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From the Editors-in-Chief

This edition of the *LBJ Journal of Public Affairs* presents articles on diverse topics, reflective of the LBJ School's Generalist policy approach: the changing relationship between two growing economic powers in Asia; how to build effective Transit Oriented Development; NGO hesitancy to leverage social and economic remittances as community development resources; quantitative exploration of the factors driving wage inequality in OECD countries; market failure analysis of American immigration reforms passed by the 109th Congress; recent controversy over Internet regulation; and the complex role played by the Turkish military in preserving national secularism.

In addition to the *LBJ Journal* print edition, the Journal Online (ww.lbjjournal.com) publishes timely opinion pieces on issues ranging from the sexual politics of Disney's film *Happy Feet* to point and counter-point articles concerning the Iraq war. The online journal allows LBJ students, staff, and community to contribute to policy debates through an informal venue, and aims to promote community discussion and understanding about otherwise divisive issues. This year marked the first time the journal staff was divided into print and online journal teams, which allowed our online publication to increase both the amount and quality of material published online.

As always, we are grateful to the LBJ School staff and the Graduate Public Affairs Council (GPAC) for their support of the journal. We especially want to thank Talitha May, head of the LBJ School's writing center, for her support and enthusiasm, as well as the guidance and wisdom offered by previous years' Editors-In-Chief Crystal Jones and Kevin Preistner.

Submissions to the LBJ Journal should be less than 5,000 words and on a topic relevant to public affairs. Citations and style should conform to the LBJ School Student Publishing Guide (http://www.utexas.edu/lbj/student_res/pubguide/) *and/or* The Chicago Manual of Style (15*th ed. 2003).*

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PRACTITIONER'S CORNER

MOST PEOPLE WOULD SAY this is the age of globalization. I prefer "interdependence," because "globalization" has largely an economic connotation. Interdependence goes beyond economics to culture, communications, travel, immigration, politics, war, peace, and it can be positive or negative or both. It simply means we can't escape each other.

If you look at the Middle East, for example, the Israelis and the Palestinians are completely interdependent. It doesn't matter whether they are fighting or working together. When I was president, we were working toward peace. There was more positive than negative interdependence, although the occasional intrusion of terrorism was negative. In the four years after I left office, four times as many Israelis and Palestinians died from violence as in the previous eight years. But they were not a bit less interdependent. It had just gone from positive to negative.

The reason terror frightens people is because we are interdependent. September 11th was an act of interdependence—19 people came from other countries and used open borders, easy travel, and easy access to information and technology to turn a bunch of jet airplanes into chemical weapons. They studied the plans of the World Trade Center and they realized that the steel girders weren't reinforced by concrete and therefore there's nothing to absorb heat and you can bring these towers down. And they can find all that out on the Internet.

We have to realize that in an interdependent world we cannot kill, jail, or occupy all of our adversaries. And if you can't kill, jail, or occupy all of your adversaries, you have to make a deal and that's where politics comes in. Think of it—we wouldn't need any politicians if we could control all events and all people, would we? If you could be the dictator of your own life, you would never have to cooperate with anybody else about anything.

But since we can't, we need to make a world with more partners and fewer enemies. And we know how to do that, we know how to end extreme poverty.

We could make all of our commitments paying 25 percent of the world's GDP toward ending extreme poverty, toward ending the worst threats of disease, to putting the 130 million children who never go to school in school. We could do all of that for probably another 25, 30, maybe 40 billion dollars more a year and we're spending $100 billion every year on one war in Iraq.

It's far less expensive to build a world with more partners and fewer enemies. And it's also more effective.

The world has always had problems. The world always will have problems. We'll always have problems for the same reason none of us will ever be in possession of the absolute truth: we are fallible human beings subject to error and afflicted with ignorance.

BY PRESIDENT BILL CLINTON

This is an excerpt from former president Bill Clinton's address to the LBJ School's graduating class of 2006.

But we have been marching toward the light; or, as Martin Luther King said, "The long arc of history bends toward justice."

Our framers said that all we could ever do is make our union more perfect. It would never be perfect, but it could always be better. The same can be said now about our troubled, but wonderful and wonderfully interconnected world. There has never been a more exciting time to be alive, never been more opportunity, never been more obligation.

You are fortunate to be leaving this great place at this moment in history. And I urge you to live your dreams and make the most of it.

Microfinance and the Knowledge Paradigm:

Overcoming Barriers to Commercial Downscaling

Introduction

Microfinance has proven to be an effective tool in promoting sustainable economic development in the poverty-stricken Third World. Recently, it has also shown itself to be a viably profitable enterprise. Large commercial banks have begun to enter the microfinance sector by "downscaling" their services such as lending and savings accounts to low-income clients.

Banks can employ two types of downscaling strategies: direct or indirect services. In the former approach, banks provide services through an internal microfinance unit or by setting up a separate legal entity whose purpose is solely microfinance. In the indirect approach, banks outsource retail operations to existent microfinance institutions (MFIs), lend to MFIs, or allow MFIs to utilize their existent infrastructure and systems (see Table 1 for a thorough overview of these models).

The largest gains in microfinance obtain when commercial banks are directly servicing low-income clientele. Even so, banks face significant barriers to entering the microfinance market directly, which may discourage them from employing a direct-services model. The microfinance literature highlights three broad barriers to "full" downscaling: excessive risk exposure, higher operating costs, and having to employ nontraditional methodology. I would like to submit, however, that a lack of knowledge is the banks' primary barrier to market entry and logically precedes the other three. Risk, cost, and methodology barriers are therefore derivatives of a knowledge barrier.

This knowledge-centric viewpoint—the "knowledge paradigm"—represents a subtle shift in thinking about microfinance and its commercial future, holding implications both for banks desiring to downscale and for policymakers hoping to facilitate that process.

by Ian S. Speir

Ian Speir graduated with a B.S. in Mathematics from Oral Roberts University and a Master of International Affairs from Texas A&M University. His graduate studies emphasized international economics and international tax. He is currently employed as a tax specialist for Mayer, Brown, Rowe & Maw LLP in Washington, D.C., and will begin law school this fall as a night student at Georgetown University.

The paradigm suggests that downscaling banks require strategies that serve to minimize the three secondary barriers to entry while addressing their primary need for knowledge. Here, I hold out two prospects for success: the joint venture and "externalization strategy." And where policymakers use the knowledge paradigm to advocate a shift in focus from direct lender subsidies to "knowledge institutions," I focus on the need for credit bureaus.

This paper proceeds through four sections. First, I discuss the rationale for commercial downscaling: why large commercial banks are finding the poor an attractive market and why direct services are the optimal means for serving that market. I then go on to discuss why banks remain reluctant to downscale their services fully, highlighting the barriers to downscaling addressed in current research and positing a more fundamental knowledge barrier. The third section delves into the implications of this knowledge paradigm for banks' strategies for entry into the microfinance sector. Lastly, I explore a promising policy avenue in accordance with my arguments, viz. credit bureaus. I follow my conclusion with proposed areas of future research.

THE RATIONALE FOR COMMERCIAL DOWNSCALING

A good deal of literature has been generated lately concerning the profitability of microfinance. A central question facing the industry today is whether large commercial banks can conceivably extend their services—lending, savings, insurance, etc.—to those poor who typically lack access to "traditional" financial services (a phenomenon called "downscaling"), while simultaneously increasing their bottom lines. The answer to this question is a critical one. Viable profitability can mean scalability, which in turn promises to extend small-scale services beyond the capabilities of the NGOs and donor- or government-supported institutions that have heretofore dominated the sector.

There are concerns that large-scale commercialization of microfinancial services will cause the social mission of microfinance to suffer.[1] One criticism in particular is that the private sector has failed to develop "safeguards that ensure adherence to social mission."[2] It is clear, however, that social benefit is intrinsic to an industry such as financial services, and commercial downscaling can only facilitate the social mission. Furthermore, it is not the task of the private sector to regulate itself. Monitoring mechanisms, such as consumer protection, are best handled at the policy level, and governments and NGOs still have a keen role to play in this process.

Indeed, microfinance *is* profitable and will only be successful if it becomes the purview of the private sector.[3] NGOs lack the size, the policy structure, and the access to capital that are necessary for maximizing the benefit to the poor. That is not to say that they are not necessary institutions, nor that their operations have been lackluster, for certainly the opposite is true. But with at least a billion people around the world living on less than $2 a day,[4] the excess demand for microfinancial services is staggering. In India, for example, total demand for microfinance loans is estimated somewhere between Rs50,000 crore and Rs80,000 crore (USD $11-18 billion), while total supply is pegged at Rs5,000 crore (USD $1.1 billion).[5] Many scholars agree that the private sector can and should be the primary vehicle for helping alleviate this problem,[6] and commercial downscaling by private banks is a promising avenue.

To take this argument further, I submit that it is ultimately a particular *kind* of downscaling that the microfinance community should seek—namely, banks offering direct services to low-income consumers. (See Table 1 for an overview of direct and indirect service models utilized by downscaling commercial banks.) When banks in the aggregate are servicing their poor clients directly, their manifold resources—their technological infrastructure (e.g., ATM networks and MIS), branch networks, human resources, and full access to capital markets, to name a few—can be leveraged for the full benefit of consumers. Banks, in turn, are able to maximize their return on those resources since their revenues are not being shared with intermediating institutions. Then will the greatest gains in microfinance be seen, benefiting both banks' bottom lines and the poor.

That being said, commercial banks face some significant barriers to entering the microfinance market directly, chief among them a lack of knowledge. Understanding these barriers is critical, since banks must develop strategies for surmounting them and policymakers must help in minimizing them.

THE KNOWLEDGE PARADIGM

Broadly speaking, the literature agrees that commercial banks may be exposed to excessive risk, incur higher operating costs, and may be forced to employ nontraditional methodology when undertaking mi-

Table 1
Strategies for Commercial Downscaling

Direct Services		
Internal microfinance unit The bank provides micro-financial services in-house, creating an internal unit to carry out the operations. In this strategy, the bank is able to leverage its existing product and service lines, infrastructure, and systems fully for the benefit of its clients. It requires adaptation of bank systems, procedures, and staff and management structures.	**Specialized financial institution** The bank incorporates a separate legal entity to set up a specialized financial institution (SFI). The SFI is regulated by local banking authorities and its corporate identity, governance, and management and staff remain independent of the bank.	**Service company** The bank incorporates a separate legal entity to set up a service company. Unlike the SFI, the service company is not separately regulated by banking authorities. Being partly or fully owned by the bank, the services it renders on behalf of its clients are registered on the parent bank's books. The service company, like an SFI, maintains a corporate identity, governance structure, and management and staff independent of the parent bank.
Indirect Services		
Outsource retail operations The bank contracts an existent, well-run MFI to originate and service microfinance loans that are registered on the bank's books. The MFI may make credit decisions independent of the bank, or the bank may establish a joint-review process. In either case, both institutions must share risks and incentives more or less commensurately in order to align the MFI's interests with those of the bank.	**Lend to MFIs** In providing commercial loans to MFIs, the bank operates in its mainstream role as a commercial creditor. The bank may grant unsecured or collateralized loans based on several criteria of the MFI, including a high-caliber loan portfolio, timely and accurate financial reporting, and the MFI's growth prospects. The MFI uses the loan as either working or lending capital, as specified in loan agreements	**Provide infrastructure and systems** The bank allows MFIs to utilize its branch and ATM networks and provides access to front- and back-office functions (e.g., cashier services and/or trans-action processing). MFIs pay the bank a fee or commission, as specified in contractual agreements. As an alternative, banks may allow MFI staff into the bank to service MFI clients (e.g., through cashier services). Clients may have accounts at the bank or simply utilize bank accounts owned by MFIs.

Source: Jennifer Isern and David Porteous, "Commercial Banks and Microfinance: Evolving Models of Success," CGAP Focus Note No. 28 (Washington, D.C.: CGAP, June 2005).

crofinance operations. I view these barriers as mere derivatives of another primary barrier—specifically, a lack of knowledge on the part of banks. This subtle yet important difference has interesting implications for bank strategists and policymakers. I develop this argument in the ensuing paragraphs by first reviewing the three broad barriers to commercial downscaling discussed in the microfinance literature, and then discussing the role of knowledge in the existence of these barriers.

Excessive risk exposure. In general, banks face two types of risk when entering the microfinance market: informational asymmetries and lack of collateral. Countries where microfinance is a necessity generally do not have sophisticated financial markets and mature institutions. Without them, transaction costs in an economy can be very high since informational asymmetries are abundant. For example, credit reporting agencies in developed countries greatly facilitate loan decisions by banks. If a lender knows a consumer's history as a borrower, the lender can tailor loan amounts, interest rates, and contractual terms in ways that minimize the lender's transactional risk and maximize its revenues. Without such an institution, lending becomes very costly and risky.

The second type of risk a bank faces is lack of collateral. Generally, the poor do not possess assets of significant value. Even if they do—if they own a plot of land, for instance—there is often no deed to affirm this, especially if country-level legal frameworks are weak. Without collateral to secure a loan, banks will be unlikely to lend. Even if a bank were able to secure a loan to a low-income borrower with sufficient collateral, it still may be averse to lending. The prospect of actually seizing the borrower's assets in the event of default is unappealing. The public outcry against the "big bank" hurting the "little guy" could be rancorous and very costly.[7]

Higher operating costs. Microfinance involves more transactions than a commercial bank may be accustomed to handling. Many small loans entail significantly more person-hours than traditional lending. Trying to overcome informational asymmetries and the collateral problem can also be very labor-intensive, time-consuming endeavors. What's more, a smaller average loan size means that costs inherent in loan review, decision-making, and

monitoring are not spread as economically as when larger, traditional loans are made. Banks faced with this prospect may be forced to charge unattractively high interest rates or simply not microlend at all.[8]

Nontraditional methodology. Lastly, for commercial banks, the microfinance terrain can be difficult to negotiate because it involves some nontraditional methodology. Bottom-of-the-pyramid (BOP)[9] consumers naturally demand different types of financial products and services, and banks' utilization of traditional consumer credit methodologies will likely be ill-suited for these clients. One can imagine, for example, that rural farmers' cash flows will be quite unlike those of urban clothing merchants. Not only that, but the culture of a large bank may not be conducive to the "high volume, small loan size business" of microfinance.[10] Revamping management and staff structures and operating procedures may therefore be a necessity.[11]

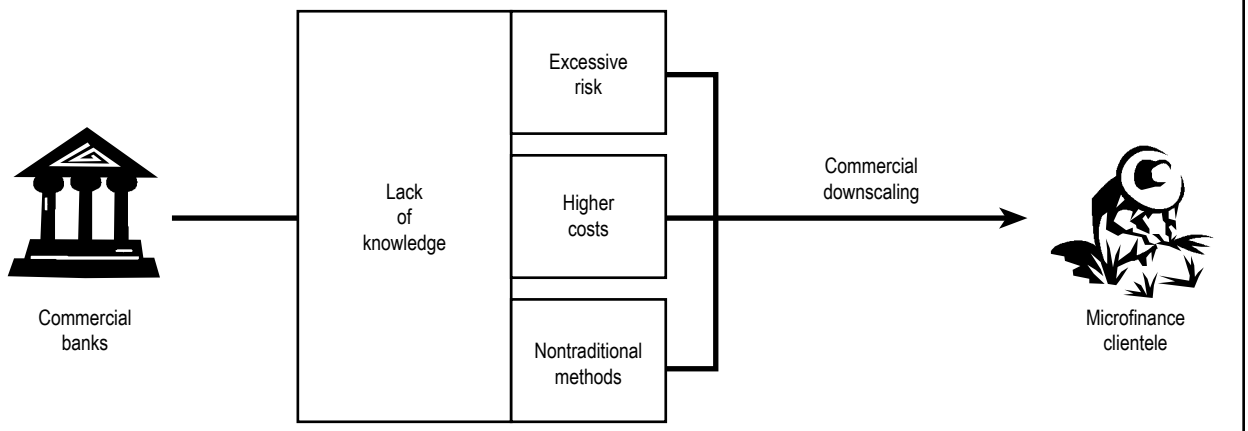
Lack of knowledge, the primary barrier. NGO-MFIs, operating more or less since the 1970s, have managed to overcome many of the above challenges. For example, they have been able to rectify informational asymmetries through proximity. Local organizations in relatively small village units have a much deeper understanding of their consumers and the local market than a large commercial bank could hope to have. They have surmounted the collateral problem in different ways, the most popular of which has been the so-called "Grameen Model," wherein a loan is made to a group and distributed among group members. The group members' collective assets—including prospects for growth of the microenterprises they may be financing—secure the loan, and peer pressure repayment is enhanced through exertion of.[12]

Naturally, the cost structure of a non-profit MFI is vastly different than that of a commercial institution. To some degree, NGO-MFIs can operate at lower cost; for example, salaries are likely to be lower than at a private bank. In addition, these organizations need not concern themselves with efficiency, economies of scale, or profit margins. This gives them considerable leeway to innovate, experiment with best practices, and adapt their methodologies and culture to the characteristics of the microfinance market.

The barriers to full commercial downscaling clearly are not insurmountable. Indeed, NGO-MFIs have managed them quite well. What banks face, above all else, is a lack of knowledge. In the broadest of terms, banks lack understanding of the BOP market itself.[13] Data on consumer behavior and tastes at the bottom of the pyramid are scarce. A bank's perception of effective marketing and pricing may be skewed. What it believes the poor want may in fact be quite off the mark.[14] Banks will have to conduct significant research in order to best tailor their services and products to microfinance clientele, and such learning curves can be costly.

Regarding microfinance specifically, commercial banks wanting to downscale will likely lack the know-how to overcome informational uncertainty. Factors such as credit history, business outlook, and micro- and macroeconomic forecasting traditionally guide lending decisions. Forecasting risk for microenterprises, however, may require knowledge of such things as past and predicted regional weather patterns (e.g., if a client farms) or the local demand for hand-made items (e.g., if a borrower makes baskets). Commercial banks similarly are accustomed to dealing with clientele who possess

Figure 1
The Knowledge Paradigm



collateral. Mitigating risk with uncollateralized loans requires both a shift in thinking for lenders and innovative techniques.[15]

In addition, banks will have little initial insight into how to minimize the costs inherent in increased transaction volume. Automation of certain bank services would naturally be desirable for reducing labor intensiveness. Branch expansion, too, can help a bank reach minimum-efficient scale. First, however, a bank must learn how to automate its "microservices" and where branch and technology (such as ATM) networks are likely to have the deepest market penetration.

Lastly, microfinancial services require specific human resources and personnel management techniques. Bank employees need special people skills; management must develop programs for incentivizing employee performance in the high-volume business, and together they must learn to adapt methodologies to service the low-income market.[16]

The focus of this paper is not to suggest strategies for effectiveness in these specific areas, but rather to address the lack of knowledge in general. The above discussion elucidates the fact that a knowledge barrier logically precedes the other three. Excessive risk exposure, higher operating costs, and nontraditional methodology result from the knowledge gap that inhibits commercial operations in an unfamiliar market.

This "knowledge paradigm" highlights a subtle yet important difference in the way in which microfinance and commercial downscaling are conceived. Take, for example, a downscaling bank that is primarily concerned with minimizing its risk exposure, operating costs, and methodological unfamiliarity. An acceptable and even profitable strategy for the bank would be to employ an indirect-services model. The bank could outsource its retail operations to MFIs or lend to MFIs who then on-lend to their clients. Alternatively, the bank could directly offer microloans guaranteed by donor- or government-supported organizations. In this process, the bank incurs large opportunity costs in terms of the knowledge it forgoes. In the first case, the bank may be two steps removed from actual microfinance clientele, thus accumulating no knowledge of the market or methodologies for operating within it. In the second case, the bank's incentive to discriminate between a good borrower and a bad borrower is reduced. It may not look closely at which factors affect borrower cash flows and payback rates. In either instance, the bank passes up a chance to gain competency in managing risk, cost, and nontraditional methodology in the microfinance market (and thus generate revenues more efficiently). As long as this continues, the bank will be averse to offering financial services directly to low-income clients, and resource allocation will be suboptimal.

Still, a downscaling bank cannot directly and fully leap into the market. It cannot simply create an in-house microfinance unit or spin off a microfinance subsidiary without the requisite innovative knowledge for managing risk, cost, and nontraditional methodology in the new market. Proper time to accumulate period of knowledge accumulation and mechanisms to ensure that knowledge is institutionalized are critical.

A downscaling bank cannot directly and fully leap into the market. It cannot simply create an in-house microfinance unit or spin off a microfinance subsidiary without the requisite innovative knowledge for managing risk, cost, and nontraditional methodology in the new market.

With its focus on knowledge as primary and the three other barriers as secondary (though no less real), the knowledge paradigm can help potential downscalers and policymakers maximize profitability and social benefit. Downscaling commercial banks require a strategy that addresses their need for knowledge while simultaneously reducing the poignancy of the secondary barriers. Policymakers must avoid thinking only in terms of credit subsidies and loan guarantees and ought to direct their attention to facilitating banks' acquisition of requisite knowledge. The following two sections of this paper expound on these arguments.

STRATEGIES FOR DOWNSCALERS

The argument for direct-services models coupled with the knowledge-centric view of commercial downscaling offers keen insight into effective strategies for entering the microfinance market. Joint ventures and "externalization strategy" show particular promise.

The proposed downscaling strategies, as outgrowths of the knowledge paradigm, are directed

toward a specific bank profile: a commercial financial institution looking for new revenue streams with no previous experience in nontraditional financial sectors. It is easy to see why this is necessary. First, the "commercial" requirement fits our definition of a downscaler. Second, the bank must see microfinance as a profitable means to augmenting its current service offerings. Lastly, and perhaps most importantly, the "no previous experience" criterion invokes the need for knowledge acquisition prior to or concurrent with market entry. The proposed strategies, for example, will not apply to commercial institutions competent in servicing nontraditional sectors, such as rural and agricultural clients or labor cooperatives, which are not unlike microfinance clients. This is because banks that have historically had such a focus can likely make the immediate jump to offering direct microfinancial services.[17] In short, the focus of these strategies is the traditional retail and corporate finance institution with an eye to downscaling.

The joint venture. Several commercial banks have successfully expanded their services to include microfinance clients by engaging in equity joint ventures (EJVs) with private investors, nongovernmental actors, and/or MFIs. These EJVs have not only included an infusion of capital from various investors for the formation of separate microfinance subsidiaries, but also the infusion of knowledge. Each such bank, seeing the potential gains in offering microfinancial services, was able to incorporate a separate legal entity, capitalized by the bank and assorted partners, and ensure the investment and institutionalization of critical knowledge in the new entity.

Acción International—an umbrella organization of NGOs and commercial institutions, as well as the hub of a vast network of MFIs—has been leading the charge in implementing this particular model. It has had a hand in the creation of a number of successful, self-sustaining subsidiaries throughout Latin America. Examples include Sogesol, a subsidiary of Haiti's Sogebank; Credife, a subsidiary of Ecuador's Banco Pichincha; Mibanco, a Peruvian EJV whose shareholders include Banco Wiese, one of Peru's largest banks; and Real Microcrédito, a subsidiary of Banco ABN AMRO Real. In these cases, commercial banks wanting to downscale their services contracted Acción to provide technical assistance and loan guarantees when setting up the new operations. Acción also helped capitalize the new entities and thus retains governing positions within them.

Knowledge transfer occurs through Acción's technical assistance programs and "resident advisors," as well as through their equity stakes in the subsidiaries. Acción's decades of experience in microfinance, as well as their ability to mobilize private capital, make them a valuable partner. The EJV-subsidiary model seems to be very effective for the banks involved: risk and costs can be spread across several institutions and investors, and original bank culture, operations, and staff structures may stand. Nontraditional knowledge critical to operating profitably in the new market is vested in the subsidiary.

An alternative to the EJV is the non-equity joint venture. Kingdom Financial Holdings Limited (KFHL, in Zimbabwe) and Banco do Nordeste (Brazil) are examples of banks that entered the microfinance market directly and unilaterally—KFHL through a wholly owned subsidiary (MicroKing Finance) and Banco do Nordeste through an internal unit (a program dubbed CrediAmigo). Both of these commercial institutions contracted with Acción for technical assistance concurrent with market entry. Acción advises them still, helping them to strengthen and expand their lending programs, as well as to provide assistance in the face of macroeconomic instability and participate in management.[18]

The ongoing success of these joint ventures lends credence and salience to the knowledge paradigm. The joint venture addresses the primary and secondary barriers to downscaling. Banks are able to spread risk and costs while retaining their traditional methodology and systems in-house. Simultaneously, they can ensure infusion of critical knowledge through partners whose core competencies are structured around microfinance and developmental finance (e.g. Acción, ProFund, the International Finance Corporation). With the banks' resources and the subsidiaries' continuous acquisition of knowledge of the market and of managing its inherent risks, costs, and unconventionality, microfinance operations can expand profitably to meet low-income consumers' manifest demand.

Externalization strategy. As noted, many commercial banks worldwide have begun to engage the microfinance sector through indirect services (outsourcing, wholesale lending, and providing infrastructure and systems to MFIs). Lending to MFIs is currently the most popular strategy employed by commercial banks.[19] These models are attractive because they allow banks both to transfer risk and costs to external entities and to negotiate more familiar terrain. By dealing with whole institutions (MFIs) rather than individuals, they can reduce their transaction volume and employ more traditional

risk assessment techniques (they can, for example, examine MFIs' financial statements). In providing MFIs with infrastructure and systems, banks are able to earn further rents on existent capital, increasing the productivity of their assets.

These indirect-services models are by no means ineffective. Indeed, banks (including familiar names such as Citibank, Wells Fargo, ICICI Bank (India), HDFC (India), and Barclays Bank) would not be thus engaged if they were not profitable. Nevertheless, these models fail to allocate resources optimally. Intermediation by MFIs can mean that the gains accruing to low-income consumers and banks are decreased: consumers do not benefit from banks' vast resources and diverse products and the banks must, in effect, share revenues with the MFIs. Fees paid to or profits shared with MFIs are essentially rents earned on the know-how MFIs possess. Since they understand the ins and outs of the BOP market and their clients' cash flows and have developed innovative ways to manage risk and costs, the MFIs are necessary. Without them, traditional commercial banks would lack access points for entering the sector.

The knowledge paradigm is instructive for policymakers because it shifts the focus from risk, cost, and methodology barriers per se to the knowledge barrier that underpins them.

Given this interdependency, downscaling banks can employ an "externalization strategy." consisting of two elements: 1) externalized transactions (i.e., indirect-services models) coupled with 2) knowledge-centric alliances with MFIs. This again satisfies the knowledge paradigm's demand for addressing both the primary and secondary barriers to downscaling. Externalizing transactions allows banks to mitigate the effects of excessive risk, higher costs, and methodological unfamiliarity involved with microfinance operations. A focus on knowledge-centric alliances with MFIs ensures a continuous flow of knowledge "upward"—from consumers to MFIs to the banks.

For example, in outsourcing retail operations to MFIs, the utilization of a joint-review process can result in significant knowledge gains, as bank personnel are involved frequently in decisions about microfinance portfolios. In the lend-to-MFIs model, banks may increase their exposure to the market over time by offering non-loan services to MFIs and their clients. Examples include deposits, cash management, and technology (such as ATM) networks.[20] Infrastructure- and system-sharing with MFIs is less conducive to knowledge acquisition for banks since they likely have little contact with microfinance clients and even less with the MFIs' portfolios. Modified arrangements could of course be constructed to allow for some knowledge flow.

The goal for commercial banks, of course, is the ability to offer direct services. If a bank lacks joint venture partners (willing investors and technical advisors), externalization strategy can be a successful means to that end. As bank personnel familiarize themselves with both the BOP market and how MFIs maneuver within it, the barriers are effectively reduced. At that point the bank can more readily, efficiently, and perhaps even profitably engage microfinance clientele directly.

India's ICICI Bank, the country's largest private bank, illustrates how an externalization strategy might appear. In 2003 it entered a non-equity strategic alliance with Cashpor, a for-profit MFI working in some of the poorest regions of India. Per the literature on joint ventures and strategic alliances,[21] the complementarity of assets in the ICICI-Cashpor partnership and a division of labor along those lines has helped ensure its success. Cashpor, deeply knowledgeable about its market, identifies clients; originates, services, and monitors loans; trains its clients; and provides delinquency management and a first-loss default guarantee. ICICI, with prime access to domestic and international capital markets, provides Cashpor with much-needed lending and working capital.[22]

Two primary factors motivated ICICI to enter this alliance: its lack of branch infrastructure in rural India and lack of knowledge of poor customers.[23] ICICI stands to make considerable gains if it concertedly strives to realize and internalize knowledge. Its staffing of a documentation officer at Cashpor headquarters provides a valuable "knowledge connection" for the bank.[24] Rotating this officer back through ICICI and providing means by which his or knowledge can be shared with other managers actively engaged in the microfinance side of business can be an effective means of absorbing and applying the new knowledge.

Financial Bank in Benin, a West African nation squeezed between Togo and Nigeria, provides another case in point for the effectiveness of externalization strategy and how it might be played out:

> In 1995 Financial Bank started microfinance operations by offering retail housing and consumer loans to salaried workers and wholesale loans to MFIs. During this time, it began to provide free cashier services to their MFI clients. Once Financial Bank realized the volume of these transactions, it offered its principal MFI clients the option of paying for these services or developing their own cashier window. MFIs opted for the latter, and Financial Bank provided initial training in cashier services. *This experience allowed Financial Bank to learn more about the microfinance client base and the regularity of their transactions.* In November 1998, Financial Bank decided to expand operations and create an internal unit to manage its microfinance operations. Building on growing success, Financial Bank spun off its internal microfinance unit as a specialized financial institution [a subsidiary]. The new institution, Finadev, began operating in July 2001. . . .[25] [emphasis added]

It is unclear whether Financial Bank was concertedly striving for knowledge gains from its MFI clients. Nevertheless, what time was spent accumulating that knowledge later translated into an additional revenue stream for the bank. Finadev has been operating successfully and profitably since its inception and has incorporated Finadev in nearby Chad, with plans to expand to Guinea, Gabon, and Togo.[26]

In sum, the knowledge paradigm can be particularly useful for crafting a strategy for direct entry into the microfinance sector. It both suggests and validates the joint venture and externalization strategies currently being utilized by some commercial banks. For others continuing to adhere merely to externalized transactions (such as Citibank), the paradigm points to the necessity of knowledge-centric alliances with MFI partners and the creation of mechanisms for "upward" knowledge flows. When commercial banks are directly engaged with offering microfinancial services, economic gains and social benefit are maximized.

POLICY IMPLICATION: CREDIT BUREAUS

The knowledge paradigm is instructive for policymakers because it shifts the focus from risk, cost, and methodology barriers *per se* to the knowledge barrier that underpins them. Since a lack of knowledge is primary and prior to the other three barriers to commercial downscaling, it follows that policy efforts that address the knowledge barrier first and foremost will have the greatest effect in minimizing risk, cost, and methodological unfamiliarity.

Where credit bureaus do not exist, or are in short supply, policymakers should actively seek their creation, whether through establishment of PCRs or through a legislative framework that fosters the development of private credit-reporting agencies.

This argument, in one sense, is about the allocation of public (including donor) funds. Government agencies and nongovernmental actors may utilize funding to subsidize lending, provide loan guarantees, or cover banks' administrative expenses. Such funding might be seen as "launch aid" to assist and prod commercial bank entry into microfinance. In some cases, it has been shown to work.[27] It also, however, can impose costs on the economy and the welfare system as a whole. This particular usage of funds may entail high opportunity costs, so the impact of usage must be weighed against alternative uses (education and public health, for instance).[28] Provision of subsidies can discourage competing banks from entering the sector, thus hurting downscaling efforts in the long run and being ultimately injurious to the poor. Lastly, as touched upon earlier, "knowledge costs" must be factored in to the equation: credit and administrative subsidy and loan guarantees can create a moral hazard, discouraging a bank from amassing the know-how critical to operating profitably (and thus sustainably) in the sector.

The classic question for policymakers remains: "How do we allocate funds the most productively?" The knowledge paradigm advocates that priority be given to the building, sustainment, and propagation of knowledge, amounting essentially to an argument for institutions—in particular, "knowledge institutions." I narrow my focus in this paper to credit bureaus. Tom Easton of *The Economist* reports that, "[w]hen representatives in Kenya of three of the world's largest banks were asked what single event would most encourage their institutions to become more involved with microfinance, they

all came up with the same answer: the presence of credit-rating agencies."[29]

Credit bureaus help banks rectify informational asymmetries and prevent adverse selection of borrowers. By providing consistent, objective risk management and credit scoring through statistical models, they also cut down on time spent by bank management on tailoring loan characteristics to borrowers and other functions.[30] Traditional commercial banks, especially in the West, are accustomed to utilizing credit-rating agencies, especially for consumer lending[31] (of which microfinance is a subset). These effects together amount to efficient management of risk, costs, and methodological unconventionality, accomplished through a knowledge-disseminating institution. And as the bank executives above attest, the presence of a credit bureau can be a critical variable in determining a bank's decision to offer microfinancial services.

A credit bureau may be a private company or a public credit registry. The former is either created by a third party who solicits financial institutions for membership or established as a membership company by the financial institutions themselves. Membership and credit-reporting are voluntary, based on the principle of reciprocity. Public credit registries, or PCRs, are generally created and supervised by a country's central bank, and financial institutions' membership and credit-reporting are regulated and mandatory.[32]

Credit bureaus are well established in the developed world. Private credit reporting agencies first emerged in the U.S. in the 1700s, and today almost every adult in the U.S. has a credit history. The same is true of many other developed economies. In poor countries, however—Pakistan or Nigeria, for example—less than one percent of adults have credit histories. Consequently, credit is very expensive, very risky, and available only to individuals with higher incomes or proper connections.[33]

Recently there have been efforts to foster the creation of credit-reporting agencies in developing economies. The International Finance Corporation's Global Credit Bureau Program aims to address the lack of credit information in such economies through feasibility studies, creation or improvement of credit bureaus, and review of and recommendations for laws and regulations governing credit-reporting and information-sharing.[34]

Perhaps the most significant strides in this regard have been in India. In 2001, the State Bank of India (SBI) and HDFC established the country's first-ever credit bureau, the Credit Information Bureau (India) Limited (CIBIL). Its initial database held approximately 4 million records of individual borrowers whose information was supplied by 12 member institutions. Since then, the database has grown, with information on 20 million borrowers from 30 member institutions by May 2005.[35]

To facilitate CIBIL's ongoing growth and to encourage the further formation of credit registries, India's recent steps toward regulatory reform must continue. Until 2005, there was no law on the books governing the setup of a credit information bureau. In fact, numerous laws prevent or inhibit banks from divulging information about their borrowers to third parties. In May 2005, the Indian parliament approved the Credit Information Companies (Regulation) Bill, providing a legislative framework for the creation of credit bureaus in India. The Reserve Bank of India (RBI) is charged with overseeing applications for the creation of such institutions, limited at this time to a total of three or four for the entire country. The hope is that other Indian banks will follow in SBI's and HDFC's footsteps in establishing such institutions for credit-rating and sharing of information.[36]

India serves as a shining example for its developing peers in China, Russia, Africa, Eastern Europe, Southeast Asia, and elsewhere. Under circumstances where credit bureaus do not exist, or are in short supply, policymakers should actively seek their creation, whether through establishment of PCRs or through a legislative framework that fosters the development of private credit-reporting agencies. These credit bureaus should incorporate information on borrowers across the economy, from the bottom of the pyramid to the top. This means that even the smallest NGO-MFI should be compelled to share information about its borrowers. Admittedly, this is a long way's off, as large commercial banks in these countries are just beginning to share information formally and more broadly. Nevertheless, as banks in developing countries are keen to downscale to underserved market segments, credit information on even the poorest borrowers will help these banks reduce their risk of non-performing assets.

For downscaling banks, the successful establishment of credit bureaus would have a threefold impact. First, their knowledge of microloan applicants would be vastly improved and allow them to better predict probability of repayment. Second, the informational playing field would be leveled across the microfinance market. Banks would earn fewer "informational rents" on their low-income customers and would be forced to price loans more competitively. Lastly, ubiquitous credit reporting

would impose discipline on borrowers. If their credit history is potentially open to all lenders, they will less readily default as their ability to secure additional loans from other lenders is significantly reduced.[37]

The credit bureau serves as a knowledge institution, prodding banks downward, easing their transition into direct services to the low-income market,[38] and helping ensure their sustainability and profitability once there.

CONCLUSION

In sum, my argument has played out along the following lines. Microfinance is a profitable sector, and commercial banks have begun to get their feet wet by downscaling their services. The greatest gains accruing to the sector obtain when banks are directly servicing low-income clients. Since, however, this model poses significant barriers to banks, they may be averse to entering the market directly.

Barriers to fully downscaling, as highlighted in the current literature, are, broadly, excessive risk exposure, higher operating costs, and having to employ nontraditional methodology. I submitted that a knowledge barrier is primary and prior to these three. This knowledge paradigm suggests that banks' downscaling strategies and the macro-level policies designed to facilitate downscaling must help minimize the three secondary barriers while addressing banks' primary need for knowledge. I offered two strategies in particular that seem to promise success for full downscalers: the joint venture and externalization strategy. I also suggested, per the knowledge paradigm, that policymakers focus their efforts on building knowledge institutions, and I examined the need for credit bureaus in specific.

I believe the primary contribution of this paper has not necessarily been the introduction of a new idea. The need for knowledge is no doubt implicitly understood by economists, financial experts, and microfinance promoters when discussing the downscaling phenomenon. In my view, this paper helps bring some cohesiveness to the current debate over microfinance best practices by moving the literature forward along "knowledge" lines (a concept heretofore not discussed). In short, explicitly laying out the knowledge paradigm permits banks' downscaling challenges to be conceived in a new light, and strategies and policies for surmounting those challenges can be crafted with a broader picture in mind.

There are several avenues of research that would serve to strengthen, or properly modify, the arguments in this paper. It would be useful, for example, to focus on *mechanisms* critical to the institutionalization of knowledge once it is gained. If a bank and MFI are engaged in, say, personnel transfers, what is the means by which bank managers involved in these transfers ensure that their increasing knowledge of microfinancial practices is internalized by the bank? An in-depth look at absorptive capacity (a firm's ability to learn and adapt) would be helpful.

Also, a more thorough examination of the literature on joint ventures and strategic alliances might prove insightful. Research might identify factors for success (and items to avoid) in bank-MFI partnerships. Lastly, the knowledge-based view of the firm (especially of the bank) could provide future guidance for bank management and policymakers in facilitating downscaling. Adapting this literature's concepts to microfinance might prove a worthy endeavor.

At the proverbial end of the day, two things will matter for microfinance: the welfare of the poor and the profitability of banks. My goal in this piece has been to paint a broad picture that holds out hope for both.

LBJ

NOTES

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8. Gangopadhyay, "Micro-Credit and Banking." See also on these points Valenzeula et al., "Commercial Banks in Microfinance: New Actors in the Microfinance World" (online); and Easton, "The hidden wealth of the poor," pp. 3-14.
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Changing the Economic Landscape in Asia:

Emerging Economic Relations between Japan and India

by Andrew David

Introduction

The remarkable growth of India's economy would seem to offer Japanese companies the opportunity to move into a new market and take advantage of India's skilled labor force. This relationship, when measured in terms of the total volume of trade between the two countries, however, appears to be relatively insignificant. In the 1990s, Japanese trade with India did not significantly increase and levels of investment in India remained much lower than investment in China and other countries in Asia. Japanese political leaders, sensing that Japan and India are failing to capitalize on a potentially mutually beneficial relationship, have lamented the weak economic ties between the two countries. "The trade and investment level of Japan-India economic relations is far too small considering the presence of the nations in Asia," Japanese Trade Minister Toshihiro Nikai stated in July 2006.[1]

What political leaders have not noticed is that the relationship between Japan and India has quietly turned a corner. Japanese multinational corporations (MNCs) are driving more trade with India and are increasing investment in India. Since about 2003, Japanese multinational corporations have gained more interest in the Indian market, started to integrate India into their global strategies and have increased their sales in India. The trade that is taking place, however, is often with Japanese affiliates in countries in Japan's regional network of production and is not captured in Japan's official trade statistics.

This changing pattern of trade has significant implications for both understanding the nature of trade in the region and the regional balance of power. The results of this study support the findings of other

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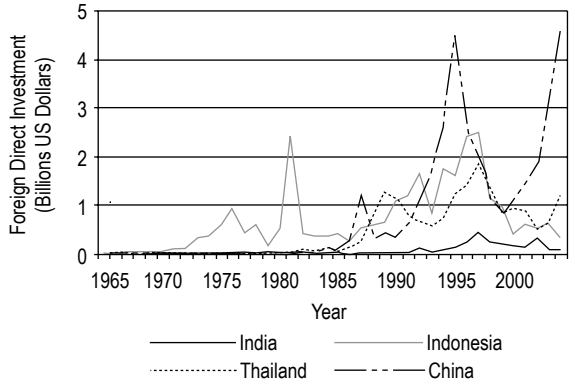
authors that the production of Japanese companies takes place across a broad network. Japan's role in Asia, therefore, cannot be understood simply in terms of domestic production and exports to the region.

The results of this study also indicate that there is a developing relationship, at least economically, between Japan and India. India and Japan's political relationship deteriorated after India's nuclear weapons tests in the late 1990s. Increasingly, however, the possibility of a Japan-India alliance to offset the rise of China has been raised by political commentators. This is unlikely to happen in the way that these commentators envision since both countries want to repair their tense political relationship with China. A closer economic relationship between Japan and India, though, has implications for the balance of power in Asia and will bring Japan and India closer together, while pulling them both closer to China.

Figure 1
Japanese Foreign Direct Investment in Select Countries in Asia



Source: Japanese Ministry of Finance, *Foreign Direct Investment*. Online. Available: http://www.mof.go.jp/english/e1c008.htm. Accessed: May 14, 2006.

JAPANESE AND INDIAN INVESTMENT AND TRADE

The Indian government began a process of economic liberalization in the 1990s that was expected to lead to more trade with Japan and more investment by Japanese MNCs. Japanese investment in India, however, remained relatively small throughout the 1990s and the first few years of the 2000s. It was significantly lower than investment in countries such as China, Indonesia and Thailand (see Figure 1). A brief increase in the 1990s was followed by a gradual decrease in investment after the Asian financial crisis and Indian nuclear tests. Only once since 1990 has Japanese foreign direct investment (FDI) in India exceeded five percent of all Japanese investment in Asia.[2] Despite the low level of investment, some Japanese companies have had success in India. Suzuki, for example, invested in a joint venture to produce small cars in India in the 1980s and became the dominant auto maker before competition lead to a decrease in its market share.[3] But this example, however, is not typical of Japanese business experiences.

A review of surveys and interviews with Japanese politicians and business leaders reveal three perceived barriers to investment in India by Japanese companies:[4]

1. **Bureaucracy/Legal Procedures:** Japanese political leaders have often pointed to bureaucracy and red tape as discouraging Japanese investment in India. In a 2004 speech in New Delhi, the Japanese minister for foreign affairs, Yoriko Kawaguchi, indicated that "permit and licensing procedures" were a problem for Japanese companies that invested in India.[5] According to a 2003 survey of Japanese manufacturing companies with overseas affiliates on problems with doing business in India, 28 percent of companies cited the "opaque operation of the local legal system," 20 percent indicated the "opaque operation of the local tax system," and 17 percent said "complexity and opacity of local investment permit procedures."[6] The 2005 METI White Paper indicated that the government of India "eliminated a series of restrictions on foreign investment in the petroleum sector, gas sector, publishing industry, private banking industry, private aviation, and communications sector in 2004 and in the construction and real estate sectors in 2005. However, concerns remain that these measures have not been fully effective because it is still necessary to meet guidelines set by all of the supervising authorities for each sector."[7]

2. **Instability:** India's 1998 nuclear tests and concern over the country's relationship with Pakistan also increased companies' uncertainty about investing in India. In 1999, 55 percent of survey respondents at Japanese manufacturing companies who thought India was a promising location for investment also indicated that the "local political and social situation" was a concern.[8]

3. **Infrastructure:** The quality of the infrastructure in India remained a serious concern and a deterrent for Japanese companies that wanted to invest in India. Poor infrastructure inhibits Indian companies' production capabilities and their abilities to either market them locally or easily export them. Additionally, companies have been concerned about unreliable energy supplies and inadequate roads.[9] As Hiroshi Okuda, Toyota president and chairman of the Nippon Keidanren, stated, "[d]elay in road, electricity, and other infrastructure development in India has discouraged Japanese companies from investing in India."[10] In 1999, 60 percent of companies rated infrastructure as their biggest concern regarding investing in India.[11]

It is evident that problems with infrastructure and the investment climate deterred investment, but by themselves these problems are not enough to fully explain the unwillingness of Japanese companies to invest in India. Many of the same problems have existed and continue to exist in China, yet companies have invested in China despite their concerns about the poor quality of infrastructure and the investment climate.[12]

While these factors are not sufficient explanations for the lack of investment, political instability is a stronger deterrent to investment by Japanese companies. For example, 2005 anti-Japanese protests in China have made Japanese companies more cautious about investing in China; many companies are now diversifying their production bases so production is not concentrated too heavily in China. Similarly, India's 1998 nuclear tests created much concern about the country's stability and may have led to a disincentive to invest. Still, even though this has made companies more cautious about investing in India, stronger market incentives may have caused companies to slow investment, as they did in China, rather than of stopping it.

Japanese companies often seem willing to overcome obstacles when there is a large enough incentive. However, Japanese companies generally have lacked knowledge and understanding of India which would have facilitated more nuanced investment decisions. In 1999, 41 percent of Japanese companies rated the "lack of information on the investment climate of the recipient country" as a concern for investing in India.[13] This was nearly half of the 15 percent of companies that considered India a promising place to invest.[14] Knowledge was most likely even lower among the remaining 85 percent that did not consider India a promising place to invest. This knowledge deficiency has partially resulted in a lower expectation of market growth creating possibilities for investment and a diminished perception of wanting to use India as an export base. As staff writer Kuraichi Yoshino wrote in *The Nikkei Weekly* in 2004, "[i]t has been more than 10 years since the government of India introduced a policy of economic opening up, but only now has the idea begun to crystallize that India could possibly become the next China."[15]

With the shortage of Japanese knowledge of India and the Indian market and political instability in India leading to the lack of investment in India, the amount of trade between the two countries grew little in the 1990s. The major products India imports from Japan include mechanical and electrical products, optical devices and specialized products, iron and steel, ships, vehicles, and vehicle parts and accessories.[16] From 1993 to 1998 Indian imports from Japan did increase, but then declined in the wake of the Asian financial crisis and India's nuclear tests. (See Figure 2.) Indian imports from most other Asian nations took similar patterns during this period, but from 2002 to 2006, India's imports from most countries in Asia increased faster than their imports from Japan. Therefore, India's imports from Japan have decreased relative to India's total imports.

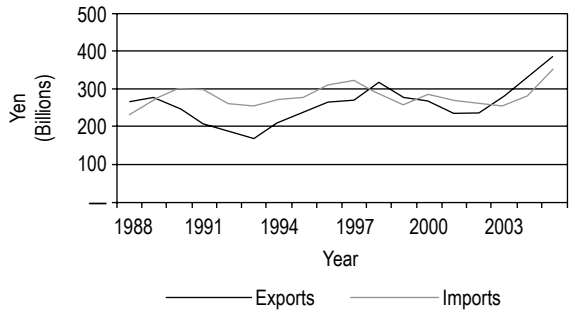
During the period from 1990 to 2003 the level of India's exports to Japan changed little (Figure 2.) India's primary exports to Japan include natural resources, fish, precious stones (particularly diamonds), and textiles.[17] Since about 2002, India's exports to other countries in Asia, except China, have increased more quickly than their exports to Japan while India's exports to Japan, as a percent of all exports, have declined.[18]

These trends seem to indicate a declining economic relationship between Japan and India. However, it will be argued later that these statistics do not capture the complete nature of the economic relationship between Japan and India and the growing trade involving Japanese companies.

OFFICIAL EFFORTS TO INCREASE INVESTMENT AND TRADE

Concerned about trade that seems to be below expectations while recognizing room for growth between the two economies, the Japanese and Indian governments have been working hard over the last six years to improve their economic rela-

Figure 2
Japanese Exports to and Imports from India



Source: Japanese Ministry of Finance, *Foreign Direct Investment*. Online. Available: http://www.mof.go.jp/english/e1c008.htm. Accessed: May 14, 2006.

tionship. These efforts have included official visits, the dispatch of Japanese business delegations, the discussion of a free trade agreement, a visit to Japan by Indian prime minister Shri Atal Bihari Vajpayee and a visit to India by Japanese prime minister Junichiro Koizumi.[19]

Political leaders from both countries have reaffirmed the importance of improving the relationship between India and Japan. Indian Ambassador Manilal Tripathi wrote in an op-ed in The Daily Yomiuri that:

> The economic content of our strategic partnership must receive special attention. Accordingly, we call upon Japanese business leaders to take a long-term view and avail themselves of the investment opportunities offered by the resurgent Indian economy. There is also much scope for enhancing bilateral trade, which is currently much below potential. Our economic cooperation has to become an important pillar of our Global Partnership.[20]

Indian commerce and industry minister Kamal Nath recently stated that "[w]e need to synergize the technology and innovation of Japan with the skilled workforce of India in the next decade."[21] Japanese prime minister Koizumi stated that "[e]conomic ties are central to strengthening the global partnership established by Japan and India five years ago."[22]

Japan has invested a significant amount of official development assistance (ODA) in India, likely in order to eventually increase investment there. Since the middle of the 1980s, India has been among the largest recipients of ODA from the Japanese government; in 2003 and 2004 India was *the* largest recipient.[23] Japanese assistance to India has specifically focused on "economic infrastructure development in the power and transportation sectors that is conducive to poverty reduction through economic growth; rural development that targets the poor; and improvements in the environment and public health. . . ."[24] Though some of the infrastructure projects help the poor, Japanese ODA is focused on infrastructure development as one of the reasons given by Japanese companies for not entering the market in India is inferior infrastructure.

Despite these efforts, the perception remains that Japanese companies have been slow to enter the market in India. In June 2006 the *Report of the India-Japan Joint Study Group* stated that "the current state of the economic relations between the two countries shows that their potential has not been fully harnessed when compared to the role they are expected to play."[25]

INCREASING ECONOMIC INTEGRATION

INTEGRATED PRODUCTION

The new dynamics of the changing trade relationship between Japan and India are related to Japan's overall structure of production in East and Southeast Asia. Japanese production is no longer solely centered within Japan but has increasingly moved production across a number of countries in East and Southeast Asia.[26] Almost two-thirds of Japanese manufacturing companies engage in overseas production, and 16.7 percent of all manufacturing by Japanese companies is now done overseas.[27] As expected, much of this investment in overseas production has taken place in China, where 60 percent of large companies and 31 percent of small and medium size enterprises engage in production.[28] Following China, the leading recipients in Asia of Japanese FDI from 1985 to 2004, in descending order, were Indonesia, Hong Kong, Thailand, and Singapore.[29]

This overseas investment has resulted in a form of integrated production in which components for a single product are produced in the countries which have a comparative advantage in their production. High technology components, for instance, are produced in Japan and the newly industrialized economies like Hong Kong and South Korea, while low technology and labor intensive components are produced in Association for Southeast Asian Nations countries and China. These components are then shipped to an assembly plant in another

Southeast Asian country or, increasingly, China. Once products are assembled, they are either sold in the local market or exported. Production for the Western export market remains important in Japanese companies' strategies, but they are also producing a large number of products for Asian markets as well.[30]

INCREASING INVESTMENTS AND TRADE

Japanese companies have become more aware of the potential of the Indian market and are increasingly positioning themselves to take advantage of this growing market. They are doing so, however, through an integrated regional network of production. Therefore, the relationship between Japan, Japanese MNCs, and India is not always direct.

Companies have become more knowledgeable and more aware of the Indian market.[31] They perceive advantages in the quality and the low cost of labor and the potential size of the market.[32] A recent survey also found that corporate executives saw advantages in investing in India over China with regard to "political and social stability, communication ability of employees, transparency of investment regulations, the level of researchers and engineers, and intellectual property rights protection."[33] Japanese companies are responding to the rapidly increasing size of the market, particularly in fast growing sectors such as automobiles and motorcycles, and are reacting to the advantage of manufacturing in India by producing and selling more products in the Indian market.[34]

Japanese companies often seem willing to overcome obstacles when there is a large enough incentive. However, Japanese companies generally have lacked knowledge and understanding of India which would have facilitated more nuanced investment decisions.

Though Japanese companies are beginning to significantly increase their investment in India, this increase has not yet been captured statistically due to the fact that it is a relatively recent trend and Japanese statistics miss most of the reinvestment in established enterprises.[35] Much of this increase is taking place in the auto industry, Japanese companies' area of traditional strength in India. For instance, Yamaha produces a large number of motorcycles in India and plans to continue to increase production, while Suzuki, the most established auto company in India, is building new plants, increasing its car production, and resuming production of motorcycles and scooters.[36] Also, Toyota is increasing production of higher-end vehicles at its joint venture in India and is introducing the production of a smaller vehicle in India.[37] Honda is planning to expand production in India and more than triple its sales to 150,000 vehicles by 2010.[38] According to Honda president and CEO Takeo Fukui, "India is one of the most important business areas for Honda, with the highest growth potential." Honda not only has manufacturing facilities in India but also runs a research and development facility there.[39]

Evidence indicates that small and medium sized enterprises (SMEs) are beginning to increase their investments in India as well. For example, a number of auto industry suppliers are establishing production in India. These companies are supplying or developing facilities to supply a range of different types of auto products including power steering components, auto paint, bearings, and carburetors and are also involved in some research and development functions.[40] Additionally, survey data and anecdotal evidence indicates an increased interest in India among SMEs, though this does not always translate into actual investment.[41]

Though exports from India to international markets remain limited, some companies have located in India to manufacture products for the region and/or markets in the West.[42] For example, Bajaj Auto Ltd. in India is producing smaller Kawasaki bikes for export to world markets. According to Bajaj vice-chairman Madhur Bajaj, "Kawasaki . . . [is] shifting the production of smaller bikes to India."[43] The Times of India reported that Suzuki, along with Korean auto maker Hyundai, have "made India the production hub for their small cars, which are sourced and marketed in the world markets, including Europe and North America."[44]

Along with increasing investment and trade, Japanese companies are significantly improving sales and distribution networks within India so products can be sold locally. JETRO's 2005 survey indicated that 16.8 percent of the respondents planned to expand sales operations in India.[45] The Economic Times reported that Toshiba, "which currently sells laptops, printers, and flat panel display

televisions in India through its national distributor HCL, is now building its own distribution network through its wholly owned subsidiary Toshiba India for its foray into home appliances."[46]

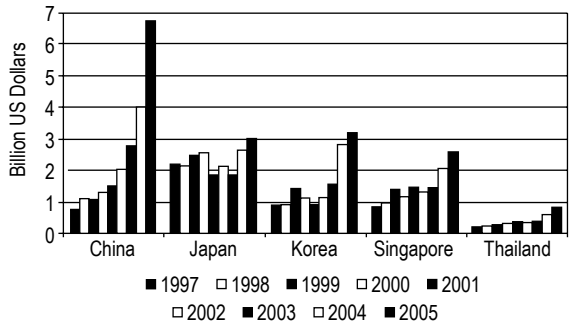
While evidence indicates that Japanese investment in India is increasing, it is not obvious whether trade between the two countries has significantly improved. Indeed, India's share of trade with countries such as China, Korea, and Thailand is rapidly increasing while their share of trade with Japan has only mildly increased. According to Figure 3, India's imports from other countries have increased faster than their imports from Japan. As shown in Figure 4, exports to other countries, such as China and Singapore, have also increased faster than exports to Japan.[47]

However, a superficial review of these statistics does not provide a complete picture of the increasing trade between Japan and India. Imports from many of these Asian countries are increasing, but many of the products that are imported are actually produced by overseas Japanese companies and, therefore, are not captured in Japan and India's bilateral trade statistics. Canon is a good example of how this process works. The company sells a large number of products in India and controls 32 percent of the digital camera market in Eastern India and 25 percent of the inkjet printer market nationwide. The products that Canon imports come from not only Japan but a range of countries including China, Malaysia, Vietnam, and Taiwan.[48]

In addition, companies based in India import many components for their products from countries other than Japan. Companies in India procure 55 percent of raw materials, parts, and accessories from overseas. While 16.1 percent of companies acquire half or more than half of raw materials and parts and accessories from Japan, 14.5 percent of companies acquire at least half other countries. Thus, there are almost as many companies acquiring a high quantity of inputs from Japan as there are from other countries.[49] These companies, as well as those few companies increasing exports, may be merging their facilities in India into their company's framework of integrated production.

The process of connecting the Indian economy with Japanese MNCs is being aided by the growing number of free trade agreements (FTA) that India has signed with countries such as Singapore and Thailand. Japanese companies, in many cases, anticipated that FTAs would have a beneficial impact on their businesses. *The Nikkei Weekly* quotes an individual associated with a Japanese auto parts company as saying, "The agreement will be very beneficial. We plan to make the most of it."[50] A senior minister in Singapore has also been urging Japanese companies to use the free trade agreement to increase exports to India.[51]

Figure 3
Indian Imports by Asian Country, 1997-2005



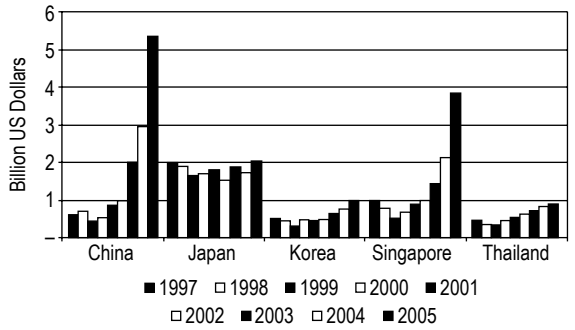
Source: Japanese Ministry of Finance, *Foreign Direct Investment.* Online. Available: http://www.mof.go.jp/english/e1c008.htm. Accessed: May 14, 2006.

THAILAND: A CASE STUDY

Trade, production, and investment between Thailand and India illustrate the ways in which Japanese companies are adapting to meet the needs of the Indian market and are taking advantage of favorable trade conditions in other countries. India and Thailand completed an FTA in September 2004 that reduced tariffs on 82 items and contributed to a significant increase in trade.[52] In fact, India's imports from April to December 2005 were 56 percent higher than the same period in 2004 and 106 percent higher than the level of trade in 2003.[53]

Japanese MNCs have taken advantage of the

Figure 4
Indian Exports by Asian Country, 1997-2005



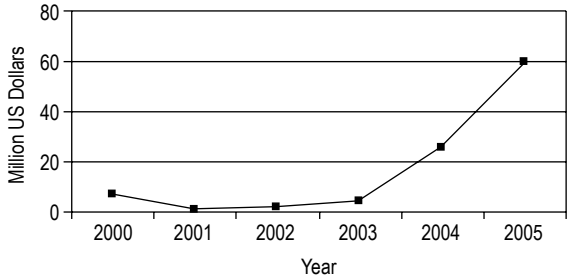
Source: Japanese Ministry of Finance, *Foreign Direct Investment.* Online. Available: http://www.mof.go.jp/english/e1c008.htm. Accessed: May 14, 2006.

FTA between India and Thailand. Japanese home appliance makers, for example, have started exporting products to India from Thailand or are planning to increase investment for this purpose.[54] Sharp announced plans in January 2006 to increase production of refrigerators at its factory in Thailand in order to meet growing demand from a number of countries, including India.[55] Hitachi produces air conditioners in India with a joint venture, and beginning in the spring of 2006, refrigerators and washing machines will be "imported from the company's . . . factory in Thailand, taking advantage of the free trade agreement between the two countries that was signed in autumn 2004."[56] Toshiba is beginning to sell a range of home appliances in India, but a number of news outlets reported that the products would be imported from Thailand in order to take advantage of the free trade agreement.[57] Itari Ishibashi, managing director of Toshiba India stated, "[w]e have a manufacturing facility in Thailand . . . initially we will source products from there but may set up a unit here depending on the market."[58]

The auto industry has also experienced expanding trade between India and Thailand, much of which involves Japanese companies. India's imports of vehicles and vehicle parts and accessories from Thailand were more than 12 times higher in 2005 than in 2003. (See Figure 5.) It is probable that much of this trade involved Japanese companies, as Japanese auto companies and their partners accounted for over 70 percent of Thailand's exports of vehicles and vehicle parts and accessories from January 2005 to May 2005.[59]

The example of Toyota represents the relationship between Japanese MNCs and trade between India and Thailand. *The Nikkei Weekly* reported in September 2005 that "Toyota Motor Corp. is shipping manual transmissions for pickup trucks from India to Thailand, and sending Corolla . . . kits . . . for assembly in India. Both items benefit from the lower tariffs of the FTA and increase Toyota's price competitiveness."[60] Toyota is now also producing cars in India for export as part of its Innovative International Multi-purpose Vehicle (IMV) project.[61]

Figure 5
Indian Auto Imports from Thailand



Source: Japanese Ministry of Finance, *Foreign Direct Investment.* Online. Available: http://www.mof.go.jp/english/e1c008.htm.Accessed: May 14, 2006.

India's importation of electronic products from Thailand nearly tripled between 2003 and 2005.[62] The production sources of these products have not been studied in depth, but it is likely that many of these imports are related to Japanese companies. As mentioned previously, Canon imports some of its consumer electronics products to India from Thailand. Additionally, Sony exports TVs from Thailand to India, though in this case it has actually resulted in the closing of a production facility in India.[63] *The Nikkei Weekly* argued that "Thailand's FTA with India also gives Japanese-affiliated makers of consumer electronics products a good opportunity to roll back the juggernaut by South Korean makers in the Indian market."[64]

This relationship is supported by a recent survey, which indicates that as a result of the Thailand-India FTA, "Japanese companies in Thailand see India as a promising market for exports."[65] Other than the domestic market, companies in India saw Thailand as the next most promising market for sales and as an "optimal production base" in the next five to ten years.[66]

DISCUSSION/CONCLUSION

Unfamiliar with India, wary of perceived political instability, and seeing more potential for low-cost production and market expansion in China and Southeast Asia, Japanese companies have concentrated their production in areas other than India. Over the last three years, however, Japanese companies have increasingly recognized the potential of the Indian market and the advantages of investing in India and, therefore, have begun to increase the amount of trade and investment in India. While the division of labor that exists across much of Asia does not yet completely apply, India is being brought into a regional network of production and marketing of Japanese products. This regional nature of production is, however, outside of the traditional bilateral framework used to examine trade and investment and is not captured in official statistics.

As this study is based on an analysis of the introduction of select products such as automobiles and

appliances into the Indian market, further analysis is needed to draw a complete conclusion regarding the Japanese-Indian market relationship. The production structure for products like computers, digital cameras, mobile phones, and other electric products has not been analyzed; it is uncertain what structure exists for these types of products and to what extent they have entered the market in India. It would be beneficial to look at foreign companies like Toshiba, as it sells a significant number of computers and digital cameras in India.[67] Also, Japanese companies export mobile phones to India and are considering increasing local production of these phones.[68] It would be interesting to examine if Japanese companies are involved in the sale of these products, and if so, the country from which they are imported. Many Japanese companies produce lower-end electronic products overseas. This area would also gain from further investigation to determine whether production and/or sales of these types of products are increasing in India or whether major electronics producers are planning to introduce these products in the near future.

Structure of India's trade with China also needs further analysis to determine the extent to which Japanese MNCs are involved. While natural resources account for a large percentage of India's imports from China, imports of electrical products have been increasing. From 2004 to 2005, electrical products accounted for about a quarter of India's imports from China.[69] It is possible that many of these products are produced by Japanese MNCs. Canon, for example, has significant market shares in a number of consumer electronics and many of their products are imported from countries across Asia, including China.[70]

The concerns of political leaders regarding the failure of Japanese companies to enter the market in India are unfounded. Japanese companies are aware of the growth of the Indian market and are rapidly increasing sales and production there. This will contribute to a stronger economic relationship between Japan and India and a stronger political relationship that will help shape the future balance of power in Asia.

LBJ

NOTES

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Land Uses within TODs:

Getting the Right Mix of Uses in the Right TODs

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Abstract

A nationwide movement has been taking shape in the last decade to re-emphasize passenger rail as a transportation mode. A key to this movement is the concept of transit-oriented development (TOD), the idea that the land near a transit stop should be developed in a dense, mixed-use, pedestrian-friendly, transit-supportive manner.

Planning TODs to increase ridership, succeed economically and "create good places" is vital to the success and expansion of current and future passenger rail systems. A proven way to achieve these goals is to provide the proper mix and location of land uses and levels of density for each specific TOD. *What are the factors affecting land use composition and development intensity? That is the topic of this discussion.*

Introduction

Transit-Oriented Development (TOD) is a transportation-related land use strategy that provides an alternative to low-density sprawl that results in automobile-dependency.[1] According to Peter Calthorpe, a Transit-Oriented Development consists of the following: "moderate and high-density housing, along with complementary public uses, jobs, retail and services, are concentrated in mixed-use developments at strategic points along the regional transit system."[2] Furthermore, a Transit-Oriented Development should promote these principles: compact and transit-supportive growth in a regional context, placement of different land uses within walking distance of transit stops, a well-connected pedestrian-friendly street network, a wide variety of housing options, the creation of open space and public space, and the efficient use of land through infill development.[3]

While these overarching goals for TODs are generally agreed on, many scholars, planners, and public officials have come up with

more specific definitions of TODs dictating the size of the TOD through a maximum distance from transit stops (usually one-fourth to one-half mile), the minimum level of density for residential and commercial land uses, and many other detailed criteria. It is often important to create specific guidelines for TOD. Many cities use TOD ordinances to insure that the development around transit stops makes sense and supports the transit system. However, for our research purposes, we will initially stay with the general principles that TOD should be mixed-use, pedestrian-friendly, moderate to high-density and well-connected to the transit stop by way of streets, sidewalks and bike lanes. As we delve further into the study of TOD, we can then reach more specific conclusions about the proper land use composition and development intensity for TOD. We will first consider guidelines for TOD in general. Then, we will study how the various types of TODs within the overall transit system should be planned for differently.

How Do We Plan for Good TOD?

The most important consideration when planning for a TOD is the land use composition. Included in the land use composition is the intensity of development, or density of land uses. According to the Urban Land Institute's guide to transit-related development, the arrangement of land uses in a TOD must concentrate activity adjacent to the station and the mix of land uses must be organized to generate transit ridership (through housing and employment uses) and support transit riders (through convenience retail and service uses).[4] Also, within a walkable distance from the transit station (one-quarter to one-half mile) the landscape must be oriented toward the pedestrian. The successful TOD performs the following:

1. Has high enough levels of density, especially housing and employment, to create a significant demand for transit ridership;

2. Has a diverse enough mix of uses so that there is pedestrian activity throughout the day and night, contributing to a safer, more pleasant environment;

3. Provides a wide variety of housing options and employment opportunities so that people of all income levels can live and work in the TOD; and

4. Creates a truly pedestrian-friendly environment through the use of sidewalks, landscaping, and traffic-calming.

Following is a discussion of some of the most important components of proper land use.

Mix of Uses

A diverse mixture of land uses makes it possible to accomplish many trip purposes by transit (such as picking up/dropping off children at day care or clothes at the dry cleaners, getting a haircut or manicure, renting a video, or going to a grocery store).[5] The mix of uses within a TOD is an important factor in its success. Given this, it would be useful to study the topic of "mixed-use developments." It is possible that those hoping to create good TODs can learn a thing or two from those that have experience with mixed-use developments that do not necessarily have a transit component. The Urban Land Institute's Mixed-use Development Handbook describes mixed use developments as containing the following three characteristics:

1. Three or more significant revenue-producing uses (retail/entertainment, office, residential, hotel, and/or civic/cultural/recreation) that in well-planned projects are mutually supporting;

2. Significant physical and functional integration of project components (and thus a relatively close-knit and intensive use of land), including uninterrupted pedestrian connections; and

3. Development in conformance with a coherent plan (that frequently stipulates the type and scale of uses, permitted densities, and related items).[6]

The three or more uses should be significant and should attract a significant market in their own right.[7] To illustrate the concept of significance, the placement of a single store or restaurant in a development with several condominium buildings and a few office towers would not constitute a mixed-use development under the Urban Land Institute's guidelines.

There are three ways to functionally integrate developments to make them mixed use:

1. A vertical mixing of project components into a single mixed-use building or tower;

2. Careful positioning of key project components

around central public spaces (for example, a street, park, plaza, atrium or shopping center); and

3. Interconnection of project components through pedestrian-friendly pathways (including sidewalks along streets, interior walkways, enclosed corridors and concourses, retail plazas and mall areas, escalators and aerial bridges between buildings).[8]

The interconnection of buildings through pedestrian circulation is an important component of mixed-use developments, differing from the more typical suburban, low-density activity centers that include multiple uses (such as offices, retail stores and hotels) but only connect them by way of roads and streets. A higher level of density than is found in typical developments helps mixed-use developments to obtain better pedestrian connectivity between buildings.

The arrangement of land uses in a TOD must concentrate activity adjacent to the station and the mix of land uses must be organized to generate transit ridership and support transit riders.

The principles of mixed-use developments can be applied with some success in transit-oriented developments. Town centers such as Addison Circle north of Dallas are a good example of how these principles work well in a TOD setting as well as a mixed-use development setting. Addison Circle is considered a TOD, although officially it might be more descriptive to describe it as a mixed-use development since it is oriented toward a *future* transit station, not an existing one. Either way, the project can be viewed as a success. It clearly satisfies the guidelines of mixed-use development. Another example of a well-designed town center mixed-use development that is compatible with TOD principles is Mizner Park in Boca Raton, Florida. It includes apartments, office space, retail, and restaurants around a main street and a village green with a central fountain, gazebos, walkways, and extensive landscaping.[9] Outdoor dining plazas and apartment balconies overlooking the activities below contribute to a buzz of activity. When it opened in 1990 it became an "instant downtown" for Boca Raton due to its popularity as a gathering place throughout the day and night.

The end result of many of these projects is often a high-quality development that more than satisfies the guidelines of either criterion (the mixed-use development guidelines or the TOD guidelines). The problem is that due to the obvious similarities between the two forms of planning for a more progressive development, in some cases the principles of mixed-use developments may be used instead of the TOD principles. This could result in developments that do not properly take advantage of or support the transit portion of the development. For instance, the first mixed-use development guideline offered by the Urban Land Institute is that the development should have "three or more significant revenue-producing uses." There are two problems with this. The first is that if there are only three uses, it may not be enough to provide for a fully functioning TOD. For example, if a development has offices, retail, and hotel uses it is clearly mixed-use; however, without residential uses the area will likely be relatively dead at night, will not be able to support as many services such as grocery stores and convenience retail and will likely generate less transit riders. The second problem is that the term revenue-producing favors developments that contain private uses, quite possibly excluding public uses from the development altogether. In order for a TOD to create the most comfortable, pedestrian-friendly environment possible, the inclusion of public uses is critical. The positive impact that a public park or plaza has on a community cannot be underestimated in the place-making objective of TOD.

Not only is it important to plan for which land uses should go in a TOD, but it is perhaps just as important to decide which land uses should not be allowed in a TOD. For example, the city of Pasadena, California, is considering a TOD ordinance that prohibits the following uses from the area within one-quarter mile from a transit station: drive-thru businesses, auto-repair and service stations, car washes, warehouses and public storage, and car dealerships.[10] The city is also limiting the amount of parking by establishing parking maximums as well as minimums, and by reducing the minimum amounts of parking by 25 percent. In minimizing the amount of land dedicated to uses that are automobile-dependent, land is not "wasted." In other words, land can be used instead on uses such as multi-story employment or residential structures that add to the area's overall density or on public

uses such as parks, ballfields, or recreational facilities that add a degree of pleasantness that make the TOD a more livable, walkable place.

Locations of Uses

Land closest to the transit stop should be used efficiently. It should be developed to its fullest potential, maximizing the possible profitability of the TOD. For example, loft apartments at Mockingbird Station in Dallas rent for 20 percent more than comparable neighboring apartments.[11] These apartments have retail on the ground level, contributing to their value and further maximizing development potential adjacent to the light rail station. So, the best land uses immediately adjacent to the transit stop add considerable value or density, such as high-rise residential buildings, high-rise offices/employment buildings, retail on the ground level of these buildings and public plazas or village greens that contribute significantly to the value of the transit stop's location.

The positive impact that a public park or plaza has on a community cannot be underestimated in the place-making objective of TOD.

Density of Development

According to Peter White, Professor of Public Transport Systems at the University of Westminster, density of population has a significant effect on public transport demand: the higher it is, the greater the level of service may be justified, and/or lower fares may be possible.[12] Extended operating hours may also be sustained.

White claims that residential density is perhaps the most important factor contributing to the creation of a dense development, followed by employment and retail concentration. The Urban Land Institute makes a similar argument, "Housing has the potential to generate more transit riders per resident than employment uses generate per employee."[13]

According to the Urban Land Institute's Mixed-use Development Handbook, the retail component is a key aspect of any mixed-use development.[14] Retail should be centrally located for two reasons. "First, an architecturally attractive center with a creative mix and positioning of tenants, especially restaurants, can serve as a stimulating amenity for all other uses; thus, retail should be designed to provide good access from all internal uses. Second, retail establishments thrive on pedestrian traffic, and one of the best ways to generate such traffic is to position and design the retail area so that pedestrian traffic can easily pass through the retail area on the way to other destinations."

From a TOD perspective, however, the Urban Land Institute gives different guidelines for retail uses. Dock and Swenson state that retail should play a secondary role in TODs, but should occupy central locations.[15] In and of itself retail does not tend to generate significant transit ridership. Its role is one of making the TOD more convenient to workers and residents by providing various services including, restaurants, pharmacies, dry cleaners, barbers, shops and grocery stores.

The Inclusion of Big-Box Stores in TODs

Many leading thinkers in the realm of TOD and new urbanism oppose the prospect of big-box stores locating within a TOD, proposing that they should be relegated to secondary areas outside of the TOD or even farther. In fact, the Transportation and Land Use Coalition cites a proposed Wal-Mart store in Fremont, less than half a mile from the future Warm Springs BART station as a "Worst Development" in its Best and Worst Developments Report due to the automobile-oriented nature of the proposed big-box store.[16] However, big-box stores have found a place for themselves within some properly functioning TODs. Particularly, the Englewood City Center on Denver's light rail line has successfully included several big-box retailers. In fact, Bob Simpson, Englewood's community development director states, "Wal-Mart has integrated itself positively into our transit-oriented development. The scale of the building, the color scheme, the use of landscaping, and the integration into the street pattern all blend positively with the rest of the project site."[17]

Now, the concept of placing big-box retailers in TODs should be taken with a grain of salt. For instance, the Englewood City Center consists of much more than big-box stores. The focus of the TOD is on an area adjacent to a light rail station which includes a village green surrounded by main-street retail, apartments, a fitness center and the Englewood Civic Center. In fact, the big-box stores are not the "main attraction" of the district; rather, they are located on the outer edges of the TOD along arterial roads.

PLANNING FOR THE DIFFERENT TYPES OF TODs

Not all TODs should have the same land use composition and intensity of development. Peter Calthorpe distinguishes only two types of TODs, Urban TODs and Neighborhood TODs.[18] Urban TODs are located directly on a "trunk" rail line and have high commercial densities, employment clusters and moderate to high residential densities. Neighborhood TODs, on the other hand, are not even located on a rail line, but instead, on a "local or feeder bus line within ten minutes' transit travel time from a trunk line transit stop," and consist of moderate density residential, service, retail and recreational uses. These two classifications for TODs are much too broad to apply to all cases. In order to better describe the different types of TOD, the following distinctions must be made. Downtown TODs are a type of Urban TOD, but are uniquely situated. Downtowns have certain characteristics (many of which are related to TODs) that are not found anywhere else in the metropolitan region. Suburban TODs are also unique since they are located in an area of low-densities, cheap land, and automobile-dependence. These two types of TODs offer different challenges and opportunities for developing a mixed-use, transit-supporting district.

The surface parking lots that are a widespread land use in many downtowns are certainly not the "highest and best use of the land" and can be redeveloped in a much more dense, profitable and transit-supportive manner.

DOWNTOWN TODs

Downtown TODs are unique in that they probably already resemble a TOD before any additional planning takes place. The Central Business District (CBD) is typically home to the highest accessibility in a metropolitan area.[19] Many of the region's major arterial roads and freeways converge at the CBD. Also, rail systems and bus routes are most extensive in the CBD. This heightened accessibility translates into a high demand for the central location of the CBD, which in turn, leads to high land values. The high land values result in an extreme intensity of development. In other words, it is common for land uses in downtown areas to represent the "highest and best use of the land," meaning that their potential for profitability has been maximized. Examples of this "maximized potential" are the luxury high-rise condominiums, four and five-star hotel towers, and sky-scraping office buildings commonly found in downtowns across the country. The CBD is also typically home to public institutions, important civic uses (universities, courthouses, city halls, and city parks) and region-serving entertainment venues (theaters, convention centers, and sports facilities). Another quality of downtowns is that they are pedestrian-friendly, usually with wider sidewalks than other areas in the city and more interesting store fronts due to street-level retail and restaurants.

So, it seems that most urban downtowns are already TODs. They have a wide variety of high density employment, residential, retail and public uses in a pedestrian-friendly environment that is already served by multiple forms of transportation. Why then should we even bother to plan for TODs in downtowns? The answer is that, despite the amount of development already there, there is still a lot of potential for growth. The surface parking lots that are a widespread land use in many downtowns are certainly not the "highest and best use of the land" and can be redeveloped in a much more dense, profitable, and transit-supportive manner. Also, steps can be taken to further integrate existing transit stations with surrounding development to create a transit hub, or a sort of "Grand Central" type of station.

A good example of a downtown that turned itself into a true TOD is Washington, D.C. Before a concerted effort was started to turn downtown Washington, D.C., it was a "run-down, forgotten area, littered with vacant lots and buildings, and where drug traders went about their business and few outsiders ventured after dark."[20] Today the area is a prosperous TOD, complete with new office buildings, hotels and restaurants, and apartments and shops are on the way. The key to the entire revitalization effort is the recently constructed $220 million MCI Center. The 1,000,000 square foot, multiuse arena sits directly atop Metrorail's Gallery Place subway station, where the yellow, red, and green lines meet, and it is only a couple of blocks from stations that serve the blue and orange lines.[21] The arena's location helps to eliminate thousands of automobile trips on game nights. In

fact, an estimated 50 to 60 percent of the audience at large MCI Center events use public transportation. Aside from being part of a downtown transit district with many different land uses, the MCI Center itself is mixed-use, housing a sports museum, two restaurants, and a sporting goods store. This helps it to attract riders not only on game days. This case demonstrates that, as previously argued, steps can be taken to further integrate transit stations with surrounding downtown land uses in order for the CBD to maximize its TOD potential.

SUBURBAN TODS

Suburban TODs offer a wide variety of challenges and opportunities for creating a transit-friendly development. One of the main challenges is the idea that having transit-oriented, dense development in the suburbs seems to go "against the grain."[22] Suburbs are by and large low-density and automobile-oriented, so it might seem counter-intuitive and incompatible with the market to push for more compact development. Another challenge to TODs in the suburbs is that nodes of activity are generally single use, land-intensive developments such as corporate campuses and regional shopping centers, the complete opposite of urban economic centers which lend themselves to transit due to compact, pedestrian-oriented buildings. However, the suburbs have one thing that more urban areas are lacking: an abundance of vacant land. This allows TODs, if placed in the correct locations, to be thoroughly planned from scratch. Hypothetically at least, the perfect TOD would be planned in an out-lying suburban area as opposed to an urban area due to this advantage. Another advantage of suburban TODs is that even if land is occupied, it is likely to be cheaper and thus more adaptable towards change than land in an urban location.

For TOD in general, the goal is to get "the right mix of uses." In suburban TODs it may be enough to just have any mix of uses, as long as there is some housing and some employment near the transit stop. Suburban TODs are the only TODs that should allow Park-and-Rides. Since suburban areas are almost completely dependent on automobiles for transportation, it may be necessary to encourage automobiles as a mode of access to the station. However, it is still important to keep the area within walking distance of the station pedestrian-friendly.

A good example of a suburban TOD that has an ideal land use composition and an even higher than necessary level of density is The Crossings in Mountain View, California, designed by Peter Calthorpe. It is an especially good model of TOD because it was built on the site of a failed automobile-dependent shopping center, and made extensive use of materials recycled from the old facility.[23] It incorporates a combination of small-lot single-family houses, townhouses, rowhouses, apartments, and condominiums in a space-efficient layout. There is 2000 square feet of retail near the station to serve commuters and residents.[24] A large Safeway supermarket is located right behind the townhouses. A 200-car garage was placed underneath the condominiums. But, even though the automobile was accommodated in this TOD, the end result is an extremely pedestrian-friendly neighborhood. The New York Times described The Crossings as a "village of pastel-colored homes, pocket parks, sidewalks, and gazebos." Many residents walk to work at several large offices nearby. The development has a residential density of 22 dwelling units/acre, well above the prescribed minimum density for suburban TODs. The Institute of Transportation Engineers recommends a minimum of nine dwelling units per residential acre and/or 35 to 50 million square feet of commercial or office space for light rail or feeder buses.[25] However, even though the district is relatively dense, "the parks, wide sidewalks, lush landscaping, and pleasant streets create a feeling of spaciousness."

Clearly, TODs can work in suburban locations, contrary to many people's beliefs. Automobiles can even be accommodated without compromising the special treatment of pedestrians within a TOD. Another lesson we can learn from The Crossings is that the addition of nice features (such as landscaping, sidewalks separated from streets, parks, porches) can make an area feel less dense than it actually is. By the same token, one can make a neighborhood denser in order to boost transit ridership and demand for retail without having many of the side effects of more dense development, if it is carried out thoughtfully.

CONCLUSION

Many factors influence the success of a transit-oriented development, but the type and intensity of land use is most likely the most important factor that determines whether a certain TOD will fail or flourish.

The findings of this research lead to the following conclusion: there are two questions one must consider when planning for the land use component of a TOD. First, is the land use composition

diverse enough and dense enough to support and benefit from the transit station, as well as create a fully functioning neighborhood unto itself with a significant potential for trip internalization? Second, what is or should be this particular TOD's role in the regional transportation system?

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Migration and Rural Development:

An Assessment of the Impact of Migration on Rural Communities in Huancavelica, Peru

by Carolyn Barker

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Introduction

The study of the relationship between migration and development has found a new audience in the last decade. Much of the interest on this topic stems from a rapid growth in economic remittance flows, which have caught the attention of political, multilateral, and academic actors. An Inter-American Development Bank (IDB) report estimated that the Latin American region received $20 billion in remittances in the year 2000 alone.[1] While the IDB and other development institutions explore ways to effectively manage these financial flows, academic scholars of migration are increasingly focused on understanding the real impact of such remittances on development. An equally important dimension of these discussions is the social and cultural implication of remittances.[2] Often overlooked by financial institutions, the ideas, practices, identities, and social capital that migrants remit home also contribute to the intricate relationship between migrants and their home communities.[3]

Indeed, in the development world, there is growing realization that migrants may act as agents of change through both the economic resources and new knowledge they share back home. At the same time, theories on human-centered development[4] have directed multilateral organizations, government agencies, and nongovernmental organizations (NGOs) to prioritize the funding of participatory human and social capital programs.[5] Against this backdrop, social and economic remittances appear to be a powerful tool for development in sending communities, particularly at a local level. Given the rising numbers of NGOs working at the local level, one would expect them

to integrate this tool into their strategic approach towards development. Yet despite the widespread attention given to the impact of remittances on development, I contend NGOs have been slow to capitalize on this important resource. To substantiate this argument, I will present five case studies of a rural area in Peru where there are a high number of NGOs and where migration is a prevalent among rural households.

LITERATURE REVIEW

As with most developing countries, Peru has undergone a process of rapid urbanization in the last half century. Once a predominantly agrarian society, Peru's national population is now overwhelmingly urban, with three-quarters of the population living in cities. The internal flows of migrants from rural areas (particularly in the Andean highlands) to urban areas (primarily Lima) have been well documented.[6] Much of the scholarly attention has been focused on the social, cultural, and political role that migrants have played in the growth of cities. Far less attention has been given to the communities that are left behind. There are a few scholarly examples,[7] but with the rapid rise in international migration from Peru (mostly from Lima) in the last decade, rural areas have fallen even more into the shadows of migration research. In this paper, I will contribute to the literature on development and migration by looking back at the origins of migration on the Peruvian Sierra and assessing the level to which the process of migration and migrants themselves have impacted rural communities.

RURAL DEVELOPMENT IN PERU

In Peru's rural sector, the incidence of poverty is double that of urban areas.[8] This disproportionately high level of poverty helps to explain why rural households are using increasingly diverse strategies to cope with changing socio-economic realities. An acute understanding of these diverse strategies is necessary to accurately define development within the rural context. A recent study of Peru, for example, estimated that 51 percent of rural incomes are from off-farm economic activities.[9] Rural households, therefore, are no longer able to depend on their land to sustain themselves. In Latin America, this reality is captured in the concept of *nueva ruralidad* (new rurality),[10] which acknowledges that interdependence of rural and urban areas. Rural areas are no longer islands of development but are instead integrated into a more complex economic network.

Within the shifting demographic context, temporary and permanent migration patterns are forging deeper and more complex connections between rural and urban societies. Although the population of Lima (pop. 8.2 million) far exceeds other urban areas, intermediary cities are also growing and becoming more vital to Peru's economic development. Scholars of rural development have started to recognize that such linkages are key components in sustainable economic growth for both urban and rural areas. In a 2004 publication, a group of Peruvian scholars assessed urban-rural linkages in three sample intermediary cities.[11] Based on their analysis, they re-defined residents in these intermediary cities as a blend of rural and urban or a person whose lifestyle stretches between the two formerly dichotomous worlds. The blurred definition of these new identities makes for a complex environment for policymaking in intermediary cities.

This analysis also confirms the existence of a strong and interdependent relationship between urban and rural areas as a result of migration flows. The increasingly important role of migration—both internal and international—in the economic welfare of Peruvian families has evolved over the last 50 years in response to economic instability, shifting demands for labor, and the internal violence during the Shining Path's guerrilla war.[12] During this period, the volume of migrants increased rapidly, which led urban areas to mushroom and an increasing number of Peruvians to leave the country altogether. Today, it is estimated that between 1.5 million and 2 million Peruvians (or roughly 10 percent of the current population) are living abroad.[13] Yet despite the fact that this migration phenomenon is rooted in rural areas and that there is common awareness of its prevalence in Peru's population, there has been little effort among policy makers or NGOs to explore what its implications are for rural development. Migration, then, is an "invisible livelihood."[14]

METHODOLOGY AND DATA COLLECTION

To assess the level to which NGOs are not capitalizing on resources of migration, I carried out five case studies in a rural area of Peru. In my interviews, I applied semi-structured interviewing methodology to extract rich-textured data on the experience of migrants and their families. With NGOs, I focused more on their objectives and strategies for promoting development as well as their perceptions of the role that migration plays in rural communities and

in their own work. In my interviews with residents of rural communities, my questions emphasized the life history and experiences of their family members as a means of assessing the effect that migration has had on their livelihoods. In total, I interviewed over 40 people in seven rural communities and representatives from six NGOs.

I conducted the case studies in Huancavelica, Peru, over a three-month period (from June through August 2005). I selected Huancavelica in part due to the fact that it is the most impoverished department in Peru (half of its population lives in extreme poverty)[15] and because more than 60 NGOs are in operation in the region.[16] Moreover, in Huancavelica the rural sector represent three-quarters of the department's population. Yet, of this large rural population, only 15 percent of rural families are able to survive solely from their farming income. The remaining 85 percent subsidize their income with temporary or part-time off-farm activities in both rural and urban areas such as construction, processing of agricultural products, mining, handcraft production, etc. While these alternative sources of income do not directly implicate dependence on migration, they do demonstrate the prevalence of non-farm income in the region. In the words of development specialists in the region:

> "The [demographic] figures can make us think erroneously that the population in Huancavelica maintains attached to their farms and animals but just the opposite is taking places: the people in the countryside are moving constantly, although their destinations are not always within the department. Huancavelica continues to have the universal tendency for rural-urban migration but in its case, the cycle starts but does not end at its borders: people that are leaving the countryside are absorbed mostly into cities in other regions."[17]

To corroborate this system, data from the 1993 census shows that for every 100 people that left Huancavelica, only 24 people entered. This is the highest level of out-migration for any department in the country. Such figures are not surprising given Huancavelica's level of poverty as well as the fact that it was one of the regions hardest hit by the internal violence in the 1980s and 1990s.

To determine the location of the case studies, I first identified the two provinces where the greatest number of NGOs is in operation: Huancavelica and Acobamba. Within these provinces, I selected at random seven communities that receive support from local and international NGOs. Initially, I had planned to conduct focus groups in a selection of communities, however due to the limited time frame of my field work, I was not able to establish the necessary level of confidence with enough residents to apply such a methodology. In addition, I found that there was a high level of distrust and suspicion among many of the residents, part of which is likely due to recent history with political violence. As a result, I modified my methodology in order to allow for more a more flexible interview process.

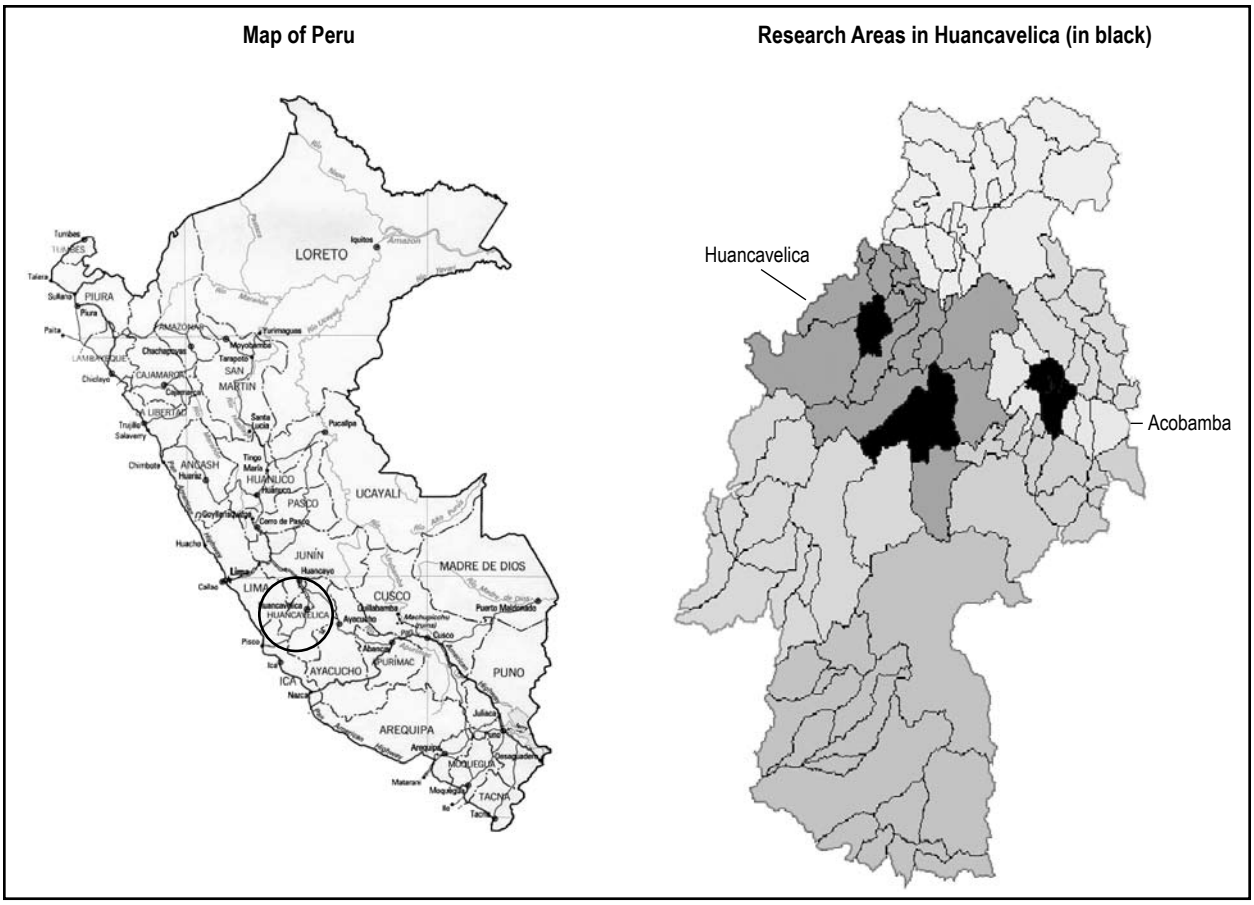
DATA AND FINDINGS

NON-GOVERNMENTAL ORGANIZATIONS (NGOS)

Of the six NGOs I interviewed, one focuses on human rights and the remaining five work on improving agricultural technologies and access to health and nutrition services in the area. Indeed, the vast majority of the funding for these organizations was directed specifically at agricultural production. In terms of migration, all of the representatives of the six NGOs were equally aware that it is a reality in the rural communities with which they work, however, they tended to see it as temporary migration. They also identified migration from Huancavelica as mainly a product of the political violence during the era of the Shining Path. In the absence of such violence and with improving living conditions, they agreed that migration is actually decreasing. There was little acknowledgment of the socio-economic factors that could also influence current migration flows. Moreover, none of the NGOs take the impact of social and economic remittances on rural households into consideration in their program development. These perspectives suggest that migration may be seen as a threat to the mission of the organization if it is used as an indicator that the NGO programs are not effective. Based on these observations, I concluded that a deeper and more analytical understanding of the impact of migration on rural livelihoods is lacking within NGOs' rural development policies.

RURAL COMMUNITIES

The formal and informal interviews I conducted in seven communities in Huancavelica yielded substantial qualitative data related to the scope of the impact of migration—both temporary and permanent—on the changing profile of rural communities. In the following boxes, I present the five case studies through an illustration of how migration



has impacted each community. Key observations are highlighted that compare and contrast the different experiences that the communities have had with migration.

Five main themes emerge from these case studies: economic stability, land tenure, youth, political violence, and geography. Together, these themes intersect to create the setting in which migration plays out in each of the communities. Antaccocha and Bellavista, for example, are the two places that are least affected by migration. Both have more economic success—Antaccocha because of its proximity to the markets in the city of Huancavelica and Bellavista because as a new community in a temperate zone, its residents benefit from access to more land and from production of a diversity of crops that tend to have more value than the potatoes and barley grown in higher elevations. As a result, there is less impetus for migration.

The communities that are most impacted by migration are those with far less gains from agricultural production and where land is more scarce. This is particularly clear in the case of the communities in Manta where subsistence farming is more common. Moreover, these communities were hardest hit by the political violence of the 1980s and 1990s. The forced displacement of hundreds of their residents to Huancayo and Lima forged migrant paths that are still in use today, primarily by the 15- to 25-year-old population. Teenagers and early 20-year-olds are in fact the main actors in migration from the communities I studied. Parents, teachers, and younger residents themselves confirmed this in their comments on the impact of migration in their communities. Migration starts as a temporary means of earning money for books and school uniforms during vacations. However, once students complete high school, many follow the migration trail again in hopes of pursuing their studies or of finding a job in urban areas. While this phenomenon of youth exodus was true for all of the communities except for Antaccocha and Bellavista, the most extreme example is that of Chilcapite, where all of this year's graduating students have gone to Huancayo or Lima. This is an interesting case since the community chose to open a vocational school that trains its students for more urban-related jobs rather than agricultural jobs. While such education might

CASE STUDY 1
MANTA, CCOLLPA, AND SAN LUIS (DISTRICT: MANTA)

Manta is a district located in the northern cone of the province of Huancavelica. Despite being a short distance from the city of Huancavelica, there is no easy access between the two. As a result, Manta is more directly connected to the city of Huancayo, which is a three-hour drive on a dirt road. Manta's location between Ayacucho and Huancayo is in fact the reason that it became one of the focal points of the military's retaliation against the Shining Path. In 1983, the Shining Path first entered Manta and declared it a "liberated zone." The majority of the local authorities fled the area in response to threats and the assassination of several of their colleagues. Many other families followed suit, fearing for their lives. Huancayo and other parts of Huancavelica were the main destinations for the displaced people. In 1984, the military replaced the Shining Path and set up a base in the town of Manta. They too threatened, abused, and caused more displacement of the people of Manta. There was military presence in Manta until 1993.

There are currently several NGOs working in Manta. I spoke to one that is focused on improving the production of native crops and another that focuses more on social rights.[18] The former NGO sponsored an agricultural fair while I was in Manta. At over 10,000 feet, agricultural production is limited to an assortment of varieties of tubers, beans, grains, and livestock. Despite the proud display of their harvest, most of the farmers I talked to admitted that they use their crops mostly for their own consumption. Little success has been made in linking them with markets.

Migration, on the other hand, plays a strong role in the lives of the people of Manta. Of the 15 people I spoke to, every one said that they had several siblings or children living in Huancayo or Lima. Teenagers in the district see migration as one of the few options they have after completing high school. Most students leave Manta during school vacations to work in Lima and Huancayo, and the vast majority of students end up moving to one of the two destinations after graduating. One of the high school teachers estimated that only 15 percent of students remain in the district. Few economic remittances come back to the district, although one man mentioned that a club of migrants from Manta who now live in Lima had assisted the village somewhat with uniforms for the soccer team and paying for the band for the *fiesta* (the local festival).

In terms of Manta's future, most parents agreed that they want their children to pursue their studies and to become professionals. According to many of these parents, there is little future on the farm. Going to school in the city, however, is a common goal. With clearly established migrant paths to Lima and Huancayo as well as the lack of opportunities in Manta, migration is one of the few livelihood strategies that the people of Manta have.

benefit the students by preparing them for higher skilled jobs, it may ultimately be detrimental to Chilcapite through the loss of human capital—both in terms of knowledge and manual labor.

Another telling dimension of this story, as mentioned in the case study above, is the fact that Chilcapite's migrant club in Lima has been supporting the expansion of this school. This is a good example of both economic and social remittances working together in that the group of residents has provided funding and actual materials to improve the school while also promoting what they value as important skills that the students should learn. In turn, practices and ideas are changing within Chilcapite's teenage population.

Geography is the last theme that emerges from the case studies. Each community is linked to its own migrant destination, depending on its location and the networks that have been established with settled migrants. Manta, which is closer to Huancayo than Huancavelica, is also linked through deep migration flows with the latter destination. As a result, several of the families I interviewed in Manta lead dual lives in which they have homes and family in Huancayo while also maintaining their farm in Manta. This ties back to the role of intermediary cities in development and of a new type of citizen who is indelibly linked to both urban-based and rural-based livelihoods. In Chanquil, Lima is the primary destination for migrants. This is likely due to the migrant networks that have been established between Chanquil and Lima since the 1950s. Rather than migrate to Huancayo or another destination where there are far fewer people from Chanquil, a

new migrant is more likely to choose a destination where s/he has social contacts on which to rely.

POLICY RECOMMENDATIONS AND CONCLUSION

In February 2005, the Inter-American Development Bank released its draft policy on rural development strategy.[19] One of the main themes that emerges in this policy is the recognition that rural livelihoods have changed substantially over the last few decades. Migration is one of the causes for the change as well as one of the IDB's "avenues out of poverty."[20] In its lessons learned for future rural development interventions, the report states:

> Rural development strategies and policies must be consistent with macroeconomic policies and encompass the entire rural milieu and rural-urban relations, addressing the multiasset nature of rural families' livelihood strategies and mapping out options for on-farm and nonagricultural employment, multiemployment, and migration.[21] [translated by author]

Drawing from the IDB's effort to acknowledge the role that migration plays in rural livelihoods and my own findings from my research on Huancavelica, I propose the following policy recommendations for integrating migration with rural development. Underlying these recommendations is my conclusion that NGOs (and state actors) should consider

CASE STUDY 2
CHILCAPITE (DISTRICT: ACOBAMBA)

Chilcapite is located in Acobamba, one of the most temperate provinces in Huancavelica. The mild climate of the area allows for more diversified production. Crops grown in the area include oats, wheat, lima beans, and peas. All of these crops tend to have a higher market value. In addition, Chilcapite is located near to the town of Acobamba, which hosts a weekly market and has a small university. In Chilcapite, I interviewed the community president as well as three women and one older man who spoke of high levels of temporary migration, particularly to Huancayo and to the Amazonian region. Several people had also migrated across borders to Argentina and Bolivia.

One of the most striking issues that came up in these conversations was the impact that the community high school has had on the community. Five years ago, a vocational school opened in Chilcapite. The high school curriculum emphasizes skills such as auto mechanics, tailoring, and sewing. A group of Chilcapite residents living in Lima has supported the school with computers, sewing machines, and even a car engine on which to practice. The first class graduated from the high school in December 2004. The community president informed me that *all* of the graduates have since left Chilcapite in search of work or in hopes of enrolling in college in Lima or Huancayo.

CASE STUDY 3
BELLAVISTA (DISTRICT: ACOBAMBA)

Located a short distance from the town of Acobamba, Bellavista is a small village that was founded in 1995 by farmers from a nearby village. The residents of Bellavista benefit from access to water and more surface territory than neighboring villages (the average size of land tenure is two hectares vs. less than one hectare in other villages). Like Chilcapite, they also benefit from the temperate climate which allows for the production of a diversity of crops. It is likely that these factors explain for the fact that migration—both temporary and permanent—is minimal in Bellavista.

In Bellavista, I interviewed a group of 20 farmers (all men, ranging in ages from approximately 20-60) who were attending a course on calculating crop production costs. I was surprised to find out that among these 20 farmers, only three had left the community temporarily to work. Moreover, very few had family members who live outside of Bellavista. Most said that they did not have time to leave due to the work on their farms or that the community leader would not give them permission if there was community work to be done. I spoke to one 28-year-old man who had left to work on the coast temporarily but returned because he claimed that he did not like working for someone else. An older man told me that he had lived in the Amazonian region for 25 years but recently returned due to the availability of land and better prospects in Bellavista.

CASE STUDY 4
CHANQUIL (DISTRICT: ROSARIO)

On the road to Paucara, one of the central towns in Acobamba, Chanquil is one of the largest communities I visited (pop. 3,900; approximately 780 families). It has two high schools and the mayor was in the process of building an impressive three-floor community center. The local economy is based on the production of a variety of crops similar to those in Bellavista and Chilcapite. Unlike Bellavista, however, there is little access to land, with most families farming less than one hectare of land. As a result, they are more dependent on the sale of meat and animals for income generation.

In Chanquil, I met with a group of four women who were part of a newly-formed baking cooperative. With assistance from an NGO, they were learning to bake cakes and cookies in a large bread oven that had been abandoned several years earlier. Talking to the women, I learned that all of them had siblings living in Lima or in the Amazonian region. The president of the cooperative—a 20-year-old woman—had herself lived in Lima for eight years where she worked in a factory. She returned to Chanquil to raise her young daughter. Outside of the bakery, I talked to three men, one of whom was the mayor. They estimated that 80 percent of the men in Chanquil are seasonal migrants who leave in September/October or December/January to work on the coast, in Huancayo, or in the Amazonian area. One of the men, a 30-year-old farmer, told me that he supports two of his younger brothers who are living and studying in Lima. He himself had never left Chanquil for work or studies.

migration a powerful tool for local development rather than a threat to it and, furthermore, that migrants themselves are agents of development.

1. **Invest in Youth.** None of the NGO programs I learned about and/or observed specifically target the needs of youth (15 to 25-year-olds). Yet, my research findings show that people under the age of 25 are the primary candidates for migration out of their communities. I therefore recommend that youth be treated as a unique sector of the population that requires special attention within NGO programming. By specifically addressing their concerns, NGOs can better assess more long-term strategies for the community. They can also help to ensure that those youth who do migrate are better equipped to adapt to life outside of their community.

   Access to better and more appropriate education is likely to be the greatest need, be it vocational training for jobs in a more urban setting or agricultural training for those who prefer to continue farming. An example of how this investment in rural youth might play out is seen in the case of a group of youth in a community on the Peruvian coast. An NGO operating in this community asked the group of youth what they would do if provided with a grant. The NGO expected that they would want to use it to migrate to Lima or elsewhere. Instead, the group's response was that they would start a fruit processing business in their community. In addition to demonstrating an entrepreneurial spirit among this group of youth, this example also shows that migration is not necessarily the first choice for many rural youth. This story also demonstrates that there is continued interest in investing in one's own

CASE STUDY 5
ANTACCOCHA (DISTRICT: HUANCAVELICA)

Antaccocha is located on the road from Huancayo to Huancavelica, only about five kilometers from the latter city. Its proximity to Huancavelica allows for direct access to a large market where much of Antaccocha's population sells meat, milk, other dairy products, and some vegetables from their greenhouses (NGO-sponsored project). Crop production in Antaccocha is limited to potatoes and barley since it is located at a high altitude (approx 3,400 meters). I interviewed four families here, three of which had children under the age of 12. In the fourth family, there were 10 children—four who were married and lived on their own in Antaccocha and six who still lived at home. Among all four families, only one of the adults had one sibling living outside of Antaccocha. Moreover, the only mention of temporary migration was to work in construction in the city of Huancavelica or other parts of the region.

community, which leads into the second policy recommendation.

2. **Tap into Migrant Resources.** Build capacities among migrants and non-migrants to work together to improve their community and to recognize their own organizational and financial capacities. By acknowledging the deep-rooted interdependence between migrants and their home communities, NGOs can tap into a wealth of resources and knowledge gained from migrants through their experiences in higher education, networking, technical advancements, and business expertise. Improved capacities in communication in the Spanish language (both written and spoken) also enhance the ability of a community to lobby public officials and NGOs. Such resources are linked to the idea of social remittances that were discussed before.

   This recommendation is based on the concept of collective remittances as described by Luin Goldring's. In this research, he shows how remittances that are sent by groups of migrants allow for increased capacities in organizational experience and institutional development both among the migrants and within their home communities.[22] Indeed, as discussed before, this fits in well with Sen's conceptualization of human development as the strengthening of human capacities.

3. **Encourage Community Investment.** Along with social remittances, it is important to take into consideration the potential impact of financial remittances. In my research financial remittances did not emerge as an important influence in the seven communities. This is likely due to the fact the most of the migrants still live within Peru and are therefore not earning as much as those migrants who have moved abroad to the United States, Europe, or other countries. There were, however, some examples of contributions from *grupos de residents*, or residential groups (similar to what are known as "Hometown Associations"). Examples of such contributions include those that financed the purchase of uniforms for soccer teams, chairs for the town hall, and computers for a vocational school. Yet, most of the contributions tend to go towards the annual *fiestas*, or festivals, held in each community. These *fiestas* play a central role in fostering a strong communal identity. Much research has also shown that the *fiestas* help to maintain a strong link between migrants and their communities by acting as an annual community reunion. NGOs can capitalize on this community identity by providing workshops on how migrants can help to support their hometown through more sustainable and productive projects. Migrants, in other words, should be considered important partners in NGOs' efforts to improve the lives of the families they left behind through greater access to education, potable water, health care, technical assistance, etc. This can be done through advocacy as discussed in the second policy recommendation and through financial contributions. The Mexican government's effort to increase the value of remittances through programs such as *Dos por Uno* and *Tres por Uno* is a good example of efforts at the federal and state level to implement such programs.[23]

4. **Identify Migrant Markets and Business Partnerships.** Given their focus on agricultural production, most of the NGOs I interviewed emphasize the need to link rural communities to viable markets. Migrant communities located in cities throughout Peru are a key source of consumers for local products. One of the NGOs I interviewed was in fact capitalizing on the existence of such a community of migrants from Huancavelica located in Ica on the Peruvian coast. The NGO has promoted the consumption of alpaca meat from Huancavelica at an annual festival in Ica and recently opened a stand in one of the markets in Ica. This effort demonstrates the NGO's recognition that migrants are important consumers. Migrants are also potential business partners as promoters of regionally produced goods, suppliers of more direct links to urban markets, and generators of new and innovative ideas. Santa Natura is a good example of a successful business run by a migrant from Huancavelica. A company based on natural vitamins and medicines, Santa Natura draws from the knowledge of rural communities in Huancavelica to create its products. NGOs should make a concerted effort to partner with such business entrepreneurs.

This list of policy recommendations provides a framework from which NGOs may start to develop a more extensive set of strategies related to rural development and migration. In particular, it shows how NGOs can partner with migrants to establish effective programming that recognizes the role of migration as a tool in development. Lacking in this

research is a more macro-level assessment of migration as a rural livelihood strategy. As I completed my field work, the *Instituto Nacional de Estadísticas e Información* (INEI) had embarked on collecting data for the 2005 National Census. A follow-up on the research I have conducted using data from the 2005 census would provide a wider scope for the findings and recommendations I have presented in this paper.

LBJ

NOTES

1. Inter-American Development Bank. *Comparative Study of Remittances in Latin American Countries,Part III.*
2. Peggy Levitt (see works cited) was one of the first scholars to recognize the importance of social remittances in the relationship between migrants and their home communities.
3. Goldring, L, 2003; Peggy Levitt, 1998.
4. As argued by the economist Amartya Sen in *Development as Freedom*, development is far more than income generation because it also demands the realization of human capabilities. He refers to these capabilities as "individual freedoms" to achieve what one values. As such, he contends, "What a person has the actual capability to achieve is influenced by economic opportunities, political liberties, social facilities, and the enabling conditions of good health, basic education, and the encouragement and cultivation of initiatives." Sen, A. 2002.
5. According to the United Nation Development Program, "Human development is about much more than the rise or fall of national incomes. It is about creating an environment in which people can develop their full potential and lead productive, creative lives in accord with their needs and interests. People are the real wealth of nations. Development is thus about expanding the choices people have to lead lives that they value. And it is thus about much more than economic growth, which is only a means—if a very important one—of enlarging people's choices." (http://hdr.undp.org/hd/).
6. Degregori et al. 1986; Roberts and Long, YR; Golte and Adams 1990; Llona, Rosa. 2004; Doig, Enrique Rodriguez, 1994; Dietz 1980, Roberts 1995; Long and Roberts 1978.
7. Salvador Rios, 1991; Brougere, 1992, Alber, 1999.
8. FAO 2002.
9. Escobal 2001
10. Instituto Interamericano de Cooperación para la Agricultura. March 2000. *El Desarrollo Rural Sostenible en el Marco de una Nueva Lectura de la Ruralidad*.
11. *Peru Hoy*: Llas ciudades en el Perú. 2004.
12. The Shining Path (*Sendero Luminoso*) was a Maoist organization that launched a guerrilla-type war on the Peruvian state in 1980. They controlled much of the Andean region throughout the 1980s and descended on Lima in the 1990s where they executed several terrorist acts. Although they claimed to be representing Peru's peasantry, the support they received from rural populations was minimal and often forced. Between their violent acts and the Peruvian military's retaliation, an estimated 70,000 people were killed or disappeared.
13. Altamirano, 2000, Quintanilla 2003, Tamagno 2003, Rodriguez 2000.
14. I borrow this term "invisible livelihoods" from Tony Bebbington who used it in his own evaluation of NGOs operating in the Peruvian and Bolivian Andes.
15. Unless otherwise noted, all data on Huancavelica comes from Rubina, Alberto and José Barreda, 2000.
16. March 2005 Directorio de Organismos No Gubernamentales en la Region de Huancavelica. Source: Gobierno Regional de Huancavelica (http://www.regionhuancavelica.gob.pe/)
17. Rubina and Carillo, 2002, p. 10. Original quote: "Las cifras pueden inducir a pensar erróneamente que la población huancavelicana se mantiene atada a sus chacras y animales, pero sucede todo lo contrario: la gente del campo se muda y traslada constantemente, aunque sus destinos no son las localidades del departamento. Huancavelica sigue la tendencia universal de migración del campo a la ciudad, pero en su caso, el ciclo comienza pero no termina en sus fronteras: la gente que deja el campo es absorbido mayoritariamente por la ciudades de otra regiones."
18. In order to maintain confidentiality, I have chosen not to name the NGOs or the individuals who I interviewed.
19. A final report has not yet been released. The draft report was open for comments for several months through a three-phase consultation process. It is still being finalized. More information can be found at http://www.iadb.org/sds/ENV/site_6581_e.htm.
20. IDB 2005, p. 25
21. Ibid., p. 11, section 3.9.
22. Goldring, Luin, 2004.
23. More information on these programs can be found on Mexico's Secretary for Social Development website: http://www.sedesol.gov.mx.

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Government Partisanship, Labor Organization, and Inequality in OECD countries, 1970-1992

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Abstract

Developed countries have experienced widening yet uneven wage differentials in the globalization era since the 1980s. What explains these varying degrees of wage inequality in those countries? By employing time-series cross-section analyses of 12 OECD countries from 1970 to 1992, I found that leftist partisanship and dense labor organization tend to reduce the wage inequality, even when controlling for other relevant variables such as inflation, unemployment, GDP per capita, trade, and capital liberalization.

Introduction

In recent decades, a buzzword in the social sciences is "globalization," which means the increasing integration of national economies into a global economy. The trend pressured for more elastic labor market where large segments of the working population can be more easily substituted by the other people and high production techniques across national boundaries, causing greater instability and unequal distribution of earnings and hours worked, a potential threat to social

integration and welfare systems in democracies around the globe.

After sharing a common pattern of narrowing educational and occupational wage differentials (i.e., inequality in wage distribution) in the 1970s, developed countries have experienced widening gaps in the differential since the 1980s. Yet the change developed unevenly. One can see a large rise in the differentials in the United Kingdom and the United States, a modest rise in Australia, Sweden, and Japan, and no noticeable changes in the Netherlands, France, Germany, and Italy.[1] What explains these varying degrees of changes in wage differentials in those countries?

This paper addresses the effects of government partisanship and labor organization on the wage inequality in member countries of the Organization for Economic Cooperation and Development (OECD) from 1970 to 1992.[2] I argue that leftist partisanship and dense labor organization tend to reduce wage inequalities, even with controlling for other relevant variables such as inflation, unemployment, GDP per capita, trade, and capital liberalization.

Leftist partisanship and dense labor organization tend to reduce wage inequalities, even with controlling for other relevant variables such as inflation, unemployment, GDP per capita, trade, and capital liberalization.

The remainder of the paper is divided into five sections. Section 2 reviews the literature on wage inequality, focusing on "supply and demand of skills," "wage-setting institutions," and "government partisanship." Section 3 describes two hypotheses about the effects of partisanship and labor organization on the wage gap. Section 4 discusses methodological issues such as measurement, data sources, and model specification. Section 5 deals with the findings from the time-series cross-section analyses on which the paper depends. Finally, section 6 draws out the conclusions and implications of the paper.

THE LITERATURE REVIEW

There are roughly three kinds of explanations on wage inequality: supply and demand of skills, wage-setting institutions, and government partisanship. The first type of explanation is, according to Conceição and Galbraith, grounded on the assumption that wages are the result of market clearing via the competitive pricing of workers' capabilities associated with skill, education, and seniority in the workforce.[3] The evolution of the difference between the prices of skills depends on the interaction between shifts in the relative demand for more-skilled labor and changes in the relative supply of skilled labor. Factors that affect the interaction include skill-biased technological change that raises the premium for more skilled workers,[4] and economic globalization that causes shifts in product demand and employment toward skill-intensive sectors.[5]

Since different developed economies operate in the same world markets with similar technologies, changes in demand move in broadly similar ways across countries. Supply changes diverged more because different countries expanded their higher education systems at different times, but, even so, the proportion of the workforce that is highly educated has risen in all advanced countries. Differences in the patterns of change in supply and demand are thus unlikely by themselves to explain cross-country variations in changes in wage inequality fully.[6] An empirical study finds that skill inequality explains only about 7 percent of the cross-country difference in wage inequality.[7] Furthermore, the dominant empirical investigation of rising inequality in developed countries continues to be single-country longitudinal studies based on labor market/human capital analysis, which suggests a problem of generalization across countries.

The second type of explanation focuses on wage-setting institutions, which suggests that the more centralized a wage-setting system, and the stronger the role of institutions in wage determination, the smaller the effect of shifts in supply and demand on relative wages, and, as a consequence, the greater their effect on relative employment.[8] This paper reexamines whether and how much the wage-setting institutions affect wage differentials.

But existing explanations, including "supply and demand of skills" explanations, have some problems in measuring the wage inequality. Most of the empirical studies on inequality are derived from surveys focused on the distribution of household income. Yet such data, especially the Gini coefficient,[9] only indirectly provides information

about the distribution of wage rates. Furthermore, survey data that are comparable internationally across time is scarce and the quality of those that do exist is uneven in many cases.[10]

The third type of studies that evaluates the effects of government partisanship on economic difference seems to examine three main questions: 1) the origins of the political effects on different macroeconomic policies, such as electoral motivation,[11] party differences,[12] and administration differences[13]; 2) the mechanism through which such influence is presumed to operate, such as fiscal policy[14] and labor organization[15]; and 3) roles of voters' rational expectation[16] and forward-looking moderation.[17] Those studies all shed light on how and why government partisanship accounts for macroeconomic differences. Since their favorable dependent variables are often unemployment, GDP growth, and inflation, they leave untouched the question of the wage inequality or income distribution that this paper explores.

CENTRAL RESEARCH HYPOTHESES

1. *The more leftist participation in governments, the lower the wage inequality.*
   Following Hibbs' intellectual tradition,[18] this paper begins with a very simple understanding of government strategy. Governments can be expected to pursue partisan economic strategies consistently because these further the interests of the governments' core political constituencies (organized interests, activists, and voters).[19] Leftist governments are expected to intervene extensively in the economy to alter market outcomes and redistribute wealth and risk more evenly, which results in low wage differentials. Rightist governments are expected to be correlated with high wage inequality, since they pursue pro-capital policy packages, less inclined to sustain minimum-wage and equal-pay legislation and a variety of redistributive income policy.[20]

2. *The stronger labor organization, the lower wage inequality.*
   Since non-market institutional forces tend to dampen inequality, wage inequality ought to be lower in countries that feature strong labor union, while higher in countries that have weak labor union. A powerful labor organization, characterized by high level of unionization and centralized wage bargaining, usually has a strong interest in reducing interfirm wage differentials since it has to maintain capacity of mobilizing workers in a sector consisting a large number of individual firms. In the same vein, "centralization facilitates the reduction of interfirm and intersectoral wage differentials, since it means that more firms and sectors are included in a single wage settlement."[21]

EMPIRICAL MEASURES, METHOD, AND ANALYSIS

To test the hypotheses outlined above, this paper uses time-series cross-section data drawn from the 12 OECD countries (Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, U.K, and U.S.) from 1970 to 1992 (276 observations). According to Beck and Katz[22] who show that the generalized least squares approach of Parks produces standard errors that lead to extreme overconfidence, this paper employs Ordinary Least Square (OLS) parameter estimates but replaces the OLS standard errors with panel-corrected standard errors (PCSEs). This paper tests the effects of government partisanship and labor organization on wage inequality, controlling for budget spending, economic globalization, some macroeconomic indicators, country-fixed effects, and time-specific effects. The models are as follows:

$$\text{Theil}_{it} = \beta 0 + \beta 1\ \text{Theil}_{it-1} + \beta 2\ \text{LEFT}_{it-1} + \beta 3\text{UNION}_{it-1} + \beta 4\text{CONTRY}_{it} + \beta 5\ \text{YEAR}_{it} + u_{it} \quad (1)$$

$$\text{Theil}_{it} = \beta 0 + \beta 1\ \text{Theil}_{it-1} + \beta 2\ \text{LEFT}_{it-1} + \beta 3\ \text{UNION}_{it-1} + \beta 4\ \text{DEF}_{it-1} + \beta 5\ \text{CONTRY}_{it} + \beta 6\ \text{YEAR}_{it} + u_{it} \quad (2)$$

$$\text{Theil}_{it} = \beta 0 + \beta 1\ \text{Theil}_{it-1} + \beta 2\ \text{LEFT}_{it-1} + \beta 3\ \text{UNION}_{it-1} + \beta 4\ \text{DEF}_{it-1} + \beta 5\ \text{TRADE}_{it-1} + \beta 6\ \text{LOWWAGE}_{it-1} + \beta 7\ \text{FDI}_{it-1} + \beta 8\ \text{CAPLIB}_{it-1} + \beta 9\ \text{CONTRY}_{it} + \beta 10\ \text{YEAR}_{it} + u_{it} \quad (3)$$

$$\text{Theil}_{it} = \beta 0 + \beta 1\ \text{Theil}_{it-1} + \beta 2\ \text{LEFT}_{it-1} + \beta 3\ \text{UNION}_{it-1} + \beta 4\ \text{DEF}_{it-1} + \beta 5\ \text{INFLA}_{it-1} + \beta 6\ \text{UNEMP}_{it-1} + \beta 7\ \text{GDPPC}_{it-1} + \beta 8\ \text{CONTRY}_{it} + \beta 9\ \text{YEAR}_{it} + u_{it} \quad (4)$$

$$\text{Theil}_{it} = \beta 0 + \beta 1\ \text{Theil}_{it-1} + \beta 2\ \text{LEFT}_{it-1} + \beta 3\ \text{UNION}_{it-1} + \beta 4\ \text{DEF}_{it-1} + \beta 5\ \text{TRADE}_{it-1} + \beta 6\ \text{LOWWAGE}_{it-1} + \beta 7\ \text{FDI}_{it-1} + \beta 8\ \text{CAPLIB}_{it-1} + \beta 9\ \text{INFLA}_{it-1} +$$

$\beta 10\ UNEMP_{it-1} + \beta 11\ GDPPC_{it-1} + \beta 12\ CONTRY_{it} + \beta 13\ YEAR_{it} + u_{it}$ (5) $Theil_{it} = \beta 0 + \beta 1\ Theil_{it-1} + \beta 2 INFLA_{it-1} + \beta 3\ UNEMP_{it-1} + \beta 4\ GDPPC_{it-1} + \beta 5\ CONTRY_{it} + \beta 6\ YEAR_{it} + u_{it}$ (6)

$Theil_{it} = \beta 0 + \beta 1\ Theil_{it-1} + \beta 2 TRADE_{it-1} + \beta 3\ LOWWAGE_{it-1} + \beta 4\ FDI_{it-1} + \beta 5\ CAPLIB_{it-1} + \beta 6\ INFLA_{it-1} + \beta 7\ UNEMP_{it-1} + \beta 8\ GDPPC_{it-1} + \beta 9\ CONTRY_{it} + \beta 10\ YEAR_{it} + u_{it}$ (7)

I use the Theil index rather than Gini coefficients as a measure of wage inequality. The Gini coefficients are flawed due to a lack of consistent data across time and country, and *indirectly* measure the wage differentials.[23] If all incomes are equal, Theil's T measure of equality is zero. As dispersion grows about the mean, T increases. It has a theoretical maximum of one given by the logarithm of the number of people in the population; that value is reached when one person has all the income. Annual Theil index is computed from the Industrial Statistics Data Base of the United Nations International Development Organization (UNIDO).[24] Meanwhile, Theil at t-1 is for controlling for cross-time correlations of wage inequality.

Government partisanship is operationalized as leftist share of seats in parliament (LEFT).[25] To ensure the causal arrows flow, the lagged value for the partisanship variable is used under the assumption that levels of wage inequality at time *t* must be caused by the degree of left partisanship at time *t-1*, i.e., the preceding year. The assumption applies to all other lagged independent variables. The degree of labor organization is measured by adjusted union density (UNION), that is the adjusted union membership (total membership less self-employed, retried and unemployed) weighted by total dependent labor force.[26]

Government fiscal policies often affect macroeconomic situation. For example, leftist government may adopt deficit budget spending in favor of social welfare. So, the regression model includes the level of budget balance (DEF) as a control variable, measured by tax revenue less government consumption.

Assuming that globalization effects on wage inequality are heterogeneous and uneven, I include in the model various indicators of integration into international markets.[27] Trade (TRADE) is measured by import plus export as a share of GDP; LOWWAGE is imports from low-wage countries as a percentage of total import; foreign direct investment (FDI) is measured by its inflow plus outflow as a percentage of GDP; as for capital liberalization (CAPLIB), I used Quinn's index of international financial openness raging from zero to fourteen with higher scores denoting more openness.[28]

Introducing country-fixed effects is particularly important when analyzing the government partisan effects because partisanship tends to vary more across countries than over time. In terms of comparative historical pattern, Scandinavian countries (Sweden, Norway, and Denmark) stand out with egalitarian wage distribution, while Japan, France, the United Kingdom, and the U.S. are characterized by a higher level of wage inequality.[29] The model also includes year dummy variables to take into account time-specific effects. If all OECD countries are subject to common pressures such as Oil Shock in the early and late 1970s, this should be considered through a series of year dummy lest these shocks contaminate the regressors of direct interest (i.e., abrupt decrease of FDI and increase of unemployment and inflation rates).

RESULTS

The results of seven time-series cross-section analyses are reported in Tables 1 and 2. The batteries of country and year dummy variables are significant, and this demonstrates the importance of controlling for both unit and time fixed effects in analyses. An interesting point is that the country dummy is significant in models 1 to 5 that include government partisanship and labor organization, while the year dummy is significant in models 5 and 6 which exclude those variables. This suggests that the partisanship and union density is a country-fixed historical tradition. In contrast, more year-specific than country-fixed variables are globalization variables (TRADE, LOWWAGE, FDI, and CAPLIB) and macroeconomic situation variables (INFLA, UNEMP, and GDPPC).

As expected from hypothesis 1 and 2, leftist partisanship (LEEF) and labor organization (UNION) have consistently negatively coefficients; they tend to dampen wage inequality across time and country. Figures 1 and 2 also illustrate that the leftist partisanship and union density, respectively, are negatively associated with the wage inequality in OECD countries.

As for control variables, government budget balance does not affect wage differentials. An interesting result shown in model 3, 5, and 7 is that

all globalization indicators are not significantly associated with the wage inequality, which suggests that effects of globalization are heterogeneous and uneven in their equality. International trade (TRADE) and, less consistently, import from low-wage countries (LOWWAGE) tend to increase the wage inequality. An increased level of international trade will provide world-competitive trade-oriented firms and their employees with more profits and labor rents, while a huge increase in manufactured imports, mainly from low-wage countries, will put asymmetric pressure on lower-wage import-competing manufacturing workers. One possibility is that the TRADE variable is biased in favor of upper level wage earners while the LOWWAGE negatively affects lower level wage earners, which widens the wage differentials in a globalizing era.

Although much less consistent compared to other globalization variables, the liberalization of capital transactions across national borders (CAPLIB) and FDI affects the inequality. Capital liberalization affects the income distribution positively, while FDI makes wage differentials more evenly. One possibility is that FDI may be invested in less skill-intensive sectors, rather than technologically advanced ones so that it condenses the wage gap. Further research will be needed to explore why different globalization variables have different effects on the wage inequality and income distributions.

The results of models 4, 5, 6, and 7 show that inflation (INFLA) does not affect the wage gap significantly. Unemployment (UNEMP), although less consistently, is positively associated with the gap, which confirms a precedent study[30] arguing that European countries that feature social welfare systems and, thus, low inequality tend to experience less unemployment than those that do not. Given that the unemployment variable is not significant in models with the government partisanship and union density variables, while significant in models without them, there is a possibility that the unemployment is a function of the partisanship and labor organization, which this article does not cover. As for GDP per capita (GDPPC), it is a consistent ex-

Table 1
The Effect of Government Partisanship and Labor Organization on Wage Inequality

Independent Variables	1	2	3	4	5
Theil $_{t-1}$	.2361*	.2002	.1813	.1494	.1316
	(.1401)	(.1538)	(.1495)	(.1344)	(.1346)
LEFT	-.00016***	-.0002***	-.00018***	-.00028***	-.00025***
	(.00004)	(.00004)	(.00004)	(.00004)	(.00005)
UNION	-. 00013***	-.0001***	-.00015***	-.00014***	-.00019***
	(.00003)	(.00002)	(.00003)	(.00002)	(.00003)
DEF		.00003	-.00007	-.00002	-.00015
		(.00006)	(.00008)	(.00006)	(.00011)
TRADE			.00006***		.000058***
			(.00001)		(.00002)
LOWWAGE			.00013***		.000035
			(.00004)		(.00005)
FDI			-.00025		-.00038
			(.00026)		(.0003)
CAPLIB			.00004		.00012
			(.00037)		(.0004)
INFLA				.00005	.00012
				(.0001)	(.0001)
UNEMP				-.00004	-.000098
				(.0001)	(.00012)
GDPPC				-6.72e-07**	-7.43e-07**
				(3.09e-07)	(3.32e-07)
COUNTRY	-.00031***	-.00033**	-.00023**	-.0004***	-.0003**
	(.00008)	(.0001)	(.0001)	(.0001)	(.00015)
YEAR	.00006	-.00005	-.00002	.0005*	.00065*
	(.00006)	(.00004)	(.00006)	(.00029)	(.0003)
R2	.292	.5716	.5865	.5723	.5813

Note: Entries are unstandardized regression coefficients with panel-corrected standard errors in parenthesis; N = 276; * p< .1; ** p< .05; ***p< .01; two-tailed test.

Table 2
The Effect of Globalization and Macroeconomic Variables on Wage Inequality

Independent Variables	6	7
Theil t-1	.2797*	.2462
	(.1671)	(.1619)
TRADE		.000038**
		(.000018)
LOWWAGE		.000253***
		(.000062)
FDI		-.00067*
		(.00028)
CAPLIB		.00067*
		(.0004)
INFLA	-.00022	-.00015
	(.00014)	(.00011)
UNEMP	.0008***	.00066***
	(.00019)	(.00016)
GDPPC	1.54e-06***	1.24e-06***
	(4.32e-07)	(.3.78e-07)
COUNTRY	.000098	.00007
	(.00037)	(.0001)
YEAR	-.00157***	-.0013***
	(.00037)	(.0003)
R2	.44	.4742

Note: Entries are unstandardized regression coefficients with panel-corrected standard errors in parenthesis; N = 276; * p< .1; ** p< .05; ***p< .01; two-tailed test.

planatory variable of varying degrees of Theil index; the higher income level, the higher wage equality. The result supports simple Kuznets hypothesis for advanced countries, although this claim is not definitive. According to Conceição and Galbraith,[31] the wage inequality is a cubic polynomial function of income because the inequality increases for the small number of highest-income countries (U.K. and U.S.) that have a manufacturing mix disproportionately weighted toward advanced and technologically monopolistic sectors. Unfortunately, the models employed here do not differentiate those countries from other OECD countries. All that the models suggest is that *overall* there is a negative association between income levels and the wage differentials in OECD countries.

CONCLUSION

This paper has shown the effects of government partisanship and labor organization on income inequality measured by the Theil index. Leftist governments and union density tends to reduce the inequality. "Supply and demand of skill" explanations argue that different capabilities associated with different levels of skill, education, and experience determine wage or income levels for workers within labor market.

This article implies the importance of capitalist democracy in the globalization era. The neoliberal globalization story assumes that workers are only employees or immediate producers in the market. Yet, this article suggests workers as *producers-cum-citizens*. Although workers have different levels of skills and are subject to unequal wage distribution, they can reduce the inequality via labor organization and their votes for leftist parties. Capitalist "one dollar, one vote" principle causing various degrees of inequality can be accommodated and counterbalanced by democratic "one man one vote" principles. This is what "democratic class struggle"[32] is all about.

This article is based on the empirical analyses of OECD countries, which suggests a problem of generalizability. It remains to be studied whether my arguments based mainly on developed countries can be applied to others such as high income non-OECD and middle income countries around the globe. Furthermore, my study does not include an

Figure 1.
Wage Inequality and Government Partisanship in 12 OECD Countries, 1970-1992

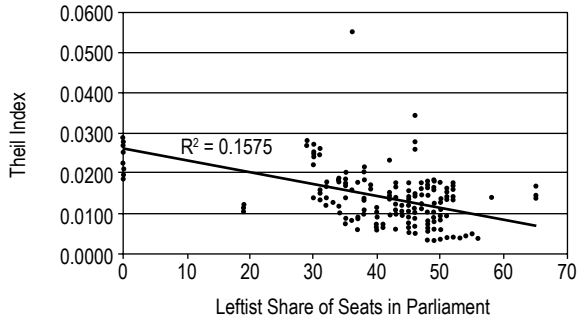
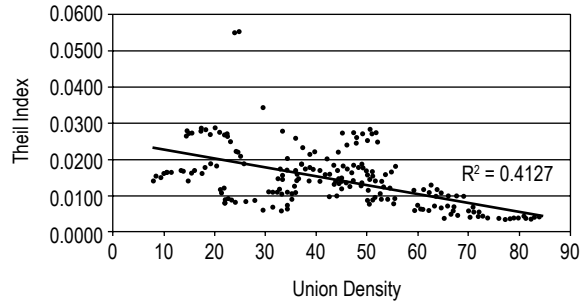


Figure 2.
Wage Inequality and Union Density in 12 OECD Countries, 1970-1992



analysis about conflict possible between organized and nonorganized workers. If unionized wage earners pursue their narrow interests (such as high pay) while sacrificing non-unionized temporary workers subordinate in their labor hierarchy, unionism may be a source of wage inequality. Further research will have to examine these problems.

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NOTES

1. Richard B. Freeman and Lawrence F. Katz, eds., *Differences and Changes in Wage Structures* (Chicago and London: The University of Chicago Press, 1995).
2. It was in the 1970s that neoliberal economic policy and ideology started in developed countries. Unfortunately, the limited time span that the article covers is mainly due to some across-time and -country missing figures in the original dataset.
3. Pedro Conceição, Pedro Ferreira, and James K. Galbraith, "Inequality and Unemployment in Europe: The American Cure," in Galbraith and Berner, eds., *Inequality and Industrial Change: A Global View* (2001), p. 141.
4. Jacob Mincer, "Changes in Wage Inequality, 1970-1990," NBER Working Paper no. 5823, p.2; Katz, L., and K. Murphy, "Changes in Relative Wages, 1963-1987: Supply and Demand Factors," *Quarterly Journal of Economics,* 107 (1) (1992), p. 1.
5. George J Borjas and Valerie A. Ramey, "Foreign Competition, Market Power and Wage Inequality: Theory and Evidence," *The Quarterly Journal of Economics,* vol. 110, no. 4 (1995), p. 1075; Paul Krugman and Anthony J. Venables, "Globalization and the Inequality of Nations,' NBER Working Paper no. 5098, 1995, p. 2; Robert Feenstra and Gordon Hanson, "Global Production Sharing and Rising Inequality: A Survey of Trade and Wages," NBER Working Paper no. 8372, 2001, p. 2; Wei, Shang-Jin and Yi Wu, "Globalization and Inequality: Evidence from within China," NBER Working Paper no. 8611, 2001, p. 2.
6. Freeman and Katz, eds., *Differences and Changes in Wage Structures*.
7. Dan Devroye and Richard B. Freeman, "Does Inequality in Skills Explain Inequality in Earnings Across Advanced Countries?," NBER Working Paper no. 8140, 2001, p. 2.
8. Francine Blau and Lawrence Kahn, "International Differences in Male Wage Inequality: Institutions versus Market Forces," *Journal of Political Economy,* 104(4) (1996), p. 831; David Card, "Falling Union Membership and Rising Wage Inequality: What's the Connection?," NBER Working Paper no. 6520, 1998, pp. 19-20; Giuseppe Bertola, Francine D. Blau, and Lawrence M. Kahn, "Comparative Analysis of Labor Market Outcomes: Lessons for the U.S. from International Long-Run Evidence," NBER Working Paper no. 8526, 2001, pp. 52-53.
9. Gini coefficient is a measure of inequality of a distribution, developed in 1912 by the Italian stastitician Corrado Gini. It is defined as a ratio with values between 0 and 1: the numerator is the area between the Lorenz Curve of the distribution and the uniform perfect distribution line; the denominator is the area under the uniform distribution line. It is often used to measure wealth inequality in a society. Wikipedia, *Gini Coefficient*. Online. Available: http://en.wikipedia.org/wiki/Gini_coefficient. Accessed: Feb. 11, 2007.
10. James K. Galbraith and Maureen Berner, "Measuring Inequality and Industrial Change," in *Inequality and Industrial Change: A Global View* (Cambridge: Cambridge University Press, 2001), p. 17.
11. William Nordhaus, "The Political Business Cycle," *Review of Economic Studies*, 42 (1975), p. 169.
12. Douglas A. Hibbs, Jr., "Political Parties and Macroeconomic Policy," *American Political Science Review,* 71 (1977), p. 1467.
13. Nathaniel Beck, "Parties, Administrations, and American Macroeconomic Outcomes," *American Political Science Review,* 76 (1982), p. 83.
14. David Lowery, "The Keynesian and Political Determinants of Unbalanced Budget: U.S. Fiscal Policy from Eisenhower to Reagan," *American Journal of Political Economy,* 29 (1985), p. 428.
15. Geoffrey Garret and Peter Lange, "Government Partisanship and Economic Performance: When and How does 'Who governs' Matter?," *Journal of Politics,* 51 (1989). p. 676; Geoffrey Garret and Peter Lange, "Internationalization, Institutions, and Political Change," in Robert O.Keohane and Helen V.Milner eds., *Internationalization and Domestic Politics* (Cambridge University Press, 1996), p. 57.
16. Henry W. Chappell and William R.Keech "Party Differences in Macroeconomic Policies and Outcomes," *American Economic Review,* 76 (1986), pp. 72.
17. Alberto Alesina and Howard Rosenthal, "Partisan Cycle in Congressional Elections and the Macroeconomy," *American Political Science Review,* 83 (1989), p. 373.
18. Hibbs, "Political Parties and Macroeconomic Policy."
19. Other studies, on the other hand, highlight political constraints on the ability of governments to act on their partisan preference. In plurality electoral systems, Downs' spatial models of electoral competition (1957) suggest that all governments should pursue policies and outcomes that appeal to the median voter, regardless of their partisanship. In multiparty proportional representation systems, the dynamics of coalition, compromise, and consensus are said to mitigate partisan effects (Jackman 1986).

20. Geoffrey Garret, *Partisan Politics in the Global Economy* (New York: Cambridge University Press, 1998), pp. 6-10.
21. David Rueda and Jonas Pontusson, "Wage Inequality and Varieties of Capitalism," *World Politics,* 52 (2000), p. 360.
22. Nathaniel Beck and Jonathan N. Katz, "What to Do (and Not to Do) with Time-Series Cross-Section Data," *American Political Science Review,* 89 (1995), pp. 634-647.
23. For useful properties and measurement of Theil index, see Galbraith and Berner, "Measuring Inequality and Industrial Change."
24. These data are available on the website of the University of Texas Inequality Project: http://utip.gov.utexas.edu.
25. The data are available from Duane Swank's website: http://www.marquette.edu/polisci/Swank.htm. Accessed: January 22, 2001.
26. Bernhard Ebbinghaus and Jelle Visser, *The Societies of Europe: Trade Unions in Western Europe since 1945* (New York: Grove's Dictionaries, 2000). pp. 59-68; Bernhard Ebbinghaus and Jelle Visser, *The Societies of Europe: Trade Unions in Western Europe since 1945,* CD-ROM (New York: Grove's Dictionaries, 2000). The data are also available from Golden, Wallerstein, and Lange' website, http://www.shelley.polisic.ucla.edu/data. Accessed: January 20, 2001.
27. World Bank, *World Development Indicators,* CD-ROM, 1997.
28. Dennis Quinn, "The Correlates of Changes in International Financial Regulation," *American Political Science Review,* 91 (1997), p. 535.
29. Rueda and Pontusson, "Wage Inequality and Varieties of Capitalism," pp. 355-356, Figures 1 and 2.
30. Pedro Conceição, Pedro Ferreira, and James K. Galbraith, "Inequality and Unemployment in Europe: The American Cure" (2001), p. 111.
31. Pedro Conceição and James K. Galbraith, "Toward a New Kuznets Hypothesis: Theory and Evidence on Growth and Inequality," in Galbraith and Berner, eds., *Inequality and Industrial Change: A Global View* (2001), p. 158.
32. Walter Korpi, *The Democratic Class Struggle* (Boston: Routledge & K. Paul, 1983), p. 21; and Adam Przeworski, *Capitalism and Social Democracy* (Cambridge: Cambridge University Press, 1985), p. 11.

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Immigration Fixes and Failures:

A Market Failure Analysis of Immigration Reforms Proposed in the 109th Congress

by Anna Fink, Carolyn Barker, and Maritza Kelly

Executive Summary

On September 29, 2006, the 109th United States Congress approved building a fence along a major section of the U.S.-Mexico border. The price tag of the fence is up for debate—estimates range from the $1.2 billion approved by Congress to over $7 billion in materials to erect the structure. Yet there are also inherent costs and benefits to this immigration policy that go beyond the price of materials. This article examines the costs and benefits of three major types of immigration reform initiatives—enforcement, legalization, and guestworker programs—from a market failure perspective.

Market failure occurs when the market is unable to allocate resources efficiently. One way in which market failure can arise is through state-led regulation of the market. By restricting and/or regulating immigration, state intervention can artificially create a labor shortage. Moreover, by generating this labor shortage, immigration policies can result in a range of negative externalities that effect both workers and employers. In this labor market analysis, we unpack the elements of market failure related to the three aforementioned types of immigration reform. Our findings demonstrate that there is a clear gap between the political rhetoric surrounding immigration reform and the need to address the root causes of labor immigration.

Overall, our findings indicate that U.S. experiences with immigration reform clearly demonstrate the weakness of shortsighted policies that have only provided temporary, if any, solutions to the current problems. Moreover, in the current debate, lawmakers are making little effort to address the demand side of labor immigration. Therefore, in order to achieve a comprehensive immigration reform program, we argue that there is a critical need for longer-term thinking about the impact of economic integration, sound economic

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development, enforcement of existing labor laws within the United States, and the recognition of the human side of immigration. Our analysis confirms that labor market failure is one of the root issues responsible for the immigration controversy. In order to adequately address the "problem" of immigration, the United States must consider policies that address the root causes of the migratory flows across the southern border: both demand (the employer side) and supply (economic inequality between the U.S. and Mexico).

BACKGROUND

In 2006, immigration reform was one of the most contentious and politically charged issues facing the U.S. Congress. Democrats and Republicans were split concerning issues related to immigration, such as nationalism, border control, labor rights, and the needs of the U.S. economy. A survey conducted by a bipartisan research center in 2006 showed that 90 percent of American voters agreed with the statement, "The immigration system is broken and needs to be fixed.[1]" Indeed, each of the current immigration reform proposals represents an effort to intervene in the labor market to "fix" the perceived economic problems of immigration. Two of the core economic issues at play in these proposals are the impact of undocumented immigrants on American workers' wages and immigrant competition for American jobs. In our market failure analysis, we tackle the labor side of the controversial reforms that are currently under debate in the House and Senate.

In an expanding global economy, the sectors of the U.S. labor market that depend on low-wage labor to help maintain competitive prices face a particular economic dilemma. These sectors are dominated by jobs that tend to require physically demanding and low-skilled work. Or, as stated by President Bush, these are the "jobs Americans won't do."[2] Indeed, the 2004 Pew Hispanic Center's Latino Labor Report confirmed that nearly 55 percent of Hispanic-born immigrants work in construction, wholesale and retail trade, professional and other business services, or eating, drinking, and lodging services. In contrast, only 40 percent of native-born workers have jobs in these same four industries.[3] This same report found that recent growth in these industries, especially in construction, has driven up the demand for an additional one million jobs for foreign-born Latinos in 2004. Yet at the same time, wages for Hispanic-born workers have fallen consistently over the last two years while native-born workers continue to see their wages increase.[4] Part of the cause for this wage dip may be the increasing numbers of immigrants who now compete against each other for jobs rather than competing against native-born workers. In other words, Hispanic-born immigrants—particularly undocumented immigrants—work in a second-tier labor market in which wages are already set low and competition is potentially pushing these wages even lower.

In the context of this tiered labor market, the U.S. Congress attempted to address the existence of some 11.2 million undocumented immigrants who prove so vital to the country's economy. Each of the proposals was an effort aimed to correct labor market failure. By focusing on the three aforementioned elements of the different proposals (enforcement, guest worker programs, and legalization) we examine how well each program addresses labor market failure.

HISTORY OF IMMIGRATION REFORM IN THE U.S.

While the rhetoric surrounding immigration has evolved since the passage of the 1790 Naturalization Act, which declared that "any alien, being a free white person, may be admitted to become a citizen of the United States," immigration policy remains a contentious subject. Throughout history, the same questions have arisen. Do immigrants depress wages? Do immigrants take American jobs? Would Americans do the work that immigrants occupy? What is the best way to regulate immigration? But beyond the questions lay the facts: There is a demand for abundant cheap, low-wage labor in this country, and people will attempt to migrate to the U.S. to fill this demand regardless of the strictness of enforcement measures.

The history of immigration policy captures the push and pull of immigrants towards the U.S. For instance, when a national emergency, such as war, creates a labor shortage, the U.S. opens its borders. (See Table 1.) Then, as soon as it no longer needs that pool of labor, it resorts back to draconian policy enforcement. These contradictory policies are more than a series of unsuccessful attempts at controlling immigration. They have also bred nativist attitudes and discrimination, turning what is largely an economic issue into a political one.

Table 1
Significant Historic Dates Affecting U.S. Immigration

Naturalization Act of 1790	Stipulated that "any alien, being a free white person, may be admitted to become a citizen of the United States."
1882 The Chinese Exclusion Act	Prohibited certain laborers from immigrating to the United States.
1885 and 1887	Alien Contract Labor laws which prohibited certain laborers from immigrating to the United States.
1892	On January 2, a new Federal U.S. immigration station opened on Ellis Island in New York Harbor.
The U.S. Immigration Act of 1907	Reorganized the states bordering Mexico (Arizona, New Mexico, and a large part of Texas) into Mexican Border District to stem the flow of immigrants into the U.S.
1917	A series of laws were enacted to further limit the number of new immigrants. These laws established the quota system and imposed passport requirements.
1924 Act	Reduced the number of U.S. immigration visas and allocated them on the basis of national origin.
1940 The Alien Registration Act	Required all aliens (non-U.S. citizens) within the United States to register with the government and receive an Alien Registration Receipt Card (the predecessor of the "green card").
1952 Act	Established the modern day U.S. immigration system. It created a quota system which imposes limits on a per-country basis. It also established the preference system that gave priority to family members and people with special skills.
1968 Act	Eliminated U.S. immigration discrimination based on race, place of birth, sex and residence. It also officially abolished restrictions on Oriental U.S. immigration.
1976 Act	Eliminated preferential treatment for residents of the Western Hemisphere.
1980 Act	Established a general policy governing the admission of refugees.
1986 Act	Focused on curtailing illegal U.S. immigration. It legalized hundred of thousands of illegal immigrants. It also introduced the employer sanctions program which fines employers for hiring illegal workers. .It also passed tough laws to prevent bogus marriage fraud.
1990 Act	Established an annual limit for certain categories of immigrants. It was aimed at helping U.S. businesses attract skilled foreign workers; thus, it expanded the business class categories to favor persons who can make educational, professional, or financial contributions.

APPROACH

While the sheer number and complexity of immigration reform proposals debated over the last year is staggering, nearly all of the proposals include one or more of the following policy elements: enforcement, guest or temporary worker programs, and legalization. To analyze these elements, we draw on experience with immigration policies that incorporated similar approaches in the past and then we identify the positive and negative externalities of each policy. Immigration reform debate has been particularly focused on Mexican migration, given the economic integration of Mexico and the U.S. under NAFTA and the fact that Mexicans are the largest group of foreign-born in the United States (about one-third of the total population of undocumented immigrants).[5] Finally, to conclude the analysis of U.S. immigration policies, we submit a set of proposed recommendations for more economically appropriate responses to the current immigration situation.

FINDINGS OF THE LABOR MARKET FAILURE ANALYSIS

ENFORCEMENT MEASURES

Enforcement measures create the type of market failure inherent in limiting the movement of labor in an economically integrated region. Since the passage of the North American Free Trade Area of the Americas (NAFTA) in 1994, there has been a free flow of goods across the Mexican-U.S. border. However, U.S. labor laws have limited movement of labor. Strict enforcement measures and limiting the flow of workers has impacted the labor market, both on the U.S. and Mexican sides of the border.

Enforcement implies creating mechanisms to fortify the border and more strictly enforce current immigration laws. Enforcement initiatives include:

- Building a wall;
- Authorizing local law enforcement to act as immigration law enforcers;
- Criminalization of undocumented immigration (those who "break" immigration law); and

- Boosting the Border Patrol's capacity to apprehend people at the border.

Previous enforcement-only initiatives include Operation Hold the Line and Operation Gatekeeper, both passed in the early 1990s. These policies employed strategies such as blockading certain high traffic areas of the border, installing sophisticated technology to detect trespassers, and increasing the number of agents patrolling these areas. These acts were known as "prevention through deterrence."[6] The Immigration Reform and Control Act (IRCA), passed in 1986, and the Illegal Immigration Reform and Immigrant Responsibility Act (IIRIRA) in 1996 also provided for increased enforcement resources. In fact, from 1980 to 1998 enforcement expenditures increased from $290 million to $1.7 billion (1998 dollars).[7]

The overall goal of enforcement policies is to "seal" the border and to limit flow of undocumented migration into the country. In analyzing the market impact of this policy, we will assume that it would actually be possible to seal the border. Closing the border would drastically reduce the inflow of the supply of unskilled workers. As fewer unskilled workers would be available for hire, the wages of the remaining workers (ostensibly native U.S. workers) would potentially increase. This, in turn, could create a shift toward capital-intensive production as supply of cheap labor would no longer be a readily available. While some believe this would increase the wages of the native workers (as there would no longer be as much competition), other theorists believe that in such a case, certain jobs might cease to exist. For example, if agricultural production could not rely on cheap labor, agro-business might simply shift production to Mexico. Additionally, by clamping down on migration, some communities in the United States would also lose a significant consumer base, and this could have a negative impact on local commerce.

The enforcement reforms of the 1990s created a black market for Mexican labor, lowered wages for legal U.S. residents, increased income inequality and worsened conditions in U.S. labor markets.

While it is possible that enforcement will increase wages for low-skilled workers in certain regions, there are a number of negative externalities related to enforcement.[8, 9] For instance, effectively sealing the 1,500-mile border with Mexico requires massive expenditures, as evidenced by congressional allocations for the building of the fence. Are these expenditures worthwhile in order to boost an undetermined number of low-skilled workers' wages? Another negative externality is the impact of enforcement on crime rates and black market activities. According to Douglas Massey, the enforcement reforms of the 1990s created a black market for Mexican labor, lowered wages for legal U.S. residents, increased income inequality, and worsened conditions in U.S. labor markets.[10] Increased enforcement encourages migrants who are able to make it to the United States without papers to find employment in the informal economy, where labor laws are virtually unenforceable. Additionally, increased enforcement also raises demand for *coyotes* or smugglers and draws migrants into a wider crime ring of black market operations.

Perhaps the most obvious negative externality of enforcement is the potential for violations of immigrants' human rights. Enforcement requires exposing would-be migrants to extreme and dangerous measures to cross the border. For instance, enforcement measures often force immigrants to attempt crossing the border in the desert and at dangerous passages: 473 immigrant deaths were reported in 2005.[11]

Limiting the numbers of migrants entering the United States through enforcement may also have a negative impact on the U.S. Social Security system and tax base. Currently, immigrants (both documented and undocumented) often pay into the Social Security system and pay taxes, either with a fake social security number or through their purchases and sales tax. Estimates of undocumented contributions to Social Security in 2002 alone equaled more than $6.4 billion.[12]

A final negative externality to consider is the militarization of a border with a friendly neighbor (Mexico). It is important to consider the message militarization sends to a neighbor whom the U.S. counts on as a partner in trading and in regional security.

Guest Worker Programs

Lawmakers have used guest worker policies as a labor-based tool for immigration regulation in the United States since World War I. Before that, immigrants were allowed to enter and exit the country

freely and this labor supply responded to market demands relatively efficiently. However, a major labor shortage arose when the nation's resources were being allocated to military operations during WWI. Immigration increased tremendously during this period, and it was under these circumstances that the U.S. Border Patrol was created.[13] Quotas were established by national origin, but agricultural growers persuaded Congress not to place limitations on immigration from Mexico: "fluid casual labor is the farmer's only salvation . . . the prime necessity of his success."[14]

During this period, the U.S. government did not extend worker protections and labor rights to the agricultural sector. While lawmakers created rules to protect both U.S. citizens and foreign workers from depressed wages and exploitative working conditions under the 1924 Immigration Act, these rules were not adequately enforced.[15] A movement for farmworker rights began to mobilize as reports of poor working conditions increased. Rather than raising wages and improving working conditions to encourage non-immigrants to take farm jobs, growers lobbied for Congress to allow more farmworkers from Mexico. This lobbying resulted in a "farm labor supply agreement" which authorized importing Mexican labor pending that no U.S. citizens were available to do the work. This is the agreement that came to be known as the Bracero Program.[16]

The Bracero Program was the first major guest-worker agreement in the U.S. In 1961, after the fourteenth year of the program, it became apparent that the Braceros were responsible for the steep declines in agricultural wages. To counter the wage drop, the federal government implemented the "adverse effect wage rate," a measure stipulating that employers must offer jobs to U.S. citizens at the adverse rate first; Bracero labor could only be used if there were any jobs remaining. The U.S. discontinued this measure because it resulted in perverse incentives: It made more economic sense for the producers to take the risk of using illegal labor than pay adequate wages.[17]

This history of guest-worker programs in the U.S. raises two important economic issues. First, there is the question of who is responsible for the decline in wages due to the presence of guestworkers. Is it the guestworkers who sign up for low-paying work? Or, rather, has government, in cooperation with the agricultural sector, created the conditions for the decline in wages by effectively stigmatizing these jobs? Secondly, guest worker programs have historically only perpetuated the undocumented immigration they were created to curtail.

LEGALIZATION

Legalization is the third and possibly most contentious element of the reforms considered by the U.S. Congress in 2006. The annual cap for granting legal permanent resident status is 480,000 family-sponsored immigrants, 140,000 employment-based immigrants, and 55,000 "diversity" immigrants.[18] Advocates have argued that the socio-economic benefits of expanding these quotas and providing a systematic path to legalize the status of undocumented immigrants would far outweigh the costs to the United States. On the surface, legalization could contribute to correcting failures in the labor market by allowing immigrants greater bargaining power and potentially increasing the efficiency of production. Some of the positive externalities of the legalization approach include the following:

1. **Expansion of the U.S. tax base:** Bringing undocumented workers into the formal labor market could mean close to 12 million more income tax payers within the next few years.

2. **Improvements in working conditions:** Workers with legal status have more options for protecting their labor rights. Undocumented immigrants currently have little recourse, except in certain cases of wage violations. In addition, asymmetric information and fear of deportation limit them from reporting such violations of their rights. Legal status would give workers more leverage at the workplace. In light of the potential for improved worker rights, it is not surprising that labor unions such as the AFL-CIO are among the most vocal advocates of legalization.

3. **Raise artificially depressed wages:** One-third of undocumented workers have jobs in the service sector. In two service sub-sectors, food preparation/serving and building maintenance/cleaning, undocumented workers account for 10 percent of all employees.[19] Although undocumented workers may not be a large portion of the workforce, their presence likely contributes to keeping wages down. Indeed, studies have found that Hispanic immigrant (legal or not legal) wages are consistently lower than non-Hispanic white and non-Hispanic immigrant's wages.[20] If undocumented immigrants were granted legal status, in theory there would no longer be an easily accessed source of cheap labor. Instead, the newly legalized workers would be on the same level as other legal work-

ers, which would give them more bargaining power in the labor market.

Such positive externalities of a legalization program shore up the arguments for providing a path to permanent residence for the over 11 million undocumented immigrants. Yet, critics of legalization label this immigration policy proposal an "amnesty" measure that rewards lawbreakers and encourages more illegal immigration into the country. Past experience with legalization show that the form this policy takes will determine the level of negative and positive externalities that a legalization measure may generate in the legal labor market. An analysis of the Immigration Reform and Control Act of 1986 helps to reveal some of these complexities as well as the overall impacts of a legalization policy.

IRCA and its Implications

Only 20 years ago, Congress heard similar calls for immigration reform at a time when there were an estimated 3.8 million undocumented people in the United States.[21] In response to the increasing concerns, Congress passed the Immigration Reform and Control Act (IRCA) in 1986. IRCA took a three-prong approach to immigration reform. It allocated $400 million to border enforcement, implemented stricter employer sanctions, and, most relevant to the reforms considered in 2006, it authorized legal status for undocumented immigrants who could prove that they had established continuous residency before 1982. The law also included a special provision mandated by the state of California to extend legalization to agriculture workers who had worked at least 90 days in 1986 or before. The intent of this legalization effort was to "wipe the slate clean" and ultimately led to the legalization of an estimated three million immigrants by 1990. Of these, roughly three-quarters or 2.3 million were of Mexican origin.[22]

A gross oversight in this one-time approach to undocumented immigration was the lack of a concerted effort to address the future inflow of immigrants. This left the estimated eight million undocumented immigrants who entered the country since IRCA's passage ineligible for legalization. The law also made those immigrants who were in the United States when IRCA was passed but had arrived after 1982 ineligible.[23] This oversight ultimately led to the current situation, where the country is again faced with the challenge of reforming immigration policies to address adequately the issue of undocumented workers. In the process, IRCA created an even more complex situation for immigrants by pairing limited legalization provisions with stricter employer sanctions. This combination resulted in a slew of negative externalities and asymmetric information that exacerbated labor market failure through higher levels of discrimination, expansion of the subcontractor sector, and the generation of an even bigger pool of undocumented workers due in part because of limited access to legal entry. The following analysis looks at these market failure components through the experience of IRCA.

Higher Levels of Discrimination

After IRCA was passed, stricter hiring standards affected both undocumented workers and legal workers who were "illegal-appearing." A 1990 Government Accountability Office study found that there was widespread discrimination against foreign-looking people after the enactment of IRCA.[24] Evidence for discrimination was also found in the widening gap between wages earned by Hispanic and non-Hispanic whites.[25] Data from the Current Population Survey in 1994 (see Table 2) revealed that real wages for workers of Mexican origin dropped by 8.4 percent after IRCA compared to only a 1.7 percent drop for non-Hispanic whites.[26] It also showed an 18 percent increase in the wage gap between non-Hispanic whites and Mexican male workers.

Expansion of the Subcontractor Sector

Much of the costs of IRCA's employee sanctions were passed onto Hispanic workers through lower wages and the use of subcontractors.[27] Indeed, since the enactment of IRCA, the number of contractors and placement agencies increased drastically. Subcontractors functioned as middlemen who assumed the responsibility for confirming the legal status of immigrants in the hiring process and effectively absolved employers for hiring undocumented workers through plausible deniability.[28, 29]

Beyond matters of legality, subcontractors also acted as a barrier between the employer and employee. As a result, the "negotiation" for setting wages is now a mediated process in which the worker has less control, largely because their access to information became even more limited. Moreover, as the middlemen, the subcontractors actually took a share of workers' pay for the services they rendered, adding to decreased wages. Once again, the burden of employer sanctions fell on the immigrants.

Table 2
Mean Real Hourly Pay of White and Mexican Male Workers Before and After IRCA

	Before IRCA (1979, 1983, 1986)	*After IRCA (1988, 1989)*	*Percent Change*
Mexican Origin	$8.42	$ 7.71	-8.4%
Native	$9.23	$ 8.50	-7.9%
Foreign-Born			
0-5 years in U.S.	$5.69	$5.75	1.1%
6-10 yrs in U.S.	$6.73	$6.40	-4.9%
11+ yrs in U.S.	$8.62	$7.86	-8.8%
Non-Hispanic Whites	$11.26	$11.07	-1.7%
Native	$11.23	$11.03	-1.8%
Foreign-Born			
0-5 yrs in U.S.	$10.26	$10.73	4.6%
6-10 yrs in U.S.	$11.33	$12.03	6.2%
11+ yrs in U.S.	$13.00	$13.47	3.6%
Wage Difference in Mexican vs. Non-Hispanic Whites	**$2.84**	**$3.36**	**18.3%**

Adapted from: Sorensen and Bean, 1994.

Increased Numbers of Undocumented Workers

The final lesson learned from the enactment of IRCA is that it made no difference in the number of undocumented people entering the country. In fact, the number of undocumented immigrants (particularly Mexican immigrants) increased dramatically after IRCA. The vast majority of the 11.1 million undocumented immigrants residing in the U.S. entered the country after IRCA. A Pew Hispanic Center study reports that almost half of these undocumented immigrants (five million people) arrived in the 1990s.[30] Another 4.4 million undocumented immigrants have arrived since 2000 (see Figure 1). Much of this movement is due to family reunification and social networks of Mexicans immigrants. The report goes onto the say that a third of the foreign-born population is undocumented. Such figures indicate that IRCA's efforts to stem the tide of undocumented immigration failed.

The overarching lesson learned from the enactment of IRCA is that a one-shot legalization process where only a certain section of the undocumented population is allowed legal status does not work. The negative externalities of this approach far outweighed the positive ones due to the fact that IRCA overlooked the arrival of future immigrants, thereby reinforcing the existence of a subclass of workers. Despite this unsuccessful policy effort of the 1980s, some of the more recent legalization efforts looked very similar. Bush's temporary worker plan, for example, did not provide any option for earning permanent residence status. In the Senate, the Hagel-Martinez modification would have created a three-tiered system in which time of arrival would determine the legal status for which an immigrant is eligible.

However, some recent proposed efforts address ongoing migration flows. The Kennedy and McCain proposal approved by the Senate, for example, provided a pathway from guest worker status to legal permanent residence, followed by citizenship several years later. Table 3 compares the differences between Hagel-Martinez and the Senate Judiciary bill. The 2006 Senate Judiciary bill would have provided a means of attaining legal status for all of the undocumented immigrants currently in the

Figure 1
Years of Arrival of Undocumented Immigrants (in millions)

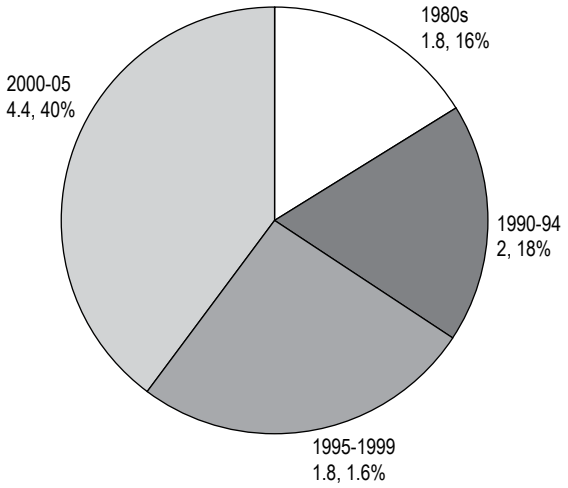

Table 3.
Comparison Legalization Components in 2006 Senate Bills

Hagel/Martinez	Senate Judiciary Bill (revised from Specter proposal)
• Three-tiered system for legalization: 1. Only undocumented workers who have been in the U.S. for more than five years can adjust to legal status. 2. Undocumented workers who have been here less than five years but more than two years will need to leave the country and return. They would have priority for obtaining a temporary worker visa. 3. Undocumented workers who have been in the U.S. for less than two years would not have any special provisions. They would need to exit the country and apply for a temporary worker visa.	• Undocumented immigrants who can prove they were living and working in the U.S. on January 7, 2004, could qualify for temporary lawful status for six years. • $1,000 fine and fees, have complied with tax filing requirements, have not committed certain crimes, and understand or are studying English, U.S. civics, and history. • After the six-year period, applicants who have worked or studied continuously and meet the other requirements of the bill would be able to adjust to lawful permanent resident (LPR) status after payment of a second $1,000 fine and additional application fees.

Adapted from: Immigration Reform Now, Immigration Reform Now, available at http://www.immigrationreformnow.org.

United States as well as for immigrants wishing to enter into the United States. This effort to construct a comprehensive solution to immigration reforms went the furthest in addressing the market failure of an economic system that is dependent on immigrants. Such a policy could potentially lead to the absorption of immigrants into the mainstream labor market, thereby opening up more space for labor rights and higher wages.

CONCLUSION AND RECOMMENDATIONS

In order to adequately address the "problem" of immigration, the United States must consider policies that address the root causes of the migratory flows across the southern border. These policies must address both demand (the employer side) and supply (economic inequality between the U.S. and Mexico).

The signing of NAFTA in 1994 fully integrated trade and regional competition between Mexico, Canada, and the United States. Since NAFTA, trade between the three countries has nearly tripled.[31] In 2003, the United States exported upwards of $62 billion to Mexico and Mexican imports to the U.S. reached over $90.2 billion.[32] Proponents of NAFTA claimed it would also serve to slow immigration flows, as companies would open operations in Mexico. In reality, the 1990s saw increases in Mexican migration to the United States. Changes provoked by trade liberalization and the economic crisis immediately following the signing of NAFTA in Mexico in fact created "a dramatic increase in undocumented immigration from Mexico to the United States, from an average of 260,000 per year from 1990 to 1994 to approximately 485,000 per year from 2000 to 2004."[33]

While NAFTA endorsed the movement of capital, goods, information, and commodities in North America, the United States in particular has continued to limit cross-border movement of labor. This state intervention is a sign of market failure. By placing limits on immigration, the United States effectively protects the native-born labor market from competition.

In order for Mexico to engage in more perfect competition with its northern neighbors, there must be increased equality of access to information and resources. To strengthen the NAFTA region, the United States should consider economic assistance to Mexico, instead of spending more on border enforcement. This could help improve the Mexican economy to a level where it can compete equally with the other regional partners.

Additionally, rather than focusing on criminalizing and cracking down on the immigrant workforce, more attention should be focused on employer enforcement. Enforcement punishes immigrant workers, not the employers who hire them. By not punishing employers, enforcement measures ignore one of the real economic issues at hand: the demand for cheap labor. By strengthening enforcement of labor standards and hiring practices, not only is the incentive to employers for hiring undocumented workers reduced (i.e., wages are increased), all workers, undocumented or not, benefit from better enforcement of workplace regulations.

If the United States wants to limit undocumented immigration, consumers must also be prepared to pay higher prices for the goods and services currently provided by cheap, undocumented la-

bor. Without undocumented workers, prices for services provided by sectors with high numbers of undocumented workers, such as domestic help, construction and food processing and preparation, would likely increase.

Finally, it is important to mention that even in the most effectively conceived economic solution to immigration, a number of "human" factors are difficult to account for. In many cases, migrant streams follow community networks. These transnational networks remain in place, regardless of changes to immigration policy. Additionally, the debate on immigration clearly brings up deep issues of culture, race and nationalism. While many initiatives seek to capitalize on the fears and dreams created by these sentiments, perhaps no policy can fully address these issues.

The following policy recommendations are based on the analysis provided in this article:

- Employer sanctions and workplace regulations must be strengthened and enforced.
- Legalization initiatives must include provisions for the ongoing flow of immigrants and provide a path to citizenship.
- Immigration policy must be linked to economic integration. To level the playing field for competition, free trade agreements must provide opportunities for economic growth for weaker countries. Providing economic support to weaker economies allows for more job creation opportunities at home, thereby reducing the wage and employment differentials between countries engaged in economic integration.
- Lawmakers should promote immigration policies that strengthen communities and recognize transnational family and community connections.

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NOTES

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Who Should Govern the Internet?

ICANN's Controversial Position Questioned and Challenged

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Introduction

The question over who or what governs the Internet is a hotly debated topic in the U.S. and internationally. Many are under the impression that the Internet is not governed or regulated. This is not the case, though, since organization and administration is necessary to ensure smooth functioning of the Internet.[1] This includes oversight of domain names, root servers, and the accompanying name registration services, among other important maintenance functions. For most people, these functions seem technical and non-political—mere formalities in a system that allows for universal participation in global financial markets, online educational tools, increased communication, and many other helpful and empowering functions. However, since the United States' decision in 1998 to incorporate Internet governance into the responsibilities of the Department of Commerce,[2] many people have questioned the legitimacy, accountability, and transparency of such an entity with direct control over a global information and communications network. Critics argue that technical decisions are indeed political and embedded in U.S. politics and history.

Internet governance and the current methods used for Internet administration were challenged and questioned by many countries in all stages of development at the World Summit on the Information Society (WSIS) that took place in Tunis, Tunisia, in November 2005. The WSIS in Tunisia was a follow-up to the WSIS 2003 in Geneva that addressed many of the same issues. The WSIS 2003/05 was organized by the United Nations' (UN) International Telecommunication Union or ITU, and innovative ideas, proposals, and projects on information and communication technology (ICT) was solicited from govern-

ments, NGOs, and citizens.[3] The WSIS conference was touted as the first UN summit to encourage participation from all sectors of society.[4]

Internet governance was at the top of the list of items to reform because many governments believe, some very strongly, that the Internet should not be administered unilaterally.[5] In this vein, one important outcome of the WSIS conference was the creation of the Internet Governance Forum (IGF), which allows for intergovernmental groups focusing on specific Internet-related topics, such as open standards and privacy issues, to discuss governance topics and bring them to the attention of UN officials.[6] Controversy surrounding Internet governance has arisen mainly because states feel slighted in the decision-making process, especially when it comes to not being able to control their specific political agendas through lack of control over the Internet.

The following discussion about Internet governance serves to explain why the topic is important and why it is, consequently, so controversial. It is necessary to understand the role of the Internet Corporation for Assigned Names and Numbers (ICANN), the private sector non-profit contracted by the Department of Commerce that is responsible for the domain name system (DNS).[7] Understanding why ICANN is being challenged is integral to the Internet governance debate because multiple stakeholders are involved in Internet issues, many of them wanting to air their grievances and reform the current Internet administration system. Throughout the discussion it will be seen that Internet governance is indeed very politicized, even if the technical administration and maintenance of the Internet is inherently non-political.

Since the United States' decision in 1998 to incorporate Internet governance into the responsibilities of the Department of Commerce, many people have questioned the legitimacy, accountability, and transparency of such an entity with direct control over a global information and communications network.

POWER THROUGH INTERNET GOVERNANCE

The Internet has been described as a "paragon of deregulation and decentralization" because, when compared to another ICT such as the telephone system, a multilateral treaty or an international governing board does not control the Internet.[8] Like the Internet itself, Internet governance is not indicative of bureaucratic and burdensome oversight commonly associated with such systems. Rather, it is decentralized in the way information is accessed, processed, and produced. However, like other systems, the Internet requires oversight and coordination in order to run smoothly. There are four areas where administration is essential for maintaining a functioning system: domain names, Internet Protocol or IP numbers, root servers, and technical standards developed for interoperability.[9]

ICANN has authority over the General Top Level Domains or gTLDs categorizing them by ".com," ".org," ".biz," and ".gov," among others.[10] The Shared Registration System or SRS allows multiple registrars to sell domain names such as "www.utexas.edu."[11] ICANN then places someone in charge of managing the database depending on the particular suffix. This also applies to the two-letter country code suffix that is appointed to a list operator for administration and database management. IP numbers, another administrative area, are assigned to every computer in the network in order to be recognized by other computers. Due to the low number of mainframe computers during the first stages of Internet use in the 1970s, IP numbers must be allocated very carefully and sparingly until the Internet is upgraded.[12]

Root servers are another important function of Internet governance. Root servers are the actual machines that allow for all the domain names to work; they match the domain names with corresponding IP numbers and are described as the "world's most important Rolodex."[13] There are only 13 root servers due to a technical problem when the Internet was first developed.[14] The Department of Commerce, through ICANN, decides who will control the root servers and where they will be based. Root service administrators are diverse and include NASA, university systems, the U.S. military, and even some foreign locations such as Stockholm, Amsterdam, and Tokyo.[15] ICANN also must set technical standards for the Internet such as coordinating the addressing system and deciding on how routers mitigate traffic. These standards

allow for a smooth operating system and also "let the Internet evolve."[16]

ICANN is capable of shaping and changing the Internet using these technical areas, collectively called the domain name system, because it can theoretically devise new ways to route information and deny domain names or IP numbers to certain individuals, communities, or countries. David Post, from the Cyberspace Law Institute, aptly describes the power an Internet governance administrator wields:

> "Any entity responsible for, and exercising control over, the root server databases possesses immense power over the future development of the Internet itself, and will, accordingly, be subject to immense pressure to act in ways that may be contrary to the best interests of the Internet community as a whole. Devising ways to prevent arbitrary, oppressive, or self-interested actions by this entity is a task of deep—of truly constitutional—importance to that community."[17]

Although these are technical areas, often seen as non-political if not neutral, they can reflect political agendas depending on how they are controlled and administered. ICANN ultimately decides how open or closed the system is; "technical standards can be designed either to foster openness or to permit censorship and surveillance."[18] The DNS is where information is controlled by the governing entity depending on the values of the system in which it exists. For this reason, many governments with historically different political values and social norms would choose to administer the Internet very differently from the United States.

WHAT IS ICANN?

The U.S. government has played a central role in the development and regulation of the Internet since 1973, when it initiated a research project to investigate interlinking packet networks under the U.S. Defense Advanced Research Projects Agency (DARPA).[19] However, it was not until 1992 that the government realized the commercial value of the TCP/IP network and acted to "privatize and commercialize the Internet backbone and local access services."[20] It took even longer to give up control of the coordinating functions of the Internet, which was eventually privatized in 1998 after very intense debates and controversies over the ideal entity best suited to regulate these important technical areas.[21] This debate was fought out after the U.S. Department of Commerce initiated a public proceeding in 1997 to receive comments about the privatization transition process.[22] In the end, ICANN was the "winner" and was incorporated in California as a non-profit "public benefit corporation."[23] With the creation of ICANN, a number of Internet-related tasks previously executed by other organizations including the Internet Assigned Numbers Authority (IANA) and Network Solutions, Inc. (NSI)) went under the purview of ICANN.[24]

According to Kenneth Cukier of *Foreign Affairs*, "ICANN was an experiment, a bottom-up, multi-stakeholder approach toward managing a global resource on a nongovernmental basis."[25] As can be expected, the non-profit has been mired in controversy, especially in its first few years, but has managed to uphold certain values linked to the American political tradition, such as free speech, which is also indicative of the nature of the Internet. The Internet has benefited from ICANN's private-sector status, enabling it to flourish without interference from government.[26]

In terms of the decision-making process, ICANN's "actions are transparent and decisions are made only after extensive consultation with Internet companies, governments, techies and freedom-of-speech organizations."[27] The staff itself hails from all over the world with Board and Council members who have extensive experience in Internet-related issues in Africa, Western and Eastern Europe, North and South America, the Caribbean, Asia and Australia and the Pacific.[28] They have diverse backgrounds in academia, the private sector, and the public sector, many of them with experience in developing countries.[29]

Despite the diverse make-up of the Board of Directors and Council members and ICANN's commitment to perpetuating an uncensored and open Internet, many foreigners and Americans find the Internet governance system appalling. Dislike for the system stems from the belief that the Internet is too large an organism to be maintained by a small non-profit corporation "accountable to the attorney general of the State of California and under the authority of the U.S. government."[30] ICANN has received criticism from other countries because it is seen as acting unilaterally with no input from outside the U.S. Within the U.S., many people in the private sector believe it is too governmental, whereas civil society groups think it's a tool for the "domain name registration businesses it was designed to regulate."[31] Regardless of the beliefs

about ICANN's performance in the past and its unconventional technical and quasi-governmental position, the non-profit maintains its role as the main figure in the domain-name addressing system despite almost worldwide appeal for change and pressure from the WSIS to transfer some power to the UN.[32]

A DICHOTOMOUS ENTITY

Difficulty in separating the technical functions of the organization from the political framework in which it works will continue to be a problem for ICANN. The non-profit's controversial role reveals some of the problems any Internet governance organization would face. Namely, the multiple interests and objectives of stakeholders involved in Internet governance, including government agencies, the private sector, and civil society, make it difficult to please all parties and makes decision-making dynamic and often time-consuming.

As mentioned, ICANN addresses mainly technical processes in Internet regulation to allow for interoperability and a smooth running network. One perception of ICANN is that it is merely a technical body that does not interfere with political functions of the U.S. government. Many experts believe it is just that; an organization where "decisions [are] made informally by a small group of experts responsive to whatever technical criteria they deem appropriate."[33] Critics of ICANN believe the Board of the organization "regards itself as a kind of technical priesthood."[34] In this way, ICANN creates a façade of legitimacy because it minimizes its role in the policymaking process. If it is simply seen as a small private organization engaging in nothing more than technical regulation and system maintenance, then it cannot be attacked for being a political entity vulnerable to U.S. policymaking agendas.

However, the other perception of ICANN is that it is a "public policymaking institution, a regulatory body of quasi-governmental character."[35] Although it manages the technical aspects of the Internet, the intrinsic value of the Internet system itself adds to ICANN's power because of the ubiquity of Internet use in financial and government sectors. The Internet is arguably one of the most important inventions in the ICT field, thus the entity that controls the DNS can hinder or enable people to use this relatively new technology. Due to the inherent importance of such a system, many argue that ICANN needs to be more transparent and accountable to the public.[36] It should have a democratic membership process and should be representative of public ICT needs in regard to the Internet.[37] It is exactly because ICANN plays a technical role, maintaining an expansive and resource-generating network, which gives rise to the controversy surrounding its existence.

Experiences in ICANN's short and turbulent existence indicate that board members themselves are somewhat unsure of the entity's regulatory scope. For example, most board members would admit to being in charge of the names and numbers necessary for domain name services, thus keeping a low profile by underscoring the banality of the technical services provided by the organization.[38] At the same time, ICANN has developed a complex system to "use its control of the root."[39] According to Professor Milton Mueller at Syracuse University, prolific writer on Internet governance, ICANN documents from 1999 reveal that the organization uses "measures designed to police trademarks and to exercise quality control over the business practices of domain-name registration."[40] As described by Mueller, these organizational functions go beyond technical administration and point to a policy-making role similar to that of the Federal Communications Commission where standards and procedures are developed, often out of necessity, to help coordinate the overall functioning of a telecommunications system.[41]

ICANN's vacillating identity as a purely technical entity to a policy-making organization makes other nation states wary of U.S. unilateral control of the Internet. Due to a history of regulatory involvement, even if it is limited, the international community's claim that ICANN can be influenced by politics is not unsubstantiated mainly because the non-profit is contracted by the Department of Commerce. It is highly unlikely, though, given that the U.S. government has historically had a "strict hands-off policy" when it comes to Internet regulation.[42]

POTENTIAL FOR POLITICAL CONFLICT: ccTLDs

It is argued by many that ICANN has done a good job in recent years in steering clear of political issues not directly under its technical domain. Although there was controversy linked to the somewhat secretive formation of ICANN and its relationship with the World Intellectual Property Organization,[43] the organization is not nearly as controversial as it used to be. One controversial area is inevitably tied up with politics and U.S. Foreign policy: the Country-

Code Top-Level Domains or ccTLDs. ICANN only has authority over General Top-Level Domains or gTLDs such as ".com," ".org," and ".biz."[44] It does not have authority over ccTLDs, though it can delegate and re-delegate the DNS, but is often called to answer questions when conflicts arise.

The late Dr. Jon Postel, one of the most important architects of the Internet, delegated the ccTLDs out of practicality and to spur Internet use. The 240 country-code domain names were assigned by Postel to encourage communities to "get online."[45] The domain names are managed by technical experts in the countries themselves with the "objective of enabling local Internet communities worldwide to develop their own locally-responsive and accountable DNS services."[46] In some countries, the ccTLDs may be run by the public or private sector, the non-governmental sector, or by an academic institution such as a university. Some countries have formal agreements with ICANN whereas others have no agreement. No countries are under the authority of ICANN, although ICANN can re-delegate ccTLDs when it is deemed necessary: "ICANN has the responsibility to neutrally investigate and assess requests on all matters relating to changes in the DNS root, including ccTLD delegations and re-delegations; and to recommend to the U.S. Department of Commerce any actions to be taken."[47] However, according to ICANN's CEO, Paul Twomey, ICANN will "only discuss a country's domain name as the result of direct request from that country and does not involve any other country in discussions."[48]

Despite the diverse make-up of the Board of Directors and Council members, and ICANN's commitment to perpetuating an uncensored and open Internet, many foreigners and Americans find the Internet governance system appalling.

ICANN board directors acknowledge that sensitive political issues of sovereignty and internal governance can be affected by who controls the DNS and their issues are addressed by the organization when problems arise. Depending on the country, the relationship between ICANN (sometimes there is no formal agreement) and the body administering the internal system can decide the fate of the domain name. For example, in the case of Moldova or ".md," the country was able to make economic gains by selling its domain name to private companies in the medical and pharmaceutical field.[49] ICANN did not dissuade or stop Moldova's government from selling the ccTLD as it was under the country's authority to strictly retain it as their domain name or sell it.[50] Although there was infighting between government officials and private companies such as Johnson & Johnson, the argument was not in the scope of ICANN's oversight functions.[51] Another perhaps more controversial example occurred in 2002 when China's Ministry of Information Industry made an inquiry as to why Taiwan had its own two-letter domain name (".tw").[52] ICANN was limited in what it could do to settle this non-technical internal political dispute but was inevitably embroiled in U.S. foreign policy matters.

These are just a few examples that demonstrate the potential for political conflict within a strictly technical Internet governance organization. ICANN is required to operate within an ever-changing Internet that frequently brings new controversies to the surface. Although its purview is DNS and IP addresses, it has to navigate through different political and economic agendas depending on country-specific circumstances. This strategic maneuvering through political agendas linked to Internet governance, especially by an organization under the U.S. Department of Commerce' authority, is bound to raise the ire of countries that disagree with U.S. political decisions and Internet policies.

INTERNATIONAL CONCERN: MORE THAN JUST DNS AUTHORITY

The WSIS 2005 was an event where UN member countries could discuss and decide Internet governance concerns. Internet governance was one of the most important topics of the Summit, if not the most important, because many countries are concerned "over the U.S.'s ultimate control over the domain name system."[53] Viviane Reding, the European Commissioner, stated, "There is a problem as many parts of the world [including the EU] don't like the fact that one country is linked to the organism that technically rules the internet [*sic*]."[54] However, the countries clamoring most for change—such as China, Saudi Arabia, Cuba, Venezuela, and Iran—are those that restrict the Internet within their boundaries.[55] Regardless of the political beliefs and values of this

group, it is important to deconstruct the arguments presented for creating a multilateral Internet governance body. Concerns about U.S. dominance are not just linked to DNS, but to the policy implications of technical aspects to Internet governance. Evaluating the results of the WSIS and any change to the current system, as unclear or vague as the WSIS agreement may be, also serves to explain future possibilities for Internet governance.

The main grievances aired by opponents to ICANN and U.S. regulatory authority are threefold. First, the current DNS system should not be under the control of one country. Rather, it should be "decentralized among the broader global community."[56] Countries admit that the DNS has generally been administered well under ICANN. However, given the growing importance of the Internet in governance and business, in terms of e-government systems, security correspondence, financial documentation and currency exchange, many governments want to see ultimate authority spread out over the broader community.[57]

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The second argument against the current DNS maintenance system is that many of the technical responsibilities of ICANN cross over into the political arena. As aforementioned, ccTLDs and the possibility of adding ".XXX" to adult content websites, among other domain name controversies, enter into more than just technical issues. They potentially influence culture, values, social norms, and governance within a country. Michael Geist, professor at the University of Ottowa in Internet law, offers some examples of "American values" such as free speech and intellectual property protection, within the regulatory framework of Internet governance. These Internet policies reflect concepts found in American political and legal history that is consequently "embedded in [U.S.] technological choices."[58] Geist notes that policy influence in technical areas of Internet governance cannot be ignored or avoided anymore because of the global nature of the Internet.[59] The claim is that broad representation in Internet governance needs to be present in order for the administrating entity to be legitimate and transparent.

The third, and perhaps most important consideration, is that "governments are struggling with the perception that they have lost control over their traditional governance mechanisms."[60] Loss of control is linked to the inability to enforce domestic laws because citizens can evade "traditional law through a network that does not easily conform to real-space borders."[61] This is argued by many as a positive change, because people in countries with oppressive regimes or very limited access to information can now communicate and access as well as produce information. This is one of the most enabling aspects of the Internet because governments can no longer effectively or efficiently control information channels. Geist, however, indicates that many countries, including developed countries with free speech legislation, are concerned about spam and intellectual property rights that are also linked to the regulatory structure of the Internet.[62]

These three areas are the main concerns among countries that participated in the WSIS 2003/05. What transpired in the 2005 meeting was not necessarily an answer to these concerns, although it is was small step toward multilateral regulation. UN Secretary General Kofi Annan proposed and passed the establishment of a new IGF comprising of government officials, business, and civil society as part of the WSIS agreement.[63] Some of the top action items for discussion among IGF contributors are Internet governance, privacy, spam, and cyber crime. The WSIS agreement signed by member countries acknowledges individual country sovereignty over "internet-related public policy issues" and recognizes the equal roles and responsibilities governments have to secure the stability and security of the Internet.[64] Sovereignty over individual ccTLDs and Internet resources was also ensured through the WSIS agreement.[65]

Despite the WSIS agreement, the U.S. did not give up any control it has over the Internet in terms of governance. American officials, among other interested parties, are skeptical of the idea that a multilateral intergovernmental body run by the UN will govern the Internet better than ICANN. If Internet governance were transferred from ICANN to another entity, the

most likely candidate within the UN would be the ITU. This is problematic for a number of reasons. Critics of the ITU point to a number of problems with the organization's decision-making process for telecommunications standards. For instance, the ITU has historically acted very slowly in developing and implementing new standards for telecommunications practices. In the 1990s the organization was involved in developing standards for mobile communication by satellite and trade in the telecommunication sector.[66] Both rounds of talks were time consuming and occurred in "closed forums."[67] Based on the ITU's involvement in past telecommunication policy, many are skeptical of its possible role in Internet governance. An even more controversial point when it comes to the ITUs involvement in Internet governance is that it would allow UN member states to directly influence the Internet potentially carrying out country-specific agendas without input from civil society groups.[68]

It is in this vein that policy makers and technology experts alike are weary of transferring technical management functions to a UN organization or any other intergovernmental group. In a letter from Secretary of State Condoleeza Rice to Jack Straw, former Acting President for the EU, Rice states that "The success of the Internet relies in its inherently decentralized nature, with the most significant growth taking place at the outer edges of the network . . . Burdensome, bureaucratic oversight is out of place in an Internet structure that has worked so well for many around the globe."[69] According to David Gross from the U.S. State Department, the signing of the WSIS agreement did not change the administration of technical aspects of Internet governance, the main concern for many prior to the Summit.[70] Even though there are no changes to Internet governance technical policy itself, even with the establishment of the IGF, there are still varying opinions as to what was really decided at the WSIS.

John Blau, a writer for InfoWorld website, reports that different entities had varying ideas about what happened at WSIS.[71] According to the U.S. there were no changes to the technical aspects of Internet governance or to ICANN. However, the EU believes that the U.S. did consent to consider a new oversight body citing the phrase "enhanced coordination" as a key indicator of U.S. willingness to attempt a multilateral Internet governance mechanism.[72] ICANN CEO Paul Twomey notes that nothing has changed for users and that eliminating other models for governance would be "destabilizing."[73] Yet another opinion from the ITU's Robert Shaw, an Internet policy advisor for the UN, was that there is no question that U.S. unilateral dominance is nearing its end based on the wording in the document signed by participating countries.[74] This leaves the agreement for the IGF and the future of Internet governance in a precarious position because of the vastly different opinions of the parties involved.

Understanding the concerns of other countries at WSIS reveals the deep-rooted fear that U.S. control of Internet governance will have negative effects in the future. For many, it may not be solely U.S. control, but the idea that one country controls a global network that affects so many people involved in financial, educational, social, and governmental systems. Although the WSIS conference offered the opportunity to articulate fears about Internet governance, the WSIS agreement and IGF do not yet offer clear-cut ways to delegate power through Internet administration. However, the IGF is allowing for more intergovernmental group formations through the use of "dynamic coalitions" which includes a coalition on privacy, open standards, and an Internet Bill of Rights.[75] These groups meet to discuss current governance issues and communicate concerns to the appropriate UN parties. The inaugural meeting took place in Athens in 2006 and was open to "all WSIS accredited entities and individuals with proven expertise and experience in Internet governance related issues."[76] Regardless of current efforts, disagreement about the WSIS agreement and the IGF indicate that issues of Internet governance are unlikely to be resolved in the near future.

CONCLUSION

The Internet has evolved into a system that enables and empowers people to become socially, politically, and financially active, accessing information while also producing it for dissemination; thus, Internet governance, the method for controlling, administering, and maintaining the network system, inevitably takes on a technical as well as a political role. ICANN is controversial for a number of reasons, but above all, its legitimacy is questioned because it manages a system that can be theoretically manipulated to suit various political agendas.

Despite the focus on Internet governance at the WSIS 2003/05 meetings, it is clear that there is a lack of consensus on who or what should govern the Internet. Arguments arise against unilateral control because it could potentially favor one country over others by endorsing particular policies or agendas. However, multilateral governance could bog down technical advances and add bureaucratic dimen-

sions that hamper Internet innovation and use. Internet governance is different from any other type of governance. As Secretary-General of the WSIS, Yoshio Utsumi (former head of the ITU) said, "The value of the Internet derives from the value of the information created and consumed rather than from the structure itself."[77] He argues that governments, rather than focusing on who or what governs the Internet, should really be formulating policies and designing innovative programs to increase access to the Internet worldwide. Likewise, Hamoudoun Toure, the newly appointed head of the ITU, recently commented that ICANNs continued management of the Internet's technical functions until 2009 allows the ITU to focus on cyber security and the digital divide.[78]

Regardless of ICANN's controversial position, the non-profit will continue to head Internet governance, at least in the short term, until an international consensus is found that is commensurate with U.S. Internet governance goals. A new contract between the Department of Commerce and ICANN ensures that the non-profit will manage technical functions until at least 2009.[79] It may be years before the world sees any dramatic change to Internet governance. In the end, this is probably the best way to maintain the values of the Internet architects who wanted accessible and open channels of information and communication (with minimal financial and political restrictions) for everyone, not just Americans.

LBJ

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Democracy Defenders:

The Role of the Military in Turkish Politics

By Erol Yayböke

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THE MILITARY IS UNDENIABLY the most popular institution in Turkey. Seen as the protectors of Atatürk's legacy and famously non-corrupt, the Turkish military challenges the belief that people enjoy less democratic freedoms in countries where militaries are strong. Decades of harsh military dictatorships in countries such as Chile, Paraguay, and Argentina have given politically involved militaries worldwide a well-deserved negative image. The Turkish military is a rare exception to this norm. For over 80 years, it has established a reputation as the protector of secularism and an advocate for democracy. It has never wished to govern the country, but rather to "guide Turkey on a steady course toward social progress and the embrace of universal ideals."[1] Ironically, this goal requires that it play an intricate role in Turkish public life, in effect meaning that Turkey is not yet a true democracy.

The military currently faces a dilemma. Accession to the European Union (EU) would be the culmination of Kemalism and high-ranking military officials have shown undeniable commitment towards that goal. The public will undoubtedly rely on the military for stability and perseverance in this time of transformation. According to Bilkent University professor Ersel Aydınlı, the military knows that it has a "unique responsibility to carry the country to the end of this road."[2] If Turkey becomes a member of the EU, the military will most likely become a European-style military with little involvement in politics, because at that point EU institutions will be responsible for holding Turkish politicians accountable for their actions. But, as Aydınlı notes, the military will not scale back its duties without the perception that the EU is completely committed to Turkish membership.[3] Few, if any, military leaders believe this commitment currently exists. Understanding the short-term threats posed by Islamic radicalism and Kurdish separatism, among other things, the military is unwilling to risk instability without a stronger signal of EU support.

Turkey still faces many threats, not the least of which is the rise

of Islamic fundamentalism within its borders. In addition, Kurdish militants threaten territorial sovereignty and are gaining political strength in neighboring Iraq. Tension with Greece continues—over its support of Kurdish terrorists, the division of Cyprus and disputes over the Greek Islands off the Turkish coast, to name a few. Syria, Iraq, and Iran, historically volatile Islamic countries, line the southern border and pose the threat of supporting terrorism and harboring violent Kurdish separatists. Additionally, some Armenian radicals seek to avenge past horrors. Former Turkish Foreign Minister Ismail Cem points out that "due to its geography and strategic importance, Turkey is a country that will almost always have security issues."[4] For the Turkish military today, weakness is not an option.

A MILITARY UNLIKE ANY OTHER

POLITICAL INFLUENCE

Turkish children are chosen at a young age for military school and are educated in modern facilities with highly skilled teachers.[5] Often these schools are better equipped than their public counterparts. Young officers-to-be train tirelessly, not only in the principles of battle, but also on the teachings of Atatürk, the founder of modern Turkey. It is an honor for almost all of them to serve as protectors of Atatürk's legacy, a duty that is not taken lightly. Many soldiers feel that without their service a modern, secular Turkey would cease to exist. These patriotic attitudes reinforce positive public opinion of the military and have allowed the military to enhance its influence.

For the Turkish military today, weakness is not an option.

Military service is required of all Turkish men, giving Turkey one of the largest standing armies in the world. Although some, including author Stephen Kinzer, argue that conscription is detrimental to the development of the country and that young Turks would be better served in higher education and/or work,[6] the size of the military is deliberately intimidating. Unlike its European counterparts today, the military also plays an active role in deciding Turkey's future. After Atatürk's death and the unsuccessful Democratic Party government of the 1950s, the military stepped in for the first time to overthrow a democratically elected government to ensure the continuity of Kemalist practices. The military would seize power again in 1971 and 1980, each time returning it to civilian hands—although not before modifying the constitution to guarantee its ability to influence politics.[7]

In order to understand the institutional reforms requested by the EU, we must first examine how and why the military gained significant influence over the civilian government. Only then can we evaluate the potential impact of reform on the military and Turkish society as a whole.

Realizing the need for order within the ranks, early Kemalist military commanders centralized power "by maintaining a strong hierarchy and limiting the channels of civilian-military interaction."[8] Their goal was a strong force that would maintain composure even as civilian leaders floundered. This was accomplished with the help of the High Military Council (HMC), an advisory body of generals that still regularly presents the National Military Strategic Concept to the government.[9] The HMC speaks as a unified and rational voice to the often politically divided civilian government.

Established in the "post-coup constitution of 1961," the National Security Council (NSC) is the most obvious way the military keeps "footholds in institutions that in most democratic countries would be entirely run by civilians."[10] For example, the United States National Security Council consists solely of civilians and is only advised by the Chairman of the Joint Chiefs of Staff. After 1961, its Turkish counterpart, however, had seven civilian and four military members, a combination that was tweaked after subsequent coups and constitutional changes. The 1982 constitution allowed for five civilian and five military members, with the civilian president most often siding with the military, meaning that this "civilian" institution was heavily influenced by the military.[11]

The 1970s were turbulent years for Turkey. Rising leftist radicalism and ideological battles by Turkish youth against the government almost caused a civil war and eventually resulted in the coup of 1980.[12] In response to these concerns, the military closely supervised education, radio, and television. The result, as is often the case in Turkey, was stability and peace at the expense of full democracy.

The military has historically intervened in Turkish politics to address gaps left by corruption, inadequacy, or a perceived threat to the Kemalist order. In fact, I would argue that it does not enjoy its role as government "watchdog," and is willing to step aside in the presence of strong, secular civil-

ian leadership. This became evident following the military coup of 1980 and the rise of Turgut Özal. When Özal, of Kurdish descent, was elected prime minister in 1983, the military immediately tried to exert its power over his new Anavatan (Motherland) Party.[13] A staunch secularist, Özal transformed the Turkish economy and fostered good relations with the United States without the guidance of generals. He also actively supported the coalition forces, against the will of the military, in the Gulf War of the early 1990s.[14] With vast public support as prime minister and later as Turkey's eighth president, he listened to, but was not overly influenced by, the opinions of military leaders. Rather than being angry about its loss of power, the military seemed content to let Özal govern with little intervention until his death in 1993.

Turkey became unstable once again following Özal's death. A series of short-lived governments, characterized by shaky coalitions and rampant corruption, finally culminated with the election of Necmettin Erbakan as prime minister. A radical Islamist, Erbakan began consolidating his power almost immediately and made no secret of his fundamentalist agenda, giving the military an incentive to intervene.[15] It had mistakenly supported secularist Tansu Çiller, the politician who ultimately made a deal with Erbakan that allowed him to become Prime Minister. In return, Erbakan quieted corruption charges against Çiller.[16] Eager to correct this mistake, the generals used the NSC to force Erbakan and Çiller out of power in 1998, banning Erbakan's Refah (Welfare) Party and banishing them both to political obscurity.[17] This action was welcomed by Kemalists and many of Erbakan's former supporters who had become wary of his extreme Islamic views. Although the methods used to oust him have been criticized, once again, the military had stepped in when civilian rule had failed.[18]

Many soldiers feel that without their service a modern, secular Turkey would cease to exist.

Interestingly, this continual dependence on the military for stability has bred complacency and allowed voters to take risks on Islamic parties. Turks tend to vote for Islamic parties on the basis of their social agendas even though they may not necessarily agree with their fundamentalism, as was the case with Refah. The public knows that if such a radically Islamic political entity gets too powerful, the military will step in and ensure that the secular order reigns supreme. Turkish voters have traditionally relied on the military for support and stability that could vanish, if accession is still uncertain, with the fulfillment of EU reforms.

Civil-Military Relations

The start of formal negotiations for EU accession in October 2005 was a bittersweet notion for the military. Although joining the EU is undoubtedly the culmination of a modernization and Westernization process that started with Atatürk, the accession process requires dramatic changes in Turkey's political structure, including lessening the influence of the military. Although the military is willing to make these changes in the name of membership, it is unwilling to do so without some confidence in future EU support.

One of the main problems with proposed EU reforms is that they are vague and open to interpretation. The political conditions of the Copenhagen Criteria[19] are as follows: "Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities."[20] All accession countries, including the most recent entrants, have unique characteristics; however, in Turkey's case its differences may be disqualifying. Turkey could be treated as an exception with more stringent accession guidelines that more geographically "European" countries would not necessarily have to deal with.

Nevertheless, the military remains vigilant in its pursuit of the EU. Against what many Europeans, and indeed many Turks, believe, the military is one of the biggest advocates of accession. In addition, former Minister Cem argues that in the over 60 NSC meetings he attended, the military has never voiced opposition to the idea.[21] Within reason, it is willing to discuss lessening certain controls—including civilian control of military budgets and military judiciary reform among other things—for the sake of furthering negotiations.[22]

According to the European Commission, "Turkey has made good progress in reforming civil-military relations" since 2002.[23] However, the NSC remains one of the prime targets for European criticism. Currently composed of seven civilian and five military members, it is chaired by a non-voting civilian. While secret meetings still raise transparency issues, regular press conferences keep the public vaguely informed of some of the issues discussed. Although

it has become the symbol of military interference in civilian affairs, in reality, its "function is exaggerated in Turkish public opinion"[24] and by European observers. The role of the NSC is to discuss and make decisions over issues of national security that are then presented to the government.[25] Dr. Aydınlı points out that the true influential power lies with the HMC, where four-star generals meet directly with the Prime Minister and his staff at least twice a year.[26] Policies are determined during these meetings and it is here, not in the NSC, that tension over policy arises. Due to the importance Europeans place on the NSC despite its limited role, the military is open to its reform.

Another point of concern for the EU has been the lack of civilian oversight over military budgets. According to the European Commission, new laws that came into effect in early 2005 "have the potential to improve budgetary transparency concerning military and defense expenditures,"[27] but have not yet done so. Additionally, civilian auditors have been authorized to audit those expenditures and report back to the Parliament.

However, the military remains firmly opposed to certain issues, such as ethnic diversity in the ranks, due to fears that reforms will inhibit its ability to help Turkey traverse these times of change.[28] The military is proud of being the protector of Atatürk's legacy, and believes it must avoid the participation of ethnic minorities, namely the Kurds, in order to maintain this integrity and identity. According to Aydınlı, it has tried to reach out to conservative Muslims, hoping to erase the radically secular image some of its leaders mistakenly perpetuated after the ousting of Erbakan in 1998;[29] no such effort has been made to reach out to minorities. The military fears recognition of minority groups would threaten cohesion and expose the isolated troops to deep divisions in Turkish society. Perhaps aware that this is a very sensitive subject, the EU has not called for great reform.

THE UNDERLYING PROBLEM

Military reform is one of many concerns the EU has regarding Turkey. Of the 146-page *2005 Progress Report* published by the European Commission, less than three pages focus on civil-military issues. This has not been a significant area of concern because of a high level of military cooperation up to this point. There could come a time, however, when the military ceases to cooperate. Although it is committed to accession to the EU, the military understands its role in Turkey's stabilization and if any part of the reform process—whether military, governmental, or economic—threatens the secular establishment of modern Turkey based on Kemalist principles, it will intervene.

The biggest internal dilemma for the military today with regards to EU accession is the rise of Islamic fundamentalism. With secular façades and rhetoric geared towards garnering support from the EU, parties based in fundamentalist Islam are attempting, in some cases successfully, to gain power in Turkish politics. With EU accession a possibility and the military's reluctance to be seen as the barrier to this goal, generals have been forced to watch from a distance as Islamism, albeit of a more moderate type, takes root. In the past it was the military's job to step in and ensure that the secular status quo was maintained. Future pressure from the EU could further curb its influence, at which point the military will have to make some difficult decisions regarding its role as stabilizer versus its commitment to the European dream.

THE ISLAMIC FUNDAMENTALIST MOVEMENT: THE ROLE OF RELIGIOUS PARTIES

The recent success of Islamic parties in Turkish politics raises a troubling dilemma for those interested in protecting the secular nature of the state. Religious freedom is widely viewed as a pillar of democracy and Turkey's efforts to control Islam, such as managing mosques to limit the spread of Islamic fundamentalism, are seen as undemocratic by many observers. The principle of separation of religion and state is arguably the least negotiable of Atatürk's teachings and vehemently protected by the Kemalist military. As Turkey looks towards Europe for its long-term economic and political future, it must also guard against secular threats presented by political Islam in the short-term.

Despite attempted controls, fundamentalist Islamic parties have had remarkable success at the ballet box in the last two decades, to the dismay of the military and other Kemalists. Public statements made by current Prime Minister Recep Tayyip Erdoğan and other AKP (Justice and Development Party) officials declare allegiance to the accession process, although it is uncertain what the goals of the party and its leader truly are with regards to Islam. If Prime Minister Erdoğan indeed wishes to create an Islamic state based on Islamic laws, as many people fear he does,[30] his pro-accession speeches amount to empty rhetoric. If he adheres to the path of moderate Islam while protecting the secular principles on which the country was

founded, Turkey may have a chance to be a successful EU member and an example to its neighbors. In the meantime, the military must watch the process unfold and be prepared to defend the secular status quo if necessary. Paradoxically, such an intervention would be detrimental to the future of Turkish-EU relations, but necessary if Turkey is to maintain its progress towards Westernization.

The Rise and Fall of Refah

The story of Islam in modern Turkish politics starts well before Refah's surprising first-place finish in the 1995 elections. The military, and indeed many government officials, felt threatened by the increasing support gained by leftist parties in the 1970s, resulting in the coup of 1971 during which many leftist party leaders were imprisoned. Religious conservatives, viewed at the time as less dangerous than the leftists, had already begun organizing politically and were not affected by the coup.[31] Among them was Necmettin Erbakan, a political figure rapidly gaining popularity among the religious right. Fearing a Marxist revolution and disturbed by the student revolts in the US and Europe around that time, Kemalist military leaders chose to support Erbakan and his new Milli Savcilar Partisi (National Salvation Party, MSP) against a secular but liberal Suleyman Demirel in the elections of 1973.[32] Although he would lose to Demirel, Erbakan's dynamic public speaking ability and his appeal to conservative Muslims quickly made him a household name.

A fundamentalist Sunni Muslim, Erbakan was again used by Kemalists as a "counterweight to . . . radical ideologies that were gaining strength in Turkey" in 1980.[33] In an effort to stop leftist radicalism, the military supported a radical Islamist whose MSP was blatantly anti-West and promised to create "a country which would be fully industrialized through economic cooperation with the Muslim world, the prerequisite of which was the return to Islam as the basis of social organization."[34] The military's attempt to choose the "lesser of two evils" not only went against its Kemalist principles but would also soon come back to haunt it.

The fall of the Soviet Union and decline in worldwide leftist radicalism meant that the time was right for Erbakan to take center stage. Candidates from his new Refah Party[35] began winning rural municipal elections as early as 1984 and burst into national prominence with impressive city mayoral victories in 1991. This local success carried over into 1994 when Refah candidates Recep Tayyip Erdoğan and Melih Gökçek became mayors of Turkey's two largest cities and previous secular strongholds, Istanbul and Ankara, respectively.[36] Islamic Party success was no longer just a rural phenomenon. The 1994 victories set the stage for the 1995 parliamentary elections when Erbakan would take on a fractured collection of secular politicians from the DYP (True Path) and Anavatan (Motherland, ANAP) parties. Garnering 21.8 percent of the total votes,[37] Refah finished in first place and formed an uneasy coalition with corruption-plagued DYP leader Tansu Çiller even after she had arguably run the most vehemently anti-Islamist campaign.[38]

How was this radical Islamic party able to gain so much support so quickly? By the mid-1990s, Turks were frustrated with the instability and corruption associated with the secular politicians of the time. The Refah platform resonated with the general Turkish public, emphasizing morals and a return to traditional family values. The party appealed to recent rural-urban migrants who suffered from high unemployment and were starving for the "just order" promised by Refah.[39] It was also able to organize at the grassroots level and truly show compassion for the "ordinary Turk,"[40] something Mesut Yılmaz of ANAP and Çiller of DYP were strangely incapable of doing. Refah won the 1995 election by a slim margin, but its victory indicated that Islamic parties (or at least their social agendas) had the potential for widespread appeal.

The military began to worry about Refah in the late 1980s, but not until Refah came to power did its discontent become obvious. As protectors of Atatürk's reforms, it had reason to worry. Erbakan was precisely the radical it had feared throughout the 1970s and 1980s, just in a fundamentalist Islamic, rather than leftist, form. In addition to wanting to make Turkey more open to Islam, his comments reflected a desire to create an Islamic state. In speeches leading up to the 1995 election, he openly proclaimed that he would "work for a just order, to liberate Bosnia, Azerbaijan, Chechnya and Jerusalem," later stating his intention to create "an Islamic United Nations, an Islamic NATO and an Islamic version of the EU."[41] At the time Turkey was not an official candidate for membership in the EU, but it is safe to say that he was generally opposed to any cooperation with the West.

Erbakan threatened to reverse secular reforms and align Turkey with its Muslim neighbors to the south, distancing it from the Europe-centric future envisioned by Atatürk. Even though a majority of Turks were shocked by the success of the Refah Party, the inability of secular politicians to cooperate against a common enemy, preferring instead

to vie for power amongst themselves, left the door open for Erbakan. Many who voted for him on the basis of his social agenda were later turned off by his overly Islamic rhetoric. Secularism was ultimately more important to Turks than social policy and Erbakan's quest for "worldwide Muslim solidarity"[42] was disconcerting at best. The Turkish population faced a problem it could not solve on its own and once again, it was time for the military to intervene on behalf of an immature voting population.

Inspired by frequent public outbursts against Erbakan's Islamism and annoyed by his reluctance to change course despite pressure from the NSC, the military began publicly releasing the problems it, and subsequently many Turkish citizens, had with him.[43] Although the military never directly asked for his resignation, the pressure eventually became overwhelming and after less than a year in office, Erbakan resigned in what has been dubbed Turkey's first post-modern "soft coup."[44] Refah was officially banned in early 1998 for "[using] religion for political purposes, [promoting] civil unrest and [seeking] to launch a theocratic state."[45] Interestingly, this decision was upheld by the European Court of Human Rights that unanimously ruled in 2003 that "'there had been no violation' of the European Convention on Human Rights,"[46] validating the military's efforts.

The public knows that if such a radically Islamic political entity gets too powerful the military will step in and ensure that the secular order reigns supreme.

ERDOĞAN'S AK PARTY

Current Prime Minister Recep Tayyip Erdoğan's form of Islamism started gaining popularity in Turkey soon after the Fazilet Party, for all practical purposes the reincarnation of Refah, was similarly banned from Turkish politics in 2001,[47] a move welcomed by secularists but widely condemned by international observers.[48] His AK (Justice) Party became the first single-party ruling government in over a decade after a comprehensive victory in the November 2002 elections. A self-proclaimed religious moderate, Erdoğan claims that his party is fully committed to seeking membership in the EU. He has gained the backing of several European governments and many secular Turks who believe that his stated commitment to Western principles, among them democracy and laicism, takes precedence over any fundamentalist Islamic aspirations he may personally have.

In reality, he is striking a delicate balance between religious fundamentalism and Westernization. The military is closely monitoring him and has voiced its limited approval of Erdoğan's government, mostly on the basis of its EU goals. As long as he remains focused on that goal both in statement and in practice, the military will keep its distance. The generals know that intervention at this point is not only unnecessary, but could lead to the disqualification of Turkey as a candidate country altogether. On the other hand, they are even more unwilling to give up on Atatürk's principles. If Erdoğan does cross over into religious radicalism, the military will undoubtedly step in as a stabilizing force to protect the secular status quo.

Educated in a religious imam-hatip school as a child, Erdoğan started his political career as a member of the Refah Party in the early 1980s. He became the mayor of Istanbul, Turkey's largest and most metropolitan city, on the Refah ticket in 1994 and was widely praised by his supporters and critics for making the centuries-old city "cleaner and greener."[49] Erdoğan was a rising star in the Islamic movement until the chaos that struck his party in the late 1990s. The banning of Refah left him still in power but with an uncertain political future, a predicament complicated by his arrest and conviction in 1998 for "inciting religious hatred."[50]

After his release from prison, Erdoğan reentered politics by creating the AK party out of the ashes of Refah and Fazilet. A shrewd politician, Erdoğan understood the need for moderation and the consequences of radical religious fundamentalism in Turkey as seen by his friend Erbakan. Thus his new party appealed to the more moderate members of the previous Islamic parties and in turn, moderately Islamic voters. Offering solutions to the economic crisis Turkey faced at the time and voicing displeasure over how the government handled the 1999 earthquake,[51] Erdoğan gained popularity as the 2002 elections approached. In addition, he was not plagued by the corruption scandals of his secular opponents, mainly Çiller and Yılmaz.

When the votes were counted from the November 2002 election, the AK party had won 363 out of a possible 550 seats in Parliament, an unprecedented success for an Islamic party in Turkey.[52] Once again, voters were willing to overlook his Islamic past and

believe his claims to have left his fundamentalist days behind him; in return they wanted economic stability and the promise of a non-corrupt government. To his credit, the economy has stabilized under his watch and, with a few minor exceptions, the AKP has been unmarred by corruption. Since he took office in 2003 his AKP has maintained its EU vision and Turkey is now, albeit with some other serious issues still to be resolved, on its way towards membership.

CONCLUSIONS

The troubling reality of Turkish politics is that voters, secular and religious conservative alike, lost faith in politicians some time ago. Constant bickering, internal feuds, and corruption scandals plagued the secular political arena during the 1990s. By the time the AKP came to power Turks had identified the prospect of Islamic fundamentalism as the lesser of two evils. "Right now, there is no viable option other than AKP," commented Philip Kaplan of the US Embassy in Ankara who follows the current administration closely.[53] Erdoğan knows that the military will not intervene as long as he stays focused on the EU, so that is what he has done; he also realizes that there may come a point when the military will be unwilling to sacrifice stability in the name of accession. He walks a fine, albeit very blurry, line.

With the presidential election in May 2007, secular parties have precious little time to come up with a solution. Erdoğan has stated his intention of running for the six-year post and is currently one of the frontrunners, a predicament that has the fragmented secular parties scrambling. "We need a single party with 50 percent support, not five parties with 10 percent support each," former Prime Minister and leader of ANAP , Mesut Yılmaz commented following his decision to reenter politics.[54] Rahşan Ecevit, wife of former Prime Minister Bulent Ecevit, recently stated that she intends to spearhead a campaign to unite at least six secular political parties to "form an election block against the AKP."[55] Despite undoubtedly pure motives, it is unlikely the parties, more importantly their leaders, will be able to unite in such a way given their histories. Hope remains for them, however, because Erdoğan did not rise to power by gaining a majority of votes. It was the fragmentation of secular parties that opened the door to him and it is the same door that, under a unified secular platform, has the ability to curb his presidential aspirations.

Whatever the outcome of the 2007 election, it is my firm belief that an overwhelming majority of Turkish voters prefer secularism to Islamism. Erdoğan was elected on the basis of his social policy and stated allegiance to the West, but if he steps over the line he can expect action, and not just from the military. On May 17, 2006, a radical Islamic lawyer burst into a Council of State chamber and shot five judges, one of whom died.[56] He was protesting a court ruling, also criticized by Erdoğan, to uphold the secular headscarf law. The violence incited stern comments from President Ahmet Necdet Sezer who warned that "no one will be able to overthrow the secular regime," saying that the shooting was "indeed an attack on the secular republic."[57] Over 40,000 people gathered the next day to show support for the secular establishment, some even calling the tragedy "the September 11 of the Turkish Republic."[58] Whatever the outcome, the shooting and resulting public outrage sent an important message of secular unity and discontent to Erdoğan and the AKP.

In contrast to Western beliefs, not all Islam in Turkey is radical. In fact, most Muslim sects try to distance themselves from violence, a task made difficult by media portrayals of Islamic extremism in the greater Middle East. Extremism must be differentiated from moderation, the latter predominating amongst Turkey's Muslims. Secularism, and Kemalism for that matter, is not inherently incompatible with Islam. Turkish secularism is designed to limit the existence of radical fundamentalists in politics. Many Kemalists are Muslims just as many EU politicians are Christians and are offended when their religion is associated with extremism and terrorism. Most are culturally Muslim, preferring to align themselves with Islam out of tradition and family heritage.[59] Turks use their beliefs as the foundation of a value system, not as the only law with which to govern society.

Accession to the EU is undoubtedly the culmination of Atatürk's dream of a Westernized Turkey, but would he have been willing to risk the rise of Islamic fundamentalism in pursuit of this goal? Westernization was his prize, a principle inherently incompatible with the ideals of a fundamentalist Islamic state. The only institution that will ensure the perpetuation of secularism is the military, and it must stay actively involved in the accession process until the end, at which point it can finally loosen the reigns. The EU must commit fully to Turkey's membership or be satisfied with the military's involvement in the transition process. Without that commitment, further reform of the military in

pursuit of the long-term goal of EU accession will only result in the short-term rise of fundamentalism and be detrimental to the secularism and stability that Turkey enjoys today.

Ultimately, the decision lies to some extent with Prime Minister Erdoğan. If he chooses to play both sides, claiming to be completely focused on the EU accession process while trying to implement fundamentalist Islamic policies to appease his radical constituency, he will fail. The two ideals are inherently incompatible with one another and if he wants to avoid massive public protests and the possibility of military involvement, he must choose to align himself solely with the principles of the modern, and secular, republic.

LBJ

NOTES

1. Stephen Kinzer, *Crescent and Star: Turkey Between Two Worlds* (New York: Farrar, Straus and Giroux, 2001), p. 165.
2. Telephone interview by Erol Yayböke with Ersel Aydınlı, Professor, Bilkent University, June 20, 2006.
3. Ibid.
4. Ismail Cem, *Türkiye, Avrupa, Avrasya: Avrupa'nın "Birliği ve Türkiye* (Istanbul: Istanbul Bilgi Üniversitesi Yayınları), p. 224.
5. Kinzer, *Crescent and Star,* p. 168.
6. Ibid., p. 172.
7. Ibid., p. 166.
8. Ersel Aydınlı, Nibat Ali Özcan, Doğan Akyaz, "The Turkish Military's March toward Europe," *Foreign Affairs,* vol. 85 no.1 (January/February 2006), pp. 77-90.
9. Ibid.
10. Ibid.
11. Ibid.
12. Ibid.
13. Kinzer, *Crescent and Star,* p. 166.
14. Ibid.
15. The rise of Erbakan and his lasting effect on Turkey's political landscape is discussed in more detail in the next section.
16. Kinzer, *Crescent and Star,* pp. 166-167.
17. Although Erbakan himself has stayed out of politics, he was instrumental in the creation of other Islamic parties that arose from the ashes of Refah. Today he is under house arrest for the "misuse of state political party aid." *The New Anatolian,* "Erbakan to serve 11-month sentence at home" (June 8, 2006). Online. Available: http://www.thenewanatolian.com/tna-8403.html. Accessed September 5, 2006.
18. Ideologically, most Turks believed that Erbakan should not be in power because his stated ambitions violated the fundamental principles upon which the Turkish state is based. However, some questioned the over-zealous methods used by certain generals, calling them as radically secular as Erbakan was Islamist and often power-hungry. This, Dr. Aydınlı claims, perpetuated a bad image of the military and ultimately resulted in the firing of several high-ranking officials involved in the "soft coup." Aydınlı, interview.
19. Based on membership criteria laid out in Copenhagen, Denmark, in June 1993, the Copenhagen criteria are the official rules that decide whether or not a country is eligible for EU membership.
20. Kemal Derviş, "The European Transformation of Modern Turkey," paper presented to the Economics and Foreign Policy Forum Centre for European Policy Studies (Istanbul), p. 14.
21. Cem, *Türkiye, Avrupa, Avrasya,* p. 222.
22. Aydınlı, interview.
23. European Commission, *Turkey, 2005 Progress Report* (Brussels, 2005), p.14.
24. Cem, *Türkiye, Avrupa, Avrasya,* p. 223.
25. Ibid.
26. Aydınlı, interview.
27. European Commission, *Turkey, 2005 Progress Report,* p. 13.
28. Aydınlı, interview.
29. Ibid.
30. Adam S. Albion, "Turkey's Bold Step into the Future: Will the EU Meet the Challenge?" *EastWest Institute,* vol. 1, no. 8 (2002), p. 2.
31. Kinzer, *Crescent and Star,* p. 63.
32. Ibid., p. 64.
33. Ibid., p. 65.
34. Ben Lombardi, "Turkey-The Return of the Reluctant Generals?" *Political Science Quarterly,* vol. 112, no. 2 (1997), pp. 191-215.
35. The MSP became defunct after the military coup of 1980, but was resurrected again in 1983 as the Refah (Welfare) Party.
36. Refah also won in 29 other cities and over 400 towns, meaning that over two-thirds of the Turkish population lived under municipal governments run by Islamic fundamentalists. Lombardi, "Turkey-The Return of the Reluctant Generals?" pp. 191-215.
37. Sultan Tepe, "Political Religion versus Secular Nationalism: A Comparative Analysis of Religious Politics in Israel and Turkey" (PhD dissertation, The

University of Texas at Austin, 2002), p. 170.

38. The Refah-DYP coalition came to power in 1996 after a military-backed DYP-ANAP coalition failed to form a government.
39. Lombardi, "Turkey-The Return of the Reluctant Generals?" pp. 191-215.
40. Kinzer, *Crescent and Star,* p. 66.
41. Lombardi, "Turkey-The Return of the Reluctant Generals?" pp. 191-215.
42. Kinzer, *Crescent and Star,* p. 70.
43. Ibid., p. 76.
44. Stephen Kinzer, "Pro-Islamic Premier Steps Down in Turkey Under Army Pressure: Military Defending Nation's Secular Character," *New York Times,* June 19, 1997.
45. Tepe, "Political Religion versus Secular Nationalism," p. 172. Full text of the indictment can be found at http://www.belgenet.com/dava/rpdava.html (accessed June 22, 2006).
46. *Turkish Daily News,* "European Court's Decision Has No Value, Erbakan" (February 17. 2003). Online. Available: http://www.turkishdailynews.com.tr/archives.php?id=31164. Accessed: June 26, 2006.
47. Ilnur Cevik, "What a Verdict," *Turkish Daily News* (June 23, 2001). Online. Available: http://www.turkishdailynews.com.tr/archives.php?id=23871. Accessed June 26, 2006.
48. Comments made by EU politicians after the fall of Fazilet voiced valid concerns yet once again showed that they had little understanding of the unique threats posed by Islamic fundamentalism in Turkey. Few took the time and effort needed to educate them of the situation and therefore were quick to judge. What they failed to realize is that the two democratically-elected parties (Refah and Fazilet) were banned because if it were entirely left up to them, there may not have been *any* future democratically elected governments. *Turkish Daily News*, "Crucial Week in Turkish-EU Relations" (26 June, 2001). Online. Available: http://www.turkishdailynews.com.tr/archives.php?id=23914. Accessed: June 26, 2006.
49. *BBC News World Edition,* "Turkey's Charismatic pro-Islamic Leader," Online. Available: http://news.bbc.co.uk/2/hi/europe/2270642.stm. Accessed: June 26, 2006.
50. He was convicted for quoting part of a poem that said, "Mosques are our barracks, domes our helmets, minarets our bayonets, believers our soldiers," and ultimately served four months of a ten-month sentence. *Wikipedia,* s.v. "Erdoğan, Tayyip." Online. Available: http://en.wikipedia.org/wiki/Tayyip_Erdogan. Accessed: June 26, 2006.
51. Ibid.
52. *Turkish Daily News,* "Erdoğan the PM" (March 10, 2003). Online. Available: http://www.turkishdailynews.com.tr/archives.php?id=31429. Accessed: June 26, 2006.
53. Interview by Erol Yayböke with Philip Kaplan, Political Section, Embassy of the United States of America, Ankara, Turkey, January 6, 2006.
54. Yılmaz was on trial for corruption but the Supreme State Council decided to drop the case if no similar charges were brought against him in the next five years. *Turkish Daily News,* "Great Game in Turkish Politics Underway" (June 26, 2006). Online. Available: http://www.turkishdailynews.com.tr/article.php?enewsid=47242. Accessed June 26, 2006.
55. Ibid.
56. *Times* (London), "Islamist Shoots Five Turkish Judges in Headscarf Protest" (May 17, 2006). Online. Available: http://www.timesonline.co.uk/article/0,,2002184610,00.html. Accessed: June 26, 2006.
57. *Times* (London), "Uproar in Turkey over Shooting of Judge" (May 18, 2006). Online. Available: http://www.timesonline.co.uk/article/0,,25689-2187272,00.html. Accessed: June 26, 2006.
58. Ibid.
59. I am often told that because my father, his father, etc., were Muslim Turks, I too am one; not *should* be one, but *am* one.

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