifically designed to facilitate the repatriation of wealth stolen from African countries and illicitly transferred to foreign financial centers.

At this juncture the interests of developed countries such as the USA would begin to converge with the interest of some developing countries. A group of developing countries was specially interested in financial centers such as the USA creating mechanisms to enable the freezing and forfeiture of stolen assets. This interest arose from particular concerns, which were quite different from developed countries’ concerns. The late 1980s witnessed a series of high profile cases where successor governments had to deal with the lack of legal mechanisms to repatriate the massive amounts of financial assets that had been stolen by deposed dictators and placed in foreign financial centers.

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182 Machado & Jorge, supra note 161 at 8.
183 As early as 1987 there were discussions on the challenges to domestic and international law represented by attempts to freeze, forfeit and repatriate assets stolen by Ferdinand Marcos and “Baby Doc”. See Richard A. Falk et al, “Pursuing the Assets of Former Dictators” (Paper delivered at the Proceeding of the Annual Meeting of American Society of International Law, April 1987), 81 Proceeding of the Annual Meeting of American Society of International Law 394.
184 Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan, UNODC, (2007) at 6 [Stolen Asset Recovery].
In 2000 the UN General Assembly adopted resolution 55/188 calling for increased international cooperation, through the United Nations system, “in regard to devising ways and means of preventing and addressing illegal transfers, as well as repatriating illegally transferred funds to the countries of origin [...]”\textsuperscript{185} With this avenue now open, in that same year Transparency International urged the 11 major international banks to agree on adopting the voluntary \textit{Wolfsburg Anti-Money Laundering Principles}. These principles can be seen as an attempt by the key financial institutions to come together and level the playing field by adopting a common anti-money laundering standard.\textsuperscript{186} However, the leading participation of TI shows how key actors concerned with corruption in developing countries were now considering anti-money laundering hard and soft regulations as key tools in this front.

As explained in the last section, in 2003 a whole chapter of the UN Convention against Corruption was dedicated to the recovery of stolen assets. In 2007 the World Bank and the United Nations Office of Drugs and Crime created the \textit{Stolen Asset Recovery (STAR)} initiative, to help developing countries overcome the legal and policy obstacles to repatriating embezzled assets residing in financial centers abroad. At this juncture the international anti-money laundering law enforcement regime and the international anti-corruption law enforcement regime began to converge in order to respond to attempts to fight corruption in foreign countries.

Today, virtually all the important financial centers have adopted anti-money laundering regulations that can be applied to freeze and forfeit assets obtained through embezzlement of public funds in developing countries. It was the congruence of (sometimes divergent) interests that made the creation of the transnational anti-money laundering regime feasible and induced host countries to accept this foreign interference in their domestic governance systems.\textsuperscript{187} However, global regulatory mechanisms that seek to press for or encourage the adoption and implementation of anti-money laundering regulations include not only extraterritorial regulations in countries that are important financial centers, but also conventional top down initiatives by the World Bank and IMF, and soft law initiatives dedicated to monitor and enforce implementation such as FATF. It has become increasingly difficult to differentiate when these initiatives seek to

\textsuperscript{185} Preventing and combatting corrupt practices and illegal transfer of funds and repatriation of such funds to the countries of origin, GA Res 55/188, UNGAOR, 55 Sess, (2000).
\textsuperscript{186} Maira R. Machado and Guilhermo Jorge argue that this private regulation was probably motivated by the desire of financial institutions to preempt more public regulations while leveling the playing field among the main financial centers. Machado & Jorge, \textit{supra} note 161
\textsuperscript{187} Stessens, Money Laundering, \textit{supra} note 4 at 3.
bypass the governance deficit in host countries and when they seek to contribute to bridging the governance deficit.

In 2007-2008 a financial crisis that began in the US and quickly became global called into question the adequacy of existing financial sector regulations in the US and abroad. This crisis has generated another special domestic juncture in the US, which would prove fertile ground for actors concerned with the resource-curse to promote the creation of new extraterritorial home-country regulations to address the problem. The Dodd-Frank Act was enacted in July 2010 with the stated objective to reform American financial sector regulations, but it included provisions requiring extractive corporations registered with the American Securities and Exchange Commission (SEC) to provide special disclosures of payments made to foreign governments for the commercial development of oil, gas and minerals, specially those dealing with conflict minerals in the Democratic Republic of Congo (DRC). The context in which these extraterritorial regulations were created shows that they were unmistakably part of a broader movement to tackle rent-seeking behavior by promoting transparency in foreign resource-rich governance-poor countries. I turn to these new extraterritorial regulations next.

5.4. Promoting transparency abroad by disclosing at home

The existence of anti-bribery and anti-money laundering home country extraterritorial regulations can be explained by an initial drive from the leading global economic and political power, the USA, followed by a gradual convergence of interests and values from other state and non-state actors. Although the original primary motivation by home-countries when creating these extraterritorial regulations was to protect their national interests, there has been a progressive change in academic and policy understanding about the negative impacts of gross corruption on development outcomes, and as a consequence a change of mindset regarding the importance of these initiatives as potential tools to contribute to fighting corruption in less developed countries. Policy actors have used this change in perception to expand the focus of many of these initiatives. While originally designed to bypass dysfunctional institutions in developing countries, these initiatives are now being also conceived as potential instruments to address corruption and rent-seeking in foreign developing countries.

In this section I argue that, as in the case of bilateral investment treaties discussed in chapter 4, an important change occurred in the dynamic of the creation of home country extraterritorial regulations. A new movement began in 2010, with a unilateral initiative by the United States to create domestic legislation to require enhanced disclosure of financial activities by mining, oil and gas transnational corporations listed with the Securities and Exchange Commission (SEC). While the creation of this movement is similar to the creation of earlier movements that
disseminated anti-bribery and anti-money laundering extraterritorial regulations described in the previous sections (the USA leads with unilateral regulation and disseminates the model), this case is different in one important aspect: this extraterritorial regulation is more clearly designed to address rent-seeking behavior, a problem that primarily concerns foreign resource-rich and governance-poor developing countries. The fact is that this extraterritorial regulation, unlike the anti-bribery and anti-money laundering original American regulations, has not originated from strong concerns of American policy makers with their own self-interests.

In fact this groundbreaking extraterritorial regulation is a direct result of advocacy efforts by civil society groups concerned with the governance deficit leading to the resource curse in resource-rich developing countries. In June of 2002 a group of six civil society organizations led by NGO Global Witness first waged a campaign entitled “Publish What You Pay” (PWYP). This campaign was created to lobby for an international mandatory initiative that would require capital-exporting countries to create home country regulations mandating extractive TNCs to report what they were paying as taxes, royalties and other revenues for extractive operations country by country.

During a 2002 World Bank Workshop on Petroleum Revenue Management Karin Lissakers, then a senior advisor to investor and philanthropist George Soros, emphasized the rationale behind the PWYP campaign, which was a result of greater awareness about the hurdles of promoting governance reform in host countries using conventional methods:

Experience tells us that reforms only take hold when driven by domestic forces. In the end, good government comes from within. The challenge for the outside world is to offer not just good systems design, but also strong incentives for internal reform. Financing and conditionality work up to a point. But in the resource-rich developing


189 Global Witness, CAFOD, Open Society Institute, Oxfam GB, Save the Children UK, Transparency International UK. See “History | Publish What You Pay”, online: <http://www.publishwhatyoupay.org/about/history>. The campaign would later receive the support of several other NGOs such as CRS, Human Rights Watch, Partnership Africa Canada, Pax Christi Netherlands and Secours Catholique/Caritas France, and several NGOs from developing countries to form the Coalition PWYP, still active. In a few years the PWYP Campaign became a formal global coalition with over 600 civil society organizations from more than 60 countries worldwide, both home and host countries. 31 of these countries have national PWYP coalitions composed of various local civil society organizations. The PWYP USA coalition, for example, encompasses 32 organizations.

190 The Open Society Foundation, the philanthropic organization created by George Soros would later finance the creation of a new NGO called Revenue Watch Institute specifically to promote transparency and accountability in the global extractive sector. Karin Lissakers became the executive director of RWI.
countries their impact is blunted. The private flows trump official aid. We must use other tools.\textsuperscript{191}

Civil society organizations were clearly trying to find additional global regulatory tools to help promote domestic governance reform in resource-rich countries, and they thought that extraterritorial home-country regulations requiring disclosure could serve as a potential tool. These organizations believed that making public certain information could contribute to changing domestic political dynamics and be more effective than top down mechanisms such as financing and conditionality. Transparency of revenue flows to resource-rich countries could have a positive effect on their domestic governance systems and create incentives for domestic reforms. National and international actors could, for example, track more easily how the revenues were or were not being invested. Discovery of illicit transfers would be facilitated.

However, civil society activists acknowledged that if extractive corporations were to take the lead in voluntarily disclosing the revenues they paid to resource-rich governments, they could face a backlash with the interest groups that benefit from rent-seeking.\textsuperscript{192} Karin Lissakers, argued:

> The Publish What You Pay campaign therefore calls for a regulatory approach. We want the G-8 countries, which are not only home to many of the world’s major oil, gas and mining companies but also to the most important stock exchanges in the world, to require extractive industries to publish what they pay as a condition for listing on their exchanges. This would ensure maximum coverage of payments, a level playing field for all the major companies so no one would enjoy a competitive advantage, and protection for the companies against retaliation by the resource-rich countries.\textsuperscript{193}

Apparently capital-exporting countries were not convinced that creating mandatory extraterritorial home-country regulations among themselves to address rent-seeking in foreign resource-rich and governance-poor developing countries would resolve the problem, and thought that this would probably give advantages to transnational extractive corporations based outside the G8 countries.


\textsuperscript{192} A concrete case in 2001 had vividly illustrated this backlash. That year British Petroleum (BP) decided to reveal how much they had paid to the Angolan government for signature bonuses in exchange for the right to explore oil in that country. The Angolan government threatened BP with contract termination, and this experience provoked a chilling effect in other oil corporations. John Mcmillan, “Promoting Transparency in Angola” (2005) 16(3) Journal of Democracy 155.

\textsuperscript{193} Lissakers, supra note 191.
Instead, during the 2002 World Summit on Sustainable Development in Johannesburg UK Prime Minister Tony Blair advanced the discussion of a global initiative that would get all home and host countries to agree on the mandatory disclosure of financial payments by corporations to resource-rich countries.\textsuperscript{194} There was, however, no consensus for a mandatory initiative. At that point in time the US government expressed strong opposition to an initiative that would make company disclosure mandatory for all extractive corporations, apparently due to both energy security and economic reasons.\textsuperscript{195} Leading policy actors then decided to explore other alternatives.

One alternative was to promote a soft law public-private initiative that shifted the responsibility of promoting disclosure from home-countries to host-countries themselves.\textsuperscript{196} This initiative, later to be named the Extractive Industries Transparency Initiative (EITI), will be discussed in Chapter 6. Here I will discuss how civil society actors insisted on the alternative of promoting securities disclosures regulations in home countries as well. Their successful strategy was to emulate the process that led to the establishment of the earlier regimes of anti-bribery and anti-money laundering extraterritorial regulations, that is, to lobby the USA to unilaterally adopt the first extraterritorial regulation requiring listed corporations to disclose the resource revenues they paid to resource-rich developing countries.\textsuperscript{197}

Civil society organizations received the important support of US Congressional members such as Senate Foreign Relations Committee member Senator Richard Lugar, who organized several


\textsuperscript{195} John Mcmillan argues that American opposition was rooted in that country’s energy security strategy. The USA has tried to reduce its energy dependence on oil imports from Middle East countries, and part of this strategy is to increase imports from African sources. In 2000 West Africa was supplying 16% of American oil imports and the expectation was to raise that share to 25% by 2015. If the USA signed an international agreement it would be pressed to enforce it, while the same can’t be said of other countries. By requiring American oil corporations to disclose their payments, the USA could risk driving countries such as Angola to give preference to non-western corporations which would not be as hard pressed to disclose. Additionally, American oil corporations would lose lucrative deals with resource-rich countries that oppose disclosure. Mcmillan, supra note 192 at 163. Dambisa Moyo argues that as of September 2010 the US was already importing 20% of its crude from Sub-Saharan African countries. Dambisa Moyo, Winner Take All: China’s Race for Resources and What it Means for the Rest of the World, (Toronto: HarperCollins, 2012), at 58.

\textsuperscript{196} Mcmillan argues that this shift in responsibility from home countries to host countries was essential to secure American support. Mcmillan, supra note 192 at 163.

\textsuperscript{197} It was this PWYP/USA that initiated a systematic campaign to promote a unilateral extractive revenues disclosure initiative by the US Congress. See “History | Publish What You Pay”, online: <http://www.publishwhatyoupay.org/about/history>.
Senate hearings on the resource curse. In 2008 House Representative Barney Frank introduced the Extractive Industries Transparency Disclosure Bill, while Senator Charles Schumer introduced a similar bill in the Senate. It is true that the politicians proposing the extraterritorial regulation also used interest-based arguments to justify the regulatory measures. They argued that the bills would strengthen America’s energy security and would also stabilize the overseas business environment, while maintaining a level playing field for American and foreign corporations. However, this was a very different context compared to the creation of earlier extraterritorial regulations, since there was no domestic scandal provoking an upsurge of values or allegations that the lack of these regulations were posing significant threats to American interests.

As expected, American TNCs opposed the initiative, arguing that this would diminish their competitiveness vis-à-vis foreign TNCs, that the costs of compliance would be too great, and that the disclosure would also jeopardize their commercial strategies. In 2009 a bipartisan coalition formed by Senators Richard Lugar (Republican), Ben Cardin (Democrat), Charles Schumer (Democrat) and Russ Feingold, introduced the Energy Security Through Transparency Bill. In July 15, 2010 this bill became section 1504 in the Dodd-Franck financial regulatory Act. Named Energy Security Through Transparency Act (ESTTA), section 1504 amended the 1934 Securities and Exchange Act to require oil, gas and mining corporations listed with the Securities and Exchange Commission (SEC) to publicly disclose key financial data relating to overseas operations, country by country.

One question is why this bill passed, despite the opposition by American corporations, and despite only indirectly protecting American interests. There is a dearth of detailed studies on the passage of this bill. Yet, one can speculate that factors such as the charged political context in the USA in the aftermath of the 2007/2008 financial crisis (that favored a broad over-haul of financial regulations), the ideology of the Obama administration, and the solid majority of Democrat parliamentarians in the 111th American Congress have tipped the scale in favor of the

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198 Firger, “Transparency”, supra note 188 at 1065.
201 There are still few detailed studies on the approval of this bill.
202 Firger, “Transparency”, supra note 188.
home-country disclosure initiatives advocated by civil society organizations.\textsuperscript{203} In other words, policy actors in favour of American extraterritorial securities regulations to provoke feedback effects in foreign resource-rich and governance-poor countries weathered a perfect storm.

However, the Republican gains in the 2010 American congressional elections would soon change this favourable balance of forces. In order for ESTTA to be enforced, SEC has to implement further rules. Apparently as a result of a new balance of forces at the domestic level, SEC’s new rules have not yet been promulgated, almost two years after the enactment of the Act.\textsuperscript{204} TNCs and representatives from the Republican party who are opposed to the Act are reportedly trying to weaken or undermine ESTTA provisions.\textsuperscript{205} The political difficulties of promulgating the SEC rules may be a sign of the added complexity of implementing extraterritorial regulations when they do not clearly advance the interests of home countries, even when there is strong knowledge about the importance of these regulations to foreign constituencies.

Despite these difficulties in implementing the securities disclosure regulation in the USA, the issue seemed to be gaining some international momentum in 2011, although it still remained highly contested. The Alternative Investment Market of the London Stock Exchange and the Hong Kong Stock Exchange have followed the US example and imposed similar reporting rules for newly listed companies in 2011.\textsuperscript{206} In October 2011 the European Commission proposed amendments to European Union legislation to require companies registered in the EU to meet mandatory reporting requirements at the European level. There is however strong opposition by corporate trade associations to this initiative and discussions are on-going.\textsuperscript{207} The World Bank

\textsuperscript{203} On the 2008 American presidential and congressional elections, and how it offered potential changes to liberal policies, see Jonathan Woon, “Change We Can Believe In? Using Political Science to Predict Policy Change in the Obama Presidency” (2009) 42 Political Science & Politics 329.


\textsuperscript{205} Marcus Baram, “Dodd-Frank One Year Later: Slow Progress on Rules Amid Industry and GOP Onslaught”, Huffington Post, (7 July 2011) online: Huffington Post <http://www.huffingtonpost.com/2011/07/21/dodd-frank-one-year-later_n_904391.html>. The resistance is not only towards the 1504 section, but rather to the whole financial reform brought by Dodd-Frank. Financial institutions are the main lobbyists against the new law.


recently released its 2011 Annual Extractive Industries Report in which it makes special mention of the Dodd-Frank legislation as an international standard to consider.\textsuperscript{208} In 2011 France’s former President Nicolas Sarkozy sponsored a discussion on securities disclosure for the global extractive sector at the G8 Summit, the G20 Summit and the OECD, but failed to achieve consensus in all of these forums.\textsuperscript{209}

It remains to be seen whether the US unilateral initiative will serve as the model – as it did in the case of anti-bribery and anti-money laundering extraterritorial regulations -- and leverage the creation of an international regime of resource revenue disclosure by countries that are home to important stock exchanges. On the one hand, the slow multiplication of extraterritorial regulations in developed countries suggests that the movement may be in this direction. On the other hand, there are no signs that emerging economies find it in their interests to sign on to this type of initiative. In this case, it may be a long time before there is really a global system with a level playing field. This will depend on how successful local civil society and political actors are in including this item on the agenda of their governments and parliaments. Yet most of the world’s major oil, mining and gas corporations are listed either in the USA, UK or Hong Kong. Therefore, these important financial centers have at least the power to require disclosure of resource revenues paid to resource-rich countries.

Policy actors that are pushing for extraterritorial securities disclosures regulations may have the noblest intentions to use this global regulatory instrument to combat corruption and address the resource curse abroad. There is, however, still a great need to understand what are the implications of their initiative for other parallel efforts to address the governance deficit in resource-rich developing countries. From its inception the proponents of this regulation have been ambiguous about its proposed objectives: it is unclear whether it seeks primarily to bypass the governance deficit in developing countries and target corporations directly, whether it seeks to provoke positive feedback effects in foreign governance systems by increasing transparency in the extractive sector, or whether it has been strategically advanced as a first step towards a future


online: United Kingdom International Chamber of Commerce <http://www.international-chamber.co.uk/blog/2012/04/26/eu-transparency-directive>.
global regulatory regime on disclosure of revenues flows in the extractive sector, or all of the above.

Regardless of its primary objective, it is clear that currently the movement towards using extraterritorial regulations to enhance disclosure of payments made by transnational corporations to foreign countries has added to - in the extractive sector at least - a constellation of other global regulatory mechanisms that have the potential to provoke feedback effects in dysfunctional domestic governance systems in resource-rich countries. While this dissertation does not seek to provide a full analysis of the potential positive or negative impacts of extraterritorial regulations in foreign domestic governance systems, in the next section I advance some initial ideas on why they may have a more limited role to play in the constellation of global regulatory alternatives to deal with the resource curse than most proponents expect.

5.5. Challenges of using extraterritorial home-country initiatives to promote foreign interests

The previous sections have shown how extraterritorial legislation have been added to a constellation of potential global regulatory instruments to provoke feedback effects in domestic governance systems in developing countries. This section presents a case study to illustrate that, although the extraterritorial anti-bribery and anti-money home country regulations have been effectively transformed into global regulatory mechanisms to address the practice of corruption in foreign resource-rich developing countries, their practical use to promote this objective has faced important challenges. One of these challenges is the lack of clarity in whether these regulations should serve as bypasses to the governance deficit in developing countries, or rather be combined with other attempts to provoke positive feedback effects in domestic governance systems.

In July 2004 the United States Senate Permanent Subcommittee on Investigations released a report revealing the findings of a large investigation into allegations that Riggs Bank (an American bank) was involved with money laundering activities related to apparent corruption schemes by the president, family members and allies of oil-rich Equatorial Guinea.210 The

210 The Report was entitled Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act, and also included findings related to money laundering activities by Chilean former dictator Augusto Pinochet. The “Patriot Act” (official complete name is Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act) is an American legislation enacted six weeks
Report showed how Riggs’ records registered large payments made by American oil companies into accounts opened in the names of the Equatoguinean government and its officials, apparently to pay for royalties and taxes from their oil extraction activities in that country.\textsuperscript{211} Records showed that in 2003 these accounts accumulated (in aggregate) deposits reaching 700 million dollars, making Equatorial Guinea’s officials by far the wealthiest clients of Riggs at the time. A series of suspicious wire transfers had been periodically made from these accounts to private individual and corporate accounts in foreign banks.\textsuperscript{212}

The Senate Subcommittee concluded that both the deposits made by the oil corporations and the wire transfers from these Riggs’ accounts likely indicated potential violations of American anti-bribery and anti-money laundering laws. The Subcommittee asked for full investigations by the American institutions responsible for enforcing these laws, and recommended further discussions on ways to strengthen the effectiveness of these regulations. As a suggested measure to increase this effectiveness, the Subcommittee recommended that the US Congress amend anti-corruption laws to require oil companies operating in resource-rich countries such as Equatorial Guinea to disclose both the substantial payments made to the government, and all business ventures entered into with government officials and family members.

\footnote{\textit{Money Laundering and Foreign Corruption}, supra note 212.}

\footnote{According to the report: These transactions included, for example, wire transfers totaling nearly $35 million from the E.G. oil account to two companies that were unknown to the bank and had bank accounts in jurisdictions with bank secrecy laws; three wire transfers totaling more than $1 million that were sent to Jadini Holdings, an offshore shell corporation owned by the wife of the E.G. account manager at Riggs; and three transfers totaling nearly $500,000 that were sent to the personal bank accounts of a senior E.G. official.\textit{Money Laundering and Foreign Corruption, supra} note 210 at 54.}

The American Security and Exchange Commission (SEC) opened an investigation against four American transnational oil corporations (Exxon Mobil, Marathon, ChevronTexaco, Devon Energy) for potential violations of the Foreign Corrupt Practices Act (FCPA), related to their deposits in the Equatoguinean Riggs accounts.\(^{213}\) The Department of Justice (DOJ) investigated potential violations of money laundering regulations, revealing that Riggs, amongst other misconduct, had assisted Equatoguinean officials in establishing shell companies in offshore havens with stringent bank secrecy laws.\(^{214}\) In 2011 the US DOJ filed civil forfeiture complaints to seize over $70 million worth in assets that were allegedly proceeds from foreign corruption in Equatorial Guinea.\(^{215}\)

The DOJ investigations also revealed that significant amounts of capital had been transferred from the Riggs account to an account at Bank Santander of Spain belonging to a private corporation owned by Equatoguinean Ministers and their relatives. In 2008 the Spanish Pre-trial Investigative Court (Juzgado de Instrucion) opened an official investigation against several Equatoguinean officials and their relatives for potential violations of Spanish anti-money laundering laws.\(^{216}\) The investigation was spurred by a complaint made by NGOs which alleged that the oil revenues transferred from Equatorial Guinea’s Riggs accounts to a shell corporation’s account at Santander Bank were used to buy luxury private properties in Spain, in the name of

\(^{213}\) In 2011 this investigation was still on-going, with the corporations reportedly cooperating with the SEC. See Shearman & Sterling LLP, “2011 Digest of FCPA cases” (2011), online: <http://www.shearman.com/files/upload/FCPA-Digest-Jan-2011.pdf> [Shearman & Sterling LLP].


Equatoguinean officials and their family members. In 2012 French police seized expensive paintings, cars and wines belonging to Agriculture Minister Teodoro Nguema Obiang Mangue (son of President Teodoro Nguema Obiang Mbasogo), following a civil law suit accusing him of using proceeds from corruption in Equatorial Guinea to buy valuable assets in France.

This brief account shows that the extraterritorial anti-bribery and anti-money home country regulations have been used as global regulatory mechanisms to address the practice of corruption in foreign resource-rich developing countries. It is possible that the emerging home-country disclosure initiatives will serve to complement and enhance the enforcement of these mechanisms for this purpose. It is still too early to know. Yet, despite the fact that these cases suggest that these mechanisms can be used to address rent-seeking behavior in resource-rich countries, there are many unanswered questions about the limitations preventing them from becoming effective tools in bridging the governance deficit in resource-rich developing countries on their own.

Enacting legislation is only the first step. As Mark Pieth, head of the OECD Working Group clearly stated in relation to anti-bribery mechanisms:

> This plethora of activities should not, however, create the illusion that the goal of effectively combating bribery in international business transactions is close at hand. There are serious problems of coordination within this movement, and it is sometimes hard to distinguish the political and rhetorical “progress” from practically meaningful efforts.

The effectiveness of extraterritorial regulations to affect corruption in foreign countries is dependent upon the resources, capacity and commitment, and incentives of authorities at the national level that are entrusted with enforcing the legislation. Enacting regulation was an important first step in the USA, and yet the actual enforcement of FCPA has proved a slow process with a fairly long and steep learning curve. The last report from the OECD Working Group on Bribery suggests that other countries are also facing similar challenges to enforcing

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217 This investigation was on-going in May 2012.
their legislation.\textsuperscript{221} The United States is the only country that has recently started to systematically enforce its domestic legislation against bribery of foreign public officials. In 2006-2007 the SEC and DOJ opened sixty-seven prosecutions against individuals and corporations.\textsuperscript{222} During the same period fifteen OECD countries did not undertake a single prosecution. Both Japan and Canada had only one prosecution during this period. In 2009 only five of the thirty-eight OECD members had imposed penalties against individuals or corporations for foreign bribery. The USA imposed sanctions on 8 individuals and 11 corporations in 2009. Germany sanctioned 3 individuals. France and Switzerland sanctioned 1 individual and the UK sanctioned 1 corporation and 2 individuals. Despite the fact that the number of investigations had risen to 260, actual enforcement was still considered marginal in the face of the problem.\textsuperscript{223}

Competition between law enforcement agencies in different countries may play a positive role in promoting more effective enforcement across the board. As the enforcement in the USA began to take place without corresponding action by other industrialized countries, criticisms that there was no real level-playing field began to emerge again. In response, American law enforcement officials began using available mechanisms to enforce FCPA against foreign corporations as well. In 2006 the US Department of Justice and SEC used FCPA to investigate and bring cases against foreign corporations that had committed bribes abroad. The only link to the USA was the use of American bank accounts or the listing of the corporation with the Securities and Exchange Commission. SEC presented, for example, cases against Statoil (Norway)\textsuperscript{224}, Alcatel (France)\textsuperscript{225}, Vetco (UK) and others.

\textsuperscript{221} Besides, there is still no study on the real impact of these extraterritorial regulations in the domestic governance system in developing countries. They may complement other global regulatory initiatives to bridge the governance deficit, but having the possibility of being used primarily to bypass this governance deficit, they may also undermine other governance reform efforts.

\textsuperscript{222} Hatchard, \textit{supra} note 31.

\textsuperscript{223} OECD, \textit{Annual Report 2010}, \textit{supra} note 113.

\textsuperscript{224} United States \textit{v} Statoil, ASA, 06-CR-00960 (SD NY 2006), online: <http://fcpa.shearman.com/?s=matter&mode=form&id=40>. Statoil paid 5.2 million in bribes to Iranian officials in 2001 and 2002 to secure contracts for oil and gas exploration in that country. Internal audits revealed the use of fake “consulting contract” to hide the bribes and recommended the immediate termination of that contract. When the CEO and Board of Directors Chairman ignored the recommendation, an investigation was opened at SEC and also one by the Norwegian fraud investigation agency. Statoil used US bank accounts to make the transfers. Norwegian authorities fined Statoil 3 million, while SEC fined Statoil 10.5 million (offset by 3 million already paid in Norway).
In 2008, of the 18 cases DOJ and SEC brought against corporations, 10 involved corporations headquartered in foreign countries. In 2009 three out of twelve cases were against foreign corporations. More international cooperation has enabled the investigation of recent cases. In 2008 German conglomerate Siemens pleaded guilty to violations of FPCA provisions and settled for a groundbreaking $US 800 million in fines. This case against Siemens was considered groundbreaking because American courts decided that American law enforcement agencies would have had jurisdiction in this case solely by virtue of the fact that “correspondent accounts” based in the USA were used to clear transactions made in US dollars. They did allege that in the specific case there were other grounds for jurisdiction (use of American bank accounts for bribes, e-mail exchanges, and the listing with SEC). However, this decision indicates how expansive the understanding by American courts of their jurisdictional power as regards FCPA has become in recent years.

This points to the possibility that American law enforcement officials will indeed serve as instruments to encourage a level playing field by pursuing corporations from countries that are slow in enforcing their own anti-bribery legislations. An assessment by Shearman & Sterling in 2010 showed that the number of FCPA cases pursued by the Department of Justice and the SEC has “steadily increased” over the past several years. The size of financial penalties has also increased over the years. And yet, as noted above, the progress of other countries in enforcing similar statutes has continued to be extremely slow.

It seems that the recent spike in American enforcement was only possible because the American anti-bribery law enforcement institutions are well resourced, as the American government has consistently increased the amount of resources invested in FCPA investigations. An increasing

225 French-based Alcatel was also accused of violating FCPA for using a US bank account to wire transfer bribes disguised as consulting fees to Costa Rican officials. United States v Christian Sapsizian and Edgar Valverde Acosta 06-20797 (SD FL 2007), online: <http://fcpa/shearman.com/?s=matter&mode=form&id=123>.

226 The case was also groundbreaking because it showed an unprecedented degree of coordination among American and German law enforcement institutions (specially a Munich prosecutor responsible for the investigation in Germany). German authorities also fined Siemens for violating anti-bribery provisions, in the amount of C596 million. The fines were the largest in the history of laws against bribery in transnational operations. Shearman & Sterling LLP, supra note 213 at 25.
number of FBI agents are fully dedicated to these cases.\textsuperscript{227} It is not clear whether the motivation of the US government to fully enforce these anti-bribery regulations is primarily to promote self-interest (leveling the playing field) or to promote values and interests abroad (contributing to the global fight against transnational corruption), or both. It is yet to be seen if other countries will be compelled to invest significant resources in law enforcement mechanisms designed to affect negative impacts of corruption abroad.

Besides, with all its recent successful enforcement cases, a recent assessment of the American anti-foreign bribery law enforcement system concluded:

\begin{quote}
Despite these advances, however, obtaining foreign evidence is still viewed by prosecutors as a lengthy and cumbersome process. [A] company’s cooperation in disclosing evidence is an important factor in the Department’s decision to offer a deferred or non-prosecution agreement precisely because that cooperation relieves investigators from issuing formal requests for foreign evidence.\textsuperscript{228}
\end{quote}

If all OECD countries and emerging economies strengthen and provide significant resources to their anti-bribery law enforcement regimes, replicating the American record, what would likely be the impact in affecting rent-seeking behavior in resource-rich but governance-poor countries? Judging by the record of American cases so far, the impact would be very marginal. Despite all the activity of FCPA enforcement, especially recently, cases against mining, oil and gas corporations operating in resource-rich and policy-poor countries have been extremely rare. There is still no research designed to understand why this is the case.

However, there has been recently a new trend by law enforcement agencies in the USA, to focus on specific sectors. Assuming that they choose to focus their resources on investigating and prosecuting American and foreign TNCs operating in the natural resources sector in resource-rich and policy-poor countries, to strengthen the fight against rent-seeking in these countries, what is the likely impact? Even in this hypothetical scenario, the home country anti-bribery mechanisms would still focus only on suppressing the supply side of corruption. This regulation would likely not have a significant impact in the gross demand side of rent-seeking, which goes beyond requiring bribes from foreign corporations and includes diverted revenues that are legally transferred to states.

\textsuperscript{227} Shearman & Sterling LLP, \textit{supra} note 213 at 24.
\textsuperscript{228} Shearman & Sterling LLP, \textit{supra} note 213 at 26.
Only very recently have American law enforcement institutions begun to push the boundaries of the US law and use anti-bribery legislation to try to reach the demand side of foreign corruption. This experience has proved to be complex and contentious. The 2009 *US v. Giffens* case entailed an interesting development, whereby the DOJ and SEC reached the proceeds of the bribery received by the foreign officials themselves. Swiss banks followed a request by the USA and froze the bank accounts of Kazakh public officials that had been associated with embezzlement. Later the US government would enter into what was called “a complicated settlement” with the Kazakh government. A trust fund was created by the World Bank to receive the funds, which were earmarked to be used in development projects in Kazakhstan, including transparency in the extractive industries.\(^{229}\) However, this seemed to be an exceptional case in all respects.

Those specializing in FCPA jurisprudence have considered this the worst FCPA case in terms of ensuring political independence of law enforcement agencies, changing corporate behavior and impacting foreign corruption. It has been proved that an American citizen, James Giffen, had paid US$84 million dollars in bribes to the president of Kazakhstan and other officials to secure public contracts. Yet, Giffens was allowed to plead guilty for only a misdemeanor and received no punishment. The judge described him as “conduit for communications on issues vital to American national interest in the region”. Andrew Spalding argues that, as a result of the case, US corporations lost much of their influence in Kazakhstan, and Chinese corporations filled the void.\(^{230}\)

This case illustrates the practical challenges of relying on anti-bribery and anti-money laundering extraterritorial regulations as bypasses to dysfunctional foreign governance systems when the foreign corrupt officials are in power and are not interested in reducing domestic corruption. In fact, repatriating stolen assets has proved difficult even when there is political will. In 2007 the United Nations and the World Bank created the STAR program precisely in an attempt to help willing developing countries face these challenges. According to the justification for this initiative:

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\(^{229}\) Shearman & Sterling LLP, *supra* note 213.

• Addressing the problem of stolen assets is an immense challenge. Even though countries as diverse as Nigeria, Peru, and the Philippines have enjoyed some success in asset recovery, the process has been time-consuming and costly.

• Generalizing from the experience of these countries, developing countries are likely to encounter serious obstacles in recovering stolen assets.

• Even where the political will to pursue stolen assets exists, limited legal, investigative, and judicial capacity and inadequate financial resources could hamper the process.\textsuperscript{231}

The Giffens case illustrates how complex it is to use home-country regulations as mechanisms to bypass the governance deficit and directly address corruption in resource-rich developing countries. When there is no political will by the host country, fighting rent-seeking behavior by way of home-country regulations may be a possibility in a few cases and to a limited extent. But it is still a formidable challenge. The recent home-country disclosure initiatives have also limited reach as potential bypasses. Their main direct practical effects seem to be to increase the information available to home-country institutions responsible for anti-bribery and anti-money laundering laws. Their indirect effect would be to increase the information available for civil society actors in developing and developed countries that have been fighting to name and shame ruling political and economic elites that are responsible for rent-seeking behavior in resource-rich and governance-poor countries.

Finally, there is a risk that using these mechanisms as bypasses to the governance deficit in developing countries will further undermine these countries’ incentives to promote domestic governance reform. As discussed in chapter 2, Ginsburg found that the use of bilateral investment treaties (BITs) to bypass deficiencies in domestic courts led to declines in domestic governance indicators in developing countries over time.\textsuperscript{232} Kevin Davis, however, indicates that despite the lack of strong empirical data, there are positive signs that global anti-corruption mechanisms, including extraterritorial anti-bribery and anti-money laundering regulations, are having deterrent effects on corruption levels in the case of some developing countries. He

\textsuperscript{231} Stolen Asset Recovery, \textit{supra} note 184.

\textsuperscript{232} Ginsburg’s empirical research found that countries that signed BITS in 1995 and 1996 “were associated with declines in levels of government effectiveness, regulatory quality, the rule of law, and corruption control in the year 2000.” The undermining effect was particularly marked in the case of the rule of law, which suffered declines even controlling for several other factors. Tom Ginsburg, “International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance”, (2005) 25 Int’l Rev L & Econ 107.
hypothesizes that sometimes these mechanisms are being used not as substitutes, but rather as complements to domestic anti-corruption efforts.

In sum, if extraterritorial regulations are to be used mainly as bypasses to dysfunctional governance system in resource rich developing countries, it is still necessary to overcome some obstacles, namely: access to resources, limited information, lack of coordination mechanisms with foreign countries, and lack of political incentives. However, if these mechanisms are regarded as potential complementary instruments, part of a broader framework of global regulatory mechanisms designed to bridge the governance deficit in resource-rich developing countries, there is still a need to understand: (i) in which ways this mechanism may interact with other governance reform efforts; (ii) how to ensure extraterritorial regulations will not further undermine, instead of serving as incentives to strengthen domestic governance systems.

5.6. Conclusion

This chapter argued that there has been a fundamental transformation in the perception of the valid objectives of extraterritorial regulations – from primarily protecting the interests of home countries to also promoting certain consensual values and the interests of foreign constituencies. The extraterritorial regulations’ boundaries between targeting the behavior of corporations operating abroad (bypassing) and influencing host country behavior have become blurred.

This movement means that extraterritorial regulations now represent one more option in a constellation of potential global regulatory mechanisms to promote the social interests of foreign populations – by, for example, fighting corruption and promoting good governance reform abroad to spur positive development outcomes. The chapter showed, however, that this regulatory option is still extremely understudied, and we still do not know its full potentialities, limitations and risks in terms of benefiting foreign interests. We also do not have a full appreciation of the relative costs and benefits of this type of initiative as compared to global regulatory alternatives. Initial indications are that they should be seen as complements to other national and global initiatives, rather than seen as substitutes for missing institutions at the national and global levels.
Chapter 6

The Extractive Industries Transparency Initiative (EITI): a New Global Mechanism to Facilitate Governance Reform

6.1. Introduction

In previous chapters I argued that while global regulatory mechanisms such as bilateral investment treaties (BITs) and home-country extraterritorial regulations have been originally designed as tools to protect or promote the self-interest of home countries, in the 2000s these mechanisms began to be considered as potential instruments to also address problems that mostly affect the interests of host countries and their constituencies. When used to protect home countries’ self-interest, instruments such as BITs and extraterritorial regulations mostly bypass the governance deficit in host countries. However, when designed or used to address problems that affect host countries, these instruments were transformed into tools to potentially bridge the governance deficit, or provoke positive feedback effects in domestic dysfunctional systems. An example is the voluntary partnership agreements (VPAs) included in recent BITs, briefly discussed in chapter 4, and the new extraterritorial securities disclosures discussed in chapter 5. I argue that the use of VPAs and extraterritorial regulations to provoke positive feedback effects in foreign countries is a sign that policy actors are trying to expand the menu of regulatory options to address the governance deficit in developing countries.

In this chapter, I argue that the Extractive Industries Transparency Initiative (EITI) is another striking example of the rise of this diversified menu of unconventional global regulatory mechanisms aimed at bridging the governance deficit in developing countries. In the case of EITI, private and public policy actors agreed on a transnational public-private partnership that has the primary objective of finding entry points to overcome intractable obstacles to domestic governance reform in resource-rich developing countries.

This chapter is structured as follows. Section 2 describes EITI’s background history. In contrast to extraterritorial home-country regulations, which were originally created to protect the self-interests of powerful home countries, EITI was originally created with a different purpose. Private actors (international NGOs) motivated by values (concern with the negative externalities of resource wealth in developing countries) spearheaded an international movement that would
ultimately lead to EITI. Yet, the initiative became possible due to a confluence of values and interests by developed countries, resource-rich developing countries, and key private transnational corporations. Section 3 argues that EITI was created not to bypass the governance deficit in resource-rich developing countries, as was the case with several earlier soft law global regulatory initiatives, but rather to serve as an entry point to promote domestic governance reform. Section 4 describes EITI’s main features and defines the initiative as a transnational public-private partnership. Section 5 describes how several of EITI’s design features have the objective of facilitating domestic governance reform in developing countries. Finally, section 6 contrasts the implicit theories behind EITI’s original design with EITI’s institutional practice to date.

6.2. EITI’s background history

In chapter 5 I mentioned how civil society organizations were behind the movement that led to the creation of securities disclosure regulations for extractive corporations in the USA, with the objective of addressing the resource curse in foreign resource-rich countries. Here I provide a more detailed historical sketch of how failed attempts to use conventional global regulatory mechanisms to deal with social and environmental problems in resource-rich developing countries, and growing awareness of the importance of domestic governance reforms, gradually led civil society actors to consider unconventional global regulatory mechanisms to address the governance deficit, such as the EITI, and how a convergence of interests and values made the creation of the initiative possible.

In the late 1990s and early 2000s there was a sense of urgency related to the resource curse conundrum, as the accounts of widespread corruption, environmental degradation, violent conflicts and human rights violations in resource-rich and governance-poor countries mounted. The case of severe environmental damage in the oil-rich Niger delta and the controversial political execution of civil society activist Ken Saro-Wiwa in Nigeria are only examples of several emblematic cases that attracted global attention.¹ The criticisms about the responsibility of states and extractive corporations for the continuing socio-environmental crises associated

with global resource extraction in resource-rich and governance-poor countries intensified. The mounting social pressure began to cause a serious legitimacy crisis of resource exploitation in resource-rich developing countries and significant reputational damage to host countries, global extractive corporations, capital-exporting countries and international organizations such as the World Bank, who often provided financial and political support for resource extraction as an engine for development.

The pressure on extractive corporations and their mainly Western developed home countries to assume greater responsibility for the negative implications of engaging in resource-rich, governance-poor countries produced a few different results. First, it gave rise to a range of corporate social responsibility (CSR) initiatives specifically directed to the extractive sector. Second, home-countries housing extractive TNCs were pressed to use some of their extraterritorial regulations and mechanisms to deal with at least some aspects of the problem (chapter 5). Multilateral and bilateral development agencies were pressed to take the social and environmental risks and negative externalities of resource-led development into account in their development assistance programs.

As experiences with CSR initiatives and home-country mechanisms began to accumulate, it became clear that neither bypassing host countries, nor relying on conditionalities in development assistance programs would suffice to address the problems. It was in this context that, following a campaign by value-based NGOs, EITI emerged as a collective response by key state and non-state actors – civil society organizations, extractive multinational corporations, developed capital-exporting countries, resource-rich host countries and international

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2 For example, in 2000 mining corporations commissioned an independent study on mining, minerals and sustainable development, to gauge the challenges faced by the sector. In 2001 transnational mining corporations created the International Council of Mining and Metals/ICMM out of recognition that the “[global mining] sector was facing significant problems in reputation, sustaining profits, access to new assets and maintaining investor and employee confidence”. See Heledd Jenkins, “Corporate Social Responsibility and the Mining Industry: Conflicts and Constructs” (2004) 14 Journal of Cleaner Production 271.

3 As noted in chapter 1, the World Bank responded to these growing condemnations by commissioning an Extractive Industries Review process, which led to a recommendation, never implemented, for the bank to phase out support to the development of the extractive sector in governance-poor developing countries. Bonnie Campbell, ed, *Mining in Africa: Regulation and Development* (London, UK Ottawa, ON, Uppsala; Pluto Press, International Development Research Center, Nordiska Afrikainstitutet, 2009).
organizations – to the intractable problem of the resource curse.\textsuperscript{4} These actors were driven, however, by concerns with very different dimensions of this predicament.

Civil society organizations were originally concerned with the worst features of the resource curse, such as increased likelihood of violent civil conflicts, environmental degradation and/or gross human rights violations, and grand corruption. Broader concerns with all negative developmental implications of the problem would come only later. Transnational corporations, capital-exporting developed countries, international organizations and host-countries, on the other hand, were all driven by a combination – in different degrees, depending on the actor - of two concerns. For some, there was a genuine concern with the developmental implications of the resource curse. For others, the main concern was with the significant reputational damage associated with any actor who maintained financial and political support for the exploitation of natural resources in governance-poor countries, despite growing evidence that in this way they were likely contributing to their “curse”.

This is not to say that these interests and values do not interact and influence each other in practice.\textsuperscript{5} For the sake of presentational clarity, though, I will assume that each actor is driven to action by a primary motivation. Despite each group of actors being driven by its own concerns, interests and values, their policy objectives converged in the creation of EITI. Next, I briefly trace an historical description of how each group of main actors behind the creation of EITI has come to consider the initiative a conducive mechanism for pursuing their policy strategies.

6.2.1. Leadership by private actors

During the cold war, civil society organizations deployed traditional advocacy strategies to deal with the civil conflicts and severe human rights violations associated with developing countries

\textsuperscript{4} EITI’s origins diverge, therefore, from the more traditional trajectory of global regulatory diffusion, which starts with regulatory innovation in a dominant state and spreads from there to other states and ultimately to the global level. See Walter Mattli & Ngaire Woods, eds, The Politics of Global Regulation, (Princeton: Princeton University Press, 2009) at 7.

\textsuperscript{5} For a detailed discussion on how values and interests by different actors intertwine to produce international regulations see Kenneth W Abbott & Duncan Snidal, “Values and Interests: International Legalization in the Fight Against Corruption” (2002) 31 J Legal Stud S141.
with significant resource wealth. They produced reports to name and shame leaders of resource-rich countries or rebel groups that were using resource revenues to fuel their fights for power. The same tactic was used to name and shame Western transnational corporations that were engaging in these countries and profiting from their natural resources, despite the context of violence and abuses, and sometimes even directly committing abuses themselves. These civil society organizations employed political pressure over host countries, home countries and international organizations to adopt “old governance” measures to deal with the problem.

The fall of the Berlin Wall in 1989 generated broad expectations that many civil conflicts that were considered proxy wars fuelled by the global ideological divide of the Cold War, being dependent on covert or explicit financial support from foreign governments, could gradually be resolved. During the Cold War the United Nations and other multilateral mechanisms dedicated to mediate these conflicts and to protect human rights and the environment had largely become political hostages of the ideological confrontation. Key actors concerned with these issues expected that without the Cold War divide those conventional multilateral mechanisms would finally fulfill their potential to serve as effective instruments to address these problems.


7 As already discussed in chapter 3, “international old governance” mechanisms, according to Abbott and Snidal, are those that rely primarily on states and state-centered institutions to create and implement rules; rely on centralized bureaucratic expertise; and may – or may not – rely on mandatory rules instead of only voluntary norms. In contrast, transnational “new governance” mechanisms are characterized by the central role of private actors in rule-making and rule-implementation, with different levels of collaboration by states depending on the initiative; by reliance on dispersed expertise; and by reliance on voluntary norms. Kenneth W Abbott & Duncan Snidal, “Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit” (2009) 42 Vand J Transnat’l L 501.

8 One example was the recognition, by the United Nations itself, that the Commission on Human Rights had not been able to perform its role due to state capture. In a 2005 Report the UN stated: “The Commission’s [on Human Rights] capacity to perform its tasks has been increasingly undermined by its declining credibility and professionalism. In particular, states have sought membership of the Commission not to strengthen human rights but to protect themselves against criticism or to criticize others. As a result, a credibility deficit has developed, which casts a shadow on the reputation of the United Nations as a whole”. Report of the Secretary General, In Larger Freedom: Toward Development, Security and Human Rights for All, UN Web Services Section Department of Public Information, UN Doc A/59/2005, (2005) at 182.
Both sets of expectations would clearly be thwarted in the coming decades. In places where there were ethnic tensions, or fierce disputes over the control of prized natural resources, long-lasting civil wars endured, or new ones developed. International coordination within and outside the United Nations remained as elusive as before, and developing countries continued asserting their sovereignty over their natural resources and their policy environment. Attempts to create international mechanisms to directly regulate TNCs also proved intractable, as briefly discussed in chapter 4. Public regulation ceded way to private coordination within and across borders in the wake of the privatizations and de-regulation of economic activities that gained steam in the late 1990s.

For those concerned with the role of natural resource wealth in civil wars, gross human rights violations and severe environmental degradation, one of the primary objectives became to understand how existing and new global regulatory mechanisms could address these problems in this new context. As I described in Chapter 4, by progressively choosing to bypass “old governance” mechanisms excessively reliant on elusive inter-state consensus, state and non-state actors provoked a large-scale shift towards “new governance” mechanisms in the 1990s. Overtime, civil society organizations concerned with civil conflicts would come to realize that the strategies they had been using were not having the expected effects.

It was in 1993, in the aftermath of the Cold War, that three friends founded a non-governmental organization called Global Witness (GW). Their objective was to produce and disseminate research on the role of natural resource rents in provoking or enabling the continuation of civil conflicts, gross human rights violations and severe environmental degradation; to raise awareness of these issues worldwide; and to advocate for institutional mechanisms to deal with the interface of global trade in natural resources and conflicts and human rights violations and environmental degradation. Beginning in 1995, Global Witness waged a campaign against the

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11 Global Witness received seed funding from Open Society Foundation. See Chuck Sudetic, The Philanthropy of George Soros: Building Open Societies, (New York: Public Affairs, 2011). George Soros’ Open Society Foundations have been original supporters of many civil society initiatives to deal with the resource curse and the living philanthropist has written openly about this support. See George Soros, The Bubble of American Supremacy:
timber trade between Cambodia and Thailand. This trade was reportedly funding Khmer Rouge militias that threatened to destabilize the still embryonic democratic government of Cambodia, causing widespread deforestation and enabling the diversion of revenues by the ruling elites. In 1992 the UN had imposed sanctions on timber trade with Khmer Rouge, after the militias failed to respect the peace plan previously brokered by the multilateral organization. The UN sanctions were followed by an official Cambodian ban on logging exports in 1994. The two “old governance” measures did succeed in bringing the official timber trade to an end. However, illegal timber trade between Thai timber companies and both Khmer Rouge militias and the Cambodian military continued to thrive. In 1995, Global Witness conducted field research in Cambodia and in the Thai/Cambodia border, documenting widespread breaches of the ban. Their research report would also detail how a significant amount of revenues from both the illegal and legal timber trade was going to a parallel budget and not to the official Royal Government of Cambodia budget.


Khmer Rouge militias controlled around 10% of Cambodia’s territory at the time, and they received significant revenues from several Thai forest corporations that had received concessions to exploit timber. The official Cambodian government also benefited from lucrative timber deals with the Thai forest industry, and most of the revenues were diverted to the military or to personal accounts. Global Witness, Forests, Famine and War: The Key to Cambodia’s Future (1 January 2000), online: Global Witness [http://www.globalwitness.org/library/forests-famine-and-war-key-cambodias-future] [Global Witness, Forests]. Global Witness, Thai – Khmer Rouge Links, and the Illegal Trade in Cambodia’s Timber (1 January 1995), online: Global Witness [http://www.globalwitness.org/library/thai-khmer-rouge-links-and-illegal-trade-cambodias-timber] [Global Witness, Thai-Khmer].

Khmer Rouge refused to disarm or demobilize their troops, hindered independent access to the areas they controlled and boycotted the previously agreed parliamentary elections. SC Res 792, UNSCOR (1992), imposing economic sanctions.

continuation of massive illegal timber trade between Cambodia and Thailand. The organization advocated “old governance” measures to deal with the problem:

The International Community should undertake to put pressure on Thailand directly, through relevant fora such as the UN, and through specific legislation, such as the upcoming United States Foreign Operations Act - 1996. The International community must similarly insist that the Royal Government of Cambodia complies with and effectively enforces its own forestry legislation. Pressure should be brought to bear through [...] bilateral and multi-lateral relations, for example the possibility of the US granting Cambodia’s “Most Favoured Nation Status.”

The international pressure also led the IMF and the World Bank, which were supporting the strengthening of Cambodian economic and social institutions, to make their funding conditional on improvements in forestry sector governance. In May 1996, the IMF suspended Cambodia’s Structural Adjustment Fund due to lack of improvements in measures to curb illegal logging and corruption. The Cambodian government agreed to enter into formal negotiations with the IMF and the World Bank to reform their forestry management systems. These measures have been partially successful, as they allegedly drained Khmer Rouge militias of funds, significantly contributing to their gradual demise.

Ultimately, the broader problem of illegal logging and diverted revenues from the timber trade would prove much more difficult to tackle than expected. For civil society activists, it became clear that one of the difficulties was the limited leverage that external actors had on the Cambodian government in this area. The option of bypassing the Cambodia governance deficit by using consumer and investor pressures to spur Western TNCs to promote voluntary industry certification was outside the equation in this case. Timber corporations that were buying legal and illegal logging from Cambodia were mainly from neighboring countries like Thailand and Vietnam, rather than Western corporations sensitive to consumer and market pressures. These corporations were also less inclined to press the Cambodian or the Thai governments to adopt measures to improve governance. The case was an illustration of how existing “old governance” global regulatory mechanisms, but even “new governance” mechanisms were inadequate to deal

15 They famously estimated that Khmer factions were earning around US$ 10 to 20 million per month. Global Witness, *Thai – Khmer*, supra note 10.
with the challenge of illegal timber trade in Cambodia. A similar regulatory challenge was becoming evident with the economic exploitation of other resource commodities.

Global Witness organized a second significant campaign related to the role of resource wealth in perpetuating civil conflicts at the time. This campaign was designed to address the role of the global diamond trade in the civil conflict in Angola. In this case, civil society activists would be able to test the efficacy of using the pressure of Western markets to help create political leverage on host countries. External bilateral financial support to the Angolan government and its opposition party, UNITA, had dried up in the late 1980s, leading many analysts to predict that the civil war would soon be over. Analysts would later recognize that vast deposits of oil (controlled by the government) and diamonds (controlled by UNITA) would serve as a financial engine that made possible the resumption of the civil war in 1992.18

In 1998 and 1999, Global Witness published two reports based on investigations on how trade in oil and diamonds was fuelling the perpetuation of the civil war in Angola.19 The first report, called “A Rough Trade”, concentrated on the trade in diamonds.20 Similarly to the Khmer Rouge militias, UNITA obtained revenues to finance its war efforts against the governing party, MPLA, by selling natural resources – in this case diamonds - from the territories they controlled. The diamond trade, however, presented some specific characteristics that made it different from the timber trade. The industry was extremely concentrated and dominated by a single transnational corporation, De Beers,21 whose main market was in Western developed countries. The second

20 Global Witness, A Rough Trade supra note 19.
21 De Beers monopolized the diamond trade worldwide for most of the 20th century, selling 85% to 90% of diamonds. In 1998 the company was still responsible for the sorting, valuing and selling of around 80% of international diamond production. De Beers began to lose market share only in the 2000s, when following an antitrust investigation by the European Commission it decided to abandon the strategy of buying, stockpiling and selling most of the global supply of rough diamonds. Yet, De Beers was still selling 45% of all rough diamonds and controlling around 40% of the diamond market in 2007. See EC, Commission Decision 2003/79/EC of of 25 July 2003 declaring a concentration to be compatible with the common market and the EEA Agreement [2003] OJ, L205/16.“Changing Facets”; The Economist, 382:68 (22 February 2007). Bain & Company, The Global Diamond Industry: Lifting the Veil of Mystery (2011), online: Bain & Company <http://www.bain.com/Images/PR_BAIN_REPORT_The_global_diamond_industry.pdf>, study commissioned by the Antwerp World Diamond Centre Private Foundation and produced by Bain and Company Inc.
difference was the fact that diamonds could be easily identified by source, “often to the level of the mine they were extracted from.”

As in the case of Cambodia, when UNITA failed to implement the peace agreement under the Lusaka Protocol, the UN passed Resolutions 1173 and 1176, prohibiting the international trade in diamonds that were not certified by the official Angolan government. The measure was not effective, however, because it was too easy to smuggle Angolan diamonds to neighboring countries that did not have to certify them. This breach was highlighted in the “A Rough Trade” report. In January 2000, a Canadian NGO named Partnership Africa Canada published an 88-page report named: The Heart of the Matter: Sierra Leone, Diamonds and Human Security. The report showed how the trade in diamonds that fuel extremely violent conflicts and gross human rights violations was not exclusive to Angola.

With extensive media coverage of the role of diamonds in fuelling conflict in Angola, Sierra Leone and, later, also Liberia, the expressions “conflict diamonds” and “blood diamonds” reached the general public, and were threatening to tarnish the image of De Beers in important consumer centers. Under De Beers’ leadership, the members of this concentrated industry decided to respond to the increasing pressure by activists and the threat to their legitimacy and reputation. In 2000, De Beers promoted the creation of the World Diamond Council (WDC), in order for all diamond industry players to collectively address the illegal trade in rough diamonds from countries in civil conflict.

This initiative epitomized the type of “new governance” initiatives characterized by firm self-regulation that mushroomed in the 1990s. However, an industry-led certification scheme, similar to those in the forest and in apparel sectors, was deemed inadequate for the diamond trade for several reasons. First, diamonds were often mined by artisanal means, and passed through several middlemen before being sold to foreign buyers. They were, therefore, very easy

22 Global Witness, A Rough Trade, supra note 19.
to smuggle. Besides, diamonds’ very high value raised the incentives to illegal trade.

Another problem was the fact that it would be extremely dangerous for foreign corporations to monitor the certification process in places facing serious civil conflicts or high levels of violence. *De Beers* was concerned that other industry buyers, less sensitive to consumer pressure, would use this opportunity to break its near monopoly of purchasing diamonds in Africa. *De Beers* and the WDC considered the participation of host countries and their neighbors essential if any attempt to curb the illegal trade in conflict or blood diamonds was to succeed. In this case, an important industry group realized that they needed a different strategy to answer their policy objectives of securing markets while acting responsibly and maintaining their international legitimacy and reputation.

This account illustrates the important shift that was beginning to evolve in private actors’ strategies in dealing with natural resources and civil conflicts in the 2000s. Both civil society organizations, TNCs and industry associations were coming to the conclusion that, in some cases, neither the strategy of relying on conventional global regulatory mechanisms to influence host country behavior, nor the strategy of bypassing host countries by pressing for corporate self-regulation, would be effective. These actors needed to find institutional mechanisms to press for or to encourage meaningful host-country engagement. They recognized that improving institutional systems in host countries was likely indispensable to ensure a socially-conscious and legitimate business environment in the long run. In other words, they began a process of converging into the “governance matters” consensus.

First private actors worked within more conventional global regulatory mechanisms, but they would nevertheless break new ground in creating an innovative global regulatory model. WDC and civil society organizations worked together in lobbying governments and the United Nations to create a certification scheme with host countries’ approval and participation, to prevent conflict diamonds from entering the legitimate market.27 In 2000, the UN General Assembly approved a resolution calling for an international scheme of diamond certification, which came

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to be known as the Kimberly Process. However, despite serving as a key “orchestrator” or catalyst in the negotiation process, the UN did not create a top-down, multilateral body, as it had done in similar circumstances.

The Kimberly Process was created as a transnational public-private partnership (PPP), a multi-stakeholder initiative with the formal participation of diamond industry players, civil society organizations, inter-governmental organizations and diamond-rich countries. Although being considered a soft law, multi-stakeholder initiative, the Kimberly Process structure was considered “quite different from other multi-stakeholder initiatives focused on ethical supply chains because governments [played] a larger role in the Kimberley Process.”

I argue that Kimberly was also different because it was the first experience of a horizontal global regulatory mechanism whose primary implicit goal was to enable a group of public and private actors to join forces and use a set of different incentives and leverage to influence resource-rich host countries to adopt more effective domestic governance systems in the diamond sector.

Under Kimberly, host countries are responsible for certifying their diamonds, and monitoring depends in high measure on customs inspections. If host countries do not certify and monitor their diamonds, they are threatened with losing access to established markets. Corporations, however, play a complementary role by running a voluntary system of warranties to ensure the diamonds they purchase truly come from legitimate sources. Virginia Haufler argues that the private sector played a key role in the design of the Kimberly Process, and still does in its implementation. It does so, however, in “extensive negotiation and collaboration with other stakeholders.” Kimberly has been lauded as an important mechanism, having arguably reduced the amount of illegal or conflict diamonds reaching the legal market from 4% to 1%

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28 Amy Lehr, “Old and New Governance Approaches to Conflict Minerals: All are Better than One” (2010) 52 Harv Int’l LJ Online 148 [Amy Lehr].
31 Amy Lehr, supra note 28 at 157. Kimberly’s formal participants reached 49 member states, representing 75 countries (European Community has one representative).
32 Amy Lehr, supra note 28 at 159.
34 Amy Lehr, supra note 28 at 159.
Witness and Partnership Africa/Canada, the two organizations considered ultimately responsible for the efforts and leadership leading to the Kimberley Process, were co-nominated for the Nobel Peace Prize in 2003. Yet, the initiative is far from perfect, and it has recently been the object of strong critiques that call into question the efficacy of the Kimberley process as a certification scheme. Critics argue, for example, that Kimberly needs to evolve away from its current overreliance on consensual decision-making, and towards a system with external and independent monitoring, and clear sanctions for non-compliance.

The Kimberley process represented the first attempt to use unconventional forms of global regulatory mechanisms to influence host country domestic regulations, since up to that point this role had been left to international treaty law and development assistance. The Kimberley process was a direct precursor of EITI. Another campaign initiated by Global Witness, on the role of natural resources in fuelling the Angolan conflict, would later be embraced by various civil society organizations and other state and non-state actors, and eventually lead to the creation of EITI.

In 1999, Global Witness published a report to show the other side of the coin: how the MPLA-led Angolan government was diverting most of the oil revenues to military and personal use. European and North American oil corporations had a massive presence in the Angolan oil sector. The goals of “A Crude Awakening” were to name and shame both the Angolan government and


36 Smillie, supra note 35.
the Western corporations that were engaging in oil exploitation in Angola. Still, there was a strong focus on industry-led corporate social responsibility initiatives. The report attempted to devise recommendations on what Western corporations should do to avoid being complicit in the corruption, violence and poverty generated or perpetuated by oil revenues in governance-poor Angola.

The report claimed, for example, that by refusing to release information on revenues paid to exploit Angolan natural resources, major multinational oil companies were complicit in the mismanagement and embezzlement of oil revenues by the country’s elites. In their words:

As the main generators of revenue to the government of Angola, the international oil industry and financial world must accept their complicity in the current situation. As such it is imperative that these companies change the way they conduct their affairs, creating new levels of transparency. The international oil industry and the finance companies that have provided oil backed loans, must play this leading role.  

Global Witness emphasized the lack of governance in Angola and other countries which were either emerging from conflicts or were still in conflict, and where structures of government accountability and transparency were “at best fragile, and at worst non-existent.” According to the organization, corporations should demonstrate an extra level of transparency in such cases, “over and beyond that which companies are normally required to demonstrate in their home countries of operation.” In other words, when faced by a governance deficit in host countries, transnational corporations were asked to fill the gap by self-regulation.

The report concluded with a public call on the oil companies operating in Angola to ‘publish what you pay’, showing a strong initial focus on directly changing corporate behavior. Disclosure by extractive corporations would bypass host countries. Host countries would be indirectly affected, but there was no call for direct engagement with them at this point. A Crude

37 Amy Lehr, supra note 28 at 2.
38 Global Witness, A Crude Awakening, supra note 19.
39 Global Witness, A Crude Awakening, supra note 19 at 5. At the same time, civil society organizations were demanding that IFIs that were giving loans and supporting the development of the extractive sector in resource-rich countries with weak governance systems to create internal policies to ensure they were not exacerbating the resource curse. In 2001 the World Bank established an internal “Extractive Industries Review” to investigate the implications of their loans and programs to extractive activities in promoting poverty reduction. Bonnie Campbell, supra note 3.
40 Global Witness, A Crude Awakening, supra note 19 at 5.
Awakening expressly mentioned Western corporations like Chevron, Elf (now Total), Exxon/Mobil, and British Petroleum (BP). They were accused of hiding behind the principle of national sovereignty to avoid doing anything about the fact that the revenues they were paying to the Angolan government were being used to perpetuate the civil war.

Global Witness, which is based in the UK, began to exert special pressure over extractive UK oil companies to voluntarily disclose what they were paying to the Angolan Government. The campaign had a significant impact on public opinion in the UK.41 British Petroleum (then BP-Amoco) had already been under increased pressure for its oil exploitation in conflict-ridden Angola. A 1997 social impact assessment commissioned by BP-Amoco, and produced by Environmental Resource Management (ERM), concluded that there are

[R]isks to the reputation of BP/Statoil if the Government of Angola fails to live up to commitments made to increase democracy, accountability and transparency and if oil revenues continue to be the main source of income to the government, although anticipated increases in oil revenue could potentially finance investment in the human capital and infrastructure necessary for economic and social development.”42

The internal BP analysis recommended that BP and Statoil, joint operators of an oil exploration project in Angola, take the lead to establish consultations in both Angola and UK to explore ways to improve this scenario. Based on this internal study and its own “Crude Awakening” report, Global Witness recommended that BP and Statoil set a benchmark for corporate transparency and accountability by publishing all the revenues paid to the Angolan government, as well as all the contracts signed with the Angolan government and the Angolan National Oil Company, Sonangol. They also suggested that BP/Amoco should form a coalition of oil corporations to encourage transparency and government accountability in Angola.43

UK corporations, however, alleged they were prohibited from disclosing payments unilaterally under contract confidentiality clauses (they would need the consent of host countries to disclose). They also claimed that they would suffer competitive disadvantages and probably lose contracts.

42 The report also includes information on how in 1999 the IMF and the World Bank decided to suspend loans and to cancel talks with Angola, after this country failed to implement promised governance reforms to increase democracy, accountability and transparency. Global Witness, A Crude Awakening, supra note 17 at 10.
43 Global Witness, A Crude Awakening, supra note 19 at 10.
to corporations from other countries that would not disclose their financial payments. Like De Beers in the case of the diamond trade, Western oil corporations came to realize that they did not have much unilateral capacity to protect themselves against reputational risks associated with weak governance systems in host countries.

Taking the allegations of British extractive corporations into account, Global Witness decided to initiate a global campaign to press G8 countries, home to the most significant transnational extractive corporations, to create securities regulations requiring their corporations to publish what they paid to any resource-rich government. The initial idea was to create enough pressure to achieve a mandatory initiative, thus leveling the playing field. Since at this juncture the global movements against corruption and in favor of greater governance transparency were gaining momentum, other organizations working on these issues would soon embrace the common cause. In June 2002, Global Witness partnered with CAFOD, Open Society Institute, Oxfam GB, Save the Children UK and Transparency International UK, to launch a worldwide Publish What You Pay (PWYP) campaign.

PWYP basically proposed that any oil and mining corporations that sought to be listed on stock exchanges in G8 countries should fulfill a condition: they should disclose all tax payments, royalties, license fees, and any revenues paid to governments of countries where they operate. While civil society activists did not achieve their goal of a top-down, mandatory global initiative, their work contributed to shaping the interests of private corporations and state actors, enabling

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44 This argument would gradually gain more currency as transnational extractive corporations from emerging economies, especially from China, began to strongly invest in resource-rich developing countries. See Deborah Brautigam, Dragon’s Gift: The Real Story of China in Africa (Oxford, UK: Oxford University Press, 2010). See also Mark Klaver & Michael Trebilcock, “Chinese Investment in Africa” (2011) 4:1 Law & Dev Rev 168.

45 Multilateral political group formed by the 7 major industrial democracies (France, United States, Britain, Germany, Japan, Italy, Canada) and Russia. See the “G8 Information Center”, online: G8 Information Centre <http://www.g7.utoronto.ca/what_is_g8.html>.


47 Subsequently, other organizations such as Catholic Relief Services, Human Rights Watch, Partnership Africa Canada, Pax Christi Netherlands and Secours Catholique/CARITAS France, along with an increasing number of NGOs from developing countries, also joined the campaign. Eigen, “Fighting Corruption”, supra note 41; “Publish What You Pay”, online: <http://www.publishwhatyoupay.org>.
the eventual creation of a new unconventional global regulatory mechanism designed to influence the domestic governance systems in host countries, the EITI.

6.2.2. Values, interests and the creation of EITI

Possibly because the UK oil corporations were feeling the brunt of the pressure at the time, it was UK Prime Minister Tony Blair that advanced the discussion of an international initiative to mandate the disclosure of financial payments by corporations to resource-rich countries during the 2002 World Summit on Sustainable Development in Johannesburg.\(^{48}\) Instead of focusing on G8 countries only, the idea was to make a broader initiative, which would ensure a level playing field for G8 corporations and corporations from other countries as well. Nevertheless, there was no consensus on this type of multilateral mandatory initiative. Blair then promoted an alternative model, a public-private partnership where host-countries would voluntarily accept that oil corporations disclose their payments, and would voluntarily disclose the revenues they received. An independent auditor would then reconcile the two financial reports. The idea was that once a host country became an EITI member, all corporations operating in the country would be required to disclose. Essentially, this initiative shifted the bulk of the disclosure responsibility from transnational corporations and home countries, to host countries themselves. The initiative would, however, also rest on the support of Western developed countries and the active participation and leverage of civil society organizations and transnational corporations besides host countries.

At this point key oil and mining corporate entrepreneurs, just as diamond corporate entrepreneurs before them, were convinced that only an international initiative that ensured the participation of host-state governments would be able to promote a level playing field.\(^{49}\) This realization may explain why a significant number of Western extractive corporations supported EITI when it was first launched. Among others, the supporters included: Anglo-American, Areva, BG group, BHP Billiton, BP, ChevronTexaco, ConocoPhillips, DeBeers, ExxonMobil, Newmont Mining, NNPC, Repsol YPF, Rio Tinto, Shell, SOCAR, Statoil, Total, Petrobras. Today, 54 TNCs support EITI,


\(^{49}\) Ibid
among them all the members of the International Council of Metals and Minerals (ICMM). Supporters include TNCs from Australia, South Africa, and Brazil. It is important to note that no corporation from China has so far given support to EITI. This represents a crucial defect, given the scale of the growing Chinese investments in the resource sector in Africa.⁵⁰

As soon as the proposal changed from a mandatory initiative to a voluntary, multistakeholder PPP, most developed countries decided to support EITI. Early supporters included all the G 7 members (Canada, France, Italy, Japan, Germany, USA, UK), as well as Australia, Belgium, Denmark, Finland, Netherlands, Norway, Spain, Sweden, Switzerland, and Qatar (a middle-income country). Many explanations were offered as to why developed countries were so eager to support the initiative. For some, interests formed the basis of their support. EITI offered a low-cost alternative for Western developed countries to deflect criticisms of complicity by their corporations with the resource curse. It would therefore help to restore their tarnished reputations and the legitimacy of their support for oil and mining TNCs operating in developing countries.⁵¹

Others argued that ideas formed the basis of the broad multistakeholder support for EITI, including by developed countries. Several concomitant global movements - against corruption, towards transparency and accountability in public affairs, and towards greater corporate social responsibility and accountability – converged in EITI. There is no doubt that all of these elements help to explain the broad acceptance of EITI among all stakeholders involved. Nonetheless, I propose a concurrent explanation as to why developed countries were massively receptive to the initiative, an explanation which has been largely missing from the literature analyzing EITI. A voluntary PPP initiative such as EITI, whose primary objective is to influence the behavior of resource-rich host countries, was also strongly converging with developed countries’ growing attempts to find ways to successfully promote reforms in dysfunctional governance systems in developing countries.

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Chapter 1 already described the evolution of the “governance matters consensus”, and Chapter 2 discussed the so far largely failed attempts to significantly improve dysfunctional governance systems using conventional global regulatory mechanisms, especially in resource-rich countries. Understanding EITI – and its precursor, the Kimberley Process - as an offspring of the “governance matters” consensus can help to explain the strong support Western capital-exporting countries gave to a new – unconventional – global regulatory initiative whose primary objective is to bridge the governance deficit in foreign developing countries. This linkage may also help to explain why no emerging economy (not even Russia, part of the G8) supports the initiative. The “governance matters” consensus remains underdeveloped in academic and policy circles in emerging economies, and disproportionally influential in developed countries.

The most puzzling question is why resource-rich developing countries would agree to participate in EITI. Many explanations were proposed, most of them directly or indirectly related to the “governance matters” consensus. Several scholars argue that a reputation for weak governance is a key obstacle preventing some developing countries from attracting more FDI. For some, signing EITI would be a way of host-countries sending a signal to external audiences that they are committed to strengthening their governance systems in order to combat corruption and manage investments wisely, thus helping them to attract more FDI. A similar argument proposes that participating in EITI reduces the political risk associated with some developing countries. Similarly, showing signs of commitment to better governance may increase flows of aid and international assistance.

There is some evidence that this type of self-interested motivation can partially explain the adherence of key resource-rich countries. Peter Eigen, who was actively involved in the EITI negotiations, wrote:

A Nigerian minister, recently commenting for the first time on her country’s acquiring an attractive credit rating, attributed a sovereign debt rating in substantial part to the

reputational effect of its energetic application of EITI to uncover, for public scrutiny, the previously hidden fiscal flows of the oil and gas industry.\textsuperscript{53}

Another concurrent explanation may be the fact that some resource-rich countries such as Timor Leste had recently undergone fundamental political changes, and were thus at conducive critical junctures. These countries allegedly wanted to lock in any potential governance improvements by linking it to an external institution. This institutionalization would modify internal power balances, making it easier to fight internal resistance to changes and therefore to consolidate the transition to democratic systems. There are also accounts that some developing countries have been compelled by donor conditionalities to participate in EITI. In these cases, the motivation of donor countries is linked to the governance matters consensus.

It bears repeating that a missing concurrent explanation is how EITI was created in a context where several developing countries were already buying into the “governance matters” discourse, which was advanced by their traditional donors and capital-sources. It is hard to know which developing countries were genuinely invested in the idea that governance matters (logic of appropriateness),\textsuperscript{54} and which developing countries were in fact only formally committing to the discourse in exchange for expected benefits (logic of consequences). Either way there was clearly growing acceptance of global mechanisms to promote domestic governance. Evidence of this movement among developing countries was the creation of the New Partnership for African

\textsuperscript{53} Eigen, “Fighting Corruption”, supra note 41.

\textsuperscript{54} International relations scholars argue that when domestic actors become convinced that certain values promoted by the international community are worth pursuing, and they therefore accept to adopt and comply with international norms, they are acting under the “logic of appropriateness”. When, on the other hand, global norms alter countries’ calculations of interests, leading domestic actors to believe that it is worth behaving in a certain way to obtain benefits from the international community or other countries, they are acting according to” a “logic of consequences”. The fact that the behavior of political actors in international relations could be explained by the logic of appropriateness, and therefore international norms potentially has a constitutive effect on state behaviour, rather than only constraining behaviour, was first advanced by March and Olsen in 1989, and became a important element of constructivist theories of international relations. James March and Johan Olsen, Discovering Institutions: The Organizational Basis of Politics (New York: Free Press, 1989). Jeffrey T. Checkel, “Bridging the Rationalist – Constructivist Divide” (1997) 3:4 European Journal of International Relations 473. Martha Finnemore, National Interests in International Society (Ithaca, NY: Cornell University Press, 1996); Peter Katzenstein, ed, The Culture of National Security: Norms and Identity in World Politics (New York: Columbia University Press, 1996). In contrast, rationalist international relations theories are based on the assumption that state behaviour responds to a logic of consequences, and international norms shape behaviour by changing incentives and imposing constraints in how states can act. For rationalist accounts and the logic of consequences see Andrew Moravesik “Explaining International Human Rights Regimes: Liberal Theory and Western Europe” (1995) 1 European Journal of International Relations; Andrew Cortell and James Davis, How do International Institutions Matter? The Domestic Impact of International Rules and Norms, (1996) 40 International Studies Quarterly 451.
Development (NEPAD) by African countries, an initiative that is strongly based in the “governance matters” consensus. The fact is that the governance matters idea seems to be linked to most of the possible explanations for why such a significant number of resource-rich and governance-poor countries agreed to participate in EITI. Some of the original statements and documents from EITI’s creation process, and its very design features, also reinforce the evidence that EITI aims to influence domestic governance systems, and should be considered a direct offshoot of the “governance matters” consensus. I turn to this evidence next.

6.3. A public-private partnership to promote governance reform

EITI is a transnational public-private partnership with the stated goal of “promoting and supporting improved governance in resource-rich countries through the full publication and verification of company payments and government revenues from oil, gas, and mining.” In 3.1 I briefly describe EITI’s main characteristics, while in 3.2 I argue that EITI diverges in important respects from conventional global regulatory initiatives to influence domestic governance systems.

6.3.1. Describing EITI

EITI’s implementing countries are those resource-rich countries that agree to the publication and verification of payments by corporations, and revenues received by the government, in relation to mining, oil and gas operations. Developed countries are classified as supporters of the initiative, providing both political and financial support. Extractive corporations and civil society organizations participate in the management and implementation of the initiative.

An EITI Board oversees the initiative and is composed of members representing resource-rich implementing countries, donor and supporting countries, extractive corporations, investor organizations and other civil society organizations. International organizations such as the World Bank, the IMF and the African Development Bank do not have representatives on the EITI Board.

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55 EITI candidate countries in June 2012 were Afghanistan, Albania, Burkina Faso, Cameroon, Chad, Cote d’Ivoire, Democratic Republic of Congo, Gabon, Guatemala, Guinea, Indonesia, Iraq, Kazakhstan, Madagascar, Mali, Mauritania, Mozambique, Peru, Republic of the Congo, Sierra Leone, Tanzania, Togo, Trinidad and Tobago and Zambia. Other countries demonstrated interest but had failed to meet basic standards as of June 2012: Equatorial Guinea, Ethiopia, Sao Tome and Prince and Ukraine. See “EITI”, online: EITI <http://eiti.org>.
Board. However, they send observers to EITI meetings and support the initiative politically and financially.

Resource-rich countries that decide to implement EITI are divided into two groups: candidate countries and compliant countries. In order to be considered an EITI candidate, a resource-rich country needs to agree to perform four main sign-up criteria:

1. To regularly publish all material oil, gas and mining payments by companies to governments and all material revenues received by governments from oil, gas and mining companies to a wide audience.

2. To submit payments and revenues to independent auditing and to reconciliation by a credible, independent administrator that will apply international auditing standards. To publish the administrator’s opinion regarding that reconciliation, including discrepancies, should any be identified.

3. To ensure civil society will be actively engaged in the design, monitoring and evaluation of the EITI process and will contribute towards public debate.

4. To prepare a public, financially sustainable work plan, with assistance from the international financial institutions where required, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints.

Implementing countries are expected to create a national multistakeholder group to ensure participation of civil society organizations and extractive corporations in the initiative. This group will jointly decide on a work plan. The “candidate” status is considered temporary and expected to eventually lead to “compliant” status. Within two and a half years after being formally declared a candidate, the implementing country must go through a validation process in order to achieve the status of “compliant”. The national multistakeholder group must jointly select an independent “validator” to conduct an assessment of the progress achieved in implementing the full set of EITI requirements. Based on this assessment, the EITI multistakeholder Board decides if the country can be declared EITI “compliant”. Compliant

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56 This text is a modified quote from the EITI 2005 Sourcebook. The sourcebook listed 6 criteria. I merged the requirement of a credible, independent auditing of the payments and revenues to the reconciliation by independent administrator. I left out the clarification that material payments should also include those made by state-owned enterprises. EITI Secretariat, EITI Source Book (January 2005), online: EITI <http://eiti.org/document/sourcebook> [EITI Source Book]; See also World Bank Group, Implementing Extractive industries Transparency: Early Lessons From the Field (2007) at 4 [World Bank, Implementing Extractive industries Transparency].

57 World Bank, Implementing Extractive industries Transparency, supra note 56.

58 EITI’s Board introduced the validation process in 2006, after EITI participants acknowledged that some EITI countries had performed very well while others had lagged behind in terms of implementation, and there was no mechanism to separate one from the other. It was agreed that all implementing countries should have their implementation validated in order in order to minimize free-riding on the initiative. See EITI International Secretariat, EITI Rules, 2011 Edition: Including the Validation Guide (2011), online: EITI <http://eiti.org/files/2011-11-01_2011_EITI_RULES.pdf>.
countries are expected to continue performing all the disclosure requirements in order to maintain this status. A stakeholder who determines that the country is falling below the standards can ask the Board to begin a new validation process at any time. EITI presents a series of characteristics that defy its classification in existing categories of global regulatory mechanisms. As other forms of “transnational new governance” mechanisms, EITI is highly decentralized and reliant on dispersed expertise.

Evidence from the process that gave rise to EITI supports the argument that the initiative belongs to the “governance matters” global movement, and does not seek to bypass or replace national governance systems. The main proponents of EITI, for example, have emphasized from the start that the initiative was just an entry point, an element of a broader set of initiatives needed to tackle the resource curse. The 2005 EITI Sourcebook stated that “EITI provides a good entry point for broader work and discussion on revenue management,” and should be seen as a complement to other efforts to increase transparency and accountability in the extractive sector. The same document further stated:

> From its inception, the EITI has enjoyed wide international support but the focus for the initiative is at the national level. […] Benefits for implementing countries are mainly realised as part of, or as an entry point to, broader efforts to improve governance”.

In 2006 EITI’s International Advisory Group reinforced this understanding of the circumscribed role that EITI was expected to play:

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59 Abbott and Snidal draw from discussions on “old governance” versus “new governance” forms of regulation on the domestic level to propose a division between “international old governance” and “transnational new governance” forms of regulation on the global level. On the domestic level “old governance” regulations are characterized by being centralized (state-centric), top down, mandatory and based on bureaucratic expertise. “New governance” regulations on the domestic level are characterized by being decentralized (with the state orchestrating private regulations instead of imposing the regulations top down), based on soft law (instead of mandatory) and dispersed expertise. “Old governance” on the international level is member-centric (relying on inter-state treaties and international institutions with official membership by representatives of states) and reliant on bureaucratic expertise, similar to old governance on the national level. However, on the international level “old governance” is characterized by limited centralization, since member-states keep a significant amount of regulatory authority. “International Old Governance initiatives” differ from old governance on the national level because international rules, even when binding, are enforced not by coercive means, but rather by managerial means. On the global level transnational new governance initiatives share with domestic new governance initiatives the characteristics of being highly decentralized, based on dispersed expertise and soft law. The only difference, according to Abbott and Snidal, is the fact that new governance on the global level lacks the same level of state orchestration; Abbott & Snidal, “Strengthening”, supra note 7.

60 EITI Source Book, supra note 56 at 5.
[...] EITI is best implemented as a key part of a broader reform. It is a step towards better governance – often the first step – and can support wider improvements in transparency and accountability within an implementing country. The benefits that come with EITI should therefore be viewed in this context.\(^{61}\)

Other evidence that EITI was designed as only a stepping-stone to further domestic governance reforms to address rent-seeking behavior is the fact that the promoted transparency standards focus only on revenue flows from corporations to governments. These flows constitute only one link among many in the extractive industries value chain. The extractive industries value chain is a framework initially proposed by Paul Collier, but later adopted by many other actors and agencies.\(^{62}\) Collier proposes that, in order for natural resources to be harnessed into sustainable development, a series of right decisions must be made along the extractive value chain. These decisions start with how the natural resources are discovered and extend to how the revenues are spent by governments. Diagram 1 illustrates Collier’s value chain of decisions in the extractive sector.\(^{63}\)

The first link relates to the key decision whether to economically exploit resources when they are discovered.\(^{64}\) The second link refers to the design of national fiscal regimes for the extractive sector, and the negotiation of contracts between governments and corporations. This stage affects

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\(^{62}\) IMF, World Bank and civil society organizations such as RWI adopted the value chain approach.


\(^{64}\) Deposits may be located in environmentally sensitive areas, or in ancestral lands belonging to indigenous communities, or their exploitation may greatly affect the livelihoods of local communities that are against the decision to extract. Countries may also not be prepared to fully benefit from extraction at a certain point in time, for lack of different capacities, including governance. One early example of the costs and benefits of exploiting resources with weak national industrial capacity can be found in Moran’s case study of Chile in the 1970s, which postponed the exploitation of its copper deposits until the country was able to build national capacity to engage in the economic exploitation, instead of relying completely on foreign corporations. Theodore H. Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile*, (Princeton, NJ: Princeton University Press, 1974). Countries need to undertake a case-by-case cost-benefit analysis to better inform the decision whether or not to extract. External donor agencies or IFIs have a key role to play in this link, since one option can be to postpone financial and technical assistance to enable resource extraction in countries that still experience acute governance problems. This was for example the main criticism against the World Bank’s support for the economic exploitation
the percentage of the resource rents that will go to the government and the percentage that will go to private corporations. The third link refers to the transfer of revenues from corporations to governments. Links two and three influence the amount of revenue flows that will actually be available for potential investment in economic and social activities by the host country government. The fourth link refers to how the government manages and spends the revenues: are they invested in or divested from socially and economically productive activities?

EITI aims to affect primarily the third link by doing two things: 1) putting a spotlight on how much corporations are paying in revenues to a certain government in exchange for the rights to exploit natural resources; and, 2) determining how much of these revenues actually get into governments coffers. EITI does not address how governments invest or spend the revenues after they are received. For Ivar Kolstad and Arne Wiig, improving transparency and accountability in government expenditures would be the most effective way to tackle rent-seeking behavior. They argue that initiatives to address the resource curse should give priority to this final link, concluding that the focus of EITI is misguided or at least incomplete.

According to the alternative view I am proposing, this account is not necessarily the case. EITI’s transparency and accountability standards are not ends in themselves, but means toward improving conditions and creating circumstances to facilitate further governance reforms. An expenditures-first focus would probably meet fierce resistance from host countries. Proposing an all-encompassing mechanism to address governance improvements in all links in the value chain would also probably invite resistance and preclude participation by several resource-rich host countries. EITI’s proponents opted to focus on a less contentious link in the value chain. Promoting transparency and accountability in the flow of revenues from corporations to governments was the first step made possible due to a rare, broad consensus among very different stakeholders and key resource-rich host countries.

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65 EITI affects the second link only indirectly, since previously confidential provisions from revenue sharing agreements between governments and corporations will be revealed by the disclosure of revenues streams.

There are other initiatives seeking to address rent-seeking in the other links of the value chain, since this framework has now been adopted by a large number of private and public actors.

There is, therefore, general awareness in various relevant political circles that EITI is only one piece of a larger strategy to promote transparency in the extractive sector and governance reform in resource-rich host countries. Nevertheless, a significant body of literature doubting the effectiveness and value of the initiative has developed. This scholarship points to the lack of clear improvements in development indicators, or to the persistently high levels of corruption in resource-rich countries participating in EITI to support its claims.

The argument of this chapter is that most current criticisms of EITI and EITI-like initiatives are missing the point. EITI’s primary purpose is neither to serve as an all-encompassing mechanism to directly address all rent-seeking opportunities throughout the value chain, nor to directly influence development outcomes. Instead, EITI should be regarded as an entry point and tool to create more conducive conditions for further attempts to promote institutional reforms in host countries. Thus, it helps to tackle major obstacles to governance reform and only indirectly improve development indicators in host countries.

In fact, a compelling theory of change that explains the mechanisms of causality leading, for example, from greater disclosure of public information to desired development outcomes, would be welcome and necessary. The features of such a needed theory, however, need qualification. A

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68 Others have questioned the effectiveness of transparency initiatives more generally, EITI among them, to achieve the ultimate goals of improving social and economic indicators. Another group of critics has been more cautious. These authors believe that transnational initiatives promoting transparency and accountability can achieve several of the desired outcomes. They affirm that it is still too early to discount these initiatives and argue that impacts may need a longer gestational time. They call for an overarching theory of social change to explain how exactly the movement from increased transparency to improved development indicators happens and its different benchmarks. For these critics there is a need for innovative methodology to assess the direct short-term impacts, and the causal chains that will eventually lead to desired developmental outcomes. Alexandra Gillies and Antoine Heuty, both of which work for the think tank and advocacy organization Revenue Watch Institute, one of the main civil society supporters of EITI and other transparency initiatives in the extractive sector, concede that participation in EITI and other transparency initiatives have not triggered “major economic or developmental transformations or any significant reductions in corruption” in resource-rich countries. They suggest that this can partly be explained by the methodological challenges to assess the impacts, including the lack of a theory of change with different steps of causality between “transparency, governance, economic, and development outcomes.” Alexandra Gillies & Antoine Heuty, “Does Transparency Work? The Challenges of Measurement and Effectiveness in Resource-Rich Countries” (2011) 6 Yale Journal of International Affairs 25 at 29.
valuable theory of change to assess EITI-like mechanisms should be unpacked, to encompass two distinct steps: 1) providing an explanation of whether and how mechanisms beyond the host-country level can improve the conditions for successful governance reforms in a certain issue area; and 2) providing an explanation of whether and how certain governance mechanisms will lead to the expected improvement in specific development outcomes.69

Most of the broader literature on good governance and development focuses on the second step. Most of the recent literature assessing transnational initiatives such as EITI misguidedly conflates the two steps, concentrating however on the second. As a consequence, there is a significant research gap at step 1. This chapter calls attention to the importance of making this distinction, and the importance of focusing on step 1. By using EITI as a case-study, this chapter offers an initial contribution to this research agenda.

Under this proposed framework, an assessment of EITI should focus on understanding the ways that the initiative has potential to fulfill this narrower policy objective of enhancing the possibilities of successfully promoting domestic governance reforms in resource-rich countries. The question is: how exactly does EITI serve – or not – as an entry point to facilitate further efforts to reform host countries governance systems, starting with those that will help tackle rent-seeking behavior? In other words, understanding if and how EITI affects governance in host countries should be part of the research agenda of those concerned with identifying the mechanisms to address path dependence and other obstacles to domestic governance reform, addressed in chapter 2.

The next section will suggest some of EITI’s design features that allow the mechanism to serve as an entry point to improve the chances of successful governance reforms, at least potentially. In sequence, section 5 will draw on EITI’s experience so far to offer hypotheses of how its mechanisms are operating in practice as compared to these assumptions. It is beyond the scope of this dissertation to propose a complete explanation of all the mechanisms in which EITI proposes to serve as an entry point to governance reform, or to fully assess the effectiveness of this

initiative to meet its explicit and implicit goals. The following hypotheses are an initial contribution to this unfolding research agenda.

### 6.3.2. Defining EITI

In this section I argue that EITI differs from earlier global regulatory mechanisms because it is using an innovative approach to influence the behavior of host countries. EITI is a voluntary public-private partnership (PPP) uniting various stakeholders around this shared goal. These stakeholders are resource-rich countries, developed capital-exporting countries, extractive corporations and civil society organizations (including investor organizations). Because of its design and performance, EITI can be considered a transnational form of public-private partnership (PPP).

Traditionally, PPPs have been most commonly employed within nation states in order to bring more efficiency to the areas of service delivery and infrastructure. Definitions of PPPs in these traditional forms emphasize the “structured cooperation between public and private partners […] in which they share or reallocate risks, costs, benefits, resources and responsibilities.” More recently, PPPs have been increasingly employed by transnational actors as a mechanism to jointly pursue a shared global governance goal. Graeme Auld, Steven Bernstein and Benjamin Cashore, for example, argue that PPPs exist at the local, national and international levels. They consider the transnational PPP as one variation of hybrid forms of global governance mechanisms that do not fit neatly in the old definitions of hard versus soft law.

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70 World Bank, Implementing Extractive industries Transparency, supra note 56.


In the book *Hard Choices, Soft Law*, edited by John Kirton and Michael Trebilcock, several authors reached a consensus that there is no dichotomy between hard law and soft law governance mechanisms in the global arena. Instead, there is a continuum. At one extreme of this continuum are the “voluntary” governance initiatives relying primarily on the authority, participation and resources of non-state actors. At the other extreme are the mandatory regimes relying primarily on states to grant authority, and to create and enforce its rules. Although recognizing that it is often hard to draw clear lines for the intermediate categories, Auld, Bernstein and Cashore propose some criteria to help locate existing initiatives in this continuum. The idea is to facilitate the understanding of the limits and possibilities of these institutional mechanisms to serve as effective drivers of social change.

According to Auld, Bernstein and Cashore’s proposed criteria, a PPP like EITI would be located somewhere in the middle of the spectrum. It is worth explaining some of these main criteria. In the ideal types of hard law or soft law initiatives, it is, respectively, the state and private actors that unilaterally create the rules. In the PPP-like initiative, on the other hand, state and non-state actors agree upon the rules. The role of the state is central in hard law initiatives, while marginal in soft law initiatives. In PPPs, the state is an active participant, although it delegates or shares authority. Enforcement systems in hard law initiatives are usually top down, based on command and control institutions. Soft law initiatives rely on non-binding forms of declarations and guidelines. PPPs are usually voluntary, but they rely on a series of market and peer pressure incentives to promote compliance, besides counting on some of the state systems either explicitly or implicitly in the background.

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75 Although the authors focus on initiatives that they classify as corporate social responsibility initiatives, the same analysis applies to transnational initiatives in other issue areas as well. Auld, Bernstein & Cashore, *supra* note 68.

In line with this classification, Derick Brinkerhoff and Jennifer Brinkerhoff, and Susan A. Aaronson, have recognized EITI as a transnational form of PPP. They argue that transnational PPPs come in many forms and nuances. Brinkerhoff and Brinkerhoff’s definition of PPPs include two major elements. The first defining element is mutuality, which encompasses the “commitment to a shared goal and the extent to which partners operate within the spirit of shared control and responsibility.” The second defining element is organizational identity, meaning “the rationale for selecting particular partners according to their distinctive competences”. The authors add: “capitalizing on and maintaining [their own competencies] constitutes the basis of partnership value-added.”

Finally, EITI can be considered a promising type of transnational PPP regulatory initiative, according to the test of the five ANIME (Agenda-setting, Negotiation of standards, Implementation, Monitoring and Enforcement) tasks of the “regulatory process” proposed by Kenneth Abbot and Duncan Snidal. Duncan and Snidal argue that, in order to create a potentially effective regulation, key actors (which they call norm entrepreneurs) need to accomplish five things. First, they must succeed in placing an issue on the political agenda and galvanizing relevant groups to action on this issue. Second, they need to negotiate, draft and promulgate standards. Fourth, they must monitor compliance and, lastly, promote, if not enforce, compliance. At least structurally, EITI has covered all ANIME steps. Under existing definitions found in the literature, therefore, EITI can be considered a transnational form of PPP.

Previously, global regulatory mechanisms designed to influence the behavior of host countries by encouraging domestic governance reform were top down forms of hard international law, or bilateral and multilateral development assistance using aid, technical assistance, capacity building and conditionalities to encourage or press for domestic governance reforms. These mechanisms were state oriented, and often perceived by developing countries as imposed on

78 Brinkerhoff & Brinkerhoff, supra note 71.
them or highly influenced by powerful developed countries. The participation of private actors was external and marginal. Being a transnational PPP designed to influence domestic governance systems in host countries, EITI diverges from these conventional global regulatory approaches to governance reform. EITI is horizontal and includes the active participation of private actors in all stages of the regulatory process. In the next section I address how EITI includes features that were apparently designed to overcome some of the shortcomings of conventional forms of global regulatory mechanisms to influence domestic governance systems.

6.4. Creating conducive conditions to domestic governance reforms

Key public and private actors have thus chosen to support the creation of this unconventional transnational public-private partnership (PPP) to serve as a potential entry point to influence governance systems in host countries. What explains their choice of a voluntary, PPP-type of institution? I argue that at least four different features of EITI seek to overcome shortcomings of conventional initiatives to influence domestic governance reform. In practice, these institutional features interact and reinforce each other. For the sake of presentational clarity, however, I discuss each feature separately. I begin, in this section, by briefly summarizing the four features, and proceed to a detailed analysis of each feature in the sub-sections that follow.

First, EITI’s design has sought to address one important shortcoming of conventional global regulatory mechanisms in promoting governance reform: the lack of ownership and legitimacy in host-countries. When the initiative to promote governance reform is externally driven, it ends up generating formal governance reforms merely to placate outsiders, failing to generate real behavioral change.  

Recent development literature posits that agreed-upon objectives with host countries, and a greater degree of control by them (or perception thereof) are essential to improving the success record of governance reform initiatives. EITI’s proponents relied on the idea that by (1) being voluntary, (2) having host countries share in rule-making and

81 Ibid.
implementation powers and responsibilities, and (3) creating a series of incentives for participation, EITI would avoid this shortcoming of conventional global regulatory mechanisms.

Second, and related, due to disparate interests converging in EITI, the initiative was able to bring together host-countries, home-countries, extractive corporations, International Financial Institutions (IFIs) and civil society organizations in a transnational public-private partnership (PPP). This PPP enabled the leverage of a significant pool of incentives, checks and balances to address a major contemporary obstacle to governance reform: rent-seeking behavior. There was growing recognition among key public and private actors that addressing rent-seeking behavior associated with resource rents was a necessary first link in any attempt to promote sequenced governance reforms in resource-rich countries. EITI became the first multilateral initiative designed to tackle this contemporary obstacle to governance reform. EITI’s model of multistakeholder public-private partnership allows for different actors to explore opportunities to press for changes in domestic systems. Alliances can be built when necessary, but there is no assumption that they should take on one single format. In other words, the public-private nature of the initiative facilitates an aggregation of different forces that allows political mobilization to become quite malleable and flexible to adjust to different circumstances.

Third, EITI sets transparency standards on the flow of resources revenues from extractive corporations to governments, beginning a process of disclosure and accountability that is assumed to directly contribute to less diversion and embezzlement of these resources. EITI’s proponents expected that this initial disclosure, although partial, would have spill over effects by encouraging governance reforms in other parts of the extractive value chain. Greater access to information on revenues flowing into government coffers is expected to increase the pressure for accountability by citizens in host countries, raising the costs of rent-seeking behavior, and thus facilitating other governance reforms that would have more direct impacts on development outcomes. Fourth, EITI requires the active participation of civil society organizations in the discussion, design and implementation of national systems to monitor the flows of revenues from corporations to governments. The idea is that allowing direct voice and participation by citizens in government affairs can potentially improve the quality and effectiveness of governance and accountability mechanisms, while also leading to more empowerment of civic organizations.

The sections that follow explain each of these four features in detail.
6.4.1. Enhancing ownership and legitimacy among host countries

One of the main challenges for those who argue that governance matters for development, besides the obstacles to governance reform such as path dependence discussed in chapter 2, is the fact that improving governance systems often entails provoking significant changes in national politics and power relations. Reformers have come to expect national ruling elites and interest groups that benefit from the status quo to resist external initiatives that impact national political dynamics. In the case of resource-rich countries, rent-seeking adds another layer of resistance, since a significant share of resource rents is at stake.

Analyses of failed attempts by the World Bank, International Monetary Fund and bilateral development agencies to use aid or loan conditionality as a tool to promote governance reform for development have suggested that agreed-upon objectives with host-countries and more control by them are essential features if the prospects of successful reform are to improve. Governance changes achieved primarily through coercive conditionality have mostly proved unsustainable, or have often remained formal yet empty reforms. For IFIs and bilateral aid agencies from traditional capital exporting countries, the task of promoting or encouraging governance reform is complicated by the strong legacy of suspicion and resistance from developing countries to what they see as “neocolonialism” by the rich and powerful countries towards the poorest ones. There is a strong sense among many developing countries that IFIs and some United Nations agencies are imposing their views and agenda top-down on developing nations, when not promoting the self-interest of powerful developed countries.

In the 1990s, development agencies provided significant amounts of capital in loans, guarantees for private investment and aid in order to support the growth of the extractive sectors in resource-

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82 Ibid.
rich developing countries. These actions sought to make natural resource wealth serve a much needed engine for development. As information on the links between governance and the resource curse became increasingly available, so did information on the failed efforts by external actors to promote governance reform in resource-rich countries. The World Bank’s financial and political support for oil exploitation in Chad, including the construction of the Chad-Cameroon pipeline, is emblematic. The Chad-Cameroon Petroleum Development and Pipeline Project became famous worldwide not only because it was the largest single private sector investment in Sub-Saharan Africa, but also because of the utter failure of the much hailed mechanisms that the World Bank had promoted to improve governance in the oil sector in Chad to avoid the resource curse.⁸⁵ One of the main conclusions was that the series of incentives and disincentives the World Bank put in place were undermined by a sheer lack of ownership by the Chad government.

When EITI was created a high degree of legitimacy among host countries was considered a condition for this new institution to avoid the same problems of lack of ownership faced by conventional global regulatory mechanisms to promote governance reform. Though EITI was first sponsored by the UK’s then Prime Minister, Tony Blair, and was quickly supported by OECD countries and IFIs, since its inception there have been attempts not only to link EITI to objectives dear to resource-rich host countries such as improved access to FDI due to reputational gains, but also to give these countries more control over the initiative.⁸⁶

The perceived need to overcome this critical problem of conventional global mechanisms to promote governance reform - the lack of ownership and legitimacy among host countries – explains many of EITI’s features. It explains its voluntary nature, its governance structure, its set of political and economic incentives to host countries, and the initially limited reach of its disclosure requirements. The assumption was that if the initiative’s design could facilitate real commitment by a significant number of host countries, over time this initial improvement in

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⁸⁶ Virginia Haufler: “Although the EITI was a foreign policy initiative of the UK government, Blair intended from the beginning for it to be adopted widely by resource-rich states.” Virginia Haufler, “Disclosure as Governance: The Extractive Industries transparency Initiative and Resource Management in the Developing World” (2010) 10:3 Global Environmental Politics 53 at 64 [Haufler, “Disclosure as Governance”].
governance systems to manage extractive revenues could have spillover effects to other governance systems, and to other sectors as well.

Transnational “new governance” initiatives such as EITI rely on voluntary participation and consensual principles. There is no top-down enforcement mechanism. Instead of binding rules supported by coercive enforcement, these initiatives rely on more indirect social and economic incentives and pressures to promote compliance. EITI’s voluntary nature means that at any time host countries – and any other stakeholder for that matter - can revoke their consent. The most serious consequence of non-compliance is removal from the initiative, with the consequent reputational costs. On the other hand, the credibility of the initiative depends on the acceptance by a significant number of host countries. This model is an assurance that the initiative’s legitimacy - and sustainability - depends in practice on the continued acceptance and positive perception of the initiative by all stakeholders, but especially by resource-rich implementing countries. There is a need for all participants to constantly reinforce this shared legitimacy.

For some, the voluntary nature of EITI is a major weakness, and without clear and strong enforcement mechanisms the initiative runs the serious risk of being merely window-dressing. There are recurrent calls for EITI to become a mandatory initiative. This voluntary nature, however, was probably crucial to ensuring a higher acceptance and commitment by resource-rich

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87 Virginia Haufler, for example, emphasized this point while tracking the history behind the initiative:

The provisions of the EITI are voluntary, but the UK and other governments promised incentives in the form of aid and diplomatic support for those who committed to participate.

Ibid at 64.

88 Steven Bernstein and Benjamin Cashore argue that this type of legitimacy deriving from voluntary initiatives is a necessary condition for the effectiveness of new governance initiatives, which they call non-state market driven initiatives, even though it does not guarantee this effectiveness. They develop this idea of legitimacy of non-state global governance mechanisms based on James Rosenau’s writings. Steven Bernstein & Benjamin Cashore, “Can Non-state Global Governance Be Legitimate? An Analytical Framework” (2007) 1:4 Regulation and Governance 247.

89 Dilan Olcer argues that disclosing information has relatively very few costs, and yet EITI participants are disclosing inconsistent and poor quality information. Having a system that involves real enforcement would be much more difficult to achieve and therefore EITI may remain a system of “toothless transparency without full accountability.” Dilan Olcer, “Extracting the Maximum from the EITI” (February 2009) OECD Working Paper Number No 276 at 22.

host countries wary of externally imposed mandatory initiatives. There are also many arguments
supporting the claim that voluntary initiatives can be equally effective despite relying on non-
traditional forms of pressure and sanctions to promote adherence and compliance. However, it
is true that many global regulatory initiatives begin as voluntary mechanisms and evolve to
mandatory initiatives when they gain broader legitimacy and support. It is important to
emphasize that in the specific case of this global regulatory initiative ensuring ownership was an
important goal, and therefore the tradeoff between “bite” and legitimacy among host countries
must be a consideration.

Framers of the EITI, seeking to increase ownership and commitment by leaders to implement
reforms, believed they could do so, in part, by giving more control and direct participation to
resource-rich host countries in the design and implementation of the initiative. Resource-rich
host countries did not actively participate in the agenda-setting process that led to EITI’s
creation. Since the first international discussion of EITI in 2002, however, a few resource-rich
host countries such as Nigeria and Azerbaijan have assumed an extremely active role in
promoting the nascent initiative and in the negotiations that defined the standards and the
governing structure of EITI. During the 2003 Conference that officially launched EITI, for
example, the representative of Azerbaijan stated:

[...] Azerbaijan, from the very beginning expressed its support for the initiative of
transparency in extractive industries. [...] We will promote this initiative inside our
country and if it is necessary, we are ready to play an active part in promotion [sic] it
outside our borders. We had full experience in creating transparency in the past and we
have good will to continue this policy in the future.

Every two years EITI holds a Global Conference to bring together all stakeholders to discuss the
initiative. As stated in section 1, the multi-stakeholder Board created to oversee the initiative’s
governance in between conferences has five representatives from host countries, working along
with three representatives from supporting countries, five representatives from civil society

91 Kirton & Trebilcock, supra note 74, Auld, Bernstein & Cashore, supra note 73, Kenneth Abbott & Duncan
92 See section 6.2, above, describing how this agenda was driven by a pool of external actors.
93 Azerbaijan government, Media Release, “Statement by Ilham Aliyev, then first Vice President of SOCAR”
online: EITI <http://eiti.org/>. Aliyev would become the next President of Azerbaijan, following his father.
organizations, and six representatives from extractive corporations and investor organizations. This governance design serves to ensure that host countries will have an active role in the discussion of the initiatives’ objectives and standards, and will be able to exit the initiative if they disagree with any new directions it may take.

The voluntary nature and the horizontal coordination of EITI means that all stakeholders, not only resource-rich host countries, share equal voice in the design and implementation of the initiative, and can also exit at anytime. This requires host countries to accept these and other conditions and outcomes that come with this type of transnational public-private partnership. EITI derives its legitimacy from the support of the many actors involved in the initiative. Therefore, maintaining this legitimacy requires constant negotiation with supporting countries, extractive corporations and civil society organizations on improving the management of their extractive resources.

The option for an unconventional type of global regulatory initiative to promote governance reform was based not only on the assumption that it could overcome the problem of lack of ownership and legitimacy among host countries, but also in its capacity to provide an unprecedented forum for the multi-stakeholder discussion and regulation of rent-seeking behavior, which I discuss next.

6.4.2. Leveraging a public-private partnership to tackle rent-seeking behavior

EITI’s proponents were based on the belief that a transnational public-private partnership (PPP) is the most feasible and efficient policy alternative to address rent-seeking behavior in resource-rich and governance-poor countries. PPPs allow a large variety of relevant actors to align forces and collaborate in different ways towards solving complex problems with a transnational nature. The idea is that conventional international law mechanisms lack state-like authority for mandatory, top-down regulation and enforcement systems, relying instead on nation-states to

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94 In January 2012 the EITI Board was composed as follows: from implementing countries, representatives of Niger, DRC, Nigeria, Mongolia and Indonesia; from supporting countries representatives of United States, Spain, Netherlands; from civil society, representatives of Open Society Forum Mongolia, Wacam/Ghana, Association Africaine de Defense des Droits de l’homme, PCQVP/DRC, Global Witness, Revenue Watch Institute/USA; from extractive corporations and investors, representatives of Statoil/Norway, Chevron/USA, Areva/France, Royal Dutch Shell/Netherlands, SRI/Standard Life Investments. EITI website, online: <http://eiti.org/>.
incorporate, implement and enforce international standards domestically. However, rent-seeking undermines the willingness or the ability of host countries to follow such a course.

Besides, long-lasting political divisions among developed and developing countries in the international sphere, and the perceived and/or real disproportionate influence exerted by capital-exporting states over international organizations such as the United Nations, contribute to preventing consensus on binding international rules that may constrain the sovereignty of resource-rich countries. In the international scenario, a PPP is expected to facilitate stakeholders reaching agreements on a common goal, despite underlying political divergences, and diverse or even conflicting objectives. According to Jennifer M. Brinkerhoff in a PPP

The potential for conflicting motivations and objectives forms the basis for accountability in upholding the pursuit of common goals or at least agreements on goals, when the diverse actors are sufficiently engaged.\(^95\)

For Walter Mattli and Ngaire Woods, successful regulatory change, whatever change this may be, always requires “sustained support of ‘entrepreneurs’ offering technical expertise, financial resources, and an organizational platform if it is to succeed.”\(^96\) EITI offers this platform and expands the potential number of public and private actors in order to address the diverse challenges presented by rent-seeking behavior in concrete cases.

In section 2 I explained how distinct policy strategies or motivations pursued by various actors ended up converging in EITI. There are other features of PPPs that are expected to reinforce participants’ engagement with such an initiative. The decentralized nature of EITI means that, like other PPPs, “accountability and coordination are horizontally organized, rather than dictated by a subset of participating actors, and decision-making is shared.”\(^97\) Besides, collaboration among a diversified pool of stakeholders is expected to favor information sharing and learning.\(^98\)


\(^96\) Mattli and Woods use the term “norm entrepreneurs” to refer to public and private actors pursuing global regulation. For them entrepreneurs can be public officials, non-governmental groups or private-sector actors”. Throughout this dissertation I have been using the term public and private actors to refer to the same individuals or groups they call entrepreneurs. Mattli & Woods, supra note 4 at 11.

\(^97\) Brinkerhoff, supra note 95; Aaronson, “Limited Partnership”, supra note 77 at 52.

to leverage complementary expertise and resources, and to reduce costs of monitoring and enforcement.

According to Virginia Haufler:

The EITI was conceived as a platform to involve the many different groups with a stake in [host countries’ management of resource revenues from transnational extractive operations], including governments, international organizations, local and international NGOs and extractive firms.

EITI was designed with a view to leveraging a broad pool of expertise, resources, incentives and pressures towards greater transparency in the management of resources revenues, with the aim of facilitating domestic governance reform. New governance initiatives also emphasize more flexible norms and procedures, in contrast to the precise and detailed nature of hard law regulations. EITI prioritizes governance improvements to address rent-seeking, but the form of these reforms will vary from country to country. Thus, each country needs to answer a single question: how to create governance mechanisms to improve transparency and accountability in the flow of extractive resources revenues? While EITI maintains a particular focus for reforms – disclosure and independent auditing of revenues flows in one link of the extractive value chain - it does not dictate the way in which the overall problem of rent-seeking will be tackled. Instead, it only creates favorable conditions for different actors to devise the most effective approaches for the particular problem at hand, given the circumstances of each particular country.

EITI is the first step, and yet an important one because it was expected to create conditions that favor or enable further reforms. EITI was also considered as the best regulatory alternative to promote transparency standards for the flows of resource revenues in the domestic level in resource-rich and governance-poor developing countries, which I discuss next.

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99 Brinkerhoff, supra note 95; Aaronson, “Limited Partnership”, supra note 77 at 52.
101 Haufler, “Disclosure as Governance”, supra note 86 at 64.
103 Abbott & Snidal, “Strengthening”, supra note 7 at 530.
6.4.3. Promoting transparency in the domestic extractive sector

EITI seeks to address rent-seeking behavior by first encouraging the disclosure of information on the flows of resource revenues from extractive corporations to the governments of resource-rich countries. The underlying assumption is that increased access to information generates accountability and improves the conditions for further reforms that promote good governance.\footnote{McGee & Gaventa, Review, supra note 69 at 4. Ann Florini, ed; The Right to Know: Transparency for an Open World, (New York: University Press, 2007) [Florini, The Right to Know]; Helen Darbishire, “Proactive Transparency: The Future of the Right to Information?” The World Bank Institute Governance Working Paper Series (2010), online: World Bank <http://siteresources.worldbank.org/WBI/Resources/213798-1259011531325/6598384-1268250334206/Darbishire_Proactive_Transparency.pdf>.} It is also assumed that fiscal transparency raises the costs of rent-seeking behavior. The actual mechanisms by which fiscal transparency would lead to accountability and good governance, changing incentives of rent-seeking behavior, are still poorly understood, and remain the object of heated debate.\footnote{Daniel Kaufmann & Ana Bellver, “Transparenting Transparency: Initial Empirics and Policy Application” (Paper delivered at the IMF conference on transparency and integrity 6 July 2005), [unpublished].} I will not address all the proposed mechanisms in detail, but will identify some of the hypotheses in the literature.\footnote{Kolstad & Wiig, supra note 66.}

Ivar Kolstad and Arne Wiig argue that transparency can affect political corruption “by helping make politicians more accountable”, by “facilitating cooperation over opportunistic rent-seeking” and by helping to maintain “norms of integrity and trust.” Applying these insights more specifically, Alexandra Gillies and Antoine Heuty argue that the extractive sector is characterized by strong asymmetries of information across the different stakeholders, which facilitates rent-seeking and inefficiencies.\footnote{Gillies & Heuty, supra note 68 at 31. “While companies possess all data related to the field or mine they are operating, information regarding production, costs and payments to the government is often dispersed (or missing) across the Ministry of Finance, the State-Owned Enterprise, and the Ministry overseeing the extractive sector. Media, parliaments, civil society, the population, opposition parties, and other outsiders often have very limited access to information which constrains their ability to exercise their oversight and accountability functions.” They also argue that more available information enables the leverage of diverse views and available expertise, thus improving efficiency.} Transparency measures may thus have a more significant transformative potential in this context, by reducing this asymmetry. Other authors propose that the public release of information would generate more political incentives to adopt
the right decisions. Finally, some propose that greater access to information would increase the costs of rent-seeking behavior by requiring more elaborate schemes to divert revenues, or by raising the possibility of internal and external pressure. This last proposition assumes that greater access to information would generate political pressure in favor of greater accountability.

This link between transparency and accountability seems to be an important underlying assumption behind EITI’s disclosure standards. As stated before, key proponents of EITI as a first step towards governance reform did not see the mechanism as a tool to directly impact corruption, or even to ensure the ultimate success of all-encompassing governance reforms to tackle corruption. Proponents of EITI saw it as an important missing tool at that time to encourage host countries to disclose key information on resources revenues. No matter what the original motivation – strategic or instrumental – of resource-rich countries to participate, it was expected that the exposure to a new set of ideas related to transparency and social participation would end up contributing, over time, to the formation of a new mindset among the elite in various resource-rich countries.

The increased information was also expected to generate political mobilization among relevant actors around the idea that further governance reforms were needed to ensure accountability. This feature is directly related to the one that I discuss next, that direct social participation in EITI would improve conditions for further governance reform.

6.4.4. Social participation and governance

A fourth underlying feature of EITI is the participation of private stakeholders (especially civil society organizations) in the design and implementation of public regulations and policies, to

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110 Mattli & Woods, supra note 4 at 36.
potentially enhance the chances of successful governance reform to address rent-seeking.\textsuperscript{111} In the 1990s, social scientists came to consider civil society as a key agent for promoting democracy and good governance.\textsuperscript{112} The United Nations Development Program (UNDP), for example, argues that

\begin{quote}
[A] viable, strong and informed civil society is central to good governance … and should be [an] effective partner in the process of development.\textsuperscript{113}
\end{quote}

Supporting the development of an informed and strong civil society, and promoting opportunities for it to participate in governance mechanisms became an essential part of promoting favorable conditions for successful governance reforms for development. The idea was to improve the

\begin{footnotesize}
\textsuperscript{111} This assumption was part of a broader movement considering direct social participation as key to ensure democratization and good governance. In the 1990s a series of geopolitical events helped to bring civil society to the forefront of governance debates. A wave of democratic transitions in Latin American and Eastern Europe, governments’ retreat from traditional forms of regulation in the wake of liberalization, privatization and other market reforms, and facilitation of opportunities for connecting and association caused by the information revolution, all contributed to a marked increase of civil society participation in governance mechanisms. In developed countries, the increasing complexity of social life has justified calls for new, more effective forms of governance where norm making and norm implementation are decentralized and where there is more experimentation and diversity in the forms of regulation. Private actors, including corporate organizations and civil society organizations, acquired independent representation in “new governance” processes. David M Trubek & Louise G Trubek, “New Governance & Legal Regulation: Complementary, Rivalry, and Transformation”, (2006) 13 Columbia Journal of European Law 539; Nkwachukwy Orji, “Civil Society, Democracy and Good Governance in Africa” (2009) 4:1 CEU Political Science Journal 76.

\textsuperscript{112} In fact, the idea that there is an institutional space “parallel to but separate from the state”, where citizens associate to independently promote individual or collective interests, can be traced back to the 18\textsuperscript{th} century. See Thomas Carothers & William Barndt, “Civil Society”, (1999) 117 Foreign Policy 18. A broader concept of civil society includes all organizations and associations outside the formal political organization of the state (governments and political parties) and the market. In thus encompasses not only advocacy NGOs but also “labour union, professional associations, chambers of commerce, ethnic associations, and others”, as well as “religious organizations, student groups, cultural organizations[…], sports clubs, and informal community groups.” Carothers & Barndt. For a similar definition see Mark E Warren, “Civil Society and Good Governance” (Paper delivered at the Conference on Civil Society and Good Governance in the US, Center for the Study of Voluntary Organizations and Services, Georgetown University, 4 June 1999), [unpublished]. It was only after WWII, however, that individuals and groups that saw their traditional political space closed or constrained by dictatorships in Latin American and Eastern Europe used the writings by Antonio Gramsci to inform their claims for legitimacy for civil society groups that performed political actions independent from the official governmental institutions. See John Keane, ed, Civil Society and the State (London, UK: Verso, 1988), especially Norberto Bobbio, Gramsci and the “Concept of Civil Society”. Influential works by Talcott Parsons and Jurgen Habermas contributed to form the modern concept of an autonomous civil society. Parsons and Habermas proposed that associative relations exert legitimate normative influence that is independent from the influence generated by the power derived from formal political formation or from organized markets. See Stephen P Savage, The Theories of Talcott Parsons: The Social Relations of Action (London, UK: Macmillian, 1981). Jurgen Habermas, The Structural Transformation of the Public Sphere: An Inquiry Into a Category of Bourgeois Society, translated by Thomas Burger with the assistance of Frederick Lawrence (Cambridge, MA: MIT Press, 1991).

\end{footnotesize}
quality of governance by allowing citizens to directly engage with bureaucrats and politicians in a more “informed, organized, constructive and systematic manner, thus increasing the chances of effective positive change”.  

Direct social participation would also serve to empower citizens groups.  

Drawing from these assumptions, one of the main features of EITI is the requirement that members of civil society organizations participate directly in the process of monitoring and validating revenue flows from corporations to governments. Some EITI supporters find the initiative promising due to its capacity to “create a feedback loop between the government and the governed, acting as a counterweight to corruption.” In this way, EITI’s proponents emphasize how the initiative directly provides a voice for and improves participation of actors previously left outside the political processes in resource-rich developing countries. This participation officially sanctioned by the state is expected to enable civil society organizations to attain a measure of political status that allows them to dialogue with governments from a stronger political platform, altering the power relationship and the dynamics of domestic political processes. The hypothesis is that civil society organizations can potentially use the leverage and knowledge acquired in these processes to exert more effective political pressure in other areas as well.

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115 McGee & Gaventa, Review, supra note 69.


6.5. EITI: theory versus practice

Despite its short existence, there is already a significant collection of papers critically assessing EITI’s impacts and limitations. Most of this literature assumes that EITI is an initiative designed to directly mitigate the negative effects associated with the resource curse, by increasing the costs of rent-seeking, minimizing corruption, and contributing to improved development outcomes.

The overall conclusion of this literature is that EITI has so far been either ineffective, or insufficient as a tool to address the resource-curse in resource-rich and governance-poor countries. Several authors that are supportive of EITI concede that the initiative has so far not provoked “major economic or developmental transformations or any significant reductions in corruption.” Even the few authors that call attention to the inflated expectations associated with EITI end up attempting to find a longer causal chain linking the initiative to control of corruption or improved development outcomes. Alexandra Gillies and Antoine Heuty, for example, question the fairness of expecting EITI to reduce corruption levels, or to instigate economic reform, when the initiative proposes only to “generate greater transparency on the

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118 EITI is still an emerging initiative. The idea of a multi-stakeholder mechanism to promote disclosure on streams of oil, gas and mining revenues from corporations to governments was first discussed in 2002 and was officially launched following a multistakeholder consultation conference in 2003. It was only in 2006 that EITI elected a Board and created a Secretariat in Oslo, Norway. The new institution only became fully operational in 2007. “Scanteam, Evaluating EITI: Progress Report by Scanteam” (Report commissioned by EITI Secretariat delivered at the EITI 2011 Global Conference in Paris, 2011), [unpublished] [“Scanteam Report”].


120 Gillies & Heuty, supra note 68; Aaronson, “Limited Partnership”, supra note 77.

121 Kolstad & Wiig, supra note 66.

122 Gillies & Heuty, supra note 68 at 26.
revenues from the extractive sector.”123 They go on, however, to argue that the causal chain through which increased transparency may indirectly lead to “social and economic wellbeing of the population or the quality of governance” needs to be identified.124

A recurring argument in the literature on EITI claims that the lack of an underlying theory of social change hampers a better understanding of how exactly EITI will lead to less corruption and improved development outcomes in the long run. The same call for better theories of change also apply to transparency and accountability initiatives more generally.125 Rosemary McGee and John Gaventa, in a 2010 analytical review of transparency and accountability initiatives, enumerate the implications of this missing analytical framework:

At the most basic level the lack of a theory of change can inhibit the effectiveness of an initiative by causing a lack of direction and focus; but also can make impact assessment or progress-tracking elusive or impossible.126

The framework I propose, by shedding a more realistic light on the potential and limits of EITI, can contribute to articulating a theory of change that should facilitate future assessments of the initiative. The focus should be on how EITI affects, directly or indirectly, processes of governance reform. Under this framework, most of the current criticisms against EITI, as well as proposed suggestions for reforming the initiative, will probably require major qualifications. Drawing from the existing critical literature and from information available on the EITI website, this section will lay out some inductive hypotheses as to how the actual implementation of EITI is happening, as compared to the assumptions that informed the strategy of its original proponents.

6.5.1. Does EITI facilitate ownership and legitimacy among host countries?

At some point along the road leading to EITI one idea started to gain currency, at least among developed countries and IFIs that have come to support the initiative. This idea was that tying incentives to a voluntary and cooperative scheme in order to induce the participation of resource-

123 Gillies & Heuty, supra note 68 at 26.
124 Gillies & Heuty, supra note 68.
125 McGee & Gaventa, Review, supra note 69.
126 McGee & Gaventa, Review, supra note 69 at 9-10.
rich countries would generate better results as an entry point for encouraging governance improvements than conventional global regulatory initiatives to promote reform using development assistance, or could perhaps complement existing initiatives. For this reason the 2003 conference that officially launched EITI was designed and implemented as a broad and participatory consultative process.  

Resource-rich host countries, developed countries, corporations, investor groups, civil society organizations and international organizations were invited to offer their views and suggestions on the proposed principles and actions that would guide the emerging initiative. Professor Wiseman Nkuhlu, the chairman of the New Partnership for African Development (NEPAD), for example, submitted a written statement expressing his support for the voluntary nature of the initiative, particularly the potential for “constant enrichment and enhancement”. In his view, EITI should be another step towards supporting developing countries’ own increasing openness and commitment to improve good governance. Corporations and industry associations also underlined the importance of a voluntary, host government-led approach.

Not all stakeholders fully agreed with the voluntary feature of the proposed new initiative, however. During the 2003 multistakeholder conference, civil society representatives welcomed

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127 EITI was officially launched with the public release of the “Statement of Principles and Agreed Actions to Increase Transparency over Payments and Revenues in the Extractive Sector”.


129 The full quote of the statement was:

The NEPAD and the Extractive Industries Transparency Initiative (EITI) share a lot of common objectives when it comes to promoting transparency with the view to improving the state of governance. […] The voluntary nature of the process forms its very strength and has the potential to allow for its constant enrichment and enhancement provided rigidity is avoided. […] Furthermore, the initiative has to be regarded as an instrument aiming at making a contribution to the broader evolving framework for an improved global agenda on governance.

Ibid.


the efforts towards improved transparency, but questioned the voluntary nature of the approach. According to the Conference report the Publish What You Pay campaign, supported by 130 NGOs, called for “the use of templates to shape mandatory arrangements” and for the “reinforcement of the principles through conditionality on export credit agency funding.”

Despite the statement of support by the head of NEPAD, the voluntary nature of the new PPP did not overcome the reluctance of resource-rich host countries at first. From the 18 resource-rich developing countries that participated in the 2003 conference only four – Nigeria, Azerbaijan, Ghana and the Kyrgyz Republic - volunteered to pilot the initiative as implementing countries. Three out of the four pilot countries were experiencing serious reputational problems (Nigeria, Kyrgyz Republic and Azerbaijan). Until 2005, despite strong support by G7 countries, IFIs and civil society organizations, EITI was still struggling to expand its membership among resource-rich countries.

The slow pace of EITI’s evolution and the dismal record of acceptance among resource-rich countries seemed to provide a basis for the concerns of civil society organizations about its voluntary nature. A strong emphasis on ownership and legitimacy among host countries could result in a very low membership. Even the few pilot implementing countries were not evidencing many signs of advancing towards the adoption of the transparency measures they had committed to. In 2005, for example, civil society representatives from Timor Leste argued that the government had conducted only partial and untimely consultations for the new regulatory framework for the country’s oil sector.

132 Ibid.
133 These include some resource-rich developing countries that are not usually included in the list of those suffering from resource curse or at risk of doing so, such as Chile, South Africa, Botswana. Besides these 17 resource-rich developing countries there were 2 resource-rich emerging economies, Russia and China, and 12 developed countries: UK, USA, Australia, Belgium, France, Germany, Canada, Italy, Japan, Netherlands, Norway. Ibid.
134 Ibid; see also Eigen, “Fighting Corruption”, supra note 41 at 334.
135 Virginia Haufler argues that the main obstacles were extractive corporations’ concerns with competition (since emerging economies failed to formally enter the initiative), and the reluctance of many resource-rich countries to commit to information disclosure. Haufler, “Disclosure as Governance”, supra note 86 at 65.
The years 2005 and 2006 marked a key moment for the initiative, since it was running the risk of losing credibility among key stakeholders such as civil society organizations and investor groups. An International Advisory Group (IAG) was commissioned to do the following: to better understand and communicate EITI’s incentives for different stakeholders; to discuss indicators to evaluate how the countries that committed to implement EITI were performing; and to suggest management and structural arrangements to facilitate EITI achieving its objectives. In the 2006 EITI international conference, following the recommendations of the International Advisory Group (IAG), participants decided to strengthen EITI by further institutionalizing it. Although co-management and ownership remained central to the initiative, some measures would begin to undermine this approach. EITI members agreed to create a Secretariat in Norway, to hold biennial conferences with all stakeholders to discuss the evolution and management of the initiative, and to appoint a multistakeholder board to oversee EITI’s management in between conferences.\(^{137}\) The board was to have a balanced representation of all stakeholders.

While emphasizing that EITI should be considered an entry point for a broader strategy to improve governance systems, the IAG proposed that the initiative should communicate the following potential direct and indirect incentives for host countries to join EITI:

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<th>Area</th>
<th>Direct Incentive</th>
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<td>Economic</td>
<td>- Improved tax collection from extractive corporations</td>
<td>- More stable and attractive investment environment;</td>
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<td></td>
<td></td>
<td>- Increased growth</td>
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<td>- Improved creditworthiness for sovereign debt ratings</td>
<td>- More access to capital</td>
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\(^{137}\) The board should “oversee the future operation of EITI”. The Board will have responsibility for the overall development, strategic direction, and credibility of EITI, as well as for outreach and advocacy, and will make recommendations on these issues for agreement by the EITI Conference, through a written report to the Conference. EITI International Advisory Group, “Extractive Industries Transparency Initiative: Report of the International Advisory Group” (2006) at 21 online: EITI <http://eiti.org/document/iagreport>.
| Governance | - Greater accountability | - Reduced risk of conflict |
| - Stronger management of public finances | - Less corruption; | - Greater accountability |
| - Respect for the rule of law and accountability | - Improved public confidence in government; | - Improved public probity |

| Development | - Increased investment in human development | - Poverty reduction |
| - Improved employment levels and working conditions | |

| Reputation management | - Seen as “leaders” | - More trust in and respect for public institutions |
| - Greater knowledge leading to more accurate expectations | - Greater political integrity |

At the same time, the World Bank and the IMF started to include participation in EITI as a condition for countries to receive the benefits from the Heavily Indebted Poor Country (HIPC)
initiative, blurring the lines between incentives and conditionalities. These actions generated the expected results. The institutional strengthening of the initiative, the better-communicated incentives, and the use of conditionalities, all contributed to the increase in participation by resource-rich countries in the initiative, from eight participants in 2005 to 35 implementing countries in 2011.\textsuperscript{138}

By all accounts the most striking feature of EITI is the high number of resource-rich host countries that, for one reason or another, have decided to participate in the voluntary initiative as implementing countries. From the list of Least Developed Countries (LDCs) that are mineral or oil exporters,\textsuperscript{139} for example, twelve out of sixteen countries are either compliant\textsuperscript{140} or candidate\textsuperscript{141} EITI countries. All of these countries have low governance indicators and are at great risk of falling prey to the resource curse. A significant number of other resource-rich countries with acute governance problems, which are in different stages of development, also have committed to EITI.\textsuperscript{142}

Although the list of participants is an impressive one, in terms of genuine autonomous commitment that is expected to improve ownership and legitimacy and therefore impact the success of governance reforms, the record is quite mixed. In practice, countries like Cameroon, Chad, Congo-Brazzaville, DRC and Sierra Leone arguably acceded to EITI not voluntarily, but under the HIPC conditions.\textsuperscript{143} For other countries, such as Iraq and Afghanistan, one may

\begin{itemize}
  \item \textsuperscript{138} In 2005 there was still no division between candidate and compliant countries. 5 countries had publicly declared their commitment to the initiative, and had started some implementation activities. Other three were still negotiating the terms of participation. EITI 2005 Sourcebook, \textit{supra} note 51. Two from these 35 countries are currently suspended due to internal political problems: Yemen and Madagascar. See EITI, \textit{Extractive Industries Transparency Initiative}, online: EITI <http://eiti.org/> [EITI, \textit{EITI}].
  \item \textsuperscript{139} The UN classifies countries as LDCs and divide them by their main export products. See United Nations Conference on Trade and Development (UNCTAD), \textit{The Least Developed Countries Report 2011}, online: United Nations Conference on Trade and Development <http://www.unctad.org/en/docs/ldc2011_en.pdf> [UNCTAD, \textit{LDCs 2011}].
  \item \textsuperscript{140} Central African Republic, Mali, Niger, Timor Leste and, though temporarily suspended due to internal political upheaval, Yemen. See EITI, \textit{EITI, supra} note 137.
  \item \textsuperscript{141} Chad, DRC, Guinea, Mauritania, Mozambique, Sierra Leone and Zambia. Ibid.
  \item \textsuperscript{142} The compliant countries include Nigeria, Ghana, Liberia, Azerbaijan, Kyrgyz Republic and Mongolia. The candidate countries include Afghanistan, Albania, Burkina Faso, Cameroon, Cote Ivoire, Gabon, Guatemala, Indonesia, Peru, Iraq, Kazakhstan, Madagascar (suspended), Republic of Congo, Tanzania, Togo (candidates). Ibid.
  \item \textsuperscript{143} Gillies & Heuty, \textit{supra} note 68.
\end{itemize}
question if there is real legitimacy and ownership, since they agreed to participate in EITI during foreign intervention.\footnote{Although I could not find any study indicating that accepting EITI was an imposition from USA to Iraq and Afghanistan, it seems intuitive that these countries did not have real autonomy to decide while under occupation.} All other countries, however, seem to have been lured either by the desire to improve their reputation and attract more investment or aid, or to lock in minimum governance standards after a critical juncture, as stated in section 2.

All indications are that for established oil and mining producers that do not have problems attracting FDI due to the size of their oil, gas or mineral deposits, and that are not experiencing any critical political juncture, the potential incentives for participating in EITI still do not outweigh the expected compliance costs.\footnote{Olcer, for example, has emphasized this point: 
When those countries most dependent on fuel and mining are taken into account […] it becomes obvious that the EITI is not very popular with them. Iraq, Algeria and Angola, for example, are among the world’s most fuel and mining dependent countries. Yet, none of them are candidate countries. There are more than ten countries where fuel and mining products account for more than 70 per cent of total exports that have not signed up to the EITI. Among OPEC countries (representing 78 per cent of world crude oil reserves), only Nigeria has formally signed up to the initiative. Olcer, \textit{supra} note 89.} The downside of the voluntary nature of the initiative is the very low costs of non-accession for these countries. Some of the world’s largest oil and mining countries who are governance-poor, such as Sudan, Equatorial Guinea or Angola, have not signed on to EITI. They attract vast sums of FDI to their extractive sectors despite their negative reputation regarding corruption and political instability and authoritarianism. These are some of the countries where the resource curse problem is most acute.

The balance of relying on voluntary participation to ensure ownership, while avoiding the risk of losing credibility if some of the main targets of the initiative - and some of the major investors in resource rich countries such as China - remain outside, has been a tricky one. The lack of sufficient incentives to lure resource-rich governance-poor countries that are established oil producers was not the only factor behind their low participation. EITI’s initial narrow focus on resource-rich and governance-poor countries made participation even less appealing: there has been little effort, for example, to engage other resource-rich developing countries that are also established oil or mining producers but do not present as significant governance challenges as Equatorial Guinea or Angola. Examples include Chile, Venezuela and Botswana.\footnote{The exception was Peru, which expressed commitment to implement EITI in 2006.}
Moreover, the initiative has been rightly accused of applying a double standard. Since EITI’s inception there has been a clear North/South divide. Until very recently, virtually no resource-rich developed country had committed to implement EITI. Developed capital-exporting countries from the G7 and others such as Norway entered the initiative only as supporting countries. They committed to provide political, technical and financial support to the initiative, but not to implement EITI’s transparency standards. This was despite the fact that some of the supporting countries, such as Norway and Australia, were also resource-rich. This evidences the fact that EITI’s standards were specifically designed for implementation by resource-rich and governance-poor developing countries. In other words, EITI was designed not to create global transparency standards in the extractive sector, but rather to serve as an entry point for improving dysfunctional governance systems in developing countries.147

With respect to the objective of encouraging greater legitimacy and ownership among host countries, however, this double standard reinforces EITI’s ambiguity, since it resembles the conventional global regulatory mechanisms used by Western capital-exporting donors to promote governance reform, which are perceived as externally driven. This double standard has come to be increasingly criticized, leading a 2007 World Bank Report on the implementation of EITI to justify the lack of implementation by developed countries:

The question has often arisen: Why do resource-rich, developed countries that support EITI financially and politically choose not to implement EITI in line with the EITI Criteria? Part of the answer is that, while many developed countries have important extractive industries, there are relatively few in which the extractive industries are the dominant source of government and export revenue. Another answer is that these developed, resource-rich countries have already, in effect, mainstreamed the key components of EITI—that is, transparency and disclosure—into their existing frameworks for managing and regulating the extractive sectors in their countries.148

The same 2007 World Bank report highlighted the beginning of a shift, when it stated: “nonetheless, it should be noted that Norway, considered a “resource-rich” country, had recently

147 Or, according to a more cynical view, to serve as window dressing to deflate the social pressure against Western developed countries and their transnational extractive corporations. See Eigen, “Fighting Corruption”, supra note 38. The problem with this theory is that: 1) civil society organizations that were exerting this pressure are part of the initiative; (2) these civil society organizations have not relented in their attempts to find other ways to press home countries and extractive corporations to assume more responsibility for the resource curse happening in host countries.

148 World Bank, Implementing Extractive industries Transparency, supra note 56.
announced its intention to implement EITI.” Indeed, in 2007, Norway would become the first developed country to commit to implement the initiative. Norway would, however, remain the only developed country to implement EITI until 2011, when the United States decided to start preparations to become an implementing country as well. In 2011 Australia also announced that it is considering implementation, and would undertake national discussions on the possibility of implementation. Other resource-rich developed countries such as Canada have continued to reject the idea of implementing EITI.

The virtual absence of established developing country oil and mineral producers, along with the late and as yet insufficient share of developed countries among implementing EITI participants, has hampered attempts to deflect accusations that EITI is focused largely on capital-scarce developing countries. EITI’s evolution so far has therefore fostered a perception that the initiative is just another scheme created by Western-based donor countries to be implemented by poor countries that are emerging as oil or mining producers and need to improve their prospects of attracting aid or FDI.

A final element that adds to this perception is the unwillingness by emerging economies, such as China, Russia, India and Brazil, to formally support – let alone implement – the initiative. EITI’s proponents have consistently tried to lure emerging economies to officially support EITI.

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149 World Bank, Implementing Extractive industries Transparency, supra note 56.
153 Canada’s rejection is arguably based on the argument that the initiative was designed only for developing countries. There has been increasing pressure by civil society organizations over the Canadian government to follow the USA lead. Publish What You Pay, Blog, online: Publish What You Pay <http://www.publishwhatyoupay.org/newsroom/blog/whos-next-eiti-canada>.
154 By June 2012 EITI received the support of 17 developed countries: the members of G10 (UK, USA, Japan, Italy, Germany, France, Canada, Belgium, the Netherlands, Sweden and Switzerland), plus Norway, Australia, Denmark, Finland, Spain, and Qatar, but not from emerging economies. http://eiti.org/
Despite general public expressions of support by the G20, none of these countries have formally agreed to participate in EITI in any capacity. Emerging economies have supported conventional global initiatives to tackle corruption, such as the UN Convention Against Corruption, as discussed in chapter 5, but they seem reluctant to endorse EITI. The exact reasons behind this resistance are still not well understood, as there is a dearth of studies on this issue.

Revenue Watch Institute proposes one theory as to why China, more specifically, does not endorse EITI: Chinese officials and corporations’ lack of familiarity with the initiative. They also argue that key private and public actors supporting EITI lack familiarity with the way policymaking happens in China. This is a less compelling explanation in cases such as Brazil or India, for example, where there is already a plethora of information on the policymaking process. A more convincing hypothesis is that the ideas and values driving EITI are much less prevalent in emerging economies. They are especially foreign to China, the biggest investor in natural resources in governance-poor countries besides Western developed countries. Bates Gill and Yanzhong Huang, for example, argue that

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\text{[t]he concept of good governance is [seen by China as] an extension of the Washington Consensus with added emphasis on the Western cultural values of the rule of law, transparency, accountability and democracy. These values, however, seem to matter little in China’s [development] success story.}
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China has a very different approach to supporting economic and social improvements in developing countries, based on its own recent successful experience with development. This approach is based on mutually beneficial agreements and strict non-interference in internal

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156 RWI started a project to research this issue. From their website: “There is a possibility that the Chinese companies face some of the same incentives toward greater transparency as the traditional company partners in the Extractive Industries Transparency Initiative (EITI), but engaging strategically with the Chinese on EITI or transparency generally will require a better understanding of how this policy is formulated and implemented, particularly with respect to Africa. It will also require laying the groundwork through efforts aimed at increasing Chinese familiarity with EITI as EITI is currently not well-known or well-understood within the Chinese government or companies”. Christopher Burke, Johanna Jansson & Wenran Jiang, The Extractive Industries Transparency Initiative (EITI) and China’s Energy Policy Formulation Process (np: Centre for Chinese Studies, 2009).
157 See Klaver & Trebilcock, supra note 44.
159 To a detailed account of the unique Chinese approach to aid, trade and investment in Africa see Deborah Brautigam, supra note 44.
affairs. Rent-seeking and corruption, still prevalent in China, are seen as domestic issues and irrelevant to economic development. There is also no tradition of direct participation of civil society organizations in regulatory processes in China. Finally, there are still no Chinese corporate and civil society actors pressing the government to adopt certain approaches to host countries where Chinese TNCs operate. Other emerging economies likely present different levels of the same features that characterize China’s stance towards developing countries.

Another hypothesis is that emerging economies as a group are resisting the very concept of a global regulatory mechanism that grants a more intrusive role to public international actors and private domestic actors in their domestic governance affairs, as compared to conventional global mechanisms. However, Brazil is co-leading the new International Open Government Partnership (OGP) with the US, an initiative launched in 2011 to set basic global standards of openness in government information, including in state budgets. South Africa is part of this initiative as well, and Russia has expressed an intention to commit to it. The design of this initiative is in many ways similar to EITI. It is a multistakeholder initiative, overseen by a steering committee of governments and civil society organizations, to improve domestic good governance through increased government transparency. OGP requires the creation and implementation of national action plans developed with wide public consultation and overseen by a national multistakeholder group. Members commit to submit progress reports to OGP, and submit to independent assessments by local and international governance experts.

More research is needed to understand exactly why Brazil is willing to lead a broader initiative such as OGP, but not to support EITI. Whatever the motives for why emerging economies have not engaged with EITI, there is a valid argument that their absence weakens incentives for EITI’s participation among resource-rich governance-poor countries that are increasingly hosting

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160 The Open Government Partnership was formally launched on September 20, 2011, by 8 founding governments: Brazil, Indonesia, Mexico, Norway, Philippines, South Africa, United Kingdom and United States. These countries endorsed an Open Government Declaration and announced national action plans. In April 2012, 47 additional governments declared the commitment to join the Partnership by creating national multistakeholder to prepare national action plans. Paulina Ibarra, Revealed: Top Ten Commitments to Open Government as Representatives from 73 Countries Gather in Brasilia (17 April 2012) online: Open Government Partnership <http://www.opengovpartnership.org/news/revealed-top-ten-commitments-open-government-representatives-73-countries-gather-brasilia>; “The Open Government Partnership, the Parting of the Red Tape: Is it just another global talking-shop – or a fresh approach to shaking out government secrecy?”, The Economist 401:8754 (8 October 2011)73.
extractive operations by their multinationals. For some, China’s refusal to support EITI has allegedly contributed to the reluctance of some established producers such as Angola, Equatorial Guinea and Sudan,\textsuperscript{161} all with a heavy presence of Chinese investments in the extractive sector, to participate in the initiative.

In sum, despite the theory that the increased ownership and legitimacy of EITI would overcome some of the most intractable problems of promoting governance reform from the outside, the practice has been ambiguous and many challenges remain. Some of the recent critiques of EITI recognize that the fact that the initiative is perceived as externally driven is one of its main shortcomings.\textsuperscript{162}

6.5.2. Can a PPP open the way to governance reform?

A second idea behind EITI was that a public private partnership (PPP), by bringing together host-countries, home-countries, extractive corporations, International Financial Institutions (IFIs) and civil society organizations, and by leveraging a significant pool of incentives, checks and balances, would be more effective than conventional global regulatory initiatives to address the major contemporary obstacle to governance reform: rent-seeking behavior. The historical governance paths and the existing political and social contexts in resource-rich but governance-poor countries are widely divergent. There should be no one-size-fits-all strategy for promoting governance reforms to tackle rent-seeking. The challenge, however, is to measure how these largely diffuse, subtle and indirect advantages expected from PPPs are playing out in specific EITI implementing countries.

There is anecdotal evidence that some of the countries that began by complying with EITI transparency requirements have taken further steps to incorporate transparency and

\textsuperscript{161} With the recent independence of South Sudan, it will be interesting to see if this oil-rich nascent country will use this critical juncture to participate in EITI. Global Witness memo advocating the benefits of Southern Sudan adherence to EITI. Global Witness, The 	extit{EITI in South Sudan: Basics and Benefits}, online: Global Witness <http://www.globalwitness.org/sites/default/files/library/110518%20EITI%20Memo.pdf>.

\textsuperscript{162} Alexandra Gillies and Antoine Heuty, after noting that “the degree of country ownership and the domestic motivation of transparency initiatives may represent a fundamental determinant of their impact and success”, argue that EITI still disproportionately prioritizes the needs of investors and donors. As this section emphasized, however, the critic would be stronger if they indicated in which ways responding to the interest of investors and donors is undermining the legitimacy and ownership of the initiative. Gillies & Heuty, 	extit{supra} note 68.
accountability norms into their domestic legislation aimed at regulating the management of resource revenues. This has allegedly happened in Nigeria, Liberia, Sao Tome and Timor-Leste. One difficulty is to distinguish whether a governance improvement in places in transition (such as Liberia or Timor Leste) can be attributed to EITI, or whether it results from a broader movement towards democratization. As Alexandra Gillies and Antoine Heuty argue

> If a country is democratizing and becoming more transparent, which of the two causes subsequent improvements in policy choice? Avoiding endogeneity problems in such a scenario is extremely challenging.

Of course, the most promising circumstances for EITI’s effectiveness occur when all actors involved perceive it as legitimate and actively pursue its implementation. If this was the case in all resource-rich developing countries, however, there would be no need for EITI. The idea was to increase the number of potential actors genuinely committed to governance reforms, even if it is not possible to know which of the single actors or groups of actors will take the lead in promoting reforms in a certain country at a certain juncture.

In fact, in these cases of critical junctures the real research challenge is to identify whether EITI’s PPP structure was able to help progressive political actors to lock in governance reform gains over time, and in which ways. In other cases where there were successful governance reforms beyond EITI, despite the absence of critical political junctures, it would still be necessary to investigate in which ways they were facilitated by the multistakeholder leverage promoted by a transnational PPP, or by other possible concurrent factors.

Further research is thus necessary to understand whether eventual reforms are a result of specific national circumstances and would have happened anyway, or whether EITI has indeed increased the success of governance reforms to address rent-seeking in the extractive value chain in certain countries. At least one research study, the 2011 Scanteam report evaluating EITI’s impact, has concluded that EITI did not offer added value:

> EITI has created some links to broader governance reform processes, but largely within the sector. In some countries, EITI was embedded as an element in a broader reform, but EITI has not been a significant driver for change. Broader reforms and expanded EITI

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163 Olcer, supra note 89.
164 Gillies & Heuty, supra note 68 at 30.
implementation beyond the sector have rather been a result of national political decisions.\textsuperscript{165}

The criticism that EITI is unlikely to become, by itself, a significant driver for change is recurrent in the literature assessing the initiative. Yet, this is further evidence of the confusion that arises from failing to assess EITI as an entry point, and so expecting too much from the initiative. By setting up a broad partnership, the PPP would allow for a different combination of alliances (which will be largely context dependent) and/or for one actor to take leadership despite the resistance of others. Therefore EITI was designed to increase the chances of success even in cases where certain actors resist, or where the governance mechanism is “captured”. There would be more chance that other actors would offer counterweights by questioning the rules, monitoring implementation, and requiring alternative actions to be taken. This explains why EITI was expected to work even in countries where the government may not be truly committed to it (for the reasons explored in the previous section).

Because EITI sets a very limited standard, serving only as an entry point, even if key actors take the lead, the process of promoting the creation of further domestic governance mechanisms to curb rent-seeking effectively in host countries is not guaranteed. Other complementary initiatives must be available in order to increase the chances of success. In line with this, the World Bank, the IMF, United Nations agencies and several bilateral aid agencies have all expressed support for EITI, and have created programs to focus on specifically promoting governance reform in the extractive sector, to tap the opportunities for further governance reform opened by the initiative. There are of course other concurrent reasons for the creation of these programs using conventional global regulatory mechanisms to promote domestic governance reform, such as increased awareness of rent-seeking as a major obstacle to governance reform, as well as the severe and unrelenting criticisms by civil society organizations of the continued engagement of transnational extractive corporations in the extractive sector of developing countries with weak governance systems.\textsuperscript{166}

\textsuperscript{165} “Scanteam Report”, supra note 118.

\textsuperscript{166} Following the Extractive Industries Review Process that offered a very critical analysis of the role of the World Bank’s support for the extractive sector in less developed countries as an engine for development, the WB has began to give special emphasis to governance in the extractive sector when the country is rich in natural resources. In December 2004 the IMF published its first draft Guide on Resource Revenue Transparency, to specifically promote transparency in the oil, gas and mining sectors. The Guide was published in 2005 and updated in 2007. IMF, Guide
EITI has, however, apparently renewed hope that resource-rich countries would be more open to these conventional donor reform programs. The World Bank has clearly tried to tap into the openness created by EITI by inaugurating an initiative called EITI ++. This initiative aims to complement EITI by encouraging transparency in all the links in the value chain associated with resource extraction. Private foundations and NGOs (in particular, the Revenue Watch Institute), are also seeking to advance other initiatives to promote further governance reforms along the extractive value chain. There seems to be, however, a general lack of “orchestration” of all these concurrent and scattered initiatives, which happen in an ad hoc manner. This is an indication that unconventional global regulatory mechanisms such as EITI may serve as complements but not substitutes to conventional regulatory mechanisms designed to influence the behavior of host countries towards their own domestic governance system.

There are other ways in which PPPs are expected to enhance the success of governance reform in the case of rent-seeking as well. Susan Aaronson argues that EITI has stimulated governance learning and “by extension can gradually improve governance.” This aspect may, however, also depend on the extent that complementary learning and capacity building initiatives are available, and the extent to which a number of individuals in a certain country will be willing first to participate, and second to become future relevant actors in the political process.

Some authors assume that transnational initiatives such as EITI offer fewer opportunities for regulatory capture than exclusively national ones. This assumption is highly debated in the literature. Several other authors claim that in fact global regulation intensifies the capture problem. More cynical critics argue that EITI offers a low cost opportunity for Western donors and Western extractive corporations to deflect criticisms and continue a “business as usual” strategy: continuing the engagement in the extractive sector in developing countries with

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168 Mattli & Woods, supra note 4.
169 Ibid.

weak governance systems, while pretending to promote governance reform. Susan A. Aaronson suggests another problem of EITI’s PPP-like design. She considers that the fact that EITI’s stakeholders have very divergent objectives hampers the effectiveness of the initiative, although she is not clear as to exactly how.\(^{170}\)

### 6.5.3. The limits and dangers of transparency

For the last two decades, transparency has been lauded as one of the best policy remedies to tackle corruption, improve accountability, promote democracy and good governance, and boost development indicators.\(^{171}\) In this context, many authors have considered that EITI’s primary objective is to set a global standard of transparency in the oil, gas, and mining sectors, in order to advance all these goals among resource-rich and governance-poor countries.\(^{172}\) For those that consider EITI as a nascent global transparency standard for the extractive sector, the initiative falls short because its disclosure requirements are arguably either mistaken and/or too limited.

Kolstad and Wigg sum up the critiques of EITI’s disclosure standards: “There is, therefore, a possibility that EITI initiative is not only narrow, but that it also gives priority to the wrong set of issues.” One problem, according to the critics, is EITI’s mistaken emphasis on the “incorrect” link in the extractive value chain. Ivar Kolstad and Arne Wiig, for example, argue that initiatives to promote governance reform in resource-rich countries should focus on those areas “whose effect on corruption and the resource curse more generally is the greatest.”\(^{173}\) They claim that in the case of the extractive sector, this should be in the expenditure link of the value chain, since this is where most of the opportunities for revenue diversion and patronage concentrate. They add that since there is also an argument that rent-seeking starts in the early stages, when countries and corporations are negotiating the distribution of revenues, the EITI transparency requirements arrive too late in order to make a real impact in rent-seeking.

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\(^{170}\) Aaronson, “Limited Partnership”, \textit{supra} note 77.

\(^{171}\) Ann Florini has been a strong advocate for transparency as a modern powerful tool to promote all these goals, besides enhancing the effectiveness of governments. Ann Florini, “The End of Secrecy” (1998) 111 Foreign Policy 50.


\(^{173}\) Kolstad & Wiig, \textit{supra} note 66.
Critics also argue that EITI minimum disclosure standards in the collection phase and its narrow focus on material payments between the government and extractive companies are too limited to trigger accountability. For Javier Santiso, EITI disclosure standards are insufficient to “provide sound information on revenue streams and enable scrutiny by the general public.”174 Another problem with the standards, according to critics, is the fact that the initiative does not include evaluation of whether the information disclosed and published is correct. It only requires the independent reconciliation of the two material disclosures of corporations and the government. Finally, the fact that EITI does not require disaggregated figures makes it more difficult to monitor the revenue flows. In Olcer’s words:

To sum up, the information in the EITI reports lacks quality and consistency, signaling that non-transparency still dominates the sector and protects it from rigorous external scrutiny.175

My theory is that key EITI proponents were indeed informed by the assumption that global standards of transparency throughout the extractive value chain would directly lead to greater accountability and, indirectly, to less diversion and embezzlement of resource rents and improved development outcomes. I argue, nevertheless, that they did not expect EITI alone to constitute this global standard in the extractive sector, at least not in the short-run. They instead assumed that beginning a process of disclosure and accountability in one link of the value chain – revenue flows from corporations to the governments of resource-rich countries – would have spillover effects, encouraging governance reforms in other parts of the extractive value chain.

The theories regarding the potential mechanisms by which transparency would directly lead to certain outcomes remain contested in the literature, and empirical findings are inconclusive. To my knowledge there has been no adequate investigation as yet regarding the assumption that transparency may lead to improved prospects of successful governance reform. A recent body of literature that assesses the effects of transparency on democracy, control of corruption, and development indicators suggests that transparency is insufficient to directly influence these outcomes. Some studies indicate that transparency initiatives have increased chances of success in provoking meaningful change when certain pre-conditions are present, or when additional

174 Olcer, supra note 89.
175 Olcer, supra note 89.
governance initiatives are concurrently promoted. The literature has attempted to identify the reasons behind this limitation, but these questions remain open.

First, the link between transparency and accountability is not a straightforward one. Increased access to information requires complementary initiatives to improve the ability of social actors to process this information, and to use this information to press for increased accountability. This requires the creation of incentives but also the opening or protection of institutional spaces where these actors can voice their demands. EITI has enabled this by encouraging social participation in the initiative, as will be discussed below.

Additionally, the literature indicates that transparency alone may sometimes be counterproductive. Information disclosure is costly, and may divert resources from other measures that could generate more optimal cost/benefit ratios. Besides, not all disclosure of financial and political information is beneficial, since revealing some pieces of information may increase insecurity or risks. A more consequential – and disconcerting – suggestion of this literature, however, is that transparency may sometimes aggravate rent-seeking behavior, instead of reducing it. Transparency measures in the extractive sector may, for example, make it easier for corporations to identify exactly which individuals or institutions to bribe, thus reducing the costs of practicing corruption.

A more worrisome recent finding suggests that some transparency measures may provoke adverse and unexpected long-term negative effects on reducing rent-seeking in democracies. The possibility of adopting short-term or limited transparency initiatives may create perverse incentives for politicians, who can exploit the reputational gains of being “transparent” in one term to be reelected, only to extract additional rents from office in the following term.

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176 McGee & Gaventa, supra note 69.
177 Kolstad & Wiig, supra note 66.
178 Kolstad & Wiig, supra note 66.
179 Florini, The Right to Know, supra note 104.
180 Kolstad & Wiig, supra note 66.
Gustavo Bobonis and others studied the evidence on the effects of the publication of routine audits of municipal government in Puerto Rico on rent-seeking behavior. They did not find any difference in the levels of municipal corruption between those municipalities that regularly published audits and those that did not. What they did find was that those incumbents that enjoyed reputational gains due to “being transparent” had increased chances of being re-elected as compared to others. However, the levels of corruption did not show any reduction in the following term.

When one considers EITI not as a global transparency standard, but rather as a potential entry point to further governance reform, and not as a stand-alone transparency standard, but rather as part of a broader public-private partnership to enhance the chance of governance gains, these criticisms lose part of their strength. To concentrate on the revenue collection link of the value chain (the one where all stakeholders were able to reach consensus) would not be a problem if, as EITI’s proponents assumed, the initiative could serve as an engine to encourage governance reforms in other parts of the value chain.

There is, however, still a lack of more specific assessments of whether promoting transparency in this part of the value chain will engender this expected effect of encouraging further governance reforms. Nonetheless, some anecdotal evidence may indicate positive signs in this direction. Liberia, under President Ellen Johnson Sirleaf, serves as our first example. Liberia was one of the first countries to commit to EITI in 2006, and one of the first to be ruled compliant under the initiative in 2009. The President has been a strong advocate for transparency in the management of natural resources.\footnote{Engagement with EITI and networking with transparency advocacy groups gave the government legitimacy and capacity to renegotiate key contracts with Firestone, ArcelorMittal and other TNCs, where the government secured better terms for their concessions. Kathryn Joyce, “Liberian President Ellen Johnson Sirleaf Wins Peace Prize”, Revenue Watch Institute News (7 October 2011) online: <http://www.revenuwatch.org/news/blog/liberian-president-and-transparency-advocate-ellen-johnson-sirleaf-wins-peace-prize>.} After agreeing to implement the EITI standards in the mining sector, the national multistakeholder body, the Liberian Extractive Industries Transparency Initiative (LEITI), extended the requirements to the forestry and rubber industries.

The law formalizing LEITI went far beyond the standard EITI requirements, mandating the disclosure and publication of contracts and licenses between corporations and government.
Despite the fact that corruption in Liberia remains endemic, and the country still ranked high in the Transparency International’s 2011 Corruption Perception Index (91 out of 182 countries), the trend has been positive. For example, in 2005 Liberia ranked 137 out of 158 countries surveyed by Transparency International. In the World Bank’s control of corruption indicator Liberia has moved from 14.1 (on a 0 to 100 scale with 100 being stronger control of corruption) in 2005 to 36.4 in 2010.\textsuperscript{183}

Timor Leste is another example that may be cited as evidence that EITI’s transparency mechanisms can potentially serve as entry points for further governance reforms. The country achieved independence in 2002, the same year that EITI was launched by Tony Blair. The small new nation, after a long troubled history of colonization and conflicts, is one of the least developed in Asia, despite being significantly rich in oil and gas. At the first official EITI Global Conference in June 2003, Timor Leste was one of the first countries to commit to EITI.\textsuperscript{184} Timor Leste went on to build model domestic legislation for its oil and mining sector, with an emphasis on transparency and accountability that goes well beyond the standard requirements of EITI. Yet, in 2011 Timor Leste ranked 143 out of 182 countries in the Transparency International Corruption Perception Index, and has not shown marked improvements in the last few years.

Because EITI is designed to leverage the effects of different strategies, such as social participation, collective learning, different market and non-market pressures and incentives, it is difficult to assess how the transparency standards in revenue flows would affect facilitating governance reform in other areas. The very different historical and political circumstances of EITI’s participants compound this problem of assessing its impacts while avoiding endogeneity problems. Timor Leste and Liberia, for example, both went through what can be described as critical junctures with significant political changes and a drive by key political leaders towards democracy. Would the improvements in transparency and governance in the extractive sector in these countries have happened anyway, independent of EITI? How has EITI improved the chances of success for these reforms? In the alternative, how has it locked in these governance


\textsuperscript{184} Asian Development Bank and OECD, “Strategies for Business, Governments and Civil Society to Fight Corruption in Asia and the Pacific” (Proceedings delivered at the 6\textsuperscript{th} Regional Anti-corruption conference in Asia and the Pacific, 26-28 November 2008), [unpublished].
improvements, and thus raised the costs of opponents of reforms in restoring the status quo ante? Are these governance improvements having spill-over effects?

In both Liberia and Timor Leste there is anecdotal evidence that civil society played an important role in advocating for EITI and further governance reforms in the extractive sector, making it difficult to evaluate how strong a role EITI’s transparency standards played by themselves. There is, however, one case that offers a useful insight into how limited the power of EITI’s transparency standards are by themselves. That is when the initiative’s mechanism designed to help empowering civic organizations is neglected, and other favorable circumstances such as a major political change are absent. In fact, the case of Azerbaijan offers a cautionary tale about the potential danger that EITI’s transparency standards can serve as perverse reputational incentives that may increase the ability of some leaders to augment their opportunities for rent-seeking.\(^{185}\)

Some applaud Azerbaijan as an EITI success story. The country was one of the first to endorse EITI and to become a pilot country, in June 2003. That year Ilham Aliyev became president, succeeding his father. Despite international observers criticizing the electoral process as full of irregularities, it was widely expected that the young and inexperienced new president would start a process of gradual political liberalization.\(^{186}\) The strong support for EITI was one of the positive signs given by the new government. Since 2004 a coalition of NGOs, inspired by these positive political signs, have pressed the government to improve on transparency and also to open spaces for civic participation in the management of oil and gas resources.\(^{187}\)

Azerbaijan became an EITI candidate country in 2007. In 2009 Azerbaijan was the first country to be declared compliant with EITI standards. This was despite the fact that Azerbaijan had not established a permanent multi-stakeholder group. The establishment of such a group is one of the

\(^{185}\) The Azerbaijani case forces the proponents of transparency in the extractive sector to take Gustavo Boboni and others’ research - on the dangers of transparency initiatives being captured as a reputational boost, but mostly irrelevant to curb corruption – seriously. See discussion above.


five criteria required from candidate countries. In order to justify its decision the EITI’s board stated: “the Validator had taken the view that sufficient arrangements for multi-stakeholder engagement had been put in place.” The board, however, indicated that “full and effective compliance with this criteria of establishing a formal, permanent multi-stakeholder group would be conditional for future validations.”

From 2003 to 2011 Azerbaijan has experienced a period of political stability under the presidency of Ilham Aliyev, and marked economic growth based on significant FDI in its extractive sector and rising oil exports. EITI has arguably played an important role, by showcasing Azerbaijan as a country committed to increased transparency and governance reform in the previously opaque oil sector. Has participation in EITI proven an effective entry point in the case of Azerbaijan? Was the initiative able to ensure the opening of political spaces promised in 2003? The short answer is no.

The International Crisis Group published a report in 2010, finding that these anticipated political and governance reforms had failed to materialize. Instead of avoiding a path towards the resource curse, Azerbaijan has gone “from a semi-authoritarian to a fully authoritarian state.” According to this report:

[Political] stability, however, has come with the consolidation of authoritarian rule, greater suppression of freedoms and an increased reliance by elites on corruption and patronage networks to dominate virtually all aspects of public life.

Azerbaijan continues to rank extremely low on Transparency International’s Corruption Perception Indicators and the WB indicator on control of corruption. Although 70% of the Azerbaijani government’s budget relies on oil and gas revenues, disclosure of revenue flow has not led to greater disclosure on how these revenues are expended. Freedom of expression has reportedly deteriorated in the country over the last few years, with several cases of violence and

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188 See EITI, Minutes 7th EITI Board Meeting, Doha (16 February 16th 2009) at 5, online: EITI <http://eiti.org/files/Minutes%20of%20the%207th%20EITI%20Board%20Meeting%20Final.pdf> [EITI, 7th Board Meeting Minutes]; see also EITI, Validation of the Extractive Industries Transparency Initiative (EITI) in the Republic of Azerbaijan (February 2009), online: EITI <http://eiti.org/files/Azerbaijan%20EITI%20Validation%20Report.pdf>.

189 EITI, 7th Board Meeting Minutes, supra note 188.

190 ICG, Azerbaijan: Vulnerable Stability, supra note 186.
police and judicial persecution of journalists and bloggers.\textsuperscript{191} Despite major economic growth, the country has seen only a mild reduction in poverty levels, which remains extremely high for a middle-income country, at 20%.

In the case of Azerbaijan, EITI may have served as an instrument to boost the country’s international reputation, and to give international legitimacy to the increased exploitation of its natural resources.\textsuperscript{192} It remains to be seen if the costs/benefits to the population are worth it. Oil revenues are expected to dwindle in Azerbaijan, due to the exhaustion of deposits. Oil corporations have legally profited from Azerbaijan’s oil boom. The political elite has also benefited by increasing their grasp on power. There has been a reduction in poverty levels, but this will probably not be sustainable without the necessary investments in other economic sectors. In this case EITI may have served as a shield protecting the country and extractive corporations from external pressure. There is a case to be made that Azerbaijan’s story may have been different if the EITI’s criteria of actively engaging civil society organizations had been fully implemented. I turn to this fourth EITI requirement next.

6.5.4. Does social participation lead to better governance?

The fourth idea underlying EITI’s design was that direct participation of civil society organizations in the governance of extractive resources revenues would increase the prospects of successful governance reform to address rent-seeking. There are many open questions about the assumption that requiring social participation is realistic in the case of many EITI target countries, and how effective social participation is in ensuring expected positive outcomes. Critics argue that in the case of various countries that were the main targets of EITI, the resource-rich but governance-poor countries, the expectation of effective civil society participation was unrealistic, since civil society organizations in these countries tend to be either


\textsuperscript{192} Although Equatorial Guinea also attracted extensive FDI despite not being part of EITI and being largely considered one of the most corrupt countries with terrible reputation.
nonexistent, or not independent, or extremely weak and therefore incapable of effective participation.\textsuperscript{193}

This criticism is misguided for two reasons. First, this is a chicken and egg problem. It is true that in many resource-rich countries civil society is still embryonic and states pose a long series of obstacles to their effective participation. Civil society may be weak due to a long history of dysfunctional governance and repressive authoritarianism, fueled or not by rent-seeking. Civil society may not have been able to develop because all political spaces were and still remain closed. In this case EITI and other complementary measures to strengthen civil society are designed precisely to counteract this lack of political space. Initially weak groups that are invited to participate could be enabled to build their capacity over time, in a process that is sanctioned by the host state, even if this sanction is initially not sincere. Part of EITI’s funds are reserved for building the capacity of civil society organizations that are participating in the initiative. There is also a pool of initiatives from multilateral, bilateral donor agencies, and from private NGOs such as Revenue Watch Institute and \textit{Publish What You Pay} (PWYP) Campaign that focus on capacity building and strengthening civil society organizations.\textsuperscript{194}

There is a second reason why the criticism that EITI will not function effectively because there are no effective civil society organizations in most resource-rich but governance-poor countries is misguided. There is in fact evidence that civil society organizations do exist in several of these countries, and, if strengthened, may prove key to facilitating processes of domestic governance reform. If the assumption that social participation in governance processes increase the chance of successful reform is correct, the EITI process could prove a significant instrument for some of the resource-rich countries that are still in transition, or that are still consolidating their democracies, but that already have a small but growing body of civil society organizations.

A quick look into a few anecdotal cases of EITI participating countries shows that civil society organizations may still be weak, with limited or negligible political power or influence, but they exist nonetheless. In some cases financial and technical support by bilateral aid agencies, private foundations and civil society organizations such as Revenue Watch Institute or PWYP Campaign

\textsuperscript{193} Olcer, \textit{supra} note 89 at 27.

\textsuperscript{194} Haufler, “Disclosure as Governance”, \textit{supra} note 86 at 68.
to existing national NGOs or networks in fact preceded the country’s entrance into EITI, and was at least partially responsible for the pressure that led to this participation in the first place. Mozambique serves as an example here.

In Mozambique, a group of civil society organizations is actively engaged in national public policy debates related to development. One example is the Center for Public Integrity (CIP), legally founded in June 2005, by a Mozambican investigative journalist and financed by European and American private philanthropic foundations such as Friedrich Ebbert, Ford Foundation, and by bilateral aid agencies such as DFID, Danish Embassy, Swiss Cooperation, Holland Embassy and Swedish Embassy. Since its founding, CIP has undertaken seminal activities related to corruption and transparency in Mozambique.

Mozambican civil society organizations were directly responsible for the country’s acceptance of EITI. They organized a national seminar in Maputo to discuss the EITI initiative, and to propose that Mozambique become a part of it. CIP invited government officials, corporations and the EITI international secretariat to this conference. Civil society organizations from countries that were already implementing EITI, such as Nigeria and Ghana, were also invited to present their experiences and to show political support. During the conference the Mozambican government expressed an intention to join EITI. Subsequently, the Mozambican government organized its own seminar to announce officially its plans to join EITI.

195 Marcelo Mosse is a prominent investigative journalist in Mozambique with a master degree in development studies from ISTCE/Lisbon and publications on corruption. See CIP, Centro de Integridade Publica, online: CIP <http://www.cip.org.mz/>. 196 This shows that there may be a nascent transnational network of civil society organizations in resource-rich and governance-poor countries. 197 Mozambique officially joined EITI in October 2008. Centro de Integridade Publica de Mocambique, CIP, Implementacao da ITIE, Gestao de Recursos Naturais e Urgencia da Renegociacao e Publicacao dos Contratos com Mega Projetos: O Caso de Mocambique, (May 2011), online: CIP <http://www.cipie.cip.org.mz/cipdoc%5C84_ANALISE%20ITIE%20MOÇAMBIQUE%202011.pdf>. CIP has been actively engaging in the current debate in Mozambique on a national anti-corruption strategy that involves changes in the criminal law, in the institutional framework to monitor and combat corruption, and in the writing of a new ethics code for public officials. CIP and other civil society organizations in Mozambique have organized a seminar in Tete, the province where the most significant mining project by Vale is taking place, to discuss the relations of the extractive sector in Mozambique, access to information and citizenship. CIP has also published a research on the impact of EITI in Mozambique in September 2009, and a guide on main questions related to the mining sector in Mozambique in November 2011. The organization has also monitored public budget with the help of international organizations that work in this area.
DRC is also a candidate EITI country with a troubled history of violent colonization and internal conflicts that are still very much alive in the Eastern part of the country. DRC civil society organizations suffered from long years of conflict. There is however a pool of civil society organizations in DRC that could be strengthened. Gillies and Heuty argue that DRC accepted participating in EITI as an imposed condition for acceptance as a Highly Indebted Poor Country (HIPC), a program for debt-relief. The country has been very slow in implementing EITI’s requirements and remains a candidate country. In 2006 thirty DRC non-governmental organizations created a Publish What You Pay national coalition to advocate the effective implementation of EITI, and to raise awareness in DRC of the importance of transparency and accountability in the extractive sector. In this case the international institutional platform provided by EITI may prove a valuable tool to keep transparency and accountability in the extractive sector constantly on the national agenda, and to attract international attention to the severe problems still faced by DRC in this sector.

Civil society organizations from Niger also created a national Publish What You Pay coalition, which has engaged in national discussions on good governance in the extractive sector in the country. Niger adhered to EITI in 2005, and formed a tripartite EITI working group with the participation of civil society representatives. Initially, Nigerien civil society organizations suffered repression. The government arrested a Nigerien civil society activist who engaged in promoting transparency in the extractive sector, under apparently sham accusations. In protest, representatives of civil society in the EITI tripartite working group in Niger resigned. A campaign by civil society representatives from EITI’s working groups in other countries created enough political pressure on Western donors and extractive corporations to provoke strong international condemnation. Nigerien civil society representatives only resumed participation in EITI after the release of the activist.

In 2010 a group of twenty opposition political parties and civil society organizations in Niger formed a coalition to oppose a referendum proposed by then president Mamadou Tandja to extend his term after a second and final term (according to the constitution) was about to expire.

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198 Gillies & Heuty, supra note 68.
The military deposed Tandja in a coup in 2008. The military junta nominated a Consultative Council to spearhead national consultations for a new constitution, to be voted on by Nigerien citizens. The leadership of this Council was given to Marou Amadou, the activist that had been previously arrested by Tandja. Thus, civil society organizations that had been engaged with resource transparency had an active role in the discussions on a new constitution, and made several suggestions related to increased transparency in the extractive sector. Evelyne Tsague, Revenue Watch Institute’s Deputy Africa Coordinator, commented on the process:

When the opportunity arose for these civil society members to be involved in the constitution drafting process, they brought their years of expertise and advocacy experience to the table in making these suggestions […]

On October 31 2010, the citizens of Niger voted on the new constitution, which was approved by a margin of 90%. This constitution included many provisions institutionalizing transparency in the natural resources sector, going beyond the EITI requirements. The constitution also mandated an election process for a new president for the country. The election took place in January 2011 (first round), and March 2011 (second round). The opposition candidate Mahamadou Issoufou won with 58% of the votes. He declared his support for transparency and accountability in the resource sector, including Niger’s continued participation at EITI. Marou Amadou, the former civil society activist, was nominated Minister of Justice and promised to pursue “an ambitious program to strengthen accountability institutions and to fight corruption.”

The political situation in Niger remains unstable, however. It is yet to be seen if EITI can serve as a mechanism to lock in these governance gains.

Therefore, it is clear that there is a nascent and in some cases already active pool of civil society organizations in various of the resource-rich and governance-poor countries that could be

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201 Ibid.

202 Article 150 of the constitution requires the publication of all contracts between the government and extractive corporations, and also all the revenues received by the government in a disaggregated, country-by-country basis. Ibid.

supported to participate in national processes aimed at improving governance reform in the extractive sector and beyond.\(^\text{204}\)

### 6.6. Conclusion

The historical circumstances in which EITI came into being, its very design, and institutional documents, all constitute evidence that EITI illustrates a significant shift of policy strategy by main actors concerned with the governance deficit in resource-rich countries in the 2000s. Instead of only relying in strategies of finding mechanisms to bypass this governance deficit (by directly influencing extractive corporations or by “borrowing” home countries institutions), key actors opted for opening a new strategic global regulatory option to complement existing forms of global regulation to promote domestic governance reform. This strategic avenue seeks to use the leverage and incentives of a transnational PPP to find entry points to influence domestic governance paths.

The arguments in this chapter diverge from the existing mainstream academic literature on EITI by arguing that this initiative, or any other global regulatory mechanism for that matter, should not be expected to be a silver bullet to solve such an intractable problem as rent-seeking behavior and/or the resource curse. All concurrent initiatives discussed in this and in previous chapters, should therefore be considered complementary and not mutually exclusive. EITI is best seen as a global regulatory option to potentially facilitate domestic governance reform. Due to the fact that the literature has yet to conceive of EITI in the way proposed in this chapter, we currently lack adequate theoretical tools and comprehensive empirical evidence to support the idea that there is a robust link between a transnational PPP such as EITI and improved domestic governance systems in resource-rich countries.

It is possible, however, to propose a tentative typology of different circumstances under which the initiative could operate, and its expected chances of success. The initiative will clearly be in its least promising format in countries whose governments do not perceive EITI as legitimate, or

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\(^{204}\) In Sierra Leone, the National Advocacy Coalition on Extractives (NACE) formed a Publish What You Pay chapter and became part of the EITI multistakeholder group. They have actively participated in policy debates around issues related to governance in the extractive sector, beyond EITI, as for example the national discussion on a new income tax law.
in those with few or no active civil society organizations. In these cases, the best we can probably hope for is for EITI to help foster the development or the empowerment of civil society organizations that may actively engage with reforms in the long term. The initiative will be most promising when there is some level of genuine governmental political opening, and the active participation of civil society organizations. It is also possible to conclude that ownership and legitimacy, and different sets of incentives, are key aspects for EITI’s success, which makes the gradual expansion of the initiative, especially to include emerging economies which are increasingly investing in resource exploitation in less developed countries, key to its success.

To some, the uncertainty about EITI’s prospect of promoting governance reform in the domestic scenario may sound too discouraging. Nonetheless, if one appreciates that in the field of development very little is certain, and that most achievements occur through experimentation, then it is at least worth persevering with EITI. Currently, this is probably the best available option to attempt an entry point to address rent-seeking in many resource-rich and governance-poor countries. Yet EITI’s success depends in large measure on complementary initiatives that are outside its scope. This is why any analysis of such mechanisms needs to consider the constellation of instruments available, and the complex interactions these instruments may have with each other, which I turn to in my concluding chapter.
Chapter 7
A Fox’s Approach to Promoting Governance Reform

7.1. Introduction

In his 1953 essay “The Hedgehog and the Fox”, Isaiah Berlin draws inspiration from a line by the ancient Greek poet Archilochus, which says: “the fox knows many things, but the hedgehog knows one big thing”. Berlin uses this aphorism to propose that there are two different types of writers, thinkers and human beings in general, as to the way they approach life and its problems: the foxes and the hedgehogs. 1 The hedgehog type is anyone who:

Relate[s] everything to a single central vision, one system, less or more coherent or articulate, in terms of which they understand, think and feel – a single, universal organizing principle in terms of which alone all that they are and say has significance. 2

In contrast, the fox type “pursue[s] many ends, often unrelated and even contradictory, connected, if at all, only in some de facto way, for some psychological or physiological cause […].” 3

The hedgehog’s great assets are focus and the capacity to decipher and simplify very complex social concepts and processes, making them more manageable. 4 The hedgehog’s main weaknesses are fixation, inflexibility and self-centeredness. 5 The fox’s main assets are capacity

1 Berlin’s main philosophical contributions centered on the difference between monist and pluralist views of moral values. His analogy of the fox and the hedgehog was also part of this contribution, and yet it came to be used far beyond discussions of moral values, to illustrate different cognitive approaches to various areas of the social sciences. George Crowder, “Book Reviews” (2003) 38:2 Australian Journal of Political Science 333.


3 The same analogy was used by psychologist Philip Tetlock who argues that fox type political experts tend to be “skeptical about grand theories, diffident about their predictions and ready to adjust their ideas based on actual events.” Tetlock found that fox political experts had a higher rate of success in predicting future events than hedgehog types. On the other hand, when hedgehogs got it right, it was about something spectacular and consequential. Philip E Tetlock, Expert Political Judgment: How Good is It? How Can We Know? (Princeton: Princeton University Press, 2005).


5 Frost, supra note 4.
to see nuance, openness and flexibility to adjust to changing circumstances. The fox’s main weakness is a scattershot and indiscriminate approach to problems.

Berlin’s analogy helps illuminate the main findings and claims of my doctoral dissertation. My doctoral research established that policy actors are adopting a fox approach to deal with the problem of the weak governance curse in resource-rich developing countries. This approach includes using a variety of unrelated, potentially contradictory global regulatory mechanisms to address the problem. This dissertation makes two important normative claims, the first one related to this fox strategy in practice, the second one related to how Law and Development (L&D) scholarship should approach this policy strategy in theory. Before introducing these two claims, I will present a brief account of how I have reached these conclusions.

I began this dissertation by presenting the commanding consensus in the academic literature around the idea that unless there are improvements in domestic governance systems, many resource-rich developing countries currently experiencing a resource boom are on a path towards the long-term adverse developmental outcomes associated with the resource curse (Chapter 1). If this is the case, why do these countries not simply improve their institutions? Two trapping mechanisms – path dependence and rent-seeking behavior – are binding these countries to weak governance, by making successful governance reform an intractable enterprise (Chapter 2). This is not to say that in such contexts governance reform is impossible, but it does suggest that it is not a simple proposition. Can global regulatory mechanisms break the “weak governance curse”? This was the central research question of this doctoral dissertation.

In answering this question I hypothesized that in some cases global regulatory mechanisms may offer opportunities for outsiders and insiders to raise their voices in favor of reforms to the system, instead of opting for exit strategies. I also argued that global regulatory mechanisms may also offer opportunities for outsiders and insiders to interact, reinforcing each other’s attempts to destabilize a national dysfunctional equilibrium that has become path dependent (chapter 2). In Chapter 3 I examined the vast literature that has analyzed domestic governance reform, focusing primarily on Law and Development, and discussed the voluminous literature analyzing transnational regulatory instruments, especially the Global Governance (GG)

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literature. I argued that currently neither the L&D literature nor the GG literature are investigating in depth how unconventional global regulatory mechanisms such as soft law initiatives and home-country extraterritorial regulations may provoke feedback effects on the stable dynamics of dysfunctional domestic governance systems.

The second part of my doctoral dissertation (Chapters 4, 5 and 6) analyzed specific global regulatory mechanisms, asking whether they may serve as tools to influence attempts to reform dysfunctional domestic governance systems in resource-rich countries. I reviewed existing and potential conventional international hard law mechanisms designed to promote domestic governance reform, and global regulatory mechanisms that are unconventional, or used in an unconventional way to provoke positive feedback effects in domestic governance reform, such as bilateral investment treaties (BITs), extraterritorial anti-bribery, anti-money laundering and securities disclosures home-country regulations, and transnational public-private soft law partnerships such as the Extractive Industries Transparency Initiative (EITI).

My doctoral research has led me to conclude that: (i) unconventional global regulatory mechanisms can potentially provoke positive feedback effects in dysfunctional domestic governance systems that have become locked in; (ii) policy actors are already employing several of these mechanisms with that objective; (iii) these mechanisms were created and remain mostly unrelated, and can potentially contradict each other, producing what I call a fox approach for dealing with the weak governance curse.

In this conclusion, I will summarize the main scholarly contributions of this dissertation, as follows. Section 2 argues that global mechanisms may serve as pathways of influence and interaction to foreign and domestic policy actors that seek to provoke positive feedback effects in domestic governance systems. Section 3 turns to the first normative claim (related to practice), proposing that policy actors are indeed using different types of global mechanisms to open alternative, and sometimes complementary, institutional pathways of interaction and influence to be potentially used by foreign and domestic policy actors who were previously excluded from any formal institutional process in the domestic level. Because the situation in each country is so different, it is possible that one institutional avenue will prove possible and effective in one case but not another, requiring a constellation of potential choices to excluded constituencies to explore. This is the advantage of the fox approach.

This fox policy approach, however, due to its lack of coordination and coherence, carries the risk of supporting mechanisms that are superfluous, or that contradict or negate one another. In
section 4, I turn to the second normative claim (related to theory), and propose that the hedgehog-like focus and capacity to illuminate complex phenomena offered by academic analysis should help reduce these risks, and my dissertation is an effort in that direction. While in Chapter 3 I argued that the L&D and the GG scholarships have yet to enter into a productive dialogue that could guide this fox policy approach, in this concluding section I will discuss possible ways for this dialogue to move forward.

In sum, there are grounds for cautious optimism regarding the potential for a constellation of global regulatory mechanisms to help break the double trap in which resource-rich countries are enmeshed by enabling different options of productive interactions between domestic reformers and external reformers. This dissertation is an initial step in the exploration of this still neglected – but nonetheless extremely relevant – field of study.

7.2. Global mechanisms as pathways of influence on and interaction with domestic governance dynamics

The various policy actors that since the 2000s began to sponsor or encourage the use of unconventional types of global mechanisms to bridge the governance deficit in resource-rich developing countries, such as EITI and home-countries securities disclosures, seem to believe, or at least to intuit, that innovative global mechanisms are needed and can provoke positive feedback effects in dysfunctional governance systems in resource-rich developing countries. The expeditious adherence to EITI by a broad number of different public and private stakeholders from developed and developing countries alike show how the use of global soft law mechanisms that seek a more intrusive intervention in governance weaknesses in host countries has gained broad legitimacy. It is important to note, however, that middle-income countries and emerging economies are still absent from this consensus (Chapter 6), in the same way that they are apparently not fully invested in the “governance matters for development” consensus.

Regardless of whether these mechanisms were intentionally designed to do so or not, global regulatory mechanisms such as EITI and home-country extraterritorial regulations such as securities disclosures should be recognized as potential institutional tools to provoke feedback effects in dysfunctional governance systems in host countries. Although this dissertation does not provide empirical evidence that this new type of external mechanism actually provokes these positive feedback effects, I build a case for why and how some of these mechanisms can potentially offer unique opportunities to produce such effects. In doing so I contribute to the
nascent debates on the interaction between external mechanisms and domestic governance systems.

I build my argument in two steps. First (3.1) I draw on the work of Steven Bernstein and Benjamin Cashore to argue that the innovative type of global regulatory mechanism that I have identified in my dissertation creates additional institutional pathways of influence for external actors concerned with dysfunctional domestic systems in resource-rich countries beyond conventional mechanisms of development assistance and international treaty law. These mechanisms also potentially open pathways of influence for internal actors that were previously excluded from the policy process. Second (3.2) I draw on studies by Curtis J. Milhaupt and Katharina Pistor, and studies by Nico Krisch, on the evolving dynamics of constituencies (policy actors) in a globalized world, to argue that in fact feedback effects happen due to the reinforcing interaction of external and internal policy actors that were previously excluded from any form of institutionalized influence in domestic systems.

7.2.1. Global regulations as pathways of influence

In a recent article, Steven Bernstein and Benjamin Cashore argue that international regime scholarship should change its research focus, from a concern with the effectiveness of – and compliance with – international regimes and its component mechanisms to a concern with the “influence” of transnational efforts in shaping domestic state policies and practices and/or the behavior of corporations.7 Bernstein and Cashore propose a framework to guide this shift, suggesting that international regimes offer four different pathways of influence to affect the behaviour of countries and/or corporations. These four pathways of influence are: (1) international rules; (2) international norms and discourses; (3) market interventions; and (4) direct access to domestic policy processes. Although I am mostly interested in the fourth pathway, I will briefly sketch all of them for the sake of clarity.

The first “pathway of influence”, according to Bernstein and Cashore, is the “international rules” pathway, represented by binding public international norms derived from multilateral or bilateral treaties or other norms that are derived from similar “authoritative” sources that create a “pull

toward compliance”. This pathway includes certain soft law standards that gain widespread recognition and are generally perceived as binding by states or corporations, along with state-centered mandatory international law initiatives. The second pathway of influence would be the “international norms and discourse” pathway. This pathway operates through both the logic of appropriateness (when domestic actors become convinced that certain values promoted by the international community are worth pursuing) and the logic of consequences (global norms alter calculations of interests, leading domestic actors believe that it is worth behaving in a certain way). Norms and discourses can derive from international organizations, social or market pressure or accumulation of consensual knowledge.

The third pathway, which Bernstein and Cashore call the “market” pathway, uses the leverage of market forces such as consumer and investor pressure to encourage domestic actors or corporations to change behavior. The fourth pathway of influence is what Bernstein and Cashore call “direct access to domestic policy-making processes”. In this pathway, influence would be exerted through “direct funding, education, training, assistance and capacity building and possibly even through co-governance via partnerships between domestic and international public and private actors and authorities.” Of course these are ideal types, presented for analytical purposes, and in practice any regulatory mechanism can be situated in more than one category. The different pathways of influence may also, whether they are created to work interconnectedly

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8 The idea is that some private or hybrid global regulatory mechanisms, despite not being anchored in states’ traditional forms of enforcement mechanisms, cannot be considered voluntary because they are rather designed to create binding and enforceable rules that generate this “pull toward compliance” effect. See Steven Bernstein & Benjamin Cashore, “Can Non-state Global Governance Be Legitimate? An Analytical Framework” (2007) 1 Regulation & Governance 1.

9 The fact that the behavior of political actors in international relations could be explained by the logic of appropriateness, and therefore international norms potentially has a constitutive effect on state behaviour, rather than only constraining behaviour, was first advanced by March and Olsen in 1989, and became a important element of constructivist theories of international relations. For March and Olsen seminal discussion on the logic of appropriateness and the logic of consequences see Jeffrey T Checkel, “International Norms and Domestic Politics: Bridging the Rationalist—Constructivist Divide” (1997) 3:4 European Journal of International Relations 473; James March & Johan Olsen, Rediscovering Institutions: The Organizational Basis of Politics (New York: Free Press, 1989); Martha Finnemore, National Interests in International Society (Ithaca, NY: Cornell University Press, 1996); Peter Katzenstein, ed, The Culture of National Security: Norms and Identify in World Politics (New York: Columbia University Press, 1996). In contrast, rationalist international relations theories are based on the assumption that state behaviour responds to a logic of consequences, and international norms shape behaviour by changing incentives and imposing constraints in how states can act. For rationalist accounts and the logic of consequences see Andrew Moravcsik “Explaining International Human Rights Regimes: Liberal Theory and Western Europe” (1995) 1 European Journal of International Relations; Andrew Cortell & James Davis, “How do International Institutions Matter? The Domestic Impact of International Rules and Norms” (1996) 40 International Studies Quarterly 451.
or independently, provoke mutually reinforcing or opposing effects.

I modify Bernstein and Cashore’s framework in order to illuminate the implications of my research findings for future academic research. The need for a modified framework is based on a key aspect that distinguishes my research from most of the global regulation studies, as highlighted in chapter 3. While Bernstein and Cashore investigate how international regimes influence the behavior of both corporations and countries more generally, my research is narrower because it does not conflate the investigation of how these pathways may influence developed, governance-rich countries and developing, governance-poor countries alike. I focus instead on the latter, and specifically on how international regimes seek to influence governance reform in host countries with dysfunctional governance systems, particularly when they became path dependent and therefore resilient to influence through more conventional regulatory mechanisms. In this modified framework there would be only two broad categories: indirect and direct pathways of influence on domestic governance reform.

In the indirect pathways of influence, external actors and institutions try to influence the foreign process of domestic governance reform exclusively from the outside. Borrowing from David Levi-Faur’s work on regulatory capitalism, I propose that this category should include the subdivisions of top-down pathways of influence on domestic governance reform, and horizontal pathways of influence on domestic governance reform. Top-down pathways of influence would include the more conventional global mechanisms of international sanctions and conditionalities. In chapter 2, I discussed how bilateral and multilateral aid agencies have extensively used this pathway of influence through conditionalities to promote governance reform in developing countries.

Horizontal pathways of influence on governance reform would include what Bernstein and Cashore call international norms and discourse, which is similar to what Levi-Faur calls “world societies of epistemic communities”. In chapter 1, I discussed how there is now a commanding

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10 This is borrowed from Levi-Faur’s concept of regulatory capitalism and focuses on the sources of policy reforms. Therefore he also discusses a third category, bottom-up sources of policy reform. Because here we are discussing cases where in principle this bottom-up option is locked, I will concentrate on the other two categories at this stage, but introduce the concept of bottom-up sources of policy reform in the direct pathway of influence category. David Levi-Faur, “Regulatory Capitalism: The Dynamics of Change beyond Telecoms and Electricity” (2006) 19:3 Governance: An International Journal of Policy, Administration, & Institutions 497.
consensus that governance matters for development, and that governance matters even more for resource-rich developing countries. I would also include here, however, part of the mechanisms of influence that Bernstein and Cashore include in the “direct pathway of influence” in their framework, such as direct funding, capacity-building and technical assistance. Although I concede that some of the mechanisms may be in a gray area between top-down and horizontal pathways of influence, I believe that they are made possible when there is a certain level of commanding consensus that serves to spur efforts to steer behavioural change in a certain direction. In the case at hand, chapter 2 also addressed the efforts by private foundations and bilateral and multilateral aid organizations to promote capacity building and technical assistance to encourage governance reform for development in developing countries.  

I do not include here the mechanisms that seek to bypass the governance deficit by focusing on influencing the behavior not of host countries, but rather the behavior of home-countries and their corporations. These mechanisms include those that Bernstein and Cashore classify within “market pathways of influence”. Chapter 5 discussed, however, how some extraterritorial regulations from home countries have been transformed into tools to influence the behaviour of host countries as well. In this case, extraterritorial regulations have moved into a grey area, and can now be considered indirect pathways of influence on domestic governance reform processes in host countries.

The direct pathway of influence category in this modified framework would include state-building after military interventions, international hard law and what Bernstein and Cashore call “co-governance via partnerships between domestic and international public and private actors and authorities.” What differentiates this direct pathway from the indirect ones such as external funding for governance reform? The direct pathways institutionalize the formal participation of public and private constituencies that were previously excluded from the domestic governance reform process, either because they were outside constituencies, or because, although domestic  

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11 Chapter 2 also addressed the demand side, explaining that either because they are convinced that governance matters for development (logic or appropriateness), or because they believe they will benefit from participating in governance reform projects (logic of consequences), the fact is that several developing countries show signs of adherence to the governance matters consensus.
constituencies, they did not have significant political leverage.\textsuperscript{12}

In exceptional circumstances, the international community or a powerful developed country such as the US may, for whatever reasons, intervene militarily in a country and exert direct influence in the building of new institutions, as in Iraq and Afghanistan. Of course, as history has proven, this top down radical approach does not offer any guarantee that these institutions – no matter how flawless in form - will be functional in practice and endure after the intervening power leaves. International hard law would represent a second form of top down, direct regulatory mechanism. For example, Brazil was prompted by its acceptance of a binding international treaty - the American Convention on Human Rights - to enter into a friendly settlement where government officials sat with representatives of the Inter-American Commission on Human Rights and representatives of a victim of forced labor to discuss governance changes to combat forced labour in the country.\textsuperscript{13}

Meanwhile, co-governance among different public and private stakeholders would represent horizontal forms of direct regulation. For example, by entering into a Voluntary Partnership Agreement (VPA) with the European Union, Ghana agreed to create a platform for a broad range of national and international public and private constituencies to participate in identifying forest governance areas that need strengthening and to work jointly to create and implement new governance mechanisms in this direction.\textsuperscript{14} Similarly, by voluntarily committing to be an EITI compliant country, Timor Leste has agreed not only to publish reports on resource revenues received by extractive corporations, but also to submit these reports to independent auditing and to peer review, and to create a national multistakeholder group composed of private and public

\textsuperscript{12} It is important to note that sometimes internal actors did have some political space, but this space was constrained, and the global regulatory mechanism could then serve to expand this domestic political space.

\textsuperscript{13} In this case, for example, the friendly settlement agreement accepted by Brazil “established certain commitments to be undertaken by the Brazilian Government, divided into four types of action: 1) the public recognition of international responsibility in relation to the violation of rights of the individual victim of forced labour 2) the payment of financial compensation for the damages suffered by the victim; 3) a commitment to prosecute and punish the individuals responsible; and 4) the institution of preventive measures, including legislative amendments, and measures to monitor and repress slave labour in Brazil, as well as measures to raise public awareness and disseminate information regarding the issue.” This fourth action characterizes the direct influence that this international rule exerted in governance reforms to address slave labour in the country. See Patricia Trindade Maranhao Costa, Fighting Forced Labour: The Example of Brazil (Washington, DC: International Labour Office (ILO); Publications of the Special Action Programme to Combat Forced Labour, 2009).

actors to supervise the process on the domestic level.

Table 7.1 represents the framework proposed by Bernstein and Cashore to investigate the pathways of influence in both domestic governance systems and transnational corporations.

**Table 7.1**

| Pathways of Influence for External Actors on Domestic Governance and Corporate Behaviour |
|:--:|:--:|
| 1) International rules | - Inter-state (hard) law (to influence host states’ behaviour);  
- Soft law perceived as binding by corporations and states |
| 2) International Norms and Discourses | - Values (logic of appropriateness);  
- Interests (logic of consequences) |
| 3) Market Mechanisms | - Consumer and investors’ pressure |
| 4) Direct Pathway | - Capacity building, technical assistance, education, etc  
- Co-governance via partnerships public/private, national/international |

Table 7.2 represents my proposed framework to investigate more specifically the pathways of influence on processes of domestic governance reform:
Table 7.2

<table>
<thead>
<tr>
<th>Pathways of Influence for External Actors on Domestic Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1) Indirect Pathways:</strong></td>
</tr>
<tr>
<td>1.1) Top down: - Aid conditionalities; trade sanctions</td>
</tr>
<tr>
<td>1.2) Horizontal: - Knowledge, norms, values and discourses (logic of appropriateness)</td>
</tr>
<tr>
<td>- Market, consumer and investor pressures (logic of consequences)</td>
</tr>
<tr>
<td>- Capacity building, technical assistance</td>
</tr>
<tr>
<td>- Extraterritorial regulations</td>
</tr>
</tbody>
</table>

| **1) Direct Pathways:**                                       |
| 1.1) Top down: - Military intervention                        |
| - International hard law                                      |
| 1.2) Horizontal: - Co-governance via partnerships public/private, national/international |

Again, it is important to emphasize that in practice all these mechanisms do not fit neatly in one category. For example, host countries may be responding to market pressures or aid conditionality (logic of consequences), or to values and knowledge (logic of appropriateness) when they decide to enter into a voluntary co-governance partnership such as EITI. The important point here is that my classification helps to illuminate how distinct forms of global regulatory mechanisms may affect the problem of path dependence and rent seeking (which are endogenous to national governance systems) differently, either using a more indirect (primarily from the outside) or a more direct strategy (engaging various constituencies with the domestic governance process).

Such a distinction is relevant because the analysis of how exactly each and every one of these pathways of influence may impact a dysfunctional domestic governance system that has become path dependent is extremely important. I rely here on the insights from the path dependence scholarship on how resilient governance paths may evolve to more functional paths over time, which I discussed in chapter 2. For Paul Pierson, when the dysfunctional domestic governance path becomes so locked-in that all internal strategies have proven insufficient to break the bad
equilibrium, only external shocks will be effective in promoting change.\textsuperscript{15} If the stakes of external actors are very high, foreign countries may choose for example to use the direct pathway of military intervention to cause a critical juncture that will affect the course of the domestic governance system. However, these externally provoked shocks are extreme cases because most often the stakes of dysfunctional governance systems in developing countries are not high enough for foreign countries to undertake such major, costly and risky interventions.\textsuperscript{16}

This does not mean that changing paths becomes impossible in the absence of external shocks. As Kathleen Thelen and Henry Farrel argue, dependent paths, however stable, are still dynamic. Small changes are always occurring, and there are often potential, if dormant, domestic institutional avenues able to steer a dysfunctional governance path towards change. Besides, in a world economy and society that is increasingly globalized, domestic governance processes are already considerably affected by more subtle but still significant external influences. Indeed, outside actors interested in reforming dysfunctional governance paths in developing countries usually rely on the more indirect pathways of influence such as trade incentives and sanctions and development assistance to encourage or to foster such potential internal changes.

There are instances, however, where the dysfunctional domestic system seems especially resilient, as in the cases of resource-rich developing countries, and where the stakes of outside actors are not so high as to justify an exceptional top-down direct external intervention, or even to spearhead a global process to create an international treaty on the subject. Yet, the stakes may be high enough for outside actors to consider conventional indirect pathways of influence insufficient to protect their values or interests affected by the governance deficit in developing countries. Drawing from Hirschman’s theory we can say that in these cases outside actors have two options: exit the system or express their voice for change in a more direct way.\textsuperscript{17} In the 1990s the mainstream choice of most outside actors has apparently been to exit the system by creating global regulatory mechanisms to bypass the dysfunctional domestic system in order to

\begin{itemize}
\item\textsuperscript{16} See, for example, recent cases of foreign intervention in Iraq, Afghanistan and Libya, and the reluctance of Western countries to intervene in Syria, despite the country being on the brink of a civil war.
\item\textsuperscript{17} Hirshman, \textit{supra} note 6.
\end{itemize}
protect their values and interests at stake. This was the case of international regulations to protect foreign investors, and the plethora of private and hybrid initiatives to influence the behavior of corporations abroad.

Although there is still insufficient evidence, there are indications that in some instances at least this strategy may pose the unintended risk of further undermining already dysfunctional domestic governance systems. Using bypassing mechanisms to exit the system also leaves potential inside reformers that are already constrained in their attempts to change the system from the bottom up on their own. The innovation of mechanisms such as the EITI and VPAs is that they represent an attempt to create global regulatory mechanisms other than conventional treaty law that will allow outside public and private actors to choose the second option: to exercise their voices for change in a foreign domestic governance system, and to potentially interact more directly with inside actors that may be developing strategies to promote bottom-up reform processes. Although this type of intervention does not represent the external shock indicated by Paul Pierson, these external mechanisms may offer the potential to trigger processes that could gradually lead to a domestic critical juncture over time, opening the way for change in resilient governance paths.

I argue that it has been the difficulty of influencing governance reform positively in certain countries using the pool of conventional indirect pathways of influence such as development assistance, the high political and financial costs of creating conventional treaty law, and the limitations of exit strategies such as extraterritorial regulations and private soft law schemes, that have led actors to seek alternatives. I emphasize that there has been an expansion, and not a shift in strategy, because policy actors did not abandon indirect pathways of influence, and did not abandon bypass mechanisms. They have added innovative pathways of influence where they can exercise their voices for change more directly in the cases where domestic reform seems especially intractable. I now turn to why these innovative pathways of influence have become possible, and in what exact ways they are expected to work where the other pathways of influence, by themselves or collectively, seem often to have failed.

7.2.2. Global regulation and cosmopolitan policy actors

One way to further illuminate the ways in which the innovative pathways of influence differ from earlier pathways of influence is to focus on how the different public, private, international and national actors participate and interact in these mechanisms. Nico Krisch has proposed a
helpful framework to guide us in this process.18 Krisch argues that the global regulatory landscape is complicated by the fact that there is a multiplicity of different public and private actors (which he calls public and private constituencies) vying for legitimacy and primacy as norm-makers. There are for example national constituencies organized in different states that are constantly affected by global regulations. Seen from the opposite angle, however, there is also an international constituency formed by the community of states that has stakes in and is constantly affected by domestic regulations - or the lack thereof.

The global regulatory arena is characterized by the increasing erosion of traditional boundaries of private versus public regulations and national versus international regulations. There are identifiable private actors within and beyond the state that have gained recognition, legitimacy and authority as subjects and sources of global regulation. Krisch calls the groups of public and private, national and international constituencies that are increasingly shaping several global regulatory mechanisms, sometimes unilaterally, sometimes jointly, cosmopolitan constituencies.19

For Krisch the question of which constituency, if any, should have primacy as the creator of global regulations is highly contested. Krisch identifies three different approaches in the ongoing debate on constituencies in the global level. The first is the nationalist approach, under which, although regulatory authority has moved to the global level in several areas, national constituencies should still have primacy in shaping and demanding accountability from global regulatory mechanisms. Under this approach, which still dominates scholarship of global regulation, national constituencies should be represented by their states in global rule-making, and national governance systems should retain full authority to implement – or not – any global regulation in the domestic level.

Under the internationalist approach, however, the international community of states should have primacy among different constituencies to create and to ensure implementation of global

18 Nico Krisch, “The Pluralism of Global Administrative Law” (2006) 17:1 The European Journal of International Law 247. Contributing to the research agenda of the Global Administrative Law (GAL) Project. Krisch’s starting point was the observation that the exercise of public power in several issue areas has increasingly moved from the national to the global level. If decision-making has moved to mechanisms at the global level, these mechanisms should be made accountable to the different constituencies they may affect [Krish, “Pluralism”].

19 Krisch, “Pluralism” supra note 18.
regulations by the various national systems. For the advocates of the internationalist approach, global regulations serve a broader, international interest. This international interest is advanced by intergovernmental organizations or inter-state agreements, which justifiably keep national systems in check when it comes to issues of global reach. Under yet a third approach, the cosmopolitan, there is a genuinely cosmopolitan constituency for global governance. Neither nation states, nor international organizations should have primacy for creating and promoting the implementation of global regulations. Rather, a pluralist community of individuals, represented by states and inter-state organizations, but also represented by national and transnational private organizations (including corporations and NGOs) should actively participate in rule making and implementation of regulatory mechanisms at the global level.

Krisch’s research on global regulation constituencies is based on the observation that the legal order has undergone a fundamental change, transforming into what he calls “postnational law”.\(^{20}\) Issues that were previously regulated by national legal systems are now subjected to different layers and forms of regulations - public and private, hard and soft, national and international. These diverse layers of regulation do not operate separately; they are deeply intertwined, influencing each other. This patchwork of global regulatory mechanisms is inherent in the global arena, and offers better prospects for balancing out pluralist values and interests than a potentially centralized system. In this regard, Krisch’s research seems to accommodate the idea that policy actors may decide for a fox approach to global regulatory mechanisms that explore these different layers, in order to tackle complex global challenges. This is an important assumption that his research project and mine seem to share. We are both abandoning any deterministic attempt to say that one specific arrangement is better than another, but instead seeking to understand these complex interactions and analyze where, when and how they work to solve a specific problem.

There is, however, one fundamental distinction between my research project and Krisch’s research agenda. Krisch’s research primarily seeks to investigate whether and how regulatory roles that were previously performed by domestic regulatory systems have moved to the global level, and how global regulatory mechanisms could perform these roles with similar levels of

accountability and legitimacy as in the national level.\textsuperscript{21} The focus is, therefore, on areas where regulatory authority has escaped the national level to the global level, or where global regulations have constrained the role of national regulations. My research, on the other hand, focuses on a case where this enmeshment of different levels and types of regulation has not been used to constrain the space of national regulation.\textsuperscript{22} In fact, in the particular case I investigate, policy actors are looking to global regulations as tools to achieve the opposite effect: to reinforce, reform or improve weak domestic governance systems.\textsuperscript{23}

My question is why cosmopolitan actors are counterintuitively looking to global regulatory mechanisms that have initially been used to bypass the domestic governance deficit or to complement domestic governance limitations as key tools to bridge the governance deficit in developing countries. What could new forms of global regulatory mechanisms potentially offer that was missing in conventional forms of global regulation?

7.2.3. Participation and interaction of cosmopolitan policy actors

I have identified in my doctoral research various cosmopolitan actors - private, public, external and domestic constituencies – that are using these new forms of global regulatory mechanisms to open institutional pathways where they can interact and directly participate in the design and implementation of governance reform in dysfunctional domestic governance systems. These new pathways of influence are institutionalizing the direct participation of public and private outside and inside actors in the design and implementation of domestic governance reform processes,

\textsuperscript{21} This is also the research agenda of the broader project of the global administrative law, of which Krisch is one of the founding scholars. In 2004 Krisch, Benedict Kingsbury and Richard Stewart initiated a research project at NYU to investigate whether and how administrative law principles such as transparency; participation, review and accountability, primarily associated to national governance systems, could and should also apply to global governance mechanisms. For a seminal article on the global administrative law project see Benedict Kingsbury, Nico Krisch & Richard Stewart, “The Emergence of Global Administrative Law” (2005) 68 Law & Contemporary Problems 15; for a detailed bibliography of scholarship related to global administrative law until 2005 see “A Global Administrative Law Bibliography” (2005) 68 Law & Contemporary Problems 357. For more recent scholarly work related to the “global administrative law” research project see IILJ, Institute for International Law and Justice at the New York University School of Law, online: IILJ <http://www.iilj.org/gal/bibliography/default.asp>.

\textsuperscript{22} Krisch, Beyond Constitutionalism, supra note 20.

\textsuperscript{23} The fact, recognized by Krisch, that in many issue areas regulatory functions that were previously primarily performed in the national level are now performed in this postnational sphere does not mean that national governance systems have become obsolete. The investigation of cases such as the object of my doctoral dissertation can enrich debates on postnational governance by illuminating how important the existence of a shadow of state regulation is for this type of regulation to be effective.
therefore opening up the possibility for these actors to enhance their political influence at the
domestic level, in a way that was formerly attempted only by conventional forms of global
regulation.

Previously, private and public foreign actors and many private domestic actors (NGOs and
corporations) could only rely on indirect pathways of influence. The exception was when an
international treaty recognized the capacity of private actors to monitor and denounce the non-
implementation of international commitments, and sometimes offered mechanisms to resolve
conflicts or to ensure redress. This happened only when there were high stakes for the
international community or for powerful developed countries willing to pay the political and
financial costs of these international hard regulations. This is not the case of the weak
governance curse, where the high stakes in fact reside with the citizens of the resource-rich and
governance-poor countries. In this case a transnational corporation concerned with the
dysfunctional governance system that enables gross corruption in a certain resource-rich country
could only threaten to exit the host country, or lobby its home country to provide bilateral aid for
governance reform, or to impose conditions or sanctions.

If the resource-rich country has adhered to EITI, however, this company can now exercise its
voice through participation in both the multistakeholder board that oversees the governance of
EITI, and in national multistakeholder groups created to implement the initiative at the domestic
level. The same can be said about new opportunities open for international and domestic civil
society organizations to actively exercise their voices in an institutionalized setting. Previously,
civil society organizations could only resort to naming and shaming host developing countries,
and/or home developed countries and their TNCs operating in resource-rich but governance-poor
countries. With EITI or VPAs they have an institutionalized place at the table where governance
mechanisms (to increase transparency and accountability in the extractive sector) are discussed at
the national level. In other words, these innovative regulatory mechanisms are enabling
cosmopolitan constituencies to perform new roles in the domestic governance process.

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24 EITI criteria requires that the national multistakeholder group includes representatives from the private sector,
independent civil society representatives and senior governmental officials to oversee the implementation in the
national level. See EITI, Extractive Industries Transparency Initiative, online: EITI <http://eiti.org>; See also David
L Goldwyn, ed, Drilling Down: The Civil Society Guide to Extractive Industry Revenues and EITI (New York:
Revenue Watch Institute, 2008).
The work of Curtis Milhpaut and Katharina Pistor can help us understand the motivations of cosmopolitan actors and the dynamics of their interactions in performing these new roles. Milhpaut and Pistor have investigated the role performed by cosmopolitan constituencies in domestic governance systems in a globalized world. For Milhpaut and Pistor the quality of national governance systems in a globalized economy and society is no longer an exclusive concern, or no longer exclusively influenced and shaped by national actors (they also use the term constituencies). External constituencies increasingly have stakes in or concerns with foreign domestic governance systems, and therefore search for ways to shape and influence these foreign national systems. Milhpaut and Pistor argue that the exposure of a domestic governance regime to international markets and practices has proved to be a prominent catalyst for change, even in the absence of a major external shock. Because I already discussed Milhpaut and Pistor’s theory in chapter 2, I will only review the main points of their theory here.

Milhpaut and Pistor’s work illuminates the possible motivations of external constituencies to bridge instead of bypass a dysfunctional domestic governance system. The authors argue that external investors may demand better governance in foreign countries to overcome the barriers they face in accessing the domestic informal networks of relations and protections that privileged insiders rely on. It is true that outside constituencies can sometimes address this challenge by using global regulatory mechanisms to bypass the deficit, and they have tools to do so (such as bilateral investment treaties providing for international arbitration). However, many outside actors would probably benefit more from the alternative strategy of helping to bridge the governance deficit in the long run. Major multinational corporations and investors are better placed to bear the financial and political costs of challenging a foreign country in external arbitral tribunals than smaller investors and corporations, for example. Besides, with increasing competition from multinational corporations and investors from emerging economies, to risk alienating host countries by engaging in an arbitral dispute may not be politically feasible.

The other self-interested motivation is reputation. There is a risk of reputational damage to both transnational corporations and their home countries if the host country is unwilling or incapable of...
of addressing serious human rights problems, environmental damage or gross corruption. Therefore, capital exporting countries and their multinational corporations do have incentives to bridge instead of bypass the governance deficit.

In chapter 1, I addressed a second motivation for foreign actors to advance global regulatory mechanisms to promote governance reform in resource-rich and governance-poor foreign countries. The commanding consensus on the importance of governance to avoiding the resource curse and ensuring positive development outcomes in resource-rich developing countries means that there are also incentives for outside actors to search for mechanisms to encourage governance reform. Western developed countries – motivated by the logic of appropriateness, the logic of consequences, or both – already invest massive amounts of funds in conventional foreign aid mechanisms to promote governance reform, as discussed in chapter 2. However, these efforts have proven insufficient to overcome the weak governance curse. The same motivation has apparently led several actors to search for alternative or complementary global regulatory mechanisms.

Milhpaut and Pistor also argue that the influence of outside constituencies in domestic governance systems is not static and one-sided. Like Kathleen Thelen and Henry Farrell, who argue that even resilient domestic governance paths harbor endogenous possibilities of change, Milhpaut and Pistor argue that often there are inside constituencies seeking to promote governance reform from the bottom up. The difference is that Milhpaut and Pistor recognize that these inside constituencies may have few chances of success due to political economy barriers to reform. Why would host countries that resist internal pressures for governance reform be more amenable to engage in global regulatory mechanisms that aim to foster governance improvements at the domestic level? For Pistor and Milhpaut, outside constituencies sometimes have the political leverage to promote institutional mechanisms that domestic actors lack.27 The flipside is, according to Pistor and Milhpaut, that despite their greater leverage, outside constituencies often lack the legitimacy to use these mechanisms to advance their own interests or values at the domestic level. Their success in promoting change is therefore conditional on the existence of demand for reform at the domestic level.

27 Ibid at 194.
The combination of efforts by these two different constituencies, each with its own motivations, may increase the chance of institutional changes at the domestic level that would not be possible otherwise. As the authors put it:

Thus, the uncoordinated but cumulative efforts of foreign and domestic actors appear to make a powerful combination for inducing institutional change in an increasingly globalized world.28

Global regulatory mechanisms such as the EITI are innovative precisely because they have transformed efforts from outside and inside actors that were previously independent and uncoordinated into a coordinated effort (or opened the space for such coordination). Thus, these mechanisms increase the probability of institutional change, without seeking to pre-determine how, when and where such change will occur. In other words, these mechanisms allow the reinforcing interaction of various different classes of constituencies - outside actors and inside actors, public actors and private actors - taking stock of the leverage and legitimacy that each constituency has to contribute to attempts to promote successful governance reform.

We should consider these unconventional global regulatory mechanisms as an expansion in the range of choices available to outside and inside pro-reform constituencies to strengthen their voices in domestic processes of governance reform. And because these mechanisms are voluntary in nature, they are also a choice for resource-rich developing countries. As a choice, however, it may be the case that a resource-rich country decides not to be bound by this mechanism, or it may be the case that domestic actors may decide not to use it, or may not be able to seize the opportunity to use it. Similarly, these mechanisms may offer outside actors an option to exercise their voices in the system, but they may choose not to do so. These options will reflect the specific circumstances of each resource-rich country.

Not all resource-rich developing countries have had sufficient incentives or felt sufficiently pressured to enter EITI, as discussed in chapter 6. From the group of countries that are EITI members, not all have private domestic constituencies (civil society organizations) able to exploit this opportunity. Therefore, despite the potential, the mechanism may prove ineffective in some cases. The fact that policy actors are also advancing mechanisms such as extraterritorial

28 Ibid at 194.
disclosure regulations that seek to provoke feedback effects more indirectly, by pressing home countries and multinational corporations to use their governance structures to promote transparency in foreign resource-rich developing countries that are not part of EITI, may therefore prove to be an important advantage. EITI-like instruments should also be seen as complements to, but not as substitutes for broader efforts to promote governance reform through conventional global regulatory mechanisms such as development assistance.

To put it differently, it is not possible to predict which of the existing global regulatory mechanisms will be effective in the very different contexts of each and every resource-rich and governance-poor country. For this reason a fox approach that invests in a broad constellation of conventional and innovative, direct and indirect, regulatory options represents the right strategy.

7.3. Global regulation and the fox policy approach

Under this strategy, each group of national and international, public and private constituencies will, depending on the particular context and conditions, choose the most appropriate policy mix to try to positively influence domestic governance reform. Yet one of the main dangers of adopting such a fox approach that relies on a broad and largely uncoordinated set of instruments, is the fact that we still do not know whether some of these mechanisms may be superfluous, or may contradict or negate each other, or may dissipate resources where some of them are not cost-efficient. As mentioned before, there is an emerging debate as to whether extraterritorial regulations that “borrow” governance structures from developed countries or international organizations, therefore bypassing host countries, may or may not reduce incentives for domestic governance reform. Would a top-down, hedgehog approach that attempted to coordinate the various global regulatory mechanisms to address the weak governance curse be feasible? Would this type of approach be preferable to the fox approach? There are good reasons to believe that a hedgehog, centralized strategy would be neither possible nor advantageous.

In this regard, this dissertation is much in line with the work of Nico Krisch, who argues that the international governance sphere has a pluralistic structure, based on “pragmatic accommodations” of different, sometimes conflicting approaches, rather than a unitary, constitution-like structure. Krisch argues that because in the global governance arena public, private, national, international and cosmopolitan constituencies are competing for primacy, the resulting framework is a “disorderly interplay of accountability mechanisms at different levels
and in different regimes.” For Krisch this is not a passing phenomenon, but an inherent characteristic of the global sphere that differs markedly from regulatory models at the national level. Most importantly, Krisch argues that this pluralistic structure should be maintained because it enhances the opportunities of individuals from many different countries and groups with divergent visions to have voice and influence in institutional structures.29

While Krisch is focusing on cases where public power is exercised through structures of global governance, his insights apply to external mechanisms that have the objective not of directly exercising public power over certain issue-areas, but rather of contributing to the strengthening of national governance structures. The more mechanisms available, and the more they are independent and open to different sets of constituencies, the more the prospects that some of these mechanisms will avoid capture by entrenched interests, and the greater the prospects that different policy actors will find the best available policy mix to attempt to break the governance curse in a specific resource-rich developing country. Despite being uncoordinated, and despite the risk of clashing objectives and results among the various global regulatory mechanisms, there are good reasons to argue that the fox policy approach is not only consistent with the pluralist structure of global governance, but also the best strategy for addressing the intractable problem of the weak governance curse.

In order to minimize the risks of clashing feedback effects, and enhance the chances of these mechanisms being used to complement and reinforce each other, however, there is a pressing need for scholarship to better understand how these mechanisms work in practice. In the next section I propose that the L&D scholarship should draw from the Global Governance (GG) scholarship to illuminate how these global regulatory mechanisms work and interact, in order to guide policy makers on the ground. My dissertation is intended to be an initial effort in that direction.

7.4. A combined scholarship to guide a fox policy approach

In chapter 3, I argued that in order to address the intractable challenge of helping resource-rich countries to escape the double trap of the weak governance curse, the L&D literature needs to

29 Krisch, Beyond Constitutionalism, supra note 20, especially chapter 3, “The Case for Pluralism”.
expand its perspective to include investigating the interaction between global regulatory mechanisms and the different endogenous strategies to overcome domestic obstacles to governance reform. In this section I will discuss how this disciplinary, intellectual and methodological move could possibly be accomplished.

First, L&D and GG scholars could and should use path dependence insights in a forward-looking way, to guide policy actors that are advancing global regulatory mechanisms to address the governance deficit in resource-rich developing countries. The L&D scholarship has shown that path dependent systems are not static and can change slowly over time. In analyzing the dynamics of such changes, the literature has pointed to the fact that if inside actors have choices, they can divert from the current path. Such choices may represent very small changes, but these changes can accumulate over time and become self-reinforcing, generating significant changes in the long run. In this regard, the L&D scholarship could fruitfully change its focus from designing the appropriate institutions to promote development to designing institutional mechanisms that create choices, which will in turn allow actors to promote institutional change. In line with the lessons of Milhaupt and Pistor, the scholarship should focus on the process of change, not on the outcome.

Second, a fruitful dialogue between L&D and GG scholars on the interactions between global regulatory mechanisms and domestic governance dynamics is needed. This requires the L&D scholarship to expand from its current inward-looking perspective that focuses on potential endogenous strategies to reform dysfunctional governance systems in normal times. The L&D scholarship needs to include the investigation of global regulatory mechanisms and how they can provide choices of institutions where different constituencies can positively interact with domestic governance dynamics. In this regard, global regulatory mechanisms such as EITI (and VPAs) have proven a rich source of information about institutional mechanisms that allow for choice, as I have suggested in this dissertation.

The L&D scholarship has accumulated a body of knowledge that provides a conceptual framework to help us understand how various institutional mechanisms may have an impact on domestic governance reforms, but this literature lacks the specific knowledge on how global regulatory mechanisms are created, how they function, as well as their weaknesses, strengths and limitations. I suggest that the L&D scholarship examine carefully research in the political science, international relations and transnational law literatures on global governance in this
regard. By encompassing this literature, however, an L&D scholar needs to decide what kind of concepts and analytical frameworks used to analyze the domestic context could be transplanted to the transnational scenario. S/he also needs to identify which concepts and analytical frameworks will need to be “borrowed” from these other disciplines. This is a major task that is beyond the scope of this dissertation. Nonetheless, this is likely to be the most useful contribution that the academic literature can bring to the practice of promoting governance reform in domestic systems that have became resilient to change and/or that face significant contemporary obstacles to reform.

In contrast to the L&D literature, the GG scholarship has been focused primarily on external mechanisms and initiatives outside of the domestic sphere in recent decades. One notable example is the fact that this literature has extensively analyzed and debated transnational mechanisms and strategies created to deal with the resource curse, such as EITI and home-country extraterritorial anti-bribery regulations. However, this literature focuses on how effective these global mechanisms are in terms of responding to the negative social and economic externalities originating from the governance deficit in developing countries, or whether global governance mechanisms suffer from an accountability deficit that risks undermining the very objectives they are trying to accomplish.

These are important research questions, but this literature could also offer insights into the ways global regulatory mechanisms may interact with and influence domestic governance systems that have become resilient to change. In order to accomplish this goal the GG literature needs to separate the investigations of global regulatory mechanisms that seek to bypass or to bridge the governance deficit in developing countries, from global regulatory mechanisms that originate from a real shift of regulatory authority from the national to the international level. In addition, studies of global regulatory mechanisms that do reflect this shift of regulatory authority from the national to the global level, and from the public to the private sphere, should more carefully investigate how these mechanisms actually affect weak domestic governance systems. My dissertation suggests that this is where the next frontier of academic research lies.

This is, for example, the research focus of a recent strand of GG scholarship called the
“Regulatory State of the South” project which I briefly discussed in chapter 3. Scholars engaged in the “Regulatory State of the South” research project propose that a dialogue between development scholars and scholars working on regulatory issues in nation states is a productive way forward. However, this literature has adopted a very narrow focus on specific forms of national governance systems: independent regulatory agencies in the infrastructure sector. The “Regulatory State of the South” project has also adopted a very narrow focus on specific forms of global regulatory mechanisms representing horizontal pathways of influence: transplants of Western regulatory models to contexts of weak domestic institutional systems through development assistance.

Their initial findings show that when transplanted to developing countries with weak governance systems, independent regulatory agencies are initially hollow institutional shells, but they do build expectations and develop norms and culture over time. Still, these expectations, norms and culture can be very different from those developed in Western developed countries with strong domestic governance systems. Regulatory agencies may become, for example, important new democratic spaces for internal constituencies. They may also serve as important vectors for broader political mobilization, in ways that had not been anticipated by the external actors that influenced their creation in the first place. This emerging dialogue between development scholars and regulation scholars has served to illuminate how transplanted models of regulatory agencies are interacting and shaping the governance of infrastructure sectors in developing countries. These investigations of the way global regulatory mechanisms interact with weak or dysfunctional domestic systems can offer important insights for reformers on the ground.

I propose that, in the same way, a dialogue between L&D scholars and global regulation scholars would be fruitful in illuminating whether and how the conventional and innovative global regulatory mechanisms are serving to bridge or undermine the governance deficit in resource-rich developing countries. This combined literature can therefore illuminate how: (i) the

31 Ibid.
32 Ibid.
33 Ibid.
innovative direct pathways of influence such as EITI and VPAs can be implemented in a way that will more easily serve as institutional choices that may enable reformers to escape dysfunctional governance paths that have become resilient; (ii) bypass strategies such as extraterritorial home country regulations may be used in a way that complement, rather than undermine conventional and new global regulatory mechanisms that aim to bridge the governance deficit.\textsuperscript{34}

7.5. Conclusion

The central theme of this dissertation is to argue that global regulatory mechanisms are very complex tools, created by a pool of distinctive policy actors to serve different and sometimes even conflicting goals as regards domestic governance systems, sometimes at the same time. The point is that they can also – intentionally or not – provoke feedback effects in stable domestic political dynamics. The L&D academic literature that seeks to investigate and guide domestic governance reform should therefore use insights from emerging global governance studies to illuminate how the fox policy approach to the weak governance curse, which includes the use of direct and indirect pathways of influence to affect domestic governance systems in resource-rich countries, is working in practice, and how these mechanisms can interact in a positive way.

I offer a scholarly contribution by (i) suggesting that unconventional global regulatory mechanisms are being used as additional institutional choices to potentially provoke positive feedback effects in dysfunctional governance systems; (ii) identifying a new policy trend to address the intractable governance deficit in resource-rich developing countries, which I call here a fox approach; (iii) arguing that in practice this fox approach is more desirable than a hedgehog approach to policy; and (iv) arguing that the academic literature needs to expand its focus in order to be able to analyze this phenomenon and to offer constructive guidelines for policy actors on the ground. In order to be able to analyze this evolution of external mechanisms, their impact on domestic governance systems, and whether they are conflicting or supporting other initiatives, the literature needs to look from the inside (how to best overcome path dependence and rent seeking obstacles to governance reform) out (to how external mechanisms may offer additional choices for policy actors).

\textsuperscript{34} Although several global regulation scholars are concerned with the social, economic and environmental impacts this lack of domestic governance is producing in the domestic sphere in developing countries, only they investigate forms to directly address these impacts.
# Appendices

## Governance Charts LDCs

(Chapter 2)

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### Statistical Table: Rule of Law, Comparison across selected countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Sources</th>
<th>Year</th>
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Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.
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### Statistical Table: Control of Corruption, Comparison across selected countries

<table>
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<tr>
<th>Country</th>
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<th>Country</th>
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