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CONTENTS

<i>Preface</i>	5
<i>Forward</i>	6
<i>Social capital and human development</i>	8
ISLAMIC EXCEPTIONALISM: HOW VALID IS THE CONCEPT OF ISLAMIC HUMAN RIGHTS? (RAY VERNON AWARD FOR BEST SUBMISSION 2000) EBRAHIM AFSAH	9
“YOU CAN’T GET NOTHIN’ DONE ‘ROUND HERE...” ORGANIZING A CRAFTS COOPERATIVE IN RURAL KENTUCKY ALISON HICKEY	18
TOWARDS PEACE IN SUDAN: ONE WOMAN’S JOURNEY CATHERINE WIESNER	23
MAKING THE LINK: SOCIAL CAPITAL AND URBAN POLICY MADELEINE PILL	32
WOMEN OF AFGHANISTAN SALLY BOALES	39
<i>Governance</i>	46
PENSION FUND SYSTEMS: WHAT CAN BE LEARNED FROM LATIN AMERICA? ALESIA RODRIGUEZ	47
THE ROLE OF PUBLIC DIPLOMACY IN BUILDING PEACE AND DEMOCRACY: BOSNIA AND HERZEGOVINA ANA S MITROVIC	54
PRESERVING SOCIAL SECTOR ACHIEVEMENTS IN CUBA MIRJAM SCHONING	62
GRASSROOTS PRESIDENTIAL POLITICS: AMERICAN DEMOCRACY IN ACTION FELICITY SPECTOR	68
MICROFINANCE REGULATION: DESIGNING AN APPROPRIATE FRAMEWORK FOR MEXICO ANNE ROTHBAUM AND JENNIFER TOBIN	72
<i>Community Development</i>	79
STRATEGIC COMMITMENT AND THE DESIGN AND PERFORMANCE OF ROTATING SAVINGS AND CREDIT ASSOCIATIONS IN KENYA MARY KAY GUGERTY	82
THE SELF-EMPLOYED WOMEN’S ASSOCIATION’S (SEWA) RURAL SAVINGS AND CREDIT PROGRAM IN GUJARAT, INDIA SHARMILA MURTHY	89
FUNDING STRATEGIES FOR A NONPROFIT MUSIC CENTER: OVERCOMING THE STARTUP CHALLENGES ANTHONY CHAVEZ	97
TRANSFER OF HOUSING TECHNOLOGY FROM LAB TO CONSTRUCTION SITE TARA SHARAFUDEEN	104

NEIGHBORHOOD BALANCE SHEETS ASSESS LOCAL ECONOMIES	KENNETH METER	110
INVESTING IN THE INNER CITY: A MODEL FOR PARALLEL GROWTH	ALEXANDRA BLAIN AND STACIE OLIVARES-HOWARD	119
STRATEGIC ALLIANCES BETWEEN BOSTON AND ITS UNIVERSITIES	LAUREN BUDDING AND ELIZABETH HUMPHREY	123
<i>Ethics culture and reform</i>		129
PRIOR INFORMED CONSENT OF PROJECT-AFFECTED INDIGENOUS PEOPLES	AARON GOLDZIMER	130
THE NIGERIAN LEGISLATURE: ARTICULATING AN AGENDA TO COMBAT CORRUPTION	OBIAGELI EZEKWESILI	141
CIVIC AND SOCIAL ENGAGEMENT OF CONGREGATIONS: HOW PARISHES MIGHT ENGAGE WELFARE REFORM	TIM MATHERN	149
WHAT DO YOU MEAN WHEN YOU SAY YOU WANT TO MAKE THE WORLD A BETTER PLACE?	MICHAEL ROTHMAN	155
HEALTH CARE: THE NEXT FRONTIER FOR ADR	ELAINE GAUSE	161
<i>International trade and finance</i>		170
THE ASIAN FINANCIAL CRISIS IN RETROSPECT: THE COOPERATIVE APPROACH TO CRISIS MANAGEMENT	RONALD UMALI MENDOZA	171
ECUADOR'S FINANCIAL CRISIS: BAD POLICY, BAD BANKING AND BAD LUCK	JUAN-CARLOS PITARQUE	181
PERSPECTIVES ON SOCIOECONOMIC REFORM AND BRAZIL'S INTERNAL DEBT	MAXIMILIAN MARTIN	187
GOVERNANCE IN THE INFORMATION AGE: INDUSTRIALIZED AND DEVELOPING ECONOMIES: THE AFRICAN CHALLENGE	MOUSLIME KABBAJ	195
FINANCIAL GLOBALIZATION: MYTHS AND REALITIES	JERRY TARDIEU	202
MORAL HAZARD AND THE VALUATION OF EMERGING MARKET SOVEREIGN DEBT	STEVEN RAHMAN AND JONATHAN ABSHIRE	206
<i>Biographies</i>		213
<i>Index</i>		221

Preface

The mission of the Kennedy School is to train public leaders and to do research that contributes to the solution of public problems. This book is the first to present the best writings of emerging KSG public leaders. It represents a novel way to forge links between current and former students, faculty and supporters of the school.

The philosophy of the student editorial staff was a pragmatic one; to initiate the project with broad inclusion criteria. The result is a good reflection of the Kennedy School's international diversity. We are the most international school at Harvard, with 40% of our students from overseas. Thirteen of the 32 authors are international students, six of which have English as a second language. Sixteen of the 28 papers focus on international issues or case studies.

The project has been an entirely student-led initiative. This first edition represents a deliberate step by current students to form a broader discussion platform than the school alone. Intended to be a dynamic link, student papers will also be accessible through the school's web site. We hope this service will develop into a powerful intellectual asset.

The project also reflects the diversity of policy analysis exercises performed at the school, from community development to international relations. It is informative and at times controversial. But perhaps its most valuable feature is its archival value. It is representative of the work of the school at the beginning of the new millennium. We hope this publication will both showcase the present generation of students and suggest new directions that future Kennedy students can choose to pursue.

Joseph S. Nye, Jr., Dean

Introduction

. . . Then felt I like some watcher of the skies
When a new planet swims into his ken;
Or like stout Cortez when with eagle eyes
He star'd at the Pacific—and all his men
Look'd at each other with a wild surmise—
Silent, upon a peak in Darien.

J Keats- On First Looking Into Chapman's Homer 1884

We stand on the edge of a world we barely recognize; one of new technology, wealth and power. Youth no longer simply look to the past for wisdom; this is a terrain increasingly of our own creation. New graduates have options; to turn their back on powerful corporations and to create their own job descriptions. They can start up, mess up and start up anew. There is plenty of money chasing fewer good ideas. In seconds, like minds can find each other. Epistemic networks can evolve, mobilize and achieve meaningful change.

Yet despite such interconnectedness, a yawning gulf remains. Behind a handful of technological winners, billions confront a rather different world. The vigorous optimism enjoyed by wealthy nations is derived from health, choice and freedom. How do we nurture similar conditions where despair and disempowerment reigns?

This makes it a fascinating time to embark upon a public career, and from the Kennedy School in particular. Growing together with future crisis workers, legislators, reformers and teachers is a memorable experience. Much of this place is not fully appreciated while we are here. We can only understand it, Tolstoy said, by the furrow left behind when it is gone. As a compact campus and a maelstrom of ideas, the Kennedy School's rich diversity, tolerance and energy impart a unique atmosphere. Likened to an intellectual ant nest, it is quite distinctive among the graduate schools at Harvard.

This enterprise began in February 2000 as an ambitious idea. Building an interactional platform for student writing was keenly yet conditionally supported. The chance to present the first of such enterprises in print in parallel with a website seemed a logical concurrence.

Past students will read this book and recall their own transition from fervid ideology to more sanguine pragmatism. Right now, this project represents a snapshot of emerging ideas, to be enjoyed by visitors, supporters and prospective students. No less importantly, tomorrow this publication represents a valuable archival document. For a relatively young school, preserving this evolution is of great importance.

From discourse at Shays and the Bow, along Brattle St and beyond, a selection of student thought from the last twelve months will find its way to broader dissemination. This is not a textbook. The editors did not solicit papers. Instead we allowed the inaugural contents page to reflect our institution, its personalities and the conversations within it. The public policy ideas are insightful, diverse and sometimes provocative. Many are yet to be tested in open forums. Some could be tomorrow's reality.

We were grateful for early support in that period from Julie Wilson, Joe Nye and Anne Drazen. Serena Syme helped during conceptualization before my editorial engine room of Lynne Lyman and Finbarr Livesey joined me in March 2000. These two caressed and cajoled manuscripts throughout the darkest moments of a busy semester. Felicity Spector, Michael Rothman and Peter Szoldan gave their time during the project while the KSSG Citizen provided office space. We were grateful for Shannon May's question to Senator John McCain in the Arco Forum that was captured on film by Martha Stewart and later transformed to our cover by Kristin Smith.

Professor Fred Schauer headed the faculty review panel. The fifteen reviewers commented upon papers throughout periods of severe demand upon their time. Curtis Nelson and Holly Sargent Taylor coordinated finance and sponsorship. Finally we acknowledge the extensive support of our alumni sponsors, in particular Mr Leon Loeb (MPP 1972) and Manuel Tiangha (MPAM 2000).

Enjoy our first edition of the Kennedy School Review.

Andrew Laming
Managing Editor

SOCIAL CAPITAL
AND HUMAN
DEVELOPMENT

Islamic Exceptionalism: The Validity of Islamic Human Rights Ebrahim Afsah

*"Nations are associates, not rivals in the grand social enterprise."
(Jeremy Bentham, cited in Oakeshott, 1993:101)*

The debate over human rights is not confined to the protection of the individual from abuse, but has wider and more consequential implications for the community of states. Nowhere has this debate been more pronounced than between the Muslim world and the Christian West. Both sides have grown accustomed to viewing each other as intrinsically different, the very embodiment of "otherness". This debate has often focused on the incompatibility of cultures, as expressed for instance in presumably mutually exclusive conceptions of human rights.

Based on the belief that there are no *essential* differences between people, including the Christian West and the Islamic East, this paper argues that notions of human rights are not the prerogative of any one cultural tradition but arose in response to the changing needs of society. Such an analysis rejects the ahistorical view that sees the emergence of human rights as the triumph of a particular cultural or religious tradition. Rather it regards the emergence of individual rights as the 'rules of the game' necessary to moderate the dialectical struggle between different sections of society, and between state and society.

This view takes due notice of the impact of historical development and the socio-economic level of societies, and permits a fuller understanding of international human rights. Seen from this perspective the claims of cultural relativism, both Western and Islamic are examined, arguing that human rights are best understood without reference to any particular religious or cultural tradition.

This paper thus commences with a brief description of the claims to particularity often made by adherents of political Islam. It is pointed out that the historical diversity and the various reactions to modernity throughout the Muslim world make it very difficult, if not impossible to identify any one authoritative version of Islam.

Part three discusses in some detail the claims of both Western and Islamic proponents of cultural relativism, concluding that relativist notions are not particularly helpful for our understanding of international law, and particularly human rights norms. This is followed by a discussion of the manipulation of relativist arguments for essentially political reasons, which take remarkably similar forms across the Third World, raising certain doubts as to legitimacy of the Islamist line of argument.

Part four examines the claim, often made by both Western and Islamic writers, about the *sui generis* character of Islamic societies. By pointing out sociological, i.e. non-religious causes for the rejection of Western models throughout the Muslim world, the section attempts to refute claims to Islamic exceptionalism.

Part five addresses the perceived genesis of international human rights norms from the Western Judeo-Christian tradition. It maintains that religion-based explanations of human rights are inferior to one that examines the secular sociological background behind the emergence of such norms.

The conclusion restates the overall claim that the rejection of Western modernity expressed in Islamist rhetoric must be understood in the context of popular exclusion and alienation brought about by the advent of an overpowering modernity.

The Islamist Position

Many governments and some scholars have argued that international human rights standards are to a large extent incompatible with the tenets of Islam. The argument is based on two interrelated claims: that international human rights are a product of Western, i.e. Judeo-Christian culture, and that these are *in toto* not compatible with the prescriptions of a precisely identifiable, distinctly Islamic position on human rights. Provisions regarding religious freedom (especially the freedom to change one's religion), gender equality, torture (i.e. *shari'a* sanctions that amount to cruel and unusual punishment), freedom of expression, privacy (sanctity of home; dress code), the freedom of dissent and scientific freedom, have been found to be at variance with the Divine law.

Said and Nasser express the fundamental point of contention succinctly: "(Islamic) jurists see human freedom in terms of personal surrender to the Divine Will. *Freedom is not an inherent right*" (1980: 76-77). The US-Iranian philosopher Nasr argues similarly that the human condition is geared towards servitude of God, freedom is therefore limited to the freedom to do what is right. Absolute freedom remains a prerogative of the Divine: "Personal freedom lies, in fact, in surrendering to the Divine Will" (1980: 96-97).

While secular notions of human rights are based on the nature of man as a rational and sentient being, Islamic notions of human rights are seen as emanating from a Divine covenant: "When we speak of human rights in Islam we mean those rights granted by God" (Mawdudi, 1980: 15). Whatever the theological merits of such an approach, its application to international human rights norms is questionable. It disregards the impact of modernity and the historical struggles that brought forth the modern notion of human rights.

This flaw is elegantly summarised by Zakaria, who criticises the theocentric conception of man behind this position and challenges it on two grounds:

"It is non-historical, or rather it freezes a certain moment of history and holds fast to it till the very end, thus doing away with dynamism, mobility and historical development. Finally, it is non-empirical; it ... seeks to imitate a theoretical and spiritual ideal, while completely disregarding the effect of practice on this theoretical ideal" (1986: 237).

The failure of the Islamist position to take into account the impact of historical forces is discussed below in the context of the advent of modernity into traditional societies. But there is a second, more serious, flaw in the argumentation of apologetics of Islamic human rights schemes, which are based on the implicit or explicit assumption that there is such a thing as *the Islam*.

The traditional schism into distinct theological and judicial schools, together with the fragmented response toward modernity render any attempt to construct a homogenous concept of Islam a vacuous exercise. In the course of the century-old encounter between the West and the Islamic Middle East, the retreating Islamic world has developed four response patterns to meet the challenge (Farhang, 1988: 65):

Secularists have argued that Islamic societies are backward and must undergo fundamental economic, socio-cultural, and legal reform to meet the technological and military challenge posed by the West. A prime example would be Kemalist Turkey.

Traditionalists reject modern cultural and political ideas, and wish to retain traditional socio-cultural values and authority structures. They do not reject the technological and bureaucratic innovations of the West, but believe that these can be detached from the “corrupting” aspects of Western life. The oil-rich Gulf monarchies are the most obvious examples of this view. They believe that their wealth allows them to import only select features of a generally alien and hostile West.

Religious modernists, in contrast, do accept the need for radical reform but maintain that it must be grounded in a liberal and scientific interpretation of Islam. They thus reject the wholesale adoption of Western mores and claim that the progressive aspects of Western thought have already existed in early Islam. This approach was followed e.g. in the Tunisian reform of personal status law in 1958.

Fundamentalists, reacting to the failure of both secularists and religious modernists to reach a functioning synthesis between Islam and modernisation, portray the cultural encounter in terms of a diametrical confrontation. Islam is seen as inherently superior to the Western tradition, including both Capitalism and Marxism. The existential confrontation does not allow for accommodation or pluralism, but posits Islam as the only moral order with themselves as exclusive representatives of the Divine will. Khomeini is probably the best known representative of this school of thought.

Apart from these largely political reactions in the modern age, it is important to bear in mind the extraordinary variety that has characterised Islamic theology and jurisprudence from its very inception, that led to the development of at least six *equally authoritative* traditions which resulted in great variations in the interpretation of Islamic doctrine (Schacht, 1962).

Whatever the respective merits of the various schools, and the degree of cross-fertilisation between them, there simply never existed a single authoritative interpretation of what constitutes the proper *canon islamicus*. Farhang (1988) thus contrasts the broad scope of Islamic law with its heterogeneous character, “despite the *shari’a*’s grasp of nearly all aspects of individual and social life, there is no unified Islamic legal system, enshrined in integrated codes and accepted by all Muslims.”

This crucial fact is often forgotten, not least with regard to the proper position of human rights within Islam. The traditional fragmentation into co-existing theological schools, together with the four broad patterns of response towards modernity which transgress the classical division of the Divine law, render *ad absurdum* any attempt to speak of Islam as a monolithical entity. Given this diversity, it is thus not surprising that Mayer finds that “Muslims have taken many differing positions on human rights, including the unqualified endorsement of international human rights standards as fully compatible with their culture and religion” (Mayer, 1991).

Cultural Relativism

The relativist position is founded on the belief in the fundamental “otherness” of Third World societies, which makes Western concepts inapplicable. This position with regard to human rights has been well expressed by Abul Aziz Said: “While the pursuit of human dignity is universal, its forms are designed by the cultures of people. ... [the] emphasis on Western common denominators projects a parochial view of human rights that excludes the cultural realities and present existential conditions of Third World societies” (1979: 86).

This position further argues that condescending neo-colonialist attitudes show a lack of respect for the sovereignty of Muslim countries. The criticism of non-western human rights practices serves as a welcome vehicle to improve the Western image and discredit Islamic culture as backward and primitive. By establishing the West's inherent moral superiority, the ultimate goal is to show "that Western political, economic, and cultural hegemony was and is a natural and beneficial phenomenon for human kind" (Mayer, 1991).

Cultural relativism is a critique of such traditional Western scholarship about non-European people. Edward Said's *Orientalism* and his more recent *Culture and Imperialism* (1978, 1993) argue that such scholarship is not conducted in a spirit of scientific research but is based on the racist assumption of Western superiority and Eastern inferiority. Such scholarship posits an ineradicable barrier between the West and the East, obscuring the common humanity of people, and thus dehumanising the Oriental (or African, etc.). Orientalist scholarship thus serves the dual purpose of legitimising Imperialist ambitions, and persuading the Oriental to accept his subjugation as the natural order by depriving him of the intellectual means for self-realisation.

Inapplicability of Cultural Relativism

"a mutilation that these societies are inflicting on themselves on the pretext of preserving their being" (Arkoun, 1984:218)

Cultural relativists condemn the notion that there are universal standards by which all cultures can be judged, denying the legitimacy of using values taken from Western culture to judge institutions of non-western cultures. They include international human rights norms among these culture-dependent values, which cannot be applied outside their original context. Apart from the cynical use of human rights for political ends, they maintain that any imposition of international, read Western, human rights norms is tantamount to "moral chauvinism and ethnocentric bias" (Schwab, 1979: 14). This seems to this author to be an untenable position born out of misguided idealism and "political correctness". Proponents of this view decry Western human rights diplomacy, while taking democratic freedoms and human rights at home for granted. Müllerson describes this position aptly as "rather arrogant and imperialistic" (1997:14).

Edward Said (1991) claims that non-European peoples are entitled to their own history, and he rejects the division of mankind into distinct, immutable categories. What he argues against is the singling out of a particular group of people as *sui generis*; but he does *not* call for new barriers dividing humanity in order to protect indigenous habits from (justified) criticism. To maintain that Western norms cannot be applicable in Islamic milieus, is to subscribe precisely to the Orientalist idea that concepts employed in the West are *ipso facto* irrelevant and inapplicable in the East. Mayer continues further that "those who charge that comparisons of international and Islamic law on human rights issues are Orientalist implicitly endorse the same elitist stance ... that international human rights are the sole prerogative of members of Western societies."

Furthermore, whatever the benefits of the relativist position with regard to *intact* traditional societies and their habits, say the absence of the concept of private property among the San (bushmen), the application of this position with regard to societies that have experienced decades of interaction with the West and have fundamentally and

irrevocably been transformed by this encounter, is open to serious doubt.

The international discourse about human rights is not conducted in an institutional void, but concerns the behaviour of *states*. The modern nation-state, so enthusiastically endorsed throughout the Muslim world, is part of a cluster of legal and institutional transplants from the West. Notions of constitutionalism and human rights developed as a reaction to the coercive potential of the nation-state and its attendant innovations, such as a modern bureaucracy, army, police, etc. When one is thus comparing the behaviour of Islamic governments or the content of so-called Islamic human rights schemes with international norms, "one is not judging an institution of an intact traditional culture by alien Western standards but examining Muslim's reactions to imported legal concepts and to transplants in national legal systems, imports and transplants that they have dealt with for decades." (Mayer, 1991:9).

Cultural relativism, particularly when invoked by a government therefore seems little more than "an ideological tool to serve the interest of powerful emergent groups" (Howard, 1986:17).

Political Use of Relativist Arguments

"In arguments about moral problems, relativism is the first refuge of the scoundrel"
(Scruton, 1994: 32)

Although Islamic governments and Islamist writers do not tire to stress the exceptional character of their religion which necessitates certain limitations or even outright violations of human rights, their arguments neatly fit into similar pronouncements by other, non-Islamic governments trying to justify repressive rule. The attempts to devise particularly Islamic moral norms inevitably lead not to a distinct ethical system, but merely curtail existing rights. Mayer (1991) rightly points out that:

"the practical results of rights policies associated with governmental Islamisation programs have simply replicated patterns of rights violations common in undemocratic countries outside the Muslim world, violations that gave rise to the current principles of international human rights."

Resistance to the changes brought about by modernity is not peculiar to Islamic societies. The resentment of an excessively individualistic culture that places undue emphasis on entitlement, without the attendant sense of obligation, pointing out the dangers of a 'me-first-society', all these are common phenomena in societies which are undergoing rapid socio-political change. Such a resistance to human rights may represent an authentic response when it comes from persons who are immersed in traditional cultures unaffected by the impact of modernisation, or resenting this impact. But this position cannot be regarded as genuine when it is pursued by urbanised elites in societies that have long succumbed to the pressures of modernity. Here "communitarian rhetoric too often cloaks the depredations of corrupt and often Westernised or deracinated elites" (Donnelly, 1989). Müllerson (1997) holds likewise, "Pressure to limit human rights comes from interested groups, and references to one's otherness ... serve to conceal power interests."

However often the terminology of these elites invokes religious sources and authority, the stakes in the battle over human rights standards are ultimately political. The argumentation employed in Tanzania, China, Indonesia, or in Iran is, not surprisingly,

very similar. It has very little to do with their alleged religious or cultural idiosyncrasies, but very much to do with rationalising the preservation of peculiar, often pre-modern social and political orders that benefit a certain elite disproportionately. "Human rights are intended to protect the weak members of societies, the dissidents, those who want to oppose their governments. There is no logical reason why that idea should be less valid for non-western societies" (Baehr, 1996:19).

Mayer stresses the fact that religious criteria serve the sole purpose of diluting or negating the protection afforded by international standards while paying lip service to the ideals of human rights that have gained too much prominence even within their own societies to deny them outright. This is not an Islamic phenomenon but, "part of a broader phenomenon of attempts by beneficiaries of undemocratic and hierarchical systems to legitimise their opposition to human rights by appeals to supposedly distinctive cultural traditions" (1991:215).

The desire to preserve elite power motivates the recourse to a highly idealised mythical past for very pragmatic political gains. It is necessary to look behind the façade of religious rhetoric and examine the historical and societal factors, which lie at the roots of supposedly religious phenomena. Cultural relativism, i.e. the notion that analytical and methodological tools are inapplicable outside their original cultural context, is fundamentally flawed and ripe for political and ideological abuse.

Islamic Exceptionalism

The portrayal of Islam as fundamentally different, indeed the very antithesis of Christianity, whether in its traditional Orientalist version or in its new cultural relativist guise is not based on any inherent characteristic of either Islam *per se* or the societies that have become Islamic. Having been locked in centuries of warfare and ideological competition, both religions have come "to see in each other the very embodiment of menace and the epitome of the 'other'." (al-Alzm, 1993:79).

Muslim societies are unquestionably different from Western societies, but that difference is one of degree not of quality. They do not function markedly different from others, and their behaviour, the forms in which societal tensions manifest themselves can well be explained by reference to socio-economic pressures and universal historical forces without the need to have recourse to the stipulations of an all-pervasive divine order that dominates these societies.

Marriage patterns in Muslim societies, for instance, are often explained through the *sunna* (model) of the prophet or Qura'nic provisions. But as Keddie (1988:79) points out eloquently, such patterns of endogamy are by no means particular to Muslim societies but can be found throughout the Mediterranean and are rooted not in religious law but in the requirements of tribal politics and economy, and the perceived need to control women.

Most commentators have concentrated on the phenomenon of Islamic fundamentalism to support their thesis of Islam's exceptionalism. The foundations on which fundamentalism is build are socio-economic, not religious. Farhang (1988) summarises this process well when he discusses the origin of the Iranian revolution: "the social disruptions caused by the process of modernisation could create anomie in the classical sense, which often results in the growth of anxiety, hostility, and fantasy. ...[where] the fundamentalist can easily transform the disorientation of the individual into a collective hatred of the *other*."

The failure of both secularist and religious modernist to reach a functioning synthesis between Islam and modernisation, together with persistent outside influence, has resulted in highly authoritarian and repressive governments. The process of very uneven development and rapid modernisation has led to "dual societies" throughout the Middle East, where the vast majority is excluded from the benefits of modernisation while becoming deeply uprooted and alienated, not only from their traditional culture but also from their own, modernised compatriots. The resulting disillusionment with Western modernisation that has failed to extend the benefits of development to the poor, "has led to considerable disenchantment with the Western model of progress generally, and ... encouraged anti-Western reaction" (Mayer, 1988). Farhang (1988) endorses the same position, arguing that we cannot understand the fundamentalist position in politics, particularly with regards to general and civil rights, if we fail to understand "the desperate existential conditions of its principal constituency - the urban poor."

Secular foundation of human rights

If one thus accept the notion of the gradual levelling of differences between societies through the working of global historical forces, then notions like democracy and human rights must also be subjected to a critical historical positioning. It is often assumed that the Western Judeo-Christian tradition has been more conducive to the development of human rights, than Eastern religions, notably Islam. Such a proposition is neither logically nor empirically tenable. Halliday (1996) is categorical in this respect: "no derivation from any religion is ultimately possible." Arthur Schlesinger (1989) concurs: "As an historian, I confess to a certain amusement when I hear the Judeo-Christian tradition being praised as the source of our concern for human rights. In fact the great religious ages were notable for their indifference to human rights in the contemporary sense."

Bertrand Russel (1935) is more candid in his criticism of the revered canon of Western tradition:

"The Jews first invented the notion that only one religion could be true, but they had no wish to convert all the world to it, and therefore only persecuted other Jews. The Christians, retaining the Judaic belief in a special revelation, added to it the Roman desire for world-wide dominion and the Greek taste for metaphysical subtleties. The combination produced the most fiercely persecuting religion that the world has yet known."

To be sure, "there are traditions, including religious ones, in all nations which can be supportive of the acceptance of human rights ideas" (Müllerson, 1997). But the development of human rights in the West was not *caused* by the existence of any particularly favourable disposition in the prevailing religious climate of Europe. Rights were *necessitated* by the emergence of new powerful institutions such as the centralised nation-state and its bureaucratic and coercive innovations. By pointing out that the cultural and political traditions of both non-western and pre-modern Western societies did neither include the practice nor the very concept of human rights, Müllerson identifies another causal origin. It is the vastly increased capability for intrusion into the autonomous sphere of the individual that necessitate some kind of protective mechanism. "Therefore, a modern state and human rights, as entitlements of the individual *vis-à-vis* the state, are *mutually conditioned*" (Müllerson, 1997:89).

Human rights were developed in the West because the necessary historical conditions for their emergence appeared first in the West. They did not appear overnight, but through a long, historical development. The Islamic world is in this respect not markedly different from other parts of the world; the resistance to the demands of globalisation will hopefully prevent the homogenisation of the world in some form of McWorld. But such resistance must find an accommodation with modernity as such, for the alternative to modernity would be, to paraphrase al-Azm, 'to end in the wastebin of history'.

Conclusion

Islamic societies are by no means as different from others as some of the proponents of political Islam would like to portray. The same applies to Western commentators who for a variety of reasons posit Islam as the very antithesis of Western values and civilisation. Political and religious tolerance was by no means inherent in Western religious tradition, but occurred, fairly late if one might add, in the process of a long historical development. This process, however, is not confined to Western industrialised societies, but can be expected to extend to other peoples as well once the requisite socio-economic conditions are in place. Human rights norms must be understood in their socio-economic context, they are conditioned far more by the level of development than by any particular religious or cultural norms.

Islamic societies have so far experienced modernisation only from the receiving end of colonised and subjugated people. Not surprisingly, modern institutions have manifested themselves in a very haphazard manner, in societies that have not had sufficient time to develop the necessary intellectual, political, and legal concepts to make sense of modernity. Most nations in the Third World did not have a chance to find their own way into modernity, but had it imposed on them through superior outside forces. One may deplore this, but there appears to be no alternative in an interrelated world. Hence, the co-existence of deeply traditional mores and customs along highly modernised sectors simultaneously in so-called dual societies seems to be a fact of life. Anti-modernist revolutions, as 1978 in Iran, might succeed in reversing partial aspects of this imbalance, but cannot stop the process *per se*.

These imbalances, together with their collateral of angry rejection of modernity are not an idiosyncratic aspect of Islam, but can be witnessed throughout the underdeveloped world. Indeed, they were an important aspect of the West's very own modernisation progress. One should thus refrain from ascribing to Islam any inherent capacity to either prevent that process or to be able to offer meaningful alternatives to it. The final accommodation of Islam with modernity, which includes secularisation appears inevitable. Human rights issues are only conceivable with a modicum of secularisation. Dogmatic objections should not obscure the debate, for they are of secondary importance when compared to the very real political role they play in the social enterprise.

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“You Can’t Get Nothin’ Done ‘Round Here...”
Organizing a Crafts Cooperative in Rural Kentucky
Allison Hickey

While living in rural Appalachia in 1994, I facilitated the start-up of a women’s crafts cooperative in an economically depressed town. Decades of abuse by large industry and marginalization by government had left the residents convinced political action was useless. The story of *Countryside Crafters* is the story of women in Livingston who overcame their skepticism about their own skills and the projects’ viability, and thus discovered the potential unleashed when women coordinate their energy.

Poverty in Rockcastle County

Livingston’s history is similar to so many tiny Appalachian towns that were momentarily buttressed by outside industry, and then deflated when that industry pulled out and jobs left. The train tracks run through downtown Livingston still, but the train no longer does. The Fall I was there, the community was feebly and unsuccessfully fighting the county’s decision to close the Livingston Elementary School. The school was essentially the last local institution that had not been moved to the county seat, Mt. Vernon, 15 miles up the road. By November, the post office, one restaurant, a tiny grocer’s, and a stoplight, comprised the remaining heart of the town.

Most residents live on the ridges or in the hollers of the hills, in trailer homes, or on small tobacco farms. In Rockcastle County, 31% of the population live below the poverty line, and while the unemployment rate is 12%, over half of the population is not considered part of the labor force (for example, people on disability or not actively seeking work). Small tobacco farmers are restricted by government quotas attached to their property which limit the pounds of tobacco that can be sold at auction each year. Tobacco is a highly labor-intensive crop which requires stages of stripping, hanging, and drying before the farmer brings the tobacco to market. After this investment in time and labor, the average annual income from farming in the county is only \$3,408 per family. As a result, tobacco farmers are almost never able to support their families on tobacco alone, and must work other jobs as well—typically in retail or service. Most other jobs—nearly 30 percent—are in manufacturing; many work ten hour shifts (often night or early morning) in automotive factories located 1-2 hours away.

A naïve and idealistic student of political science, I was struck most by the apathy and isolation of Livingston residents regarding politics and government. As far as my friends Jimmy and Ina Taylor were concerned, Washington DC was not only geographically distant; it contained social classes, interests, lifestyles, and opportunities foreign or incomprehensible to a Livingston native. Intellectually and viscerally, I viewed the federal government as accessible and accountable, albeit bureaucratic. For Livingston residents, it was a set of rich and powerful people doing their own thing. The individuals I knew showed little belief in their ability to effect change in government, and little sense of ownership. This was also their perception of state and local government. The officials at the state capitol were considered unresponsive, self-centered, and a different breed. Even Mt. Vernon was viewed by Livingston residents as beyond their scope of control or impact. At the November elections, I heard frequent grumbling that county politics were

dominated by Mt. Vernon issues and elected positions controlled by Mt. Vernon families. I sensed from the dilapidated barns, potholed backroads, conversations at the post office, and Sunday sermons that Appalachia was the underside of American tobacco farming and industry, the poor counties were the embarrassment of the state, and Livingston was the backwoods of Rockcastle County. I was unable to convince Jimmy to vote in the county elections, much less the national elections. Women in Livingston encounter further disadvantage. Few women hold jobs outside the home and a quarter of households are without a phone. Most families own one vehicle, and if groceries or other errands require a trip down the hill to town, both husband and wife go. For most of the women I knew, the car is the man's domain and the women are infrequently permitted to take the car themselves. As a result, many women are very isolated from the community. Verbal abuse and/or controlling behavior by their husbands is a familiar experience for women. (Physical abuse is present often as well, although not spoken of.) If the husband is employed, control of the money usually remains with him; the same was typically true of welfare support and unemployment or disability compensation.

Livingston Economic Alternatives in Progress

Women constituted the leadership and focus of Livingston Economic Alternatives in Progress (LEAP), the small non-profit organization where I worked. Founded in 1980, LEAP had not become a bustling community center with expanding programs, but it had survived—a feat in itself in Appalachia. Its primary program was a gourmet foods mail-order business. Eight years ago, Nell Hurd, Marie Faulkner, and Ina Taylor had come together around a kitchen table, pooled their favorite recipes, and decided to try their hand at producing and selling those items. By 1994, *Golden Kentucky Products* had created an 8-page black and white catalogue of sorghum products, chocolate candies, biscuit and soup mixes, and mustards, and employed three women part-time or full-time (depending on the season). The Executive Director of LEAP was Ina, a stubborn, energetic, intelligent and committed woman. Born in Livingston into a family of ten, Ina married at sixteen and moved to the tobacco farm across Rt. 16. In addition to farming, her husband Jimmy also drove a school bus ten hours a day. Ina was responsible for the accounting, fundraising, program management, and business operations for Golden Kentucky, in addition to overseeing the other agricultural, relief and livestock projects at LEAP.

The tremendous hours Ina put in and her constant worry about LEAP's precarious future and reputation made clear how deeply she believed in the organization. Yet I heard her complain repeatedly, "You can't get nothing done 'round here. Its useless...." She and other LEAP members often referred to their fellow residents as lazy, unambitious, unreliable, gossiping and back-stabbing. When Ina was removed from the bookkeeping and the petty politics of the community and sitting back on her porch swing in the evenings, sometimes we would talk about the visions she had for LEAP: establishing a community land trust, hiring a marketing person for Golden Kentucky, or starting a farmers' market. But when only two Board members showed up for a meeting, or ten times as many people applied to receive food baskets than offered to help put them together, she slip back to cynicism and depression, giving up again.

Getting the Ball Rolling: The Role of the Outsider

The idea of a crafts cooperative had been around for two or three years—

offered up in Board meetings, batted around with a few women, but never taken up. As with many other project ideas, Ina had become discouraged and angry when LEAP members appeared enthusiastic about a new project and the benefits it would bring them personally, but entirely unwilling to put the time or work in to make it happen.

When I suggested that we call a meeting of the female members of LEAP to organize a crafts project, Ina responded positively but unenthusiastically. When I pushed her further, she admitted she thought it wouldn't work and wasn't worth the effort: nobody would come. I realized then that my role as an outsider might serve as the needed ingredient. Every day I lived in Kentucky I was forced to deal with the reality of myself as a wealthy, single, educated female outsider. The assumption on the part of Ina and the community was that my ambition, intelligence, and previous exciting travel experience only gave good reason to believe that I would simply dip in, do good, and fly back out again. Stubborn and vehement, I fought each day in my personal interactions to convey that I was at LEAP because I respected the organization and its women, that their courage and experience surpassed anything I had studied at university or seen in my overseas travels, and that I knew I had indescribable amounts to learn from them. In their opinion, their community was dull, provincial, and of little value, compared to my home. When Ina introduced me to neighbors, she would inevitably make a joke that she had no idea why I would want to come to little Livingston, and that when I wised up and realized how boring it was, I would surely leave.

In the first months when friendships were new, I learned to censor my language and drop any references to my past experiences. Mention of my life outside Kentucky only served as a reminder of the privileges and travels I'd enjoyed, thus underlining the differences between us. The person with whom I was speaking would grow quiet. I learned to listen, and let who I was be conveyed in the questions I asked, the enthusiasm, affection, and laughs I shared. I had no understanding of local community dynamics—who liked or didn't like who, who one could trust, what works and what doesn't. I wasn't from 'round here—who was I to speak?

The challenge of being an outsider in community development is balancing the unique advantages with the humbleness inherent in the role. On most occasions, it was my duty to shut up and listen. But the crafts cooperative was a circumstance where my naivete and lack of local ties were precisely my strength. Ina refused to convene a meeting to organize the cooperative—in such a tight, gossiping community, she didn't want to call a meeting and have nobody come. But as that crazy girl from California, I had no reputation to concern me and was almost expected to take risks and do things differently. One morning I brought up the crafts project again and Ina shrugged, "Don't bother—nobody will come. You can't get nothin' done 'round here." Exasperated, confused, I said angrily, "Then why don't I just get on a plane tomorrow and leave?" "Why don't you?" she shot back.

From that moment, Ina left the crafts idea to me and did not attend the first or second meetings. I sent out meeting notices, called interested friends to personally encourage them to come, and posted signs. Later, when the group had sold their work at a crafts fair in Lexington and sent other crafts off to church fairs in Cincinnati, she came to meetings and sat in the back. I overheard her speaking to others proudly of the group's success. Although my boss's lack of support and presence was disheartening, her choice and my own choice to proceed make sense to me.

Successful Christmas Season

The crafts cooperative met bi-weekly into the Christmas season. Members volunteered to staff a booth at a large crafts fair in Lexington. Little was sold at that crafts fair. Better success was found in relationships built, through LEAP, with two suburban Presbyterian churches in Cincinnati hosting parish crafts fairs. The group chose a deadline when members would bring in their crafts and then the women spent the evening boxing the items for mailing. Each item was priced, with the agreement made that the entire amount would return to the artist.

The diversity and creativity of the crafts was great fun—women made hotpads, wooden baskets, Christmas tree ornaments, tea towels, full-size and baby quilts, dolls, quilted pillows, woven baskets, and wreaths. They used a whole variety of materials: clothespins, yarn, pushpins, wood, string, beads, pine cones, feathers, straw, gourds, dried apples, lace, and ribbon. The group obviously delighted in seeing each other creations, sharing ideas and tips.

Not all the women felt they had the talent to match the others. Some were hesitant to bring in their creations and initially dismissed the notion that the crafts they had been making at home for years were valuable and marketable. More than one woman expressed pure amazement that someone—someone from a wealthy suburb of a major city—would pay money for what she just puttered with at home. Their disbelief was apparent in the prices they suggested for their work. Betty Smith brought in a tack quilt to sell for \$40; when I told her I thought \$100 would not be unreasonable at all, she laughed, “Oh, honey, I don’t need that. I just make these up at home to pass the time....”

The group’s first meeting took place in September. By the end of the Christmas season, the group of 20 women had sold \$1,245.60 worth of crafts. The money came back to them in cash, in envelopes with their names on them. The significance of this money was not just that it was earned for their handiwork, but that it was in their control. Charlene Scott told me this money wasn’t going to be spent by her husband on new tires for the car, but on Christmas presents for her children. My most vivid memory is of Dora Smith looking in her envelope at \$25, shaking her head and saying “I’m shy. I don’t get out. I didn’t expect any of this to sell. I would have been so happy if I got a dollar...and \$25! I have no talent, but seeing this stuff, and trying, coming down here, just folks gathering, its like therapy for me. We’ve talked about it before but we needed it to get done.”

The Effect of Women Working Together

Ann Bettencourt speaks of four forces that prompt individuals to become grassroots activists: basic needs, a sense of self-efficacy, the experience of social connection, and a desire to rectify injustices. In the case of this crafts cooperative, the women initially came out of curiosity to see if this endeavor could work, who would be there, and possibly to make a few dollars. My experience of the resignation and depression of the community as a whole made me suspect that if I pushed grand plans for the group, the women would become overwhelmed by the challenge and skeptical of possible success. Therefore, the first meetings needed to excite their imagination and get them thinking what they might personally gain from involvement.

For this reason, I focused on the upcoming Christmas season and money that could be earned immediately—small and short-term, but solid and achievable goals. I

wanted the impetus for larger and more long-term goals to come from the group members themselves. Therefore, I was really pleased when Peggy Faulkner spoke up during our second meeting and suggested that we needed a name. At the end of the third meeting on her way out the door, Carol Blackburn suggested that each person bring some snacks to the next meeting for a potluck. Those were seemingly trivial comments, but actually telling marks of project ownership by the women. They displayed how the social connections and sense of solidarity as women was becoming a reason in itself to participate in the group—whether money was earned or not. For Dora Smith and some of the others who lived isolated up on the ridge, this was the first time they had spent time like this with the other women in Livingston and the only time during the week they came into town and really talked to people.

Developing Leadership

From September, I was aware that I would be leaving Kentucky at Christmas. I guessed, correctly I believe, that if the women were aware of this initially they would not have believed the project could successfully get off the ground. They did not trust they possessed the skills to find markets for the crafts and manage the money. I also quickly saw that curiosity about me was drawing women to the meetings who wanted to meet this odd girl from California. I saw that simple friendliness, cheerfulness, and my encouragement of them and their artistic talents helped to pull the group together. I needed to let the group use me as a focal point, without crossing the line to making myself integral to the on-going success of the project. I had only three months to build the group and pass it off. With all this in mind, I made sure to make decision-making consensual and dispel any of the mystery of my role. I emphasized that nothing I did, they couldn't do. All the information I received from the churches, any possible contacts, and any money taken in was listed on large posters so that the information was in the possession of the whole group.

Conclusion

As I left, Marie Faulkner assumed primary leadership of the group, after receiving some basic training in the primitive bookkeeping system I had set up for tracking the funds. Marie eventually was hired on part-time at LEAP through a federal program. When I returned to visit Livingston last year, Marie shared with me the larger story. At the time of Countryside Crafters' birth, she was getting a divorce from her abusive husband and the crafts program had been a blessing in building her self-esteem and hope and earning some much-needed income. Countryside Crafters has now been in existence four years. With approximately 20 active members, the group has developed contacts with two gift stores in Kentucky to sell their crafts, continued to sell at crafts fairs, and produced a small color catalogue.

The women in Livingston taught me that sustainable development is not defined by the longevity of the project, but by the extent to which the process has engendered in the community a belief in its own capacity to get up and walk. If this project fails in a few years, do community members believe they can initiate another? And will they have the knowledge and experience to know where to start? The women were driven to work together by their need for basic income, and the process by which they earned it also demonstrated to them their own worth and the value of group effort.

Towards Peace in Sudan: One Woman's Journey

Catherine Wiesner

In December of 1999, 102 women from 10 different conflict zones around the world gathered at Harvard University to participate in the launch of Women Waging Peace, a global initiative of the Women and Public Policy Program at the Kennedy School of Government and Hunt Alternatives. A central objective of the ongoing initiative is to document the successful strategies of women peace activists and to bring their perspectives to inform international policy making.

Rebecca Joshua Okwaci is one of the many Sudanese refugees who live in Kenya and crowd Nairobi's busy streets and teeming slums. But this woman would not be lost in any crowd. More than six feet tall in stature, with a decidedly regal bearing, Rebecca Joshua Okwaci literally towers above the fray. Moreover, it is her dynamic and unflagging commitment to a just peace for the people of her native Sudan that truly stands out, a brilliant testament to hope in an ongoing crisis.

Working for peace has become her life's endeavor, and empowering women to step forward and take their place in the peace building process, her own personal crusade. Okwaci switches roles from mother to journalist to political leader with a fluidity that sometimes conforms with, but often belies, both academic gender theories and a Sudanese conception of women's traditional roles. Her work embodies an emerging class of women peace activists engaged in the continuous struggle to build a bridge between their communities' grassroots reality and the political world of policymaking.

The Conflict

The Sudan has been afflicted with civil war for all but ten years since the country gained independence from the British in 1956. The war is most broadly described as a conflict between an Arab-Muslim North and an African-Animist-Christian South. The latest period of the war has been fought primarily between the Government of Sudan and southern-based rebels, although as many as five major armed factions are involved, with various splits and alliances on both sides.

Two million Sudanese have died in the past 15 years of the war and four million more have been uprooted and displaced in what is arguably the world's worst sustained humanitarian catastrophe since World War II. In 1972 the Addis Ababa Peace Accord was signed but was subsequently abrogated by the Khartoum regime in 1983. Dr. John Garang's Sudan People's Liberation Movement/Army (SPLA) then resumed the war, following attempts by the government to impose Sharia law and a full Islamic agenda on the country. In 1996-97 the war spread, with new fronts opening in the northeast. In 1997 the US imposed economic sanctions on Sudan for its continued human rights violations and alleged involvement in international terrorism. Following the embassy bombings in Kenya and Tanzania in 1998, the US bombed a suspected weapons plant in Khartoum, tenuously linked to international terrorist Osama Bin-Laden.

The Issues

The civil war is essentially concerned with two fundamental issues: *first*, the identity of the Sudanese state, and *second*, the question of who gains control over the

natural resources of the south. Decades of war have consolidated self-perceptions in the north and the south into racial, cultural, and religious identities and attitudes that are basically sustained by confrontation and conflict (Deng 1995). The civil war is often reported as one between black Africans and Arabs, southerners and northerners, Christians and Muslims. But these distinctions are blurred. Ethnic "southerners" live in northern regions, black Muslims live in both the north and the south, and significant ideological divisions within the northern Arab government exist. Furthermore, such essentialist and politically convenient manipulations of Sudanese identity ignore the equally central issue of control over resources: including infrastructure, water, agriculture, cattle, and most recently, lucrative southern oil deposits. Certainly ethnicity and religion are major contemporary factors, but their origins are historic and any inherent divisions have been crystallized by conflict.

Prospects for Peace

Most analysts agree it is unlikely that either side can militarily overwhelm the other, and unfortunately gross human rights violations and intense fighting have often continued amidst various declarations of peace rhetoric from all sides. The greatest hope for achieving a comprehensive peace in Sudan may lie in the Addis Ababa Agreement that temporarily ended the war in 1972. The dramatic, if limited, impact of the agreement was to reduce the political uses of underlying ethnic, regional, and religious feelings. In contrast, the civil war since 1983 and the policies of the national government have sharply intensified the salience of ethnicity, regional interests and religion in Sudanese politics (Kasfir 1991).

Prospects for peace are also encouraged by the successful negotiation of various smaller and internal peace negotiations. Cease-fires have allowed international aid to reach famine stricken areas, intertribal reconciliations appear to be on the rise, and a peace forum in 1997 between the government and a number of opposition groups shows possible areas of agreement—although the mainstream SPLA was notably absent. The agreement 1) addresses the issue of Sharia law with a complicated compromise, 2) includes a discussion of political rights, regional inequity and wealth sharing, and 3) offers frameworks like an interim period of confidence building with security arrangements. It also clearly lays out socioeconomic planning and policy making, along with political mobilization toward a referendum to determine the political future of the south. Most recently, shared development revenues from newly tapped oil fields could have been a powerful incentive for all parties to come to the peace table, had foreign oil companies and the international community cooperated. Instead, human rights groups charge that multinational corporations are collaborating with the Khartoum regime to support local militias in securing the oilfields, resulting in massive displacement, killing and famine.

Although many within the mainstream rebel movements may discretely prefer secession as the ultimate goal, southern leaders obviously realize that fighting for broader goals of justice or equality has been more effective in attracting outside sympathy and support than a blanket call for independence. Their rhetoric has therefore been crafted within a framework of equitable unity, and they have worked to establish cooperation with a diverse collection of actors motivated by the prospects of a national alliance behind the goal of a new, democratic, secular and pluralistic Sudan (Deng 1995). As a whole, the opposition movement has achieved some success in defending a common agenda for a secular state, but still suffers from southern ethnic and political divisions.

Women's Role in War

The simplest characterization of women in the Sudanese war is to acknowledge that the majority suffer the devastation in powerless silence. Of course the reality of women's experiences are manifold. For example, partly inspired by their counterparts in Eritrea—where participation in the liberation struggle is considered to have helped emancipate women and raise the status of women's rights to one of the most advanced levels in Africa—a few Sudanese women have even joined the rebel armies to fight alongside men in southern Sudan. Far more are actively engaged in protest movements and peacemaking. In 1995, Sudanese women were involved in peace forums ranging from the World Women's Conference in Beijing to the UNIFEM-Carter Peace Dialogue in Nairobi, and multiple local activities including workshops organized by Ahfad University for Women in Khartoum and forums organized by the women's desk of the Sudan Council of Churches.

Another facet of women's peace activism in Sudan can be found among the women, some quite elderly, who have lead protests in the north against the conscription of young men to fight in a distant and increasingly unpopular war. Though their protests on the streets of Khartoum have led to arrests and ongoing repression, their determination to speak out has not been curbed.

The Life of an Activist

Rebecca Joshua Okwaci lives in Nairobi, Kenya with her two small children, ages 6 and 3. A university graduate, she left Sudan in 1986 when her husband went south to fight with the rebel armies. Despite their frequent and prolonged separations, Okwaci points to her husband as a major source of inspiration and strength. Describing their partnership, she says, "He is a great man, an educated man. He would have lived comfortably and taken care of my family and me, but he saw the oppression and he opted to take up the cause of liberating our people. He's not a traditional Sudanese husband; he knows my strength and he is behind me."

Joining the exodus of refugees from Sudan, Okwaci found herself in the Itang refugee camp, Ethiopia's largest. Active earlier in student unions, she was invited to join a clandestine radio station broadcasting into southern Sudan and across the region. Building on her experience with radio in Ethiopia, she has since had the opportunity to go for training in various media techniques in Kenya, Cuba, and Germany.

After moving to Kenya, Okwaci was a founding member of the Sudanese Women's Association in Nairobi (SWAN), an economic empowerment group, and moved on to found the Sudanese Women's Voice for Peace (SWVP). Today, she works as a news editor and translator for BBC Monitoring Service. She continues her work as a peace activist, publishing articles on the efforts of Sudanese women in peace building and traveling to southern Sudan to enlist the voices of women in policy formation.

Identity

Okwaci is a proud member of southern Sudan's Shilluk tribe and a devout Christian. Yet none of these are binding identities for her. She moves easily from her role as a mother in the community to her political affiliations with the rebel SPLM United, and from the responsibilities of an international journalist to those of a local leadership trainer. The reality of these combined roles leads her to recount stories of chairing large meetings or

drafting organizational constitutions with a baby on her back. She describes the arrival of young men, separated from their families at a young age, who come to her crowded house in Nairobi, fleeing the fighting in Sudan and in search of opportunity; "Many times I have acted as a mother. They are traumatized, they have lost the love of their parents and they need to feel that they are accepted."

At first glance, her grassroots approach to peacemaking supports a connection between feminism and peace, drawing links between empowerment of Sudanese women and the emancipation of all of southern Sudan from suffering and war. But quick to point out that "we are not only talking about women..." she also repudiates the assertions of feminist scholars that the connection between feminism and peace is absolute or even that women necessarily have a predisposition to peace.

One Woman's Vision For Peace

Okwaci combines a commitment to women's empowerment, conflict management, and peace building with the specific use of media tools in promoting these interconnected aims. Her work with women and civil society on both the grassroots and the political levels is an extraordinary example of strategies that bridge the gap between grassroots activism and policymaking. Confident about the benefits of pushing on many levels simultaneously, she is prepared to knock unceasingly on all manner of "peace doors." In her view, success lies in the involvement of women from every region of Sudan, as well as those living in exile. She recognizes that women's attempts at peace building often go undocumented and unrecognized. Her goal is to support Sudanese women to identify issues at stake in the peace process, take the lead in both informal and formal negotiations, benefit from international support and recognition, and set their own agenda for peace.

Okwaci's work shows how threats leveled at their families and communities can lead women to political activism. Finding money to support their families, feed their children and send them to school was the foundation for cooperation that led to an active engagement in the peace process and the subsequent founding of the Sudanese Women's Voice for Peace. Okwaci's experience with fellow refugees illustrates how women move from specific survival needs to broader demands for human emancipation and justice (Kaplan 1997).

Successful Strategies - Working with Women on a Grassroots Level

When Okwaci travels to the war-ravaged lands of southern Sudan, her objectives are to build local capacities in peace building and to involve all stakeholders in contributing towards a solution to the multi-level conflicts in Sudan. One of her main activities is to elicit stories that highlight the impact of war on civilians, and then to feed the concerns of rural women into higher political structures. Channeling information in the opposite direction, Okwaci has found that the dissemination of documents and information from formal peace processes to the grassroots often gives rise to the creative use of drama and song to reach a largely illiterate population. Okwaci also organizes workshops in southern Sudan that combine sensitization and education on existing peace negotiations, training in facilitation and conflict resolution, and general leadership skills to empower women to take up peace work. The trainers then accompany the women back to their home areas and spend two weeks helping them to become established as local peace educators.

Okwaci asserts that women in southern Sudan have traditionally been instrumental

in resolving various types of conflicts. The resolution of certain community conflicts were historically referred to powerful women who sat as chiefs and judges, and who also proactively engaged the community in debate on issues that were likely to generate conflict. Other widely used strategies have been to compose songs that emphasized the power of solving problems peacefully through debate and discussion, or to suggest the binding of two antagonistic communities through inter-community marriage (Badri & Sadig 1998). In contrast, traditional roles that encourage and intensify conflict also exist. One example are the *hakamas*, women who call on their tribesmen to defend the honor of the group, threatening to publicly disgrace any man who refuses to join in the fighting. Okwaci is aware that as in all cultures, Sudanese women have the opportunity to build on both positive and negative traditions as they build a gendered movement for peace.

In her current work, Okwaci has continued to recognize the connection between addressing women's basic survival needs and allowing for the creation of the space and psychological energy to think towards peace. For example, she has attempted to use some of her experience with refugees in Nairobi to establishing income-generating projects with the women she works with in southern Sudan. Her ideas include building community training centers that would respond to priority development needs, while providing gathering points for women to conduct skills training and peace activities. This type of integration, linking relief and rehabilitation aid to peace activities, is an approach that could offer great promise and deserves more attention.

Successful Strategies -Using Media Skills

Okwaci uses her skills in radio broadcasting, journalism and photography to promote women's empowerment in Sudan and in the peace process. It is a natural way for her to make the link between her commitment to grassroots organizing and the political realism that lands her in the offices of state officials. Referring to her numerous publications and press releases, she speaks most fondly of the small newsletters she has produced for women inside Sudan which illustrate to them how their activities and contributions are connected to the rest of the country and the outside world. Widespread illiteracy hinders communication and therefore understanding, so recording and showing videos of women participating in peace workshops in their own mother tongue helps. "They feel their message has gone out, we have helped to transmit it and they have received feedback. It creates this trust of working together."

Successful Strategies -The Power of Small Steps

Okwaci's involvement in a number of peace initiatives has given her a unique perspective on what any one initiative can accomplish. She likens her work to the layering of bricks, with every small contribution towards peace adding something to the overall objective. Okwaci believes that appreciating every contribution means recognizing local sources of power. For example, the traditional king of her own Shilluk tribe brokered a peace negotiation between the SPLM United faction and Sudanese government forces fighting in his area. She describes the value of locally mediated agreements as small steps toward peace, "I feel it is a precious time when the firing of the guns has stopped. People can go and cultivate without fear and it creates an atmosphere where we can sit down and talk. The community has some breathing space to discuss. Local leaders are able to come together to negotiate." Her description is also strikingly similar to the viewpoint of Sudanese

scholars who point to the potential of national agreements like the 1972 Addis Ababa Agreement that offer the hope of “a breathing space in which fundamental shifts in identification might be promoted” (Kasfir 1991).

This emphasis on building local conflict resolution skills has yielded dividends beyond the negotiation of a formal agreement to end the war. It has also encouraged the Sudanese people to approach the overwhelming task of reconciliation at the local level. The coming together of displaced persons from all over the country with refugees who may have lived their entire lives outside Sudan will entail reconciliation on many issues ranging from changing cultures and disparate educational systems to sensitive questions about legitimacy, privilege and power.

Successful Strategies- Coalition Building and Networking

Including women from both the south and the north in coalition building has been a challenge and a significant achievement for Rebecca Okwaci. “We have to respect differences and give people the right to say, ‘I want to work my own way.’ We are building a dialogue of understanding so that when the day comes, whether we decide to live together or not, our decision will come out of a real understanding. We have one overriding goal that holds us together, and that is a just and lasting peace in Sudan.”

Okwaci has found that avoiding generalizations, giving credit where due and increasing everyone’s understanding of cultural backgrounds has helped. Approaching disagreements with a mind to *manage* conflicting interests rather than building consensus on every issue has also been a valuable approach.

The various groups involved in the Dutch Peace Initiative, which brings together women from all regions of Sudan, have managed to form a flexible coalition with room for changes. As a group, they have acknowledged that the peace process is unpredictable and that different stages can often only be marked by changes as they come. Each group has its own action plan, vision and objectives depending on the nature and location of its work. Okwaci and her colleagues welcomed the initiative because it offered support without the imposition of new structures, “and we are still the ones guiding the work.”

Successful Strategies- Women-Centered and Inclusive

Okwaci is quick to add that, “I would like to make it very clear that we are not focusing on women alone, because we have seen that women alone cannot bring peace. We are combining women as the core group with civil society, traditional leaders, other peace-loving men and so on.” In fact, she describes her delight at finding an unexpected resource in more and more young men who are getting involved in peace work, choosing not to join the ranks of soldiers. Offering them a positive alternative such as training them to carry out field work, complements the peace activities of the women.

Including young people in her work is vital. Okwaci is concerned that the complex, political, economic and social elements of the war are being distorted. The result is a simplistic racial and religious framework, which has had a negative impact on the social development of the young. She knows that thoughtful attention to the education of the next generation will be necessary to sustain any peace agreement. This emphasis on a new socialization process for youth, influenced by women and encompassing “cross-cutting relations” could promote alternative values of caring, connection and nonaggression in support of peace (Staub 1989).

When she speaks of her approach to including traditional leaders in her work, Okwaci demonstrates her ability to switch identities and work within the dominant cultural context. "The most important thing is that we learn how to conduct ourselves when we are dealing with them. When I am addressing elders I have to go in the shoes of a mother or a woman from the traditional point of view so that they accept me first as someone who respects them as leaders in their own societies." Once that basic respect is established, she and her colleagues have found many community elders to be highly supportive of their efforts to combine local knowledge with their own training in conflict resolution.

Addressing the Political Element

Traditional demeanor aside, Rebecca Okwaci's belief that women's empowerment should lead to direct political participation is partly based on her own experience with the political side of peace activism. An early and ambitious goal of Sudanese Women's Voice for Peace was to actually meet and talk individually with the military leaders of the various Sudanese liberation armies. "That they gave us an audience was tremendous. It was a breakthrough. And their guarantee of support allowed us to move freely among communities and across zones." Okwaci has since toiled to keep the channels of communication with military and political leaders open. "It is one reason why our public statements are so often focused on addressing our leaders. We believe that it is we, the community, Sudanese leaders and Sudanese society who must start tackling our problem before we start running to the outside world and telling them to help us in solving our conflict. We are appealing to the outside world to support us toward promoting our peace process, but the work should start from within."

The need to be very clear and objective about considering existing political lines was also a lesson that Okwaci learned even within the women's groups that she helped to found. There was a time when she became quite disenchanted by the way political differences among women seemed to be undermining the work. When she saw that women in certain regions of southern Sudan were being denied attention and support because of unspoken political differences, she decided that there can be a certain naivete in simply saying, "We are women and we want peace," and leaving everything else floating. A lack of established procedures, structures and organization allowed small disagreements to grow into big misunderstandings and power struggles to develop. Based on these experiences, Okwaci now believes in incorporating the political element early on, by recognizing political affiliations and differences even while building coalitions. "Otherwise, as we move up the ladder from grassroots empowerment to engendering the peace process, the political element would inevitably cause a crisis before we even reached the national issues."

From Dichotomy to a Broad Human Rights Agenda

With her vision of justice and human rights for all, Okwaci is driven by a very personal desire to end the suffering of her people. Moving away from a simplistic north-south dichotomy is one of the goals of Sudanese women's collective activism. Human rights violations are central to the conflict, and therefore central to the resolution. Another way to make the distinction is to differentiate between *ethnic nationalism* and *civic nationalism*, the latter regarding ethnicity and religion as irrelevant to citizenship status (Little 1999). For example, the attempt made during the 1972-1983 peace to provide

linguistic, cultural and religious autonomy—in other words, fundamental nondiscrimination in the public structure—instilled a degree of optimism for the future that Okwaci still carries.

The Role of the United States

Although certainly one of Okwaci's aims is to raise the profile of the war in Sudan on the international level, she stops short of advocating for the United Nations or United States intervention that other Sudanese women may call for. She is wary of the sorts of interventions witnessed in other African states like Somalia. Straightforward in expressing that any peace initiative must ultimately be Sudanese owned, her concerns about US involvement center around American accountability to the local civil society. In any case, Okwaci's multileveled approach to peace activism makes possible a range of recommendations for maximizing her efforts—both through direct support and by contributing to a conducive environment for women peace builders.

The current challenge for US policy makers is to, “turn away from strategies that reward warriors and toward policies that support peacemakers” (Bell 1999). Washington's focus on combating terrorism and Islamic fundamentalism has blinded it to possible openings to the Khartoum government and the manifest faults of the SPLA, serving only to harden radical stances and further isolate peace seeking pragmatists from all sides.

Policy Recommendations: Building on the Women Waging Peace Initiative

- Maintain personal contacts made by Okwaci and other delegates at the Women Waging Peace launch including Oxfam America, MA State Black Caucus, Members of Congress, and the Vice President's National Security Advisor.

- Build upon and inform the growing grassroots lobby for Sudan in America by linking Women Waging Peace delegates with church groups and American religious leaders interested in coordinating trips to Sudan.

- Utilize the radio skills of Rebecca Okwaci to support peace and development activities inside Sudan. USAID has experimented with information strategies through the Office of Transition Initiatives, and the State Department is implementing a Presidential Directive to use information tools to prevent and mitigate crisis around the world.

- Promote women's peace initiatives through InterAction, a coalition of US based relief, development and refugee agencies committed to maintaining a dialogue with the State Department on implementation of U.S. policy toward Sudan. Combining Okwaci's empowerment and peace education activities with the relief work of InterAction members would help feed grassroots input into policy. Aid agencies can tailor their population resettlement, vaccination, animal health, education and training programs to support the implementation of local peace agreements and enhance intercommunal cooperation.

- Increase support for the participation of women in USAID financed local reconciliation forums, like the Dinka-Nuer People to People conferences. Complementing financial support with logistical and diplomatic support by field staff who are familiar with and involved in efforts to strengthen the regional IGAD peace process will promote an integrated approach. (Prendergast 1999)

- Involve Okwaci's and other women's groups in the civil society components of USAID's Sudan Transitional Assistance for Rehabilitation (STAR) program as meaning-

ful participants in the development of future civil administration and governance capacities in southern Sudan. The Women Waging Peace network can supply names of local gender experts to employ in the planning and implementation of the program.

-Lobby against the overt provision of food assistance to the SPLA, which incites the sort of factionalism Okwaci's work aims to mitigate. Such policies are expected to invite immediate retaliation against both innocent civilians and Operation Lifeline Sudan, the international assistance program already operating in Sudan. Using food as a weapon of war goes against American policy, would perniciously undercut any ability to be an honest broker in the effort to end the civil war, and could very well backfire further by strengthening Khartoum's hand with support from other Arab states.

The Collective Efforts of Extraordinary Individuals

Okwaci asserts that she is not unique, that there are many high caliber Sudanese women who can be champions of peace. "Some are definitely potential political leaders, but they are scattered and their voices are not heard." Peace activists have refrained from identifying and embracing such women because of questions concerning both the legitimacy of representation in political forums and the appropriate role of political affiliations within women's grassroots movements. But Okwaci feels that, in her position, she has a special responsibility to "dig out those voices" and empower women from the south, noting that it is very difficult to bring out a voice from southern Sudan without the connections of the Sudanese community in Nairobi. Okwaci's determination to navigate the many roles and identities she has chosen to take on in her work as a peace activist is the consequence of her deep conviction about the role of women in championing human rights in Sudan.

Rebecca Joshua Okwaci is convinced that the presence of ever more empowered and vocal women will be one of the strongest ingredients of a just and lasting peace in Sudan. It is the only type of peace she's interested in building.

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Making the Link: Social Capital and Urban Policy

Madeleine Pill

Introduction

Social capital - features of social life, networks, norms, and trust - enables communities to act together more effectively to pursue shared objectives. Social capital is a resource as important as financial, physical and human capital in improving deprived urban communities (Putnam, 1998).

Policymakers must appreciate the different forms of social capital when deciding which policies would best tackle the problems of deprived urban areas. There are two types of social capital which affect the geography of urban opportunity – social support (“getting by”) and social leverage (“getting ahead”). Social support is closely tied to the local community and benefits from dense networks (bonding social capital). Social leverage broadly and loosely links individuals to the outside world (bridging social capital) to enable access to clout and influence. It is characterised by dispersed, weak networks (Briggs, 1998). The challenge is to enable enough social support for the disadvantaged to get by whilst extending their social relations wide enough to leverage opportunity.

Dispersal responses to concentrated urban poverty - such as HUD's current voucher-based Moving to Opportunity demonstration programme - have a social leverage rationale. *In situ* approaches have a social support rationale. This paper takes as its focus *in situ* comprehensive initiatives to alleviating the multi-faceted problems of deprived urban areas.

Applying the concept of social capital to urban policy demonstrates that both place and people-based strategies are needed to improve the quality of life of the deprived. Urban policy should facilitate the development of social capital to aid community social, economic and physical development. It is therefore pertinent to ask to what extent has the value of social capital been recognised in US and UK urban policy.

The 1990s - The Comprehensive Area Approach

In both the US and UK, growing recognition of the value of comprehensive, area-focused approaches to urban problems characterised urban policy in the 1990s. The approach is summed up by the UK government's current policy mantra of ‘joined up solutions for joined up problems.’

The belief in the need for a comprehensive approach to neighbourhood development can be traced back to the nineteenth century settlement houses. The 1960s CAP and Model Cities programmes in the US, and the UK's CDP and Urban Programme, showed a resurgence of this approach, then subsumed by the privatism (Barnekov *et al*, 1989) of the 1970s and 1980s. These decades did bring an understanding of the value of partnership, however, and this concept has been extended in the 1990s to embrace all stakeholders (such as the community and non-profits) rather than just the public and private sectors.

Power's (1996) influential work in the UK on tackling the problems of deprived public housing estates illustrates the value of the comprehensive, area-based approach. She calls for the localisation of housing, policing, social, health and education services, to all large, low income public housing estates. She found that the link between estate

residents and the wider urban area (bridging social capital) was crucial to their success. She also stressed the importance of the development of residents' initiatives and organisation (bonding social capital).

The comprehensive area approach in the US has been furthered by Community Development Corporations (CDCs), which are mediating institutions between government and local communities. Since the mid-1980s their functions have broadened from a focus on housing development to encompass comprehensive approaches utilising the "community building" approach. They encourage empowerment and bonding social capital creation through tenant and community organising, and develop social norms (at least for tenants) which can be enforced through the sanction of tenant selection and eviction (Naparstek and Dooley, 1997).

Strong local leadership and government backing (as well as access to support from the wider urban community) are crucial. Top-down solutions imposed on communities tend to undermine local initiatives with which people are engaged, and do not build on existing community infrastructure or "primary supports" (for example, the black church). As a result, they do not generate local input and ownership. On the other hand, approaches that are solely bottom up, although often effective for building support for single issues, are less likely to produce comprehensive change.

Current Relevant National Urban Policies-the US

Community Development Block Grants (CDGB) are described by HUD as a "flexible source of annual grant funds for local governments – funds that they, with the participation of local citizens, can devote to the activities that best serve their own particular development priorities" (HUD website). The activities eligible for assistance do enable a comprehensive area approach, encompassing physical, social and economic activities. Requirements regarding community involvement are vague.

Through the "Capacity Building for Community Development and Affordable Housing" programme, HUD also provides "funds to help communities improve their knowledge and skills in the planning, development, management and administration of CDGB." However, despite the community being listed as the beneficiary, community organisations are not eligible to apply. This contrasts significantly with the concept of "capacity building" in UK urban policy.

Empowerment Zones/ Enterprise Communities target tax incentives, performance grants, and loans to low-income areas, "to create jobs, expand business opportunities, and support people looking for work" (HUD website). To gain designation, an economically distressed area needs to develop "a comprehensive strategy to promote economic opportunity and community revitalisation". Within each designated area "residents decide what projects and activities should occur... and help determine how funds will be allocated". The Empowerment Zone Programme is based on recognition of the value of the community-generation of solutions to problems and the need for comprehensive and integrated strategies and implementation. This does imply implicit recognition of the value of social capital, encouraging its creation through empowering local communities.

Homeownership zones "allow communities to reclaim vacant and blighted properties, increase homeownership, and promote economic revitalisation by creating entire neighbourhoods of new, single family homes...communities are encouraged to use New Urbanist design principles" (HUD website).

This programme can be considered in terms of social capital, particularly as home ownership gives people a stake in the community and therefore enables them to accumulate and mobilise social capital. Its espousal of New Urbanist design is also relevant, given that this has been described as providing “an architecture of engagement” which promotes community bonds (Bothwell et al, 1998). However, the initiative does not seem to promote mixed communities, at least in the sense of the life cycle of families, and therefore cannot be seen as demonstrating a commitment to bridging social capital creation.

The Urban Revitalization Demonstration Project (Hope VI) is the US’s most explicit espousal of the comprehensive area approach. The programme aims to transform some of the nation’s most distressed public housing developments into supportive mixed-income communities. Resident organisations design and coordinate a comprehensive strategy for their communities.

These strategies offer residents opportunities for civic engagement and decision making in matters affecting their lives. They also afford the chance to define the values and behaviours acceptable to the community and provide access to a range of life opportunities. Examples include eviction policy, jobs, education, and housing options.

Recognition of the value of social capital is implicit in all of these elements. Hope VI combines the dispersal approach of creating bridging social capital with the attraction of working families to enable mixed-income areas; with the in situ approach of resident involvement enabling empowerment and facilitating bonding social capital. It is also noteworthy that the programme involves communities in the definition of social norms (in terms of determining behaviour deserving of eviction) – one of the three features of social life defined by Putnam (1995) of which social capital comprises. The success of Hope VI programmes depends significantly on the extent to which the area benefits from, or is able to generate, a motivated and articulate resident leadership.

Current Relevant National Urban Policies-the UK

The Single Regeneration Budget Challenge Fund (SRB) was designed as a flexible, competitively allocated, funding source to promote “holistic, locally devised solutions to complex, socio-economic problems” to be delivered by inclusive local partnerships (Hall and Nevin, 1999). This explicit recognition of the importance of the “bottom up” approach is operationalised through the requirement that funding applications must come from formal partnerships that “include the community sector, who must be involved in the development of strategic plans and participate in implementation” (OECD, 1998). Partnerships gain funds for periods of up to seven years, with the intention that regeneration is stimulated which will be sustained following the end of the programme lifetime.

The policy imperative can be seen as encouraging multi-agency partnership working, reflecting recognition that multiple disadvantage requires a multiple response. The DETR (1998) describes partnerships as “community enablers” which should seek to empower individuals and groups to have more control over their personal lives and community life. Is the rhetoric carried into reality? A study by Hall *et al* (1998) found that local authorities and the private sector were represented in over 80% of successful partnerships by the third SRB funding round. However, community and voluntary sector were only present in 60%, making them the least well represented of the major sectoral interests. The study also found that lead partners (typically local authorities) tended to

exert a disproportionate influence on the form and content of bids, indicating that local regeneration partnerships may be used by local authorities to legitimise pre-existing strategies rather than these being generated by all local stakeholders. Ironically, the competitive bidding process itself can be termed “a process of disempowerment” (Fordham et al, 1999), given its potential to raise community expectations, leading to subsequent disillusionment and withdrawal when bids are unsuccessful.

There is also a lack of mechanisms to ensure the accountability of partnerships to their local public; and of individual partnership members to the bodies they are representing. This is particularly true for residential community partnership representatives. There can be competition for the ‘community franchise’ offered by the urban regeneration body amongst community groups and organisations. In the absence of formal mechanisms such as community representative elections, the lead partner may use the community partnership ‘slot’ as a way of either co-opting adversarial groups or rewarding co-operative groups. Inevitably groups within the geographical community will not be represented, reflecting and even deepening divides.

The Labour Government issued new SRB guidance in 1998 which does recognise that the mere partnership presence of community representatives is inadequate to ensure that the community has a significant say in decisions. Local partnerships now “have to demonstrate how communities are involved in developing and implementing bids”, and to highlight “how representative structures are being developed to facilitate involvement” (DETR, 1998). It is unclear as yet how this change in the rhetoric has affected actuality.

Capacity building is defined as “activities to increase the capacity of local communities to contribute to regeneration and the strengthening of the social fabric”. This can be seen as explicit recognition of the value of social capital, both as an end in itself and as an underpinning for the programme as a whole. Capacity can be developed “for example through training of staff and volunteers in community groups, through the strengthening of networks, forums or representative structures” (DETR SRB Bidding Guidance, 1998). Here social networks have been made an intentional part of programme design.

The SRB regime is the comprehensive area programme for deprived urban communities, which most explicitly recognises the value of social capital in achieving its aims in the UK or US.

The New Deal for Communities NDC (introduced in 1998) is the UK’s latest comprehensive area initiative. In this regime government is expecting that deprived communities take on a more major and central role in the regeneration of their areas than in the SRB regime. The community is expected to be the lead partner in developing and implementing the programme, which is targeted at areas of between 1,000 and 4,000 dwellings. This is backed up by provision of budgets and a lead in year for community capacity building, continuing the recognition of the value of social capital evident in the SRB regime.

Has Social Capital received the recognition it deserves?

Social capital remains a relatively underdeveloped policy resource but there is growing recognition that its enhancement is key to improving the quality of life of deprived urban communities. It is argued that this recognition is more advanced in the UK than in the US.

The UK's SRB regime most explicitly recognises the value of social capital in tackling urban problems. The regime is predicated on a more robust appreciation and operationalisation of social capital than the US comprehensive area programmes. Despite the misgivings expressed regarding the achievement of "genuine" partnerships in SRB programmes, the extent of partnership working stimulated by the SRB in localities is without precedent and should assist in engendering the co-operation and trust which underpins social capital. However, the SRB regime does lack appreciation of the value of creating bridging as well as bonding social capital.

SRB programmes build upon the primary supports in their target areas as many of the service providers of the projects are in the voluntary/community sector. This demonstrates that the government is making some attempt to "foster the multiplicity of associations that exist in the community" and is directing resources through such groups (Halpern, 1999). However, a difficulty is that at the project delivery level it is hard to retain awareness of the holistic nature of the programme, with service deliverers seeing the SRB as just another funding source which has different monitoring requirements to the other funding sources being juggled. Religious based communities are not used to underpin the programmes as public funding of religious groups is a contentious issue. This can be seen as a social capital opportunity cost, though if it did occur it would hinder bridging social capital creation within target areas.

The SRB regime is regarded as the most social capital rich programme, given its emphasis upon and specific designation of funds for social capital. The description of possible activities, and the expectation that partnerships should fund capacity building contrasts with the 'technical assistance' element of the US CDGB programme. Community organisations in the US are not even eligible to apply for the 'Capacity Building for Community Development' funds of the CDBG programme. Though it is optimistic to expect that deprived communities will actually lead the UK's New Deal for Communities initiatives, at least the emphasis on capacity building recognises that a certain level of internal capacity needs to be developed before attempts are made to devolve control.

The Hope VI regime is the most praiseworthy US initiative in terms of its recognition of social capital, though Empowerment Zones and Enterprise Communities are also a favourable development – all three do seek to "more directly tap into community assets and leverage the existing civic infrastructure" (Chaskin et al, 1997). The Hope VI emphasis upon "community building" is in the spirit in which the SRB regime uses the term "capacity building". The regime can also be said to be predicated on an understanding of social support (*in situ* bonding) and social leverage (dispersal bridging) forms of social capital with its place based but mixed income housing approach. This combination of social capital forms is more sophisticated than that seen in the SRB regime.

Overall, the partnership approach to tackling urban problems via the development and management of comprehensive area programmes (such as Hope VI and the SRB) should be welcomed in both the US and the UK. It can potentially develop bonding social capital within urban areas, and bridging social capital between the different groups within the urban area. However, there are problems with the partnership approach in both countries.

Partnerships can only be valuable in social capital terms if they are genuine, with each sector (public, private and community) adequately represented and able to wield sufficient power. Concern focuses on the community's role, which can range from that of

being excluded to that of being in control (though the latter is extremely rare and hard to attain even when strived for). Permanent, developmental and sustainable regeneration is only attainable when there are higher levels of involvement, building on and developing social capital, and creating "virtuous circles" which can sustain the impact of these short-lived, pump priming programmes (OECD, 1998).

The UK's greater recognition of social capital in its urban policy than the US can be related to the relative power of central government in urban policy. Indeed, whilst it can be said that the role of the community in regeneration programmes has moved from a passive to an active one, central government still retains a tight control over the regeneration process in the UK. Prime Minister Tony Blair's 1998 statement "this is the Third Way - a modernised social democracy for a changing world which will build its prosperity on human and social capital" shows that the rhetoric at least is being espoused from the very top.

In the US devolution has meant more control to the states and localities, with more individual accountability using less federal money with fewer conditions attached. Federal government is therefore more limited in propagating social capital. However, the US context of devolution does imply a greater commitment to local empowerment than that implied by the UK context of local government reform. Such efforts are hard to disentangle from the increasing central government espousal of self-help in light of declining central funds in real terms for regeneration efforts in both countries.

The creation of the Social Exclusion Unit (SEU) by the Labour government in the UK must also be emphasised when considering the extent to which the value of social capital in tackling urban problems has been recognised. The SEU is intended to underpin and inform the policies of government departments and agencies, and indicates that reducing income inequality and status differentials are regarded as a central objective of government policy. The SEU's 1998 report sets out steps towards what is described as "a national strategy for tackling poor neighbourhoods." Lessons highlighted continue the emphasis on a holistic, comprehensive approach with community involvement. Though it is unclear as yet to what extent the SEU will bring influence to bear on other government departments and agencies, its creation can be seen to further recognition of the value of social capital. The SEU could also assist in realising Halpern's (1999) suggestion that government should build a consideration of social capital into policymaking decisions with the incorporation of a 'social capital audit' which will 'cost' the impact of proposals' externalities on networks, norms and sanctions in society.

Policymakers and funders must still make a leap of faith in terms of recognising the value of, and funding, social capital as part of their programmes. The sooner detailed measurement and evaluation of social capital can commence the better. The use of a standard methodology would enable comparison of programme and area specific factors in influencing social capital creation and would even facilitate cross-national comparison easing assessment of the transferability of policies and programmes to tackle urban problems. Such detailed information should assist in mitigating the risk, as demonstrated particularly by the exchange of policies of privatisation in the 1980s, regarding the exchange of policy instruments between the US and the UK without substantive assessment of their effectiveness and systematic knowledge of their performance. This is captured by Halsey (quoted in Barnekov et al, 1989:8), who wrote of "ideas drifting casually across the Atlantic, soggy on arrival and of dubious utility."

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Women Of Afghanistan

Sally A. Boales

Introduction

The central Asian country of Afghanistan has been affected by decades of civil war. When the hard-line Taliban militia emerged as the most dominant force, it radically changed Afghan culture, particularly for women and girls. It is important to look at the conditions which women and girls are forced to endure. It is also important to examine the interventions of the United Nations, and the interests that drive them. It is then necessary to decide if there is a more optimal policy for the United Nations.

Violations of a UN Member State

The *Convention on the Elimination of All Forms of Discrimination Against Women* was adopted by the United Nations (UN) General Assembly as resolution 34/180 on December 18, 1979. Afghanistan, a UN member state since November 14, 1946, is a signature state of the Convention on the Elimination of All Forms of Discrimination Against Women, henceforth referred to as "the Convention."

Human rights abuses against women and girls in Afghanistan involve the denial of all forms of education as provided in Part III, Article 10 of the Convention, the denial of employment outside the home (Part III, Article 11), the denial of access to health care (Part III, Article 12), and restrictions on the freedom of movement and denial of humanitarian aid as provided in Articles 13 and 25, respectively, of the Universal Declaration of Human Rights. These rights are denied based on gender. The tenet on which the Universal Declaration of Human Rights is based, that all humans are born free and equal, is not yet realized by these women and girls.

Background

The lack of gender equality is pervasive within this culture. Human rights abuses against the women and girls of Afghanistan relate directly to the emergence of the Taliban, a fundamentalist Islamic group from a movement born in Pakistani religious schools, or "madrassas" (Bruner, 1999). Afghanistan was invaded in 1979 by the former Soviet Union. Afghanistan's resistance lasted for ten years before Russia finally withdrew its troops. During the war, many Afghans fled to Pakistan and Iran where they remain today as fighting continues between the Taliban and the United Front (also known as the Northern Alliance). The Taliban are Sunni Muslims, mostly Pashtun, a majority ethnic group in Afghanistan. The opposition groups are mostly religious and ethnic minorities including Shiites, Tajiks, Hazaras and Uzbeks (ASIANOW, 1999). The Taliban now controls 90 percent of the country. They have imposed an extreme interpretation of Islam which includes public executions and punitive amputations.

Human Rights Abuses

The human rights abuses toward women and girls in Afghanistan are severe under Taliban rule. Although women were able to work outside the home as lawyers, judges, doctors and government officials while under the Communist regime, the Taliban forbids women from working outside the home except in extremely limited circumstances.

Girls are prohibited from attending school. Access to medical care is restricted to female doctors, the number of which is now extremely limited. Women have died because male doctors are prohibited from treating them. Women are forbidden from appearing outside their homes without the accompaniment of a male relative, and houses with female occupants are required to paint the window glass. A full head to toe covering, called a burqa, is required of all women when they are outside their homes.

Any perceived violations of these social edicts by the 'religious police' result in beatings on the spot. Women are also flogged and killed for transgressions. War widows, numbering in the tens of thousands, have resorted to begging in order to provide for their children.

The first public execution of a woman occurred on November 16, 1999 with thousands of onlookers. The mother of seven children was convicted of killing her husband. According to news accounts, the woman attempted to flee, "but was stopped by a policewoman, who forced her to sit down again. The soldier moved closer and shot her three times. After the killing, shouts of 'God is great!' were heard" (Shah, 1999).

Sharifa Ahklas of the Afghan Media Resource Center was forced to relocate from her native Afghanistan for reporting human rights abuses in her country. She reported a level of despair so great that women resorted to suicide as their only means of escape. Not wanting to leave their children behind in such dismal circumstances, some women "take their children with them". Refugee camps in Pakistan are often as brutal. Women are often exploited sexually, then viewed as "living a life of immorality."

Refugee camps offer little in the way of staples, providing one bag of rice and a bottle of oil to sustain a woman and six children for a month. When asked how the women of Afghanistan support each other, Ms. Ahklas stated it is difficult since they all face the same persecution. Educated women, such as she, try to draw out women who wish to verbalize their pain. They also provide educational instruction to those who request it. Ms. Ahklas continues to seek information and provide support to the women of Afghanistan by going back to her country. She was discovered and beaten by the militiamen, but feels it is her duty to continue to be a voice for the women of her country (personal communication, November 1, 1999).

Human rights abuses of women and girls are compounded by the ongoing civil tensions and the monetary costs of war, by the increasing isolation of the country for its role in terrorism and narcotics trafficking, and the refusal of the Taliban to abide by the code of conduct established by the United Nations.

UN Response to the Emergence of the Taliban

The United Nations has provided humanitarian assistance and pursued constructive engagement in Afghanistan for decades. UN involvement pertaining to the human rights abuses of women and girls emerged in concert with the growing presence of the Taliban regime, starting in 1994. During 1994 a UN Special Mission under the leadership of Mohmoud Mestiri was authorized (General Assembly Resolution, 48/208). Mr. Mestiri recommended a cease-fire, provision of security to Kabul, a transfer of power to a fully representative Authoritarian Council, and the establishment of a transitional government by convening a Loya Jirga, or Grand National Assembly. These recommendations were endorsed by the Security Council in November 1994 and later by the General Assembly in December 1994.

On October 1, 1996 the High Commissioner for Human Rights (José Ayaia-Lasso) sent a message to the Special Representative of the Secretary General for Afghanistan (Norbert Holl) to convey to the Supreme Council of the Taliban (Mullah Mohammad Omar) strong concern for the situation of human rights not in keeping with the international standards. The High Commissioner "emphasized the legally binding obligations" stemming from the large number of international human rights instruments Afghanistan has ratified and signed over the years, including the Convention on the Elimination of All Forms of Discrimination Against Women (UN Press Release, October 1, 1996).

In 1997 a series of meetings were held of border countries and others wishing to influence a peaceful solution. The Foreign Ministers of the Islamic Republic of Iran, Pakistan and Turkey met over concerns relating to the imposition of an ultra-orthodox Islamic state and the negative implications of the prolonged warfare. The Taliban refused to attend this meeting. Later, the Defense Ministers of Kazakhstan, Kyrgyzstan, Tajikistan, the Russian Federation and Uzbekistan met to reaffirm their commitment jointly to defend their borders. The governments of Pakistan and the Islamic Republic of Iran attempted to promote a negotiated settlement without success. The Afghan parties did not view them as impartial.

In his report dated November 14, 1997 the Secretary General conveyed a deepening division along ethnic lines and a lack of serious consideration by all factions in Afghanistan to a political, rather than military, solution. The battle of Mazar-i-Sharif, where eight Iranian diplomats and a journalist were killed, disrupted the political and humanitarian activities of the UN. There were explicit threats directed at UN personnel and looting of UN offices and equipment. Afghanistan was now the world's largest producer of heroin despite the involvement of the UN International Drug Control Programme.

The Secretary General's report documents the existence of foreign military intervention, a troubling finding since clear support for a UN peace process was expressed by the likely perpetrators. A Special Envoy for Afghanistan was appointed by the Secretary General to consult interested and relevant countries and parties. Clearly noted in the report are the serious implications for regional peace and stability and changing interest in the country now that it no longer played a part in the super-power rivalry. The Secretary General warned against foreign interference and the provision of arms and even considered an arms embargo to curb the flow of arms.

Threat to humanitarian assistance

Throughout 1994 and 1995 the UN had enough influence on the warring factions to support the provision of humanitarian assistance. In January 1995 there were 300,000 Afghans living in camps supported by the UN, the International Community of the Red Cross (ICRC) and various non-government organizations (NGOs). During this time the health and nutrition of the population improved.

A UN press release on October 6, 1996 expressed concern about the ability of the World Food Programme (WFP), the food agency of the UN and the largest relief agency in Afghanistan, to continue operations. The WFP used local women to assist with its operations. With their help, there was greater assurance that food and rehabilitation projects were accessible to women. The ban on outside employment for women severely restricted their operations. At this time the WFP fed 1.8 million people, with 57% of the

multilateral assistance being channeled through them.

On March 8, 1999 the Commission on the Status of Women offered a resolution to the Economic and Security Council, which was later adopted, which outlined the abuses to women and girls and condemned the discrimination directed toward them particularly by the Taliban. The resolution stresses the need to maintain humanitarian assistance, to promote and protect the human rights of women, and establishes the positions of Gender Coordinator and Human Rights Coordinator at the UN Office for the Coordination of Humanitarian Assistance for Afghanistan (Commission of the Status of Women, 1999).

US Response

The March 10, 1998 report of the US Department of State on *Women and Girls in Afghanistan* states that the US condemns the human rights violations of the Taliban, that it does not recognize any government that is not broad-based and representative, and that it is committed to providing humanitarian assistance. The US backed this commitment when it provided \$26.4 million for use by the UNHCR, ICRC and WFP. An additional \$1.7 million was provided to NGOs such as CARE and the International Rescue Commission. The US also called for the UNHCR to investigate reports of violence against women and girls in refugee camps in Pakistan.

On July 5, 1999 the US, angered by the harboring of terrorist Osama bin Laden, imposed economic sanctions against the Taliban with the condition that Osama bin Laden be expelled or extradited. The US sanctions ban US trade and investment with the Taliban, prohibits American use of Ariana Afghan airlines and seizes the airline's US assets. The US pledged to maintain its humanitarian assistance. The US also placed bin Laden on the FBI's 10 most-wanted list and offered a \$5 million reward for his arrest after the 1998 bombings (ASIANOW, 1999).

During this period, The Feminist Majority initiated a campaign titled *Stop Gender Apartheid in Afghanistan*. Speakers, such as Eleanor Smeal who spoke at Harvard College in November, are traveling across the country to gain support for their efforts to assist the women of Afghanistan. Ms. Smeal described the situation for women and girls to her audience and encouraged women to act as a key constituency to effect political action.

Secretary General's Report

The Secretary General's report of September 21, 1999 indicates a weakening ability of the UNSMA to engage the warring factions in negotiations. It acknowledges Pakistan's inability to influence a settlement because of their covert political and military support for the Taliban. Meetings of the "six plus two" countries, border countries and the US and Russia, have not successfully leveraged cooperation of either side to seek a peaceful settlement. Also included in the report was:

1. Efforts by the UN-coordinated Mine Action Programme, with the assistance of US\$16.4 million, to control the placement of land mines,
2. Condemnation of policies and practices of discrimination against women are offered by the Special Rapporteur on the situation of Human Rights (Kamal Hossain) and on Violence against Women (Radhika Coomaraswamy), appointment of an Investigation Team of the Office of the UNHCR to research alleged massacres in 1997 and 1998,

3. A statement acknowledging an increase in the opium poppy production and
4. The Secretary General refers to Afghanistan as "one of the most deadly places on earth".

UN Sanctions Imposed

On October 15, 1999 the UN Security Council voted to impose financial and aviation sanctions in 30 days unless Osama bin Laden was turned over for trial. This US sponsored resolution restricted foreign landing rights for Ariana airlines, froze bank accounts and forbade investments in Taliban controlled property (Goldman, 1999). On October 18, 1999 the Taliban rejected the ultimatum and on October 21, 1999 the UN Special Envoy suspended efforts to negotiate an end to the war. On November 14, 1999 the sanctions were imposed despite the request of the Taliban for postponement. News accounts following the imposition of sanctions described violence toward any UN and US presence, including burning the UN building to the ground, and the bombings of UN facilities in Pakistan.

More Optimal Policy

The extensive interventions by the UN have not produced a peaceful settlement between the warring factions, nor have they successfully reduced the human rights abuses. The instability of the area due to opposition groups has effectively undermined the efforts of the international community, further contributing to Afghanistan's isolation and poverty. The opposition parties have expressed little interest in any objective outside military victory. Afghanistan remains a threat to the peace and stability of the region for its terrorist activities and access to arsenals. The following interventions are suggested as a more optimal policy to address issues that have contributed to the conditions promoting human rights abuses toward women and girls.

Arms Embargo

There is suspicion that UN member states are involved in the provision of arms to Afghanistan. For this reason, the UN should consider an arms embargo. Such a move puts pressure on other countries to abide by UN standards, and gives the UN some leverage against recalcitrant states. Without the influx of weapons and ammunition the Taliban and the opposition front would not be able to sustain the intensity of the ongoing civil conflict.

Military Intervention for Interdiction, Sanctions

The international community should consider the use of military intervention for purposes of interdiction, to stop the influx of narcotics into their countries. Border States in particular can control the exportation of any commodity in this land-locked country. The sanction against the only Afghan airline limits one shipping option. As a result, the aviation sanctions currently in place should remain. Without access to their foreign assets their purchasing power for weapons is restricted. Consequently, the economic sanctions currently in place, which freezes their assets, should remain.

Intervention for Humanitarian Assistance

Use of intervention for humanitarian assistance should be authorized. Although

both the UN and the US stated their intentions to continue humanitarian assistance despite the sanctions they have imposed, there is no guarantee that the Taliban would allow it.

As stated earlier, Ms. Ahklas has first hand knowledge of the existing circumstances of Afghanistan and when asked about what the international community can do to help women she stated that there needs to be more involvement of the NGOs providing humanitarian assistance. Their mission cannot be limited simply to the provision of staples. They are viewed by women as a place where they can go not just for material assistance, but where they can have a moment of safety, find a compassionate listener, get a glimpse of the outside world and find a reason to hope. The military presence in Afghanistan is so threatening that many of the organizations responsible for this assistance are not safe to remain in the country. An outside military presence that is neutral to the parties involved in the civil war may be an acceptable alternative. This presence would be able to assure that assistance did not fall into the hands of the fighters, and not be available for those who need it most.

Constructive Engagement, Moral Persuasion

The long history of the UN and its envoys in attempting to forge improved relations, to reduce civil tensions, and to reduce human rights abuses has not been successful. The human rights abuses in Afghanistan are so severe it seems punitive to rely on the long process of constructive engagement to resolve these egregious practices. There appears to be little loyalty from the Taliban toward other nations outside of some potential to respond to those states providing arms.

Moral persuasion may be an option, especially by other Muslim countries, but it has not deterred the practices of the Taliban to date. The country is not moving "in the right direction". On the contrary, the Taliban are demanding sovereignty despite the lack of representation by ethnic minorities. It remains to be seen if economic sanctions are effective. However, because of the potential for some degree of success, constructive engagement must remain an option.

The Organization of the Islamic Conference may be influential in tempering the practices of the Taliban. The Muslim community is represented by many nations. The degree to which harmful practices are attributed to religion is certainly of concern to other Muslim groups. Their influence in dissuading severe interpretations of Islamic law is much greater than the voice of the US and the European community.

The most significant player in controlling the current state of Afghanistan is the Taliban, and its leader, Mullah Mohammad Omar. The UN is not a voice to the Taliban because, according to Omar, the UN does not recognize the Taliban as the government of Afghanistan. Consequently, Omar believes that the Taliban is not accountable to the UN or any of its Conventions because it was a different government at the time of agreement by Afghanistan and because they are an unrecognized government.

Conclusion

The objectives of the "optimal policy" are to provide humanitarian assistance and moral persuasion in the short term to alleviate as much suffering and inhumane treatment toward women as possible. The use of neutral military forces and cooperation of Muslim countries with the potential to influence the Taliban are the means. Efforts of

women's groups, such as the Feminist Majority Foundation, serve to provide funding for relief efforts and as political persuasion to member states of the UN.

In the long term, increased stability of the region and adherence to UN standards are the goal. Controlling arms flow, restricting income from narcotics, and maintaining economic sanctions are the means to reaching this goal.

The optimal policy outlined here is in line with the goals set out by the UN. The UN has received support by member states to impose economic sanctions, an indication that there is willingness to impose changes on Afghanistan. Border States would be mistaken to challenge the efforts of the UN to stop the flow of narcotics from Afghanistan because it would indicate participation in an illegal activity for which there are consequences. The UN and the US intend to maintain humanitarian assistance, but need to establish an effective infrastructure to secure and monitor their efforts.

A peaceful settlement in Afghanistan must consist of a broad-based, multi-ethnic representative government in compliance with all norms of behavior on all human rights issues including the rights of women and girls. This is the stated aim of UN special missions and the US. The new government must remove any discriminatory laws and practices against women and girls if it is to meet the stated objectives.

Although none of these proposed interventions are directed primarily at eliminating human rights abuses, they may reduce the fighting and improve the chances for a peaceful settlement. Without war, and with the presence of the international community, Afghanistan could start to rebuild. All of the women and girls of Afghanistan would benefit from better access to food, shelter and improved sanitation whether it is obtained by uninterrupted humanitarian assistance or by an improved economy.

The Clock is Ticking

The women of Afghanistan will be forced to endure severe physical and emotional abuse until conditions improve in their country. They will continue to beg to feed their children, endure the shame of hiding their bodies, sit in the darkness of their homes with their female children who cannot attend school, suffer the physical pain created by sickness and injury, and they will wait. And when they cannot wait any longer, they will consider killing themselves and their children. For women, Afghanistan truly is one of the most deadly places on earth.

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GOVERNANCE

Establishing Pension Fund Systems: Lessons from Latin America

Alesia Rodriguez

The growing numbers of elderly people and diminishing numbers of young people entering the active workforce poses major problems for governments across the world, not least of which is finance. In many developing countries, pension fund reform is therefore a key component of structural reform. It is both a vital ingredient of social security and an important public policy instrument. In addition to influencing national savings and financial systems, pension funds affect public finance and the labor market. For these reasons, both the design and implementation of pension fund reform poses critical challenges to government.

Pension fund reformers confront two key questions. Firstly, are proposed reforms short-term or sustainable changes? Secondly, can reform expand benefits to satisfy the rising numbers of seniors and people on lower incomes?

The answers to these questions are very much linked to the structure set up in the reform; its design must therefore address all the major issues within the country's specific context. Sustainability of the reform depends on both the degree of structural change and the inbuilt political compromise. The broader the scope of issues considered and their synergy will determine how feasible it is to achieve greater benefits from the reform.

This paper focuses upon public policy perspectives, and will examine key lessons derived from the different pension fund reforms in Latin America. As a pioneer in pension fund reform, Chile is analyzed as a base case. A brief comparison with other pension fund systems in Latin America is then made in order to draw the main lessons learned during almost 20 years of pension reform efforts in the region.

Alternatives in Pension System design

The structures of pension fund systems in Latin America follow two main approaches: a One Pillar or a Multi-Pillar approach. Based on the scopes of contribution and administration both types of schemes have different criteria.

In a One-Pillar approach, contributions tend to be set according to replacement rate targets previously agreed as an objective, derived from the overall perspective of the reform. The administration of the funds could be public, private or a mixture of the two.

A Multi-Pillar approach relies on three types of pillars: a basic, a complementary and a voluntary pillar. The basic pillar is mandatory and tends to be based on a defined benefit scheme, while the complementary, also mandatory, and the voluntary can be based on any of these criteria: defined benefit, defined contribution or occupational.

The contributions in both the basic and complementary pillars are set according to replacement rate targets, but the voluntary pillar is determined on the level of contributions defined by the workers. These pillars can have public, private or mixed administration, but usually the complementary pillar when set on a defined contribution is on a private basis.

In the designing stage five key areas can be identified as part of the system's sequence: the inflows based on the contribution levels, the contribution's collection process, the management of the resources accumulated in the pension funds, the investment criteria, and the outflows or type of benefits provided as pensions. In each area a set of choices have to be made as to how to shape the structure of the new pension system.

On the inflows of resources, the percentage of contributions to each pillar has to be determined and here actuarial studies play a fundamental role. When considering the collection stage of these contributions, the type of collection system has to be defined from the two main options: an open collection system or a centralized one where the management could be private, public or mixed.

An open system implies the collection of contributions by each pension fund administrator, which implies a broader base of collecting points that could result in higher administrative costs to the overall system. In the case of a centralized collection process, the contributions are gathered by an institution set up for that purpose through a concession granted by the government. The selected institution has the responsibility to carry out the accounting control of the contribution levels, providing a uniform database of the system and minimizing overall costs.

A decision has to be reached regarding which pillars are to be managed by the private and public sector and which would benefit from a mixed administration. The investment criteria has to be determined depending on the financial market structure of the economy, paired with a regulatory framework that sets the responsibilities of pension funds administrators and the government in the investment of the workers' contributions. From the outflow perspective, the main decisions are the type and source of benefits provided as pensions, and the replacement rate targets to achieve.

A hotly debated issue has been the provision of a minimum pension guaranteed by the government in the case of those workers who do not reach the lowest subsistence pension level. Guarantees by the government entail many political elements usually not aligned with the financial viability of such a promise, which sometimes places at risk the fiscal stance of the country and subsequently leads to the accumulation of unsustainable government debt levels.

Nonetheless, the social implications of this type of decisions are what make these choices very difficult to evaluate from a public policy perspective, as the ramifications are very diverse and, in many cases, interrelated. The final choice and decision lies with the country's government, which must analyze the trade offs based on the consequences of such a decision from an economic, political and social perspective.

Chilean Pension Reform

Chile is the base model for pension reforms in Latin America as it pioneered its revolutionary scheme of individual capitalization accounts in 1980. The reform tried to overcome the old system's main problems, most of which can be seen in all other Latin American countries. These main problems were multiple pension systems and lack of portability, an absence of financing for the solidarity scheme, evasion of contributions, loss of reserves due to inflation and/or political pressures, low coverage of independent workers, financial imbalances due to defined benefit failure within pay as you go and increased administrative costs.

The new system addressed these problems two ways. On the one hand, workers see a correspondence between efforts and benefits through an individual capitalization accounts scheme, and on the other, managers of pension funds learn to protect resources against inflation and political pressures. The new scheme involved a privatization of the pension system by which workers became responsible to make contributions to pension funds managed by private pension fund administrators called *Administradoras de Fondos de Pensiones* (AFP).

These AFP are required to comply with the Pension Fund Law and with all the regulations set up by the industry's regulatory agency, the Superintendency of Private Pension Funds. This new perspective required a redefinition of the role of the State both as manager and supervisor, as it delegated the administration of resources to AFPs and assumed a more active and serious role as the supervisor of a well functioning system.

The pension fund system established in Chile in 1980 gave workers at that time the option between systems, but membership in the new scheme was mandatory for new salaried workers since 1983 and optional for self-employed, with the military also exempted.

The contributions to the Chilean pension fund system are based on defined contribution scheme with a compulsory tax-free rate of 10% of base salary and a voluntary contribution to the fund, both not to exceed a pre-determined indexed level. Since 1987, given the successful high returns obtained by the AFP, voluntary savings accounts were allowed without placing limits on contribution levels, with funds that are not withdrawn tax-free. These accounts were separate from the base account to stimulate further national savings. In addition, an "agreed deposit" between the employee and the employer could increase resources invested in the fund.

The collection process can be characterized as an open system in which the worker chooses only one AFP. These AFPs are charged with managing the pension fund's resources, but they are private companies with a legal structure different to the pension fund. This provides further protection to workers should the AFP goes bankrupt. The commission structure is set on a uniform basis within the AFP and on a fixed or variable basis depending on the type of account.

A strong and enforceable regulatory context is one of the key defining characteristics of the Chilean pension system. The main regulatory and supervisory responsibility relies on the Superintendency of Private Pension Fund Administrators. Nonetheless, the Chilean Central Bank, the Superintendency of Securities and Insurance, and the Risk Rating Classification Commission set in the Pension Fund Law (Decree Law 3.500 of 1980), also play an important financial supervisory role. The supervisory coordination of these institutions has been an important challenge to overcome, but it has been successful in imposing discipline and accountability on the system's performance.

The Risk Rating Classification Commission was a novelty introduced by the Chilean experience, because in Latin America risk valuation accounting and techniques have been lagging in many cases. Although it has provided some discipline, when paired with too strict investment limits by law, it has constrained in many cases the creativity of investment diversification that could provide workers with higher returns and less of a herd effect regarding portfolio composition.

The outflows of resources are distinguished by the provision of old age and advanced retirement pensions, as well as disability and survival insurance. A worker has the choice of exercising these benefits once they qualify with all the requisites set by law

and they could do so on an annuity, programmed withdrawal or deferred annuity basis.

The Chilean reform manages the financing of the transition cost through the issuance of Recognition Bonds to compensate for past contributions to the old state-run system. This bond yields a real 4% return per year and is used for the calculation of a workers final pension.

In the redefinition of the role of the state as a supervisor and not a manager, it still has to guarantee equitable benefits to workers under the new system. This role highlights the responsibility of the state to guarantee the entitlement of a minimum pension to all workers that meet the basic requirements even if the balance in their individual capitalization account is insufficient. Other guarantees or protection mechanisms are embedded in the regulation to protect the resources from cases of AFP bankruptcies and fraud.

Comparing pension systems in Latin America

The diversity among countries in Latin America implies significant differences in reforms, but the influence of the Chilean model is evident as all the reforms include a mandatory but privately managed funded pillar to finance pensions. Reforms in the region show that analysis of pension policy should not be based only on a demographic approach, as it would ignore other key issues such as reliability of the pension promises, full funding scheme's positive effect on the labor market, economic growth and benefits from international competition.

The main Latin American countries that have implemented pension fund reforms are Chile in 1981, Peru in 1993, Argentina and Colombia in 1994, Bolivia in 1996, and Mexico in 1997. The levels of assets under management of these six countries are quite significant, reaching almost US\$ 60,000 million by 1998. More than half of these resources are concentrated in Chile, which represents around 40% of the country's GDP, followed by Argentina and Mexico close to US\$10,000 million each, implying less than 3.5% of their GDP [Salomon Smith Barney 1998]. The importance of these funds as sources of finance for the economy has become evident, making its management and supervision all the more significant. Although the last three years have provided lower real returns for different reasons, such as the Asian Crisis, on average over the long run the new systems have provided an attractive real return trend [Salomon Smith Barney 1998].

In general, fully funded systems achieve more attractive rates of returns than pay as you go systems when there is less political interference in the investment portfolio decisions and greater protection of the assets from monetary and exchange rate disturbances. Competition between suppliers of pension services, creating private pension managers and allowing workers to choose the service provider, are all ways used to reduce political interference.

Regarding economic risk minimization, it has been fundamental to the development of long-term debt markets through the issuance of instruments indexed to the local CPI, and the promotion of international diversification of the portfolio as the local market saturates and the new system matures. The Mexican case provides an example of a government's effort to provide a stronger domestic government securities markets that could both offer safe investment alternatives to pension funds while being issued in terms and conditions aligned with public debt management objectives of maturity and interest service.

Government and private sector costs and responsibilities

Although most systems have financed the transition cost through 'Recognition Bonds', their characteristics vary by case. The Argentinean and Mexican schemes have been very interesting, as neither involves the issuance of Recognition Bonds. The Argentinean case provides a compensatory pension from the government and guarantees a minimum return on the assets under management in case the AFP is unable to fulfill the legal required minimum return once all safety nets are used. The Mexican case provides workers with a lifetime switch option as to which system will provide their benefits, but the Government guarantees a minimum pension for all workers equal to the minimum salary, adjusted for inflation.

All the cases in Latin America have established a regulatory and supervisory body with the sole responsibility of overseeing the market. The coordination of financial regulation is essential in the case of pension funds because of their relation and influence on the banking, insurance and capital markets. In the case of Colombia, given the centralized financial coordination embedded in their regulatory scheme for the financial system, the Superintendency of Pension Funds is implicitly part of such a structure.

The regulatory limits vary by country, be it due to the regulatory culture already existing or to other endogenous characteristics that shape government and political concern. For example, the limits on bank ownership of AFP have been highly debated across the region based on conflict of interest arguments.

At the beginning of the Chilean case, the banking crisis experienced prior to the pension reform posed concerns as to the fragility of the banking system and raised concerns about the consequences of its involvement in the management of retirement funds. Notwithstanding, many countries have addressed these concerns differently. Colombia incorporates an interesting scheme to minimize the AFP's moral hazard by requiring them to invest part of their own shareholder's equity in the same portfolio set for the mandatory pension fund.

Another interesting legacy from the Chilean model is the existence of a 'Profitability Fluctuation Reserve' (PFR) established with the intention of providing an additional safety net mechanism to the minimum pension guarantee. It requires AFPs to deposit a proportion of excess returns in the PFR, to be used when there are difficulties in reaching the required minimum return. This type of mechanism, if excessively applied, places heavy and sometimes unnecessary burdens on the system, increases moral hazard behavior and a herd portfolio trend that in the long run inhibits the achievement of greater risk adjusted returns to workers. Peru and Mexico deviated from this type of initiative minimizing many risks through legal reserves, conflict of interest regulations, and other regulatory requirements. While most countries have used the legacy of the Chilean case to offer guaranteed minimum returns, again Mexico and Peru diverted in this area. Peru kept it only until 1996, and in Mexico, it was never established.

Contribution levels vary by country based on actuarial calculations. All pension systems in Latin America incorporate voluntary contributions, but only Chile and Argentina do not provide government contributions to the pension funds. The commission structures and percentages also vary by country. The Colombian commission structure is the least flexible with only fixed and discount commissions allowed, whereas Mexico offers the most flexible commission structure by which Afores (the term for AFPs in Mexico) can charge fixed and/or variable rates as well as offer discounts.

Centralized or decentralized collection?

An essential element in the efficiency of the system is closely related to the collection process, as it affects the operative and administrative cost that are transferred to the worker by earning lower net real rates of return. Based on the Chilean model, most countries also applied a decentralized collection process. Argentina was the first to divert and introduce a centralized scheme, but its reliance on the tax authority agency raised concerns as to the transparency of its execution, possibilities of crossing data and whether the operational capacity to taken on additional responsibility existed. Nonetheless, the costs relative to the benefits derived from a centralized scheme made the Mexican government implement a collection process that enhanced the Argentinean model. It did so mainly by delegating this role to an institution, which was granted a license to perform the task under the surveillance of the Superintendency of Pension Funds.

The Mexican case offers one of the most comprehensive and flexible pension systems in Latin America. A mix of being the last one established after many years of the Chilean reform, and the adjustment to the intricacies of the country has allowed for a positive learning experience in the region. Besides the centralized collection process, the main differences of the Mexican and Chilean systems are based on the possibility of allowing multiple funds within an Afore, always keeping the base fund invested in fixed income securities; the absence of rigid investment limits in the law; and a diverse commission structure. Nonetheless, implicit in the contribution is the Mexican government subsidy of a minimum pension guarantee.

What can be learned from Latin America?

Latin America provides many lessons regarding the diversity of approaches to pension fund reform. A pension fund reform, although difficult and complex, is feasible if adjusted to the economic, market structures and political realities of the country undergoing the reform. The main objective must always be to provide "retirement income security" to workers, effects on capital markets and the overall economy are secondary. One of the key elements for the success of the reform process is strong political commitment and stability.

The existence of a base model as the Chilean case does not imply that there is a standard way to structure and establish a pension fund system, nor that all Latin American pension reforms are alike or their performance directly comparable. A multi-pillar approach has been the tendency in Latin America reforms and is strongly advised especially due to concerns about financial markets volatility. A pension reform should not take place in isolation. Its success relates to previous, parallel and complementary structural reforms in other areas of the economy. Development of local markets in long term indexed debt instruments, as well as promoting international diversification as the local market saturates and the new pension system matures tends to reduce economic risk.

A centralized process is preferable for collection of social security contributions, and even preferable if not run by the tax collection agent. Open competition is preferable for pension services such as bookkeeping, investment management and pension provision. Allowing suppliers of pension funds to compete, by privatizing part of the system and giving the worker as much choice as possible, can minimize political risk. Fixed investment limits by law are not necessarily a pre-condition for achieving positive net real returns on a risk-adjusted basis.

Lessons and challenges

Some of the challenges still confronted in many Latin American countries are the implications of the schemes for financing the transition costs. There are still problems with affiliation and coverage levels, maintenance of a net real rate of returns in the long run, portfolio uniformity, operating and administrative costs reduction, development of annuities markets, and the management of the impact on capital and financial markets as well as in public finances.

For the regulatory framework the challenge is to enhance and formalize further the financial supervisory coordination between Pension Funds Superintendence and other financial market supervisors. Also, achievement of greater stimulus towards self-regulation within the pension fund administrators is very important, leaning more towards 'Prudent Man Rule' as market and systems mature.

The extension of the level of international investment diversification is still a strongly debated issue that some countries have incorporated with caution. This issue still has to be addressed more extensively in all its dimensions, as it is important to maintain a proper balance between investment portfolios' returns, risks and the benefits of resource availability to the local economy.

A particular challenge for Latin America has been the achievement of comprehensive risk management systems that addresses the need to adopt a proper risk accounting framework and the strengthening of conflict of interest regulation and supervision. The need to fortify supportive infrastructure for the pension system is essential, and this still poses a threat in countries with shallow and illiquid financial markets.

Important issues still on the agenda that require further analysis and debate are the possibility of allowing the management of different funds within an AFP so to adjust to diverse risk-return profiles of affiliates, and the implementation of a more flexible commission scheme that could permit greater competition.

Latin American pension reforms since Chile's in 1980 provide different approaches. Changes in the regulatory framework and market trends are taking the Chilean system nearer to the Mexican. These trends clearly have, over time, defined in better terms the level of competition within the system, the accountability of each participant, better risk analysis and overall profitability, measured in terms of real rates of returns achieved and level of pension benefits provided. The greatest challenge of all is to ensure continual learning in order to reach in a sustainable manner the main objective - the provision of retirement income protection.

The Role of Public Diplomacy in Building Peace and Democracy: The Case of Bosnia and Herzegovina

Ana Mitrovic

Public diplomacy transcends intergovernmental diplomacy. It defines the relations of one government with the *people* of another government. The central idea of public diplomacy is that communicating directly with foreign peoples will influence their thinking and, ultimately, the behavior of their governments (Thompson, 1987). Although public diplomacy emerged as a companion to traditional diplomacy in the seventeenth century, it was not modernized until the twentieth century when it became an official government policy. Today public diplomacy remains an undeveloped and at times misused instrument of diplomacy, as the case of Bosnia and Herzegovina reveals.

The phrase 'public diplomacy' was created in 1965 by Stanton Commissioner and former Foreign Service Officer, Dean Edmund Gallion of Tufts University's Fletcher School (Arndt 1987). Some claim that public diplomacy is "a euphemism for the word modern Americans abhor propaganda" (Green, 1988). Indeed, although the word propaganda comes from Latin 'propagare' meaning to extend, enlarge, carry forward or advance, it had a meaning suggesting neither good nor evil (Caterini, 1973), until use by Goebels and Nazi Germany gave the word a more pejorative connotation.

In theory, public diplomacy of the international community signifies the joined public diplomacy of many states acting together to produce a change in another state or a group of other states. Since the Cold War, a change usually implied peace or democratization. In practice, the phrase "international community" has often represented only the dominant world powers, and since the Cold War especially, it has often been simply equalized to the views of the most important of these powers – the United States. An overview of the US public diplomacy will therefore serve as the best model of public diplomacy in practice. This analysis will be followed by a study of selected public diplomacy efforts in Bosnia and Herzegovina during the civil war and immediately thereafter (1992-1995). It is important to note, however, that a comprehensive critique of the foreign intervention in Bosnia will remain beyond the scope of this paper.

United States' Public Diplomacy

"America's ideas are powerful; and through the power of communication, we can share them with the world." (President George Bush, April 2, 1990)

Until October 1999, United States' Information Agency (USIA) carried out American public diplomacy. USIA then merged with the State Department, but Voice of America (VOA) and some other services remained independent. Evelyn Lieberman, the Undersecretary for Public Diplomacy and Public Affairs, is the present coordinator of US public diplomacy.

American public diplomats are charged with explaining government policies and actions to foreign audiences. They also advise the government on the implications of foreign public opinion for American policies. The diplomats' principal goal is "to speak officially for the United States government to the populations of all other countries, to promote understanding of America as a political, cultural entity, and to try to win support

for America's foreign policy" (Green, 1988). A more humorous description pertained to USIA as a renown export house, producing "ideas, opinions, beliefs, knowledge, facts, figures, and, in a broad sense, culture" (Cited in Green, 1988).

The main public diplomacy products are publications, films, radio tapes, videotapes, books, VOA and the Washington file (previously called the wireless file). The Washington file is said to be "the single most important, complete, dependable, and verifiable pipeline of information between USIA Washington [today State Department] and its field offices, "[setting] the record straight when there is a crisis to explain, an accomplishment to tout, an enemy propaganda attack to refute, or extra dimensions needed on a personality, event, or the character and customs of the United States" (Green, 1988).

All of the products except books must faithfully reflect foreign policy, which means that the State Department controls which stories will be carried, which omitted, and what elements will be stressed. It is important to reiterate, however, that public diplomacy does not create the American foreign policy. It explains it.

After the Cold War, the task of American public diplomacy is no longer to fight another ideology but to build the confidence and leadership through which the US national interest may be harmonized with a public philosophy of a free people. This is why the US Advisory Commission on Public Diplomacy emphasizes the need to foster democratization of Eastern Europe in its 1990 agenda, and why democratization is today a symbol of US foreign policy.

Once the US became a sole superpower, obtaining a unique position to influence and shape the direction of the world, its public diplomacy has become even less distinguishable from the public diplomacy of the so-called international community. The line between actions that are taken in American self-interest and those taken in the interest of the international community is a fine one. Often the interest is mutual, but not as mutual as Americans purport, which is why Reinhold Niebuhr (1959) cautions the American leadership:

"We are not a sanctified nation and we must not assume that all our actions are dictated by considerations of disinterested justice. If we fall into this error, the natural resentments against our power on the part of the weaker nations will be compounded with resentments against our pretensions of superior virtue."

Indeed, most policy analysts stress a need for a more balanced American public diplomacy that would continue to strongly advocate democratic ideology but with a lesser ethnocentric conceptualization;

"Greater acceptance of pluralism, respect for differences, and less identification with bipolar division, made naive propaganda and ethnocentric self-advertising seem anachronistic as well as ineffective" (Fisher, 1987).

One of the ways of improving the US image in the world, and consequently, the success of its public diplomacy in promoting democracy is through increased attempts for cultural understanding. Currently, "where the main thrust of cultural programs is 'sell America' or 'sell democracy,' the quest for cultural understanding is pushed into the background" (Thompson, 1987). Often cultural empathy is overlooked and American design imposed on others. Secondly, the language used by the American leaders must reflect reality more faithfully, instead of increasing the present ambiguity of the American – and international – actions.

Post-Cold War presidents have often reached back to the old rhetoric in order to

mobilize public support for international undertakings whose strategic rationale has been very difficult to define. "Did George Bush really think that Saddam Hussein was 'worse than Hitler?' Does Bill Clinton really believe that the United States is 'the conscience of the international community?' Or should such statements be dismissed as rhetorical flourishes designed to achieve that elusive public consensus about the US role in the post-Cold War world?" Such quest for foreign policy consensus has been both an understandable presidential response to a fragmented, sometimes stalemated domestic political system and a dangerous temptation for them to misrepresent their foreign policies (Melanson, 1996).

Certainly, if the United States is going to be a successful world leader – and a successful public diplomat – it must overcome its "nationalistic universalism" which claims for one nation the right to impose its valuations and standards of action upon all other nations. The American public diplomacy will become significantly more successful in promoting democracy abroad once the US becomes more culturally sensitive and more universal in its concern over human rights and in its application of justice. This, however, is a political decision beyond the scope of any public diplomacy strategy planning.

Public Diplomacy Case Study: Bosnia and Herzegovina

In order to faithfully portray the diversity of public diplomacy in Bosnia, several international figures and a spectrum of audiences will be presented. The examples come from accounts by three of Bosnia's key peace-makers:

1. David Owen, the co-author of Vance-Owen and Owen-Stoltenberg Peace Plans;
2. General Michael Rose, the Head of UN Peacekeeping Operations;
3. Richard Holbrooke, the broker of the Dayton Peace Accords who later became the US Ambassador to the UN.

The experiences of these three mediators will be integrated to uncover four public diplomacy aspects: (a) US relating to Europe and to American citizens; (b) Bosnian Muslim Government relating to the world; (c) International representatives relating to the world, and (d) "International Community" relating to the people of Bosnia.

The Issue of Ground Troops: United States to Europe & United States to American citizens

The decision concerning the deployment of US ground troops in Bosnia is illustrative of the American public diplomacy towards Europe and at the same time a demonstration of conduct of its public affairs (public diplomacy on a domestic level). It is a good example of the merge of the public diplomacy with public affairs. Such trends are not rare in international politics. In April 1993, President Clinton's advisers revoked Clinton's statement made on March 31, 1993 in which he promised troops for Bosnia, "He wasn't serious, they said after the idea encountered a hostile reception; it was merely 'public diplomacy' designed to placate the Europeans" (Clarke, 1995).

Clearly, the US President used public diplomacy in order to bridge the opposition between the government's need to act abroad and satisfy an isolationist domestic opinion. Once the US government decided to finally place the ground troops in Bosnia following the Dayton Peace Accords, it had to engage in a public campaign to gain support from its constituency for this decision. The US public was not receptive to the deployment of

ground troops, not even after the Dayton Peace Accords were signed. "While the public applauded our diplomatic efforts, opinion polls put public opposition to the deployment of American forces to Bosnia at around 70 percent," Richard Holbrooke affirmed (1998), calling for a public affairs effort that would explain the importance of acquiescing to the deployment to the American public. The ensuing American public campaign was not only an act of public affairs but also an act of public diplomacy because the entire world was also their audience, expecting the United States to fully participate in the international effort in Bosnia.

Bosnian Muslim Government to the World

Newt Gingrich stated that "the best national security investment the government of Bosnia ever made was not in buying any weapons but in hiring a professional public relations firm ... in Washington" (Forget Diplomacy, 1995). Indeed the public diplomacy of the Bosnian Muslim government reached out to the world, and strongly influenced the international community's actions. Bosnian Muslims frequently pointed out that an international coalition led by America took military action against Iraq when Kuwait was invaded, whereas the international community did nothing to help Bosnia in the face of a similar aggression. This was an effective public diplomacy, even if it did not accurately reflect the situation in Yugoslavia, which represented a civil war about territory (Rose, 1994), rather than an external aggression. Another illustration of Bosnian Muslim propaganda was the provocation of Serb shelling of Sarajevo by attacking the Serb positions just before the international visitors entered the city.

"Visitors were thus given a practical demonstration of the aggression being committed against the State of Bosnia. In this way, the Bosnian Government hoped to persuade the West to become involved in the war on their side. [...] civilians mattered less to the Bosnian government than images of suffering and war" (Rose, 1994).

The international community was aware of this action by the Bosnian Muslim government, but, as Secretary of State, Madeleine Albright, explained to General Rose, "they could do little about it." The policy was often above the faithful conduct of public diplomacy.

The most striking example yet is the so-called Markale Incident when Sarajevo citizens were shelled at the marketplace. The Serbs were blamed for this incident and NATO bombing of Serb positions ensued shortly thereafter. An inquiry into the incident was inconclusive, with ample evidence pointing to the possibility that it may have been an action of the Bosnian Muslims shelling their own people to draw world attention and induce the bombing of the Serbs.

NATO's explanation of their decision to bomb therefore did not mention the Markale incident; "some within NATO had already been tipped off about the need for the decision to be a free-standing one, not linked to a particular incident" (Owen, 1995). General Rose had also sent a report to the UN that the mortar shell might have been launched by the Bosnian Muslim army and that the investigation would continue.

"In addition, a senior ballistics expert in Zagreb had studied a map of likely trajectory patterns produced by UN investigators in Sarajevo and believed the angle at which the mortar had hit the roof of the market still indicated that the firing point was more likely to be 1100-2,000 metres from the impact than 2,000-3,000 metres, and that this would indicate that the mortar had been fired from a Bosnian army position. When this highly charged

information reached the UN in New York on Tuesday everything was done to clamp down on the number of people who saw it so as to reduce the chance of a press leak" (Owen, 1995).

The reason why the international community did not widely publicize this report at the time was that they feared a collapse of their diplomatic efforts.

"Our dilemma was acute, for if the slightest hint that the Muslims were thought to be responsible came out of the ICFY in Geneva, the Bosnian Muslims would not attend. NATO, having just taken its decision, would also be in disarray if the public perception of the Serbs being responsible for the market-place bomb were suddenly shattered. What was needed was a little news management of the sort that international organizations are not very good at." (Owen, 1995).

Indeed, General Rose used this momentum to convince the Muslim leader, Izetbegovic, to sign to a ceasefire agreement.

"At the Presidency I demanded to see President Izetbegovic and was told that the President was giving an interview to Christiane Amampour of CNN. All the better, I thought. [...] The world would not understand why the President would not agree to the UN proposals to halt the fighting around Sarajevo" (Rose, 1998).

Nevertheless, the Bosnian Muslims thereafter decided to pursue a war strategy rather than accepting any peace settlement that would lead to a divided Bosnia. They were certain that they could not lose, because the public opinion was on their side;

"If the Bosnian Army attacked and lost, the resulting images of war and suffering guaranteed support in the West for the "victim State." If they won, then the Bosnian Government would be able to dictate the terms of any future political settlement. It was the task of their propaganda machine to conceal the true nature of this policy by blaming the UN for the war" (Rose, 1998).

Indeed, the Bosnian Muslim army often disrespected the ceasefire agreements, because "it was inconceivable that NATO could be seen bombing the 'victim State' (Rose, 1998). The Bosnian Muslim public diplomacy directly aided their war effort. This represents a negative use of public diplomacy, undermining peace and democracy building even if it contributed to a greater international focus on Bosnia and its tragic civil war.

International Community Representatives to the World

The difficulty of the UN's public diplomacy in Bosnia lay in the discrepancy between the language used to describe their peacekeeping operations, and the actual mandate and the political and military means available for its successful completion;

"The UN's failure to use appropriate language greatly undermined the credibility of the UNPROFOR mission and put a long-term question mark in many people's minds concerning UN's ability as a peacekeeper to respond effectively to the challenges of the new world disorder" (Rose, 1998).

Secondly, many of the media approached the conflict with a bias, sometimes unfaithfully reporting from the area in order to create sufficient impetus for air strikes on the Serbs, which they thought was the right solution;

"I watched a dramatic report by Peter Arnett of CNN ... implying that the UN ceasefire had already broken down and that Sarajevo was under heavy attacks by the Serbs, although from his footage, it seemed to us that the rounds were outgoing and had been fired by the Muslims" (Rose, 1998).

Such reporting created problems for the UN. In this particular incident, General Rose asked Peter Arnett to leave Bosnia, but not all coverage could be scrutinized for authenticity.

Finally, the NATO credibility appeared to be more important than the UN credibility and peace itself. The British Chief of Defence Staff, Peter Harding, even told Rose that he “had to understand that the credibility of NATO was more important than peace in Bosnia (Rose, 1998).” In brief, although the UN had its own flaws of policy which also resulted in mistakes in public diplomacy, most of the reasons for their failure stem from the external factors.

A striking illustration of a NATO’s mistake in the public diplomacy was the situation where the Bosnian Serb General Mladic and NATO General Clark exchange their military hats and forgot to return them before leaving the meeting. As they were coming out of the room, they were filmed and photographed wearing each other’s hat and smiling, which related a message to the world that NATO and the Bosnian Serb army had perhaps engaged in a partnership.

Dayton, on the other hand, represents a success of public diplomacy credited to the United States, and consequently to the international community. The broker of the peace accords, Richard Holbrooke successfully cooperated both with his government and with the press corps to convince the people of Bosnia and the entire world that this agreement would work. “We asked Washington not to sound too upbeat. [...] I believed it was best to underplay signs of progress and minimize optimism, while simultaneously seeking to establish a sense of new American commitment and engagement” (Holbrooke, 1998).

In order to portray the Dayton Peace Accords as an ultimate success, Holbrooke did not invite the representatives of the three factions to attend the final press conference, because “their natural proclivity to argue would divert attention from the Joint Agreed Principles.”

Even though such public diplomacy efforts convinced many of Dayton’s success and in this manner assisted this peace effort, the difficulties that continue to be faced in the implementation of the agreement have been tarnishing this image. This proves once again that public diplomacy cannot succeed where foreign policy has not. It can only strengthen that policy.

International Community to the People of Bosnia and Herzegovina

When Secretary Baker visited Belgrade in the spring of 1991, the people of Yugoslavia listened attentively to his message. However, it appeared that the United States was unaware of the strong effect of their public diplomacy at this moment. Though Secretary Baker, in a well-publicized speech in Belgrade in the spring of 1991, pleaded for Yugoslavian unity, he seemed to be aiming his remarks primarily at the Soviet republics. Moreover, he also acknowledged at about same time that “we don’t have a dog in this [i.e. Yugoslav] fight.”

The Yugoslav republics of Slovenia and Croatia understood Baker’s statements as an assurance of American non-intervention in case of Yugoslav disintegration. As a result, they announced their intention to secede shortly thereafter. Later, the United States paid more attention to their public diplomacy. For instance, when the three members of the US team died in a vehicle accident on Mount Igman, President Clinton urged Holbrooke;

“make clear publicly that our commitment to peace effort will continue and that you will lead it” (Holbrooke, 1998). Such a statement certainly raised hopes in the hearts of the people of Bosnia and Herzegovina that the international community would seek solutions to end the bloody civil war.

Although the UN’s public diplomacy to the world concerning Bosnia can be described as a failure, its public diplomacy towards the people of Bosnia and Herzegovina has achieved some success. General Rose walked on the streets of Sarajevo to demonstrate the UN’s confidence in the peace process to the local people. He often talked to the people and reiterated the international community’s commitment to peace. When asked whether the UN would bring peace to Sarajevo, he would say, “Only the people of Bosnia can do that,” I replied. “If you want to stop this senseless killing, then it will stop. You must tell your political leaders this, and so will we” (Rose, 1998).

The UN attempted to bolster people’s spirits during the war and sustain their belief in peace. The most successful such effort was the organization of a football match between the Muslims and the UN, preceded by a performance of the British royal band. “The appearance of the band had been reminder to the people of Bosnia of the existence of a civilised and orderly world that had once been theirs. The match itself was a triumph of diplomacy: Sarajevo won by three goals to one” (Rose, 1998).

When General Rose encountered the so called “women of Hadzici,” who blocked the road outside their town seeking their missing husbands and sons, he promised to get their story to the Bosnian Muslim government and the media. This was the first time that someone empathized with the women’s tragedy, and they burst into tears once Rose had soup and bread brought to them. Unfortunately, General Rose could not fully complete his promise as the media was unwilling to take up their cause. He then sarcastically commented; “Maybe the incarceration of Serbs in inhuman conditions was not news.”

The visits of various presidents and other high state officials coming from all over the world, before and after Dayton, also related a strong message to the people. Holbrooke (1998) particularly praises Secretary Albright’s public diplomacy efforts, claiming that her own background contributed to her success;

“Throughout her visit, Albright showed a deft sense of how to communicate with the people of the region. Perhaps this was a function of her background; after all, she had only been born in Czechoslovakia but spent part of her childhood in Belgrade.” At the same time, Holbrooke (1998) signals one failure of the American public diplomacy during President Clinton’s visit to Bosnia after the Peace Accords were signed.

“The last meeting, planned at my request, was designed to stimulate the leaders of the Muslim, Orthodox, Catholic, and Jewish communities to work for reconciliation. [...During the meeting,] the Secret Service insisted that the President leave the room; “As the astonished and disappointed Bosnians watched, I almost yanked the President out of the room.”

In this case a public diplomacy undertaking was sacrificed for President Clinton’s personal safety. Still, it is important to note that the public diplomacy efforts towards the people of Bosnia and Herzegovina have been critical in the actual implementation of the international community’s policies, especially concerning the ongoing application of Dayton Peace Accords.

Conclusion

The case study of Bosnia reiterates the importance of public diplomacy as a component of foreign policy of building peace and democracy. The public diplomacy of the international representatives in Bosnia and the leading world governments played a vital role in securing worldwide public support for international action. Importantly, the international representatives also attempted to ensure a positive attitude from the people on the ground and build their confidence in the mission's success.

The most striking example of the significance of public diplomacy, however, was the Bosnian Muslim government's effort to involve the international community militarily in the conflict. Yet while public diplomacy proved to be the best means for the Bosnian Muslims to achieve their political goal, their use of public diplomacy was not always ethical. The difficulty in guarding against such misuses lies in a larger ethical dilemma concerning media's transmittal of information. The international community was indeed international in many aspects, but American in the main aspect of policy-making. The role of the United States was crucial in deriving the outcome of Bosnia's civil war. Therefore, it was also a critical component of the international community's public diplomacy. The issue of ground troops represents an example of how the United States bridged a gap between its public affairs and its public diplomacy.

One of the most important lessons of this public diplomacy experience should be to try to focus more on the people affected by an internal conflict and instigate the creation of public pressure to end the war, instead of ensuring one's own credibility at home and abroad. As General Rose indicated, "Had the UN been able to appeal directly to the people of Bosnia (who always said that it was not their war), then public pressure could have been put on the political and military leaders to end the war earlier" (Rose, 1998). Sadly, this lesson is not yet learned, and the public diplomacy of the international community today fails yet again in Yugoslavia by alienating the people and destroying the democratic opposition in the country through the policies of bombing and economic sanctions.

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Safeguarding Cuba's Social Achievements

Mirjam Schoning

Introduction

Surviving the transition from Communism is a tough challenge; for governments and their people. Social services, which once were a basic right, suddenly become vulnerable to the new pressures and constraints of the market economy. This paper will describe how international organisations can help to alleviate many of the problems. Experience from other transition economies in Eastern Europe and Central Asia has shown a rapid decline of the quality and quantity of health and education services delivered to the population. This has led to a decline in the public support for economic reforms. The challenge for Cuba, then, is to find a more careful approach.

The paper will first describe the government's efforts, illustrated by performance indicators of the social sectors in Cuba until 1990 (see section 2). These will mainly cover the sectors in which Cuba achieved the largest advances – health and education. Cuba's achievements in the education sector have been very impressive. The adult illiteracy rate in 1997 was only 4.1%, even lower than Chile's 4.8%. A recent UN study comparing the school performance in 12 Latin American countries showed that the math and science scores of Cuban school children were far superior to their Latin American counterparts and in some cases, better than children in the United States. The revolution also installed an impressive health system. In the 1980s everyone had access to health services. Cuban doctors and hospitals gained an international reputation.

Several of these advancements, however, have been reversed during the crisis of the 1990s. The collapse of the Soviet Union and the ensuing economic crisis in Cuba have drained the resources spent on the social sectors. The precarious food situation has led to widespread malnutrition. Doctors and hospitals lack the resources for medicine and equipment. Professionals in the health and education sectors find that they can earn several times their salaries as taxi drivers or waiters in tourist hotels. This paper will provide an overview of the past decade, in order to examine the cumulative effects of the economic crisis on the social sectors.

The US embargo on Cuba has had an important influence in the social sectors; especially health. The impact has sharply accelerated since 1992. This trend is directly linked to the fact that in 1992 the U.S. trade embargo, one of the most stringent embargoes of its kind, prohibiting the sale of food and sharply restricting the sale of medicines and medical equipment, was further tightened by the 1992 Cuban Democracy Act. As this paper will argue, loosening some of the embargo restrictions could greatly benefit the Cuban humanitarian cause.

The final section will provide an outlook and recommendations. These efforts can have a significant impact in easing the economic transition and reducing the suffering and discontent of the Cuban population. It gives Cubans a chance to work towards a peaceful transition within Cuba, guaranteed a decent level of health and education, instead of seeing emigration as the only solution to a better standard of life.

The Social Sectors before and during the Revolution

Attempting to assess the social achievements of the Castro regime is a particularly difficult task, because most of the existing studies are politically biased. Those described as "friends of the revolution" tend to emphasize the current social indicators. Cuba enjoys very high literacy and low infant mortality rates, particularly when compared to other Latin American countries. However there is a widespread concern that statistics published within Cuba are not very trustworthy. Exiled academics and opponents of the regime argue that Cuba already enjoyed similar relative health and education levels before the revolution and has since merely maintained its advantage. Thus, in order to shed some light on this controversy, the study will also draw on data from the pre-revolutionary period up to 1959.

However at this stage this paper will focus on health and education, as the Cuban socialist government claims the greatest achievements in these two sectors. Cuba's advances between the pre-1959 period and the revolutionary period are assessed in terms of the available social indicators in both areas. Where possible, the expenditure necessary to achieve these social indicators are quantified and then compared to other Latin American countries.

Health

There is a lively debate on whether the Castro regime significantly improved the state of health services or whether it simply upheld the high standards achieved before 1959. It is clear that the revolutionary government did inherit a fairly advanced health sector. Pre-revolutionary Cuba enjoyed a wide medical coverage in terms of physicians and dentists per capita as well as the number of hospital beds. According to UN data, Cuba's infant mortality rate in 1957 of 32 per 1000 live births was the lowest in Latin America and the 13th lowest in the world (Smith, Kirby and Llorens, 1998).

While some Cuban-American researchers argue that the country has failed to maintain its worldwide rank during the revolutionary years, it must be acknowledged that its achievement has been far superior to that of most of its Latin American neighbors. At the beginning of the 1990s Cuba still performed better than its Latin American neighbors, although it fell from 13th place to 25th in the worldwide ranking. Between 1980 and 1990 Cuba was able to almost cut in half the number of infants who died, per 1000 live births. Across the region, only Chile, Uruguay and El Salvador managed to reduce the infant mortality rate by a similar rate. The average reduction of the infant mortality rate in Latin America was 33% compared to the 45% Cuba achieved during this period.

Indeed, within Latin America as a whole in 1990, only the Costa Ricans have a higher life expectancy at birth than the Cubans. However, Cuba did manage to lose the advantage it had throughout the 1980s, slipping back from the top of the list. In fact, after Paraguay, Cuba reveals the lowest increase in life expectancy over the 1980s - only 1.4 years.

Although Cuba has not improved its life expectancy dramatically over the 1980s, it is still striking in comparison with its Caribbean neighbors. Haiti, Jamaica and the Dominican Republic have been included to provide such a benchmark. In terms of health and education indicators, the figures differ greatly. From a strictly cultural point of view, the Dominican Republic is the closest match, though the average life span is almost six years shorter. While it clearly has to be recognized that Cuba already had an impressive

health care system before the revolution, it is also clear that this was not accessible to everyone. Equal access has only been achieved in later years and is widely attributed to the Castro regime.

Education

The Castro regime claims that teaching its people to read has been one of its greatest achievements. Indeed Cuba had the third lowest illiteracy rate in Latin America in 1980 and was able to reduce it even further until 1997 by an impressive 49%.

The pre-revolutionary illiteracy rate of Cuba was comparatively low in the region at 24%. Nevertheless countries like Argentina (13%), Chile (19%) and Costa Rica (21%) were lower. During the revolutionary period however, Cuba managed to surpass Costa Rica and Chile. In 1990 Cuba's illiteracy rates were at 5.3%, compared to Chile's and Costa Rica's 6.1%. In education the Castro regime has truly been able to bring reading skills to the masses and move ahead of its regional counterparts.

The very high secondary enrollment rates achieved during the revolution are another illustration of educational achievements. In 1980, secondary enrollment rates in Cuba were by far the highest in Latin America at 80%. Cuba was able to increase this rate to 90.2% in 1989, staying far ahead of the rest of the region.

Cuba's impressive achievements in the education sector, however, came at a price. Cuba spent between 6-7% of its GNP on education throughout the 1980s. Only Jamaica, in the Caribbean, and Costa Rica had similarly high rates, whereas most Latin American countries only dedicated between 3-5% of their GNP to education. This number declined in many cases throughout the 1980s as a consequence of the growing debt crisis.

The Social Sectors during the Crisis of the 1990s

The collapse of the Soviet Union in 1991 triggered a severe economic crisis in Cuba, prompting the need to adapt its economic model. Cuba relied heavily on trade with the Soviet Union, in particular subsidized oil imports. In fact, 79% of Cuban trade in 1989, took place with the Soviet Union. The situation was further aggravated by low sugar prices at the time of the collapse of the Soviet state, and Cuba sank to its lowest point in 1994. Thanks to the lack of oil, the food processing industry collapsed. Despite the efforts to promote agriculture, food was scarce and malnutrition widespread.

The deep economic crisis affected the capacity of Cuba to deliver health and education services due to the sheer lack of resources. Nevertheless, many of the indicators described above, such as life expectancy, infant mortality and literacy, have been upheld or have even slightly improved during the 1990s. This has mainly been achieved through a particular government focus on health and education, reflected in high spending figures. However, simply relying on social indicators fails to reveal the short-term effects of a rapid deterioration of the social sectors. This paper will now examine further indicators, such as malnutrition, medical expenditure, and school enrollment rates demonstrate the real consequences of the crisis on the social sectors and safety net.

Cuba has managed to alleviate some of the economic crisis during the second half of the 1990s economic crisis through massive promotion of tourism and the much sought-after hard currency it provides. This bolsters the budget and enables the government to set aside some resources for the social sectors. On the other hand, the

“tourist apartheid” has led to a whole set of problems on its own. All of a sudden it became much more attractive for professionals in the health and education sector to abandon their field and work in tourism, where they have a chance of accessing dollars. Doctors and teachers alike have chosen to drive taxis or open small restaurants, called paladares.

Health

The effects of the recession on the health sector are most noticeable in the desperate shortage of medicine and medical equipment. Doctors continue to provide an extensive coverage and offer their services for free, but they often lack the resources to actually treat diseases.

Cuban imports of medical products and pharmaceuticals dropped from \$54 million in 1990 to \$18 million in 1996. During the same time period, the peso expenditures on public health have actually grown slightly. Since the 1992 passage of the Torricelli Law by the US Congress, licenses are required for the sale of medical products to Cuba. It is difficult to determine in how far these restrictions are the cause for the downturn in medical imports or whether the embargo is a welcome excuse for the Cuban government to divert the dollars to other sectors, like tourism, where dollar investment is particularly necessary for acquiring imports.

The recession has visibly impacted the levels of disease. The number of people dying from diarrhea almost doubled between 1992 and 1993, only dropping slightly again in 1995. At the same time, the number of underweight babies born increased as well. Heart disease is the number one cause of death in Cuba. Mortality rates for men and women have increased since 1989: with 189.3 deaths per 100,000 in 1989 and 199.8 deaths per 100,000 in 1995. By one estimate, daily caloric intake dropped 33 percent between 1989 and 1993.

Education

The crisis of the 1990s has left clear marks on the quantity and quality of education received by the current adolescent Cuban generation. Secondary education figures dropped from a peak of 90.2% in 1989 to only 80.8% in 1996, thus reversing the entire ground gained during the 1980s. In 1994, during the worst phase of the economic crisis, the secondary enrollment rate fell as low as 74.5%.

This stands in contrast to most other Latin American countries, which were able to significantly increase their secondary enrollment ratios during the 1990s. As a result, Cuba no longer enjoyed the highest secondary enrollment rates in Latin America, but came second to Uruguay, and was closely followed by Argentina in 1996.

Indeed Cuba and Ecuador are the only Latin American countries where the tertiary enrollment figures have declined throughout the 1990s. In 1980 Cuba had the 6th highest tertiary enrollment rate in Latin America at 17.3%, after Ecuador, Argentina, Costa Rica, Panama and Venezuela. The rate increased in the 1980s and then sharply dropped during the crisis years from 20.9% in 1990 to 12.4% in 1996. This leaves Cuba in 15th place in Latin America, even behind countries like Nicaragua.

As the economic situation grew worse, more and more adolescents could not afford to attend high school or universities. Instead, they often spent their time trying to earn money or find food. University careers like many professions, pay far less than the

tourist or the illegal private sector. Many skilled workers are either leaving or dedicating less time to their professions, in order to search for additional income sources.

The Effect of the US Embargo on the Social Sectors

The American Association for World Health (AAWH) has published an extensive report on the "Impact of the US Embargo on Health and Nutrition in Cuba". Over a twelve-month period between 1995 and 1996, a multi-disciplinary research team traced the implications of embargo restrictions on health care delivery and food security in Cuba. The study came to the conclusion that "that the U.S. embargo of Cuba has dramatically harmed the health and nutrition of large numbers of ordinary Cuban citizens." The study highlighted trade bans, licensing, shipping and humanitarian aid as factors stemming from the US Congress Cuban Democracy Act, passed in 1992, which have exacerbated the human effect of the 37 year old trade embargo (AAWH Report, 1997).

Conclusion

Almost every description of Cuba by a foreign visitor includes the words "a country full of paradoxes and contradictions." One is the stark contrast between economic adversity and impressive education and health provision. The social safety net is the pride and backbone of the current regime in Cuba. It remains very important to the Cuban people and underpins the continued support for Castro. Though humanitarian arguments for aiding the Cuban population is clear, it ignores political considerations. If the objective is to move Cuba towards transition, a rapid deterioration in education, health, food and housing could accelerate the collapse. This has been the main rationale behind the U.S. embargo. On the other hand the Cuban population might be more willing to embark upon a transition if international backing of their treasured social safety net is secured. Without the fear of losing the most important benefits, the economic and political reforms would face less resistance.

How can these two highly developed sectors be best supported by the international community? Canada and the European countries could increase their bilateral aid by providing technical expertise and material aid, particularly in the health sector. Rather than increasing Cuba's health expenditures, efficient use of existing funds should aim to build up biotechnological and pharmaceutical capacity as well as the export of medical services to the region ("health tourism").

Imports of pharmaceuticals are very expensive and foreign donations are essential. Yet these should be strictly limited to those that Cuba cannot produce and which have no substitute in local herbal drugs. This would prevent collapse of the local industry as seen in many Eastern Bloc countries. Medical research earned Cuba over \$100 million abroad in 1998. Its scientists helped to develop the Meningitis-B vaccine. Their ability to find further cures and local remedies should not be underestimated.

Material donation of medical equipment however, remains essential. Much of the current equipment is rendered unusable by the lack of spare parts and high cost of importation. Needs analysis of medical equipment and associated spare parts is essential. Foreign donations are critical to addressing these shortfalls.

Cuba confronts the same health sector inefficiencies that trouble developed economies. It is proud of not having closed a single hospital in recent years. Cuba has the world's highest physician-patient ratio, at 5.3 physicians for every 1000 people. In reality, it would gain more from concentrating its resources on fewer hospitals and physicians, allowing targeting of scarce resources and higher quality care.

In order to retain skilled medical and nursing staff, the international community should support commercially viable elements of Cuba's health sector. Hospitals like the Cira Gracia, the Cimex and partly the *Hermanos Almeijeiras* offer complex surgical care to Latin American patients, bringing in \$30 million in 1998. This sector enables Cuba to earn much needed dollars, which should then be exclusively used to subsidize the public health clinics open to everyone.

Currently there are several factors jeopardizing the Cuban social safety system. The economic crisis and transition period of the 1990s, as well as the tightening of the U.S. embargo in 1992, have severely aggravated the situation. If this was not severe enough, the worst may lie ahead. The move to market-determined prices is likely to increase the costs of the social programs substantially. One of Cuba's most important assets is therefore at risk: a highly educated and healthy workforce. In the interest of preserving Cuba's social sector capacities and easing their economic transition, it is imperative to act now, in order to safeguard Cuban remarkable achievements in health and education.

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Real Politics: A behind the scenes glimpse into the world of a grassroots Presidential campaign

Felicity Spector

Four forty-five am, on a wintry January night: most of New Hampshire's residents are sensibly tucked up in bed. Yet in a large, dilapidated warehouse building housed in a converted Manchester mill, the lights are burning and the computers are humming into life.

Ross, a twenty year old volunteer with the Bill Bradley for President campaign is already hard at work, Dunkin Donuts coffee mug clutched in his hand. His task is to clip press cuttings from the New Hampshire press concerning the Primary election campaign, paste them neatly into a packet and fax them to the Bradley HQ in New Jersey – all before six am. The Manchester warehouse is bitterly cold: outside the temperature hovers forty degrees below zero. Inside, the pipes have frozen, but Ross works on, such is his dedication to his chosen political cause. By six am, the cuttings are faxed, and Ross munches on cold Pop Tarts for breakfast before finally taking a nap, curled up under his coat on a broken couch. Other young volunteers are drifting in, wrapped tightly in knitted scarves and ski hats, collecting banners and placards to wave on street corners, appealing to passing motorists to "Beep for Bradley". They call this "visibility".

These grassroots, retail Primary campaigns have a language all of their own. To take part is to enter a world of strange activities from "lit-dropping" to "phone-banking". Conversations are littered with jargon like "push-polling" and "bar-coding". Muffins are not breakfast but the generic name for young teenaged volunteers. A 'Flop House' is where the youngsters spend each night, sleeping bags littering the floors, the trash cans packed with beer cans, candy wrappers and pretzel bags. The owners are incredibly trusting: typically they have donated their homes to the campaign while they are away in sunnier climes for the winter months.

It's all incredibly prosaic, a real haven for old-fashioned political action in the midst of the frenetic hyper-reality of the modern media age. New Hampshire politics is all about knocking on doors and tramping the streets, coffee mornings and outdoor rallies, photocopied fliers and hand-painted signs. Every wall in the Manchester HQ is plastered with slogans: "It can happen!" "You are now entering Bradley country!" It's all about volunteers, too. There are literally thousands of people involved: from college students who have abandoned their courses for a semester or two, to older professionals who've taken leave or even quit their jobs.

Some are employed as full-time staffers: paid well below minimum wage to work around the clock, organising interns, working the computers, arranging the canvass teams.

Stephanie is twenty-two; she is in charge of the entire campaign software programme. Until she arrived, no-one was in charge. She is teaching herself on the job, spending hours in front of her screen, working out how best to translate the answers voters give on the doorstep or telephone into data which the campaign can process electronically for future use. She's found herself improvising completely new skills: climbing up a ladder and somehow working out how to rewire the office so that more computers can be used. It is perhaps not the most efficient way to run the computer campaign: but it is certainly an entire education for Stephanie. Melissa is just nineteen, but she's already a veteran of the Clinton '96 campaign.

David is in his fifties, and took early retirement from his diplomatic career to work for the Bradley campaign. He's never been involved in politics before but says he has always admired Bill Bradley and would never have forgiven himself if he had not seized this chance to help. So his wife, back in DC, sees him every third weekend, and in between David sleeps on a foldaway sofa bed and subsists on the campaign diet of pizza and peanut butter.

Hundreds of others, unseen, unsung, are also contributing to the cause. Families give up their basements and spare rooms to house out-of-state volunteers. Couples drive round town reviving flagging canvassers with flasks of coffee and tubs of home-made hot food.

Each weekend brings an influx of helpers from all over the country. A typical group drove a van for seven hours from Delaware. The thermometer outside reads twenty below; but these folk are well prepared, kitted out in sturdy outdoor gear, special hand and footwarmers stacked neatly in the glove-box. They are dispatched to Rochester, an unremarkable suburban sort of place, where clusters of houses nestle in the pinewoods. It is a typical day; they canvass in heavy snow for six hours – perhaps less than two dozen households promise their firm support.

For a registered voter in this state, January might be called the cruellest month. Canvassers, calling at the door. A mountain of pamphlets and fliers and leaflets stuffed daily. Phone calls several times a night: "I'm calling for the Bill Bradley for President Campaign. Have you made up your mind who you're going to support in the Primary election on February the first? Are there any issues you're interested in? Can we send you any literature on that? Do you have any questions?" It's enough to drive some people to pretend they're out, or have a wrong number, or speak no English. Then there are the downright embarrassing calls: "I'm sorry, my wife passed away last week." "Oh, so she won't be voting then?" If election results mirrored canvass returns then the "Not at Home" party would win by miles. Hours of struggling down endless streets, through blizzards and ice storms and bitter winds, many hours more of phone bank calls to a mindlessly repetitive script... and perhaps just one in ten people are actually at home.

In fact the canvass operation reveals a key inefficiency of the Bradley campaign. Who knows where they obtained their voter list: in any case it is hopelessly out of date. At least a quarter of the people listed here have moved. Forty percent of the phone numbers are wrong. No-one seems to know how the list could be updated or improved. And there's precious little training for the canvassers themselves, no briefings on the issues, no instructions about what to say.

But still the contact work goes on – in fact, it never stops. Details of voting intentions are coded into 'strong Bradley, weak Bradley, don't know, Gore supporters, republicans', which must all be typed into the computer database by hand. Requests for literature must be followed up, along with a handwritten letter "Thank you for your interest, I am forwarding you the campaign information you asked for, if you have any more questions please call..." In some ways it almost looks like the campaign is inventing work for its hundreds of volunteers to do. In the Manchester HQ one Sunday, a group of elderly folk are sitting round a large table, writing by hand on a huge pile of campaign leaflets 'sorry you were out' and signing them 'A Bill Bradley volunteer'. Papers are hand folded to be posted off, stamps licked one by one – have they not heard of franking machines? At one stage the drinking water runs out – no-body has paid the bill. Finally the state

organiser, a swaggering Texan called Kevin Keefe, grudgingly agrees to find the cash. It might be inefficient, penniless, old fashioned, but there is no doubt that campaigns like this run almost exclusively on the enthusiasm and outright commitment and passion of the volunteers.

The professional consultants in their slick suits and palm pilots would look out of place here, amid the mounds of paper and sticky labels and felt-tip pens, and the donut boxes spilling out their sugary contents on the tabletops in between. Ask anyone why they are here and their eyes shine with an almost missionary-like zeal. "It's all about Bill" is their mantra: this aloof, distant, almost professorial former senator is the embodiment of all their hopes for a revival of liberal values and a shake-up in the status quo.

There is, by all accounts, something of the spirit of the nineteen sixties about all this, the idealism and the faith in "something better than ourselves". The campaign themes – "a different kind of politics" "finding the untapped potential of every American to do good" are a deliberate echo of Eugene McCarthy; the young people an echo of that earlier army of volunteers who covered the length and breadth of New Hampshire with their pledge to stay "Clean for Gene". It is living proof, if proof were needed, that the young generation is not entirely lost to apathy and alienation from political ideals.

The involvement of eager young people generates its own kind of madness. They never seem to need any sleep. It is three in the morning at Manchester airport: at one end of the private aircraft terminal a special hangar has been set aside for the supporters of George W Bush. There are ladies in fur coats. Most people look as if they are on their way to a job interview. In the corridor at the other end (no private rooms here) – the Bradley crowd. High school kids with painted faces and brightly coloured hair. Everyone is dancing to the haphazard music of a college rock band.

The nocturnal parties have been laid on to welcome the candidates back from Iowa after the caucuses have delivered their verdict. Bradley has not done well, but it seems nothing can deter the New Hampshire team from their celebrations. The plane has been delayed; it is late, but still the band plays on. Finally Bill arrives and wades his way through the crowd, a tall figure bobbing among the placards and balloons. He looks exhausted: nevertheless his supporters are going wild.

In the capital city, Concord, things are less frenetic, although Matt, the office organiser, is clearly a driven man. This former schoolteacher, still in his twenties, has been working here for almost a year. He has taken just two days off, for Thanksgiving. Away from the overseeing gaze of the campaign's big bosses, he has his region beautifully worked out, with separate teams assigned to work on their own areas, visiting supporters in person, getting to know the ground. Nationally, the polls don't look good: there is some tension in the air. But far from demoralising everyone, it seems to increase the sense of urgency: this is a small place, where every vote really does count. Kids return from banging signs into the frozen ground, and barely stop to brush the snow from their coats before rushing out again. Every telephone is in constant use: the computers are hot to the touch. Bradley himself is coming to town: the office has been asked to make personal phone calls to twenty thousand voters inviting them to attend a number of events. Unbelievably, in these frigid days, one outdoor rally has been scheduled for nine am.

In the event, despite six straight days of cold-calling voters around the clock, only about fifty people turn up for the event. Even fewer actually wait until nine-forty-five for Bill Bradley to actually arrive: for some reason he is constantly late. His wife, Earnestine,

sports purple ear muffs as protection against the icy wind. Bill delivers his stump speech with perfunctory speed, signs an autograph or two, and is gone. Again he has declined to speak to the waiting press, brushing past television cameras on his way to his car. In fact this reluctance to engage with the media has damaged him throughout the campaign. In stark contrast to the “other” insurgent, John McCain, who has made accessibility and openness the watchwords of his campaign, Bradley seems totally uninterested in helping the press do their job. His staff sneer at Gore for “sucking up” to local editors then seem surprised when he garners key endorsements from the Boston Globe to the Concord Monitor.

This matters because despite the importance of grassroots campaigning – publicity and image still matter. Bradley seems to think that because he has pledged to do things ‘differently’, he can spurn all of the old rules. The TV commercials are endearingly home-made but the dodgy sound quality makes comprehension something of a challenge. For some incredibly stupid reason, the campaign’s single best advertisement – the ace in their pack, the personal endorsement of Michael Jordan, is kept under wraps until March, when the campaign is on its last legs and the race is already lost. The campaign is awash with money – more cash on hand than Vice-president Gore – but water bills go unpaid, parking fines are ignored, stationary runs dangerously low until specific donations are made. As one New Republic journalist noted, if reform campaigns forget how to have fun they can become something of an ordeal. And sometimes the long hours, the cold weather, the junk food and the bad opinion polls do take their toll.

But back to that volunteer mantra: It’s all about Bill. These people really believe. They listen to the speeches about racial unity and universal health care and tough new gun controls and hope lights up their eyes. It’s what gets them out of bed at three thirty in the morning and keeps them on the telephones until their throats are hoarse and the same old canvassing script echoes in their dreams.

It’s one of the few reasons to believe in the future of politics. Because in this twenty-first century world of technology and multi-media and mass cynicism about Government and public life – there is still a place for this. There are plenty of reasons to criticise the New Hampshire campaign. The state is tiny, almost a hundred percent white, totally unrepresentative of America as a whole. But once every four years its people are treated to an exercise in democracy which every voter should try. The candidates for the highest office in the land have to take to the road, to meet them, hear their concerns, answer their questions, engage with their issues.

When Bradley first came here, it was his grassroots operation which propelled him ahead in the polls, and forced Gore to rethink the priorities of his own campaign. True, as soon as the massed ranks of the national press corps flooded into town for the final days of the campaign, the old instincts took over, and the schedules were suddenly packed with corny photo-ops and cheesy speeches at old peoples’ homes. But the Presidential candidates could not have survived that far, without the old-fashioned retail campaigns, without the army of volunteers and the real people with real passion, people who cared and wanted only the chance to put their ideals to work.

So – even though Bill Bradley eventually lost: perhaps this was the best lesson from New Hampshire. That politics can matter in everyday life after all. That, offered the chance to engage their hearts as well as minds, offered the chance to make a difference – the American people will still rise to the challenge with honours.

Microfinance regulation: Designing an Appropriate Framework for Mexico

Anne Rothbaum and Jennifer Tobin

Introduction

Microfinance in an institutional form is a relatively new phenomenon. It developed primarily in response to the market's failure to serve marginalized sectors of developing countries. Precisely, Microfinance Institutions (MFIs) provide credit and saving services to the poor as a means of alleviating poverty. Over the past 10 to 20 years, small MFIs emerged with varied methodologies and ideologies, from small non-governmental organizations (NGOs) granting subsidized credit to financial institutions offering a myriad of loan products. Many MFIs were borne of community development organizations, typically not for profit institutions. Due to the lack of regulation of small-scale financial activity, MFIs generally incorporated as NGOs. However, in contrast to most NGOs, MFIs operationally resemble commercial banks or savings and loans. This functional distinction places MFIs in a hazy area in terms of potential government regulation.

In the past these MFIs did not exist or remained small enough that there was no need for regulation. The industry is expanding rapidly and safeguards need to be put in place in order to establish a strong sector that provides savings and credit services to the urban and rural poor in developing countries. As more MFIs seek to access funds from commercial financial markets and re-lend borrower savings, more countries must consider regulation of the microfinance sector.

A myriad of regulatory options exist, including modifying existing regulation, creating MFI-specific regulation, and incorporating as traditional finance intermediaries. MFIs exist in distinctly different forms that require different levels of regulation. In this analysis, we focus on the regulation of Credit and Savings MFIs. By imposing restrictions on operation, regulation can have an important effect on the likelihood that an MFI will succeed, both financially and socially, and on an MFIs ability to attract funding. We will examine three theories regarding regulation: 1) That government regulation has an effect on the strength or financial sustainability of MFIs, 2) That government regulation can aid MFIs in attracting funds from outside donor and commercial sources and 3) That aside from regulation, the socio-political environment of a country has a significant effect on an institution's ability to attract funds.

Our goal is to understand the interplay of all three of these theories and to define an appropriate regulatory environment from our findings. We consider various commercial bank regulations, unique regulatory schemes, and institutional measures to test the above hypotheses. Finally, we apply our findings to the specific case of Mexico.

To gauge the effect of various microfinance regulations, we analyze the strength of MFIs and investor/donor confidence. We use the financial sustainability of an organization as a proxy for strength. To measure donor/investor confidence, we estimated the number of MFIs per million people in the population. To measure whether exogenous factors affect the strength of a country's microfinance sector, we estimated the effect of a country's socio-political environment on this same proxy of donor confidence.

From our analysis, the relationship between regulation and financial sustainability is inconclusive. Financial sustainability is neither compromised nor fostered by regulation.

In contrast, the size of the microfinance industry is correlated with regulations, specifically, the existence of a subsidized credit program in a country and an organization's ability to accept savings deposits. Both of these policies correspond to lower levels of donor investment in a country. In addition to regulations, the socio-political environment of a country affects the level of donor/investor confidence and consequently, the number of MFIs in a country. Economic and political freedoms foster donor confidence and are correlated with larger microfinance industries. Finally, countries with English Common Law foundations, those with smaller and more efficient bureaucracies, encourage donor confidence in the form of larger microfinance sectors.

Why Regulate Microfinance?

For the purposes of this analysis, we separate MFIs into 3 categories, low-level MFIs, Credit/Savings Institutions and Pseudo Commercial Banks. We concentrate on the regulatory needs of credit and saving institutions, those MFIs that offer savings services but do not intend to serve as commercial banks. Low-level MFIs do not offer savings services, and any regulation other than an interest rate cap would have little effect on operations. MFIs operating as pseudo commercial banks are smaller in number and have a greater need for regulations that mirror the regulations for commercial banks. While it is also important to look at regulations for these types of MFIs, we focus this paper on MFIs that offer credit and savings services to their clients but do not mobilize significant amounts of their borrower's savings for loan capital. We focus on these types of institutions, because they represent the largest segment of the microfinance industry and require some form of oversight that does not exist currently in Mexico.

The principal goals of financial regulation are to encourage competitiveness and to protect investor funds. Specifically, regulators should preserve the integrity of the financial system by ensuring the solvency and financial soundness of all financial intermediaries, protecting small depositors and large donors, and finally promoting the efficient performance of institutions and markets (Neave 1999, Chaves Gonzalez-Vega 1992).

As the industry is expanding rapidly, safeguards need to be put in place in order to establish strong sectors that provide savings and credit services to the urban and rural poor. At the same time, it would be costly to establish a unique and comprehensive regulatory structure to supervise such a diverse group of institutions. In sum, some form of regulation is necessary to protect both donor investments and client savings in MFIs.

Proponents of Regulations: Many practitioners believe that regulation and supervision can enhance competition and create an enabling environment for the growth of the entire industry. In addition, specific MFIs that wish to access funds from the capital market and from their borrowers require regulation. These practitioners believe that the adoption of standards would force MFIs to improve their products and services, would preclude unsuccessful institutions from obtaining subsidies and would strengthen and increase the outreach of more competitive MFIs. Although the misconduct or failure of one MFI will not destroy the entire microfinance system, failure could reduce confidence, damaging the integrity of the system as a whole (McGuire 1998 and Christen 1999).

From the donor perspective, inadequate financial reporting and monitoring hinder a donor's ability to judge the stability and performance of MFIs. To ensure an MFI's long term viability as well as confidence in the microfinance industry as a whole, many donors wish to establish regulatory guidelines and standards.

Regulators and government officials consider three objectives for the regulation of the microfinance sector. First, if MFIs have access to government and donor credit lines, regulation could ensure the effective and efficient use of the funds. Secondly, if MFIs are planning on becoming regulated financial institutions, regulators need to familiarize themselves with these organizations to better fulfill their monitoring responsibilities. Finally, and perhaps most importantly, regulators may want to assume control over credit and savings services offered to the marginalized populations within their countries (Valenzuela 1999 and Berenbach and Churchill 1997).

Critics of Regulations: An equal number of microfinance practitioners and researchers believe that regulation is unnecessary unless MFIs mobilize voluntary savings to re-lend to clients. Because the majority of MFI clients are net borrowers, not net savers, the failure of an MFI might actually benefit clients. On the other hand, the failure of an MFI does adversely affect the possibility of future loans. The departure of the MFI removes the borrower's access to credit and discourages entry of other MFIs.

Practitioners and governments fear that regulations might preclude small and remote MFIs from operating, because their size and location makes effective supervision costly to both MFIs and regulators. Also, they believe that regulation can constrain competition and innovation. According to Berenbach and Churchill (1997), "as unregulated financial entities, the better microfinance institutions have had considerable freedom to adapt operating methods to serve their target markets effectively. This has led to the development of a small but growing number of robust, specialized financial institutions, innovative delivery methods, and an extension of the financial services market."

Arguments both for and against regulation abound in the microfinance literature. To date, however, there is no empirical evidence to support any of these arguments. We now turn to three models to provide empirical insight into these arguments.

Method: We used three models to determine the importance of regulation for microfinance. Our first model examines whether regulation has an effect on the financial sustainability of an individual MFI. Our second model examines whether regulation affects an MFI's ability to attract donor funds. In our third model, in contrast to regulation, we examine the effect of legal origin, economic freedom, and political rights on the strength of a country's microfinance sector.

Financial sustainability estimates the ability of an MFI to operate in a competitive market. The unique characteristics of MFIs enable efficient programs to operate in a self-sustaining manner. Financial sustainability diminishes an MFI's need to compete for limited resources. Furthermore, efficient operations allow MFIs to serve greater populations. Another measure of the effect of regulation on the microfinance sector is an MFI's ability to attract funds from outside sources. International donors invest millions of dollars each year to fund and start-up MFIs. A strong regulatory environment is likely to provide an important incentive for donors to invest in microfinance. To estimate this effect we measured the impact of regulations on the number of MFIs per million persons.

While financial sustainability and the ability to attract funding are not the only determinants of strength and efficiency of MFIs, they are stated goals of the majority of these institutions. We examined other measures of institutional financial strength (delinquency rate on loans, client efficiency in terms of dollars spent per client, subsidy dependence) and of institutional social strength (the percentage of female clients and the average loan size of an organization.) The results from these models mirror our results for

financial sustainability.

Because commercial banks and MFIs incur different risks, it is impossible to simply apply commercial bank regulations to MFIs. Traditional regulatory measures, such as reporting and minimum capital requirements, would place disproportionate demands on credit and savings MFIs making it impossible for MFIs to operate efficiently and cost-effectively. The regulations we examined are licensing requirements, interest rate caps, the ability to accept savings deposits, the existence of a regulatory body for MFIs and the existence of a subsidized credit institution. We selected these policies based on their relative importance and based on data-availability constraints. The remaining regulations continue to be important for examining the effect of regulation on the strength of the microfinance sector.

Aside from regulation, "limited government, a relatively benign and uncorrupt bureaucracy, a legal system that protects property rights and enforces contracts, and modest taxation and regulation" may encourage donor or investor confidence in a country (La Porta, Lopez-de-Silanes, Shleifer and Vishny 1998). Therefore, to devise an appropriate MFI environment that encourages donor investment, we must understand not only the regulatory environment, but also the socio-political environment of a country. In this vein, we try to measure the effect of good economic institutions or good government on the prevalence of MFIs in a country.

A number of hypotheses arise with respect to what fosters good economic institutions. For the purpose of this analysis, we will focus on three determinants of institutions, the origin of the legal system, economic freedom, and political rights.

Policy recommendations will be difficult to advance regarding our findings for two reasons. First, we do not know the direction of causation. Weak institutions could necessitate the regulations or the regulations could encourage (discourage) weak (strong) institutions. Second, our sample set is biased because it only includes organizations that have existed for at least five years. The selection prejudice could mask the true relationship between our variables of interest (policy variables) and our dependent variables, financial sustainability and donor confidence. Even with these caveats, a positive correlation between our policy variables and our dependent variables implies that 'good' policy is related to financial sustainability and donor confidence.

Model: To gauge financial sustainability, we calculated the ratio of profit to size for each MFI in our sample. We measured a country's ability to attract funds from donors, or donor confidence, as the number of MFIs in the country per million inhabitants. The following equation details this calculation:

$$\text{Financial sustainability} = \frac{(\text{current loans outstanding} - \text{current arrears}) * \text{average interest}}{\text{current loans outstanding}}$$

Different types of policies are not the only factor affecting the success of MFIs. Their success also depends on the unique characteristics of each MFI, which we divide into three categories: demographic characteristics, such as geographic location and population density, social characteristics such as infant mortality rates and Gini ratios, and institutional characteristics, such as the percent of female borrowers and the average interest rate charged. To test the impact of regulations on financial sustainability and donor confidence, we ran two regression models. First, we regressed the level of

financial sustainability of each MFI on the demographic, institutional and regulatory characteristics of each MFI. Secondly, we regressed the number of MFIs per million people on the regulatory variables and the socio-economic variables of each country. Finally, to examine the effect of legal origin, economic freedom and political rights on the prevalence of MFIs in a country, we regressed the number of MFIs per million people on the socio-political variables of each country.

From these regressions, we estimated the marginal effect of each policy and of each characteristic on the financial success of an MFI and on donor confidence in the microfinance sector of a country. These estimates allow us to determine which policies are binding and restrictive and which characteristics are significant.

Results

Regulation Variables (Dependent Variable=Financial Sustainability)

Licensing regulations, interest rate caps and the existence of a subsidized credit institution are negatively correlated with financial sustainability. In contrast, the existence of a regulatory organization is positively correlated with financial sustainability of MFIs. Without controlling for demographic and institutional characteristics, both interest rate caps and apex regulatory institutions are significantly correlated with increased financial

Sustainability When we control for demographic and institutional characteristics, these relationships disappear. None of these policy variables exhibits a significant correlation with the financial sustainability of an MFI.

Regulation Variables (Dependent Variable=Donor Confidence)

In contrast to our first model, we interest rate caps and the existence of a subsidized credit program are negatively correlated with the number of MFIs in a country. Interest rate caps distort the MFI market, limiting an MFI's ability to become self-sustainable. The existence of a subsidized credit program substitutes for sustainable microfinance programs. Additionally, the ability to accept deposits while no form of supervision exists creates a risky environment for the MFI. In contrast, we licensing requirements and the presence of an apex organization are positively correlated with the number of MFIs in a country. Both of these regulatory structures create safer environments encouraging donor confidence.

From our second regression, we find that countries with subsidized credit programs have fewer MFIs per million than countries without these programs. On average, countries with subsidized credit programs have one fewer MFI per million people. Countries that allow MFIs to accept deposits have, on average, two fewer MFIs per million people than countries that prohibit MFIs from accepting deposits. We found that licensing requirements, interest rate caps and apex regulatory agencies are not significantly correlated with the number of MFIs in a country.

Demographic and Institutional Variables (Dependent Variable=Financial Sustainability)

None of the country demographic variables are significantly correlated with the financial sustainability of an MFI. In contrast, the percentage of the loan portfolio dedicated to microfinance is correlated with the financial sustainability of an MFI. As an institution focuses more on microfinance, the institution compromises its financial sustainability. A

one percent increase in loans dedicated to microfinance corresponds to a two percent decrease in financial sustainability. To a lesser extent, both the total loan balance of an institution and whether an institution offers additional services is correlated with the financial sustainability of an MFI. Organizations with higher levels of net loans outstanding are more financially sustainable. Additionally, organizations that offer other services, such as business or health services, tend to be more financially sustainable than organizations that do not offer such services.

Socio-Political Variables (Dependent Variable=Donor Confidence)

Freer economic and political environments foster donor confidence in a country. These hypotheses were confirmed by our analysis. As the levels of economic and political freedom in a country increase, the number of MFIs per million people increases. With an increase in freedom of one rating point in economic freedom and in political freedom, the number of MFIs per million people increases by 0.8 and 0.7, respectively. Furthermore, countries with English legal origin have more MFIs per million people than countries with socialist legal origin. All results were statistically significant at the 95 % confidence level.

Demographic and Institutional Variables (Dependent Variable=Donor Confidence)

From our second model, countries with greater income inequality have more MFIs per million people. The implicit assumption that donors invest in poorer countries may explain the higher prevalence of MFIs in countries with higher income inequality. Lastly, there was no significant correlation between GNP per capita or infant mortality and the number of MFIs in a country.

In our third model, only the gini index exhibits a significant correlation with the number of MFIs per million people. Countries with greater income inequality have more MFIs per million people. Again, the assumption that donors invest more in poorer countries likely explains this higher prevalence of MFIs in these countries.

A Case Study of Mexico and Recommendations

The results of our analysis demonstrate that while regulation might not be significantly correlated with the sustainability of individual MFIs, regulation is correlated with the strength of the microfinance sector as a whole. Again, policy recommendations regarding regulations are difficult to advance because regulation may be a cause of or may result from strong institutions and a strong environment. In contrast, the socio-political environment of a country does influence the strength of the microfinance industry as a whole.

Mexico is ranked 76 out of 87 countries in our survey for number of MFIs per million inhabitants. With respect to political rights, Mexico is slightly better than average. Mexico is classified as 'mostly unfree' by the 2000 Index of Economic Freedom. These measures indicate that Mexico is weak in terms of socio-political environment. Policies in the form of regulation can and should serve as a tool to strengthen this environment. Therefore, Mexico should adopt some form of regulation of the microfinance industry.

Experts have suggested a myriad of models for regulation and supervision of microfinance, ranging from none to full governmental regulation. Possible schemes include: no regulation, self-regulation, modification of existing law, creation of new law and delegated supervision to an unrelated party. With regard to self-regulation, according to

a conference of microfinance experts in 1999, attempts at self-regulation have been largely unsuccessful. "Membership in such schemes is voluntary, and the membership organization lacks the legal backing and power to license, enforce compliance, and close insolvent institutions." Without these incentives it is difficult to create an environment that encourages donor support (Valenzuela 1999). Self-regulation is therefore not a viable option for Mexico where a strong environment is necessitated.

The creation of a new set of laws specifically designed for microfinance is inappropriate for most countries. As discussed earlier, the costs of creating a new set of laws for this sector eclipse the potential benefits. Specifically, this sector is so small, the risks to borrowers are minimal and failure of an MFI will not greatly impact the financial sector as a whole. Additionally, according to Patricia Armendariz, former Vice President of Supervision at CNBV, the Mexican government is unwilling to alter and to supervise MFI specific-laws. Again, the alteration or creation of laws is not an option for Mexico.

The remaining option, delegated supervision, emerges as the most feasible and efficient option for Mexico. The CNBV, Mexico's superintendency of Banks would delegate supervision of the sector to an apex, or other third party advisory board approved by donors and any existing coalition of practitioners. While the work of supervision and regulation would rest with this body, the Central Bank would retain the power to intervene and to enforce regulations when necessary (Valenzuela 1999).

Two examples of these types of delegated supervision exist. The first example is on the islands of Java and Madura in Indonesia. Bank Rakyat Indonesia (BRI), a government-owned bank, supervises the island's MFIs. As Indonesia is a highly populated country, it is difficult to estimate the effects of the program from only two islands. However, experts recognize Indonesia as a model environment for maintaining and encouraging a strong microfinance sector (Otero and Rhyne 1994). The second example is in South Africa where a delegated supervisory board oversees the microfinance sector. Unfortunately, its recent introduction makes it difficult to estimate the effects of the program (Valenzuela 1999).

A delegated supervisory organization in Mexico would strengthen the microfinance environment in the following way. The delegated organization should focus on strengthening the environment in terms of improving donor confidence, because regulations do not appear to be correlated with the financial sustainability of individual MFIs. In other words, the delegated organization should alter the socio-political environment in Mexico by improving investment conditions for donors. Because most of the reviewed regulations or policies (licensing requirements, interest rate caps, the ability to accept deposits and the existence of a subsidized credit program) do not exist in Mexico, the environment is virtually unregulated. In addition, although an apex organization exists, the institution's functions remain undefined. The existence of licensing requirements and of an apex organization protect donor interest, therefore, Mexico should implement both of these reforms. Finally, because MFIs focus on encouraging client savings and clients are usually net borrowers, Mexico should permit MFIs to capture client savings.

In implementing these reforms, Mexico should delegate a supervisory board to regulate the microfinance sector. Member MFIs would pay membership fees to the organization, bearing the costs of the regulation. Only licensed MFIs will be able to access funding. The board would require MFIs to apply for annual recertification based

on independent audits and other financial reports. This scheme accomplishes two objectives. First, it creates an incentive for membership in the organization. Second, it provides donors with an effective means of evaluating and supervising potential and current recipient MFIs.

Mexico is well positioned to implement this policy recommendation, because an independent institution already exists in Mexico. Currently, this institution functions as a clearinghouse that gathers and disseminates best-practice information. This institution should expand its operations to include compiling MFI financial statements, licensing MFIs, and recertifying MFIs. Because MFIs would pay an annual fee, the apex organization would not bear the additional costs of expansion.

A delegated supervisory organization in Mexico addresses the concerns of donors, the government and MFI practitioners. This design provides donors with a set of standards on which to evaluate their investments. Government would be assured of maintaining control over the sector without the costs of actual supervision. Finally, MFIs would retain some control over their own regulation in an environment favorable to donor investment.

Conclusion

Regulations are not significantly correlated with the financial sustainability of individual MFIs. On a micro-level, the financial sustainability of an MFI appears to stem from organizational characteristics, such as institutional size and focus. Alternatively, regulations and the socio-political environment of a country may affect the microfinance industry on a countrywide level. Specifically, they may affect the ability of MFIs to attract donor funds, and therefore may determine the size of the microfinance industry in a country. Therefore, any regulation should focus on improving donor confidence in a country and not on promoting financial sustainability of individual MFIs.

Although both the ability to accept savings deposits and the existence of a subsidized credit program are correlated with donor confidence in a country; apex regulatory institutions, interest rate caps and licensing requirements are not significantly correlated with donor confidence. In contrast to financial sustainability, regulation does influence donor confidence in a country, although additional factors may also contribute to donor confidence.

The socio-political environment shapes institutions and influences their level of involvement. In this vein, the socio-political environment plays a key role in determining donor/investor confidence in a country. In countries with 'good' institutions, regulations may be redundant or of lesser concern. In countries with 'weak' institutions, countries could raise donor confidence by instituting policies that foster greater economic and political freedom. Therefore, where necessary, regulation policy should encourage growth of the microfinance industry through increased donor confidence in the country.

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COMMUNITY DEVELOPMENT

You Can't Save Alone: Strategic Commitment and the Design and Performance of Rotating Savings and Credit Associations in Kenya

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Introduction

Rotating savings and credit associations (roscas) are among the most prevalent savings institutions found in the world. Roscas are locally organized groups that meet at regular intervals; at each meeting members contribute funds that are given in turn to one or more of the members. Once every participant has received the funds, the rosca can disband or begin another round. Roscas are found in almost every country in the world, but are particularly prevalent in developing countries where financial markets are quite thin. In parts of sub-Saharan Africa, it is estimated that as many as 80% of adults belong to some kind of rotating savings fund (Bouman, 1995). Given the prevalence of financial market imperfections in these economies, understanding how communities develop institutions to overcome these imperfections has important implications for financial market development and economic growth on the continent.

Why do roscas exist? The current literature suggests that roscas are used to finance the purchase of a lumpy durable good in the absence of credit markets (Besley, Coate, and Loury, 1993), to provide insurance (Calomiris and Rajaraman, 1998), or to isolate savings from husbands (Anderson and Baland, 1999). In general, the theory of roscas is founded on the idea that individuals join a rosca because they expect to receive the amount of the rosca 'winnings' sooner than they would if they saved alone. This paper finds, however, that the structure of many roscas is inconsistent with this explanation and suggests that the main motive for joining a rosca is a time consistency problem: individuals are unable to commit themselves to future saving.

Using a detailed dataset on 70 roscas and 340 rosca members in western Kenya, this paper suggests that the structure of these organizations is inconsistent with current theory. In particular, roscas in Kenya (and in many parts of the developing world) are characterized by a degree of inflexibility that is rational only in the face of time-inconsistent preferences. There is a great deal of literature that suggests that preferences are hyperbolic (Laibson, 1997, 1994; Ainslie, 1992) or present-biased (O'Donoghue and Rabin, 1999).

Many of the examples of time-inconsistent behavior—what O'Donoghue and Rabin call 'smoking guns'—are taken from developed country contexts. This research presents the opportunity to study the savings behavior of 'sophisticated' (that is, aware of their self-control problem) individuals in the context of high poverty and high discount rates. How do such individuals construct savings institutions that circumvent their consumption-oriented future selves?

The inability to commit to savings presents a problem for economics. Under the standard assumptions about exponential individual utility functions and economic behavior, a rational individual has preferences that are constant over time. This implies that when individuals commit to a certain behavior in the future, such as saving, when the future arrives their preferences will not have changed. They will continue to prefer saving

over current consumption; their marginal rate of transformation across time periods is constant. But examples of time inconsistent behavior are quite common: it is a problem as old as Ulysses and the sirens (Elster, 1979), and as new as the use of illiquid forms of savings such as CD's or individual retirement accounts. In this paper I suggest that dynamically inconsistent preferences can also explain the existence of roscas that would otherwise appear to be inefficient and costly institutions.

In addition to the implications for economic theory, the design of roscas has a number of policy implications. First, theoretic work on income distribution and wealth suggests that inequality in the presence of credit market imperfections can affect long-run growth (Galor and Zeira, 1993). The inability to access credit to meet shocks is also likely to be costly in the short-term, both in terms of overall economic efficiency and individual welfare (Aghion, Caroli, and Garcia-Penalosa, 1999). These costs may be the highest for those most disadvantaged in a society.

Second, roscas are very prevalent, very durable, and come in a dazzling variety of shapes and sizes, making them fertile ground for studying the relationship between environment and institutional design. Roscas are found in nearly every developing country in the world, and in many developed countries as well (Bouman, 1995). These groups take on a multitude of forms and are prevalent in both rural and urban areas in developing countries, where government services are limited and the markets for credit and insurance are virtually non-existent. Membership in such groups is particularly important in Africa, where many areas suffer from extremely thin markets for land, labor, credit, and output.

Third, understanding roscas should illuminate micro-level constraints to the mobilization of savings and the development of formal financial markets. In Africa, as in most developing countries, domestic and national savings are dominated by private savings, and household savings comprise the larger part of that savings (Aryeetey and Udry, 1998). The lack of a reliable and safe mechanism for saving cash is a problem for millions of individuals world-wide. Understanding how informal savings institutions function is therefore critical to understanding the scope and limits of financial market development.

Fourth and finally, roscas provide a durable mechanism to overcome the collective action problem in groups in a wide variety of settings. Roscas are often cited as examples of social capital in action: social connections among individuals provide the trust required to overcome collective action problems. The social sanctions employed by rotating savings associations have also been adopted by the burgeoning microcredit and microfinance movement (Morduch, 1999). Many microfinance institutions are moving to provide a wider range of banking and savings services to the poor; understanding how lower income individuals save will be critical to designing appropriate and effective banking products for the poor (Wright, 1999; Rutherford, 1999).

Rosca Design

The 70 roscas in the sample are located in Busia and Teso districts in western Kenya, an agricultural region that is among the poorest agricultural regions in Kenya, with a daily agricultural wage rate of eighty-five cents. The rosca participants in the sample are poorer than the district average, but are not generally drawn from the 'poorest of the poor'. The average monthly income from wages, salaries, and profits is \$33; the

district average is \$49 (Kenya Bureau of Statistics, 1996). The rosca participants are largely married women. Ninety percent of the participants are women, ninety-six percent of participants are married, and seventy percent of female participants have husbands living on the home compound. The average participant is forty years old and has five years of formal education. Fifty-seven percent of members report no regular source of income apart from their farm, and only twelve percent have formal sector salaried jobs.

Formal credit markets in the rural areas of these districts are virtually non-existent. There are only three bank branches located in the two districts which cover nearly 2,000 square kilometers and have a population of roughly half a million people. The average distance to a bank for the groups in the sample is 18 kilometers, and less than one-fifth of the groups could identify a moneylender within an hour's walk of the rosca.

In general, the roscas in the sample are relatively small, both in terms of membership size and contributions. The average individual contribution is just under two dollars, usually contributed on a monthly basis. The average size of the rosca in these groups is fifteen, though there are roscas with as many as thirty members in the sample. Thus, the average rosca recipient expects to receive about twenty-five dollars, or about one-quarter of average monthly household expenditures in the area, which were ninety-three dollars in 1994. (Kenya Bureau of Statistics, 1996) This is enough, for example, to buy two bags of maize, or two iron roofing sheets, or a mattress or a blanket, but it is insufficient to buy a larger good such as a bicycle. The average length of a rosca in the area is just under a year.

The Allocation and Use of Funds

There two fundamental decisions every rosca must make: first, how to allocate the funds to participants and second, how to ensure sustainability, that is, how to prevent members from defaulting once they have received their funds. The first member to receive funds is in essence receiving a loan from the rest of the group, which she then pays back over the life of the rosca. The last person to receive funds saves throughout, receiving her savings at the end of the cycle. The prevailing theory of roscas (Besley, Coate, and Loury, 1993) suggests that roscas exist to finance the purchase of lumpy durable goods in the absence of credit markets. In this and other theories, roscas are modeled as one-shot games that allocate funds either by randomized allocation at each meeting or by members submitting bids for the funds (Calomiris and Rajaraman, 1998). This stylized model, however, does not capture the salient features of many roscas in the current sample, which are often designed with a premium on inflexibility, rather than efficiency.

In this sample, all the roscas are repeated; once the current round has finished, the rosca begins again. Members may leave the rosca at this point, and new members can be admitted. This is characteristic of most roscas in eastern and southern Africa (Ardener and Burman, 1985; Bouman, 1995; Wright, 1999). Just over half the roscas allocate their pot through randomization; thirty-four percent allocate positions according to member preference or need. In ninety-percent of the roscas, the order of allocation is determined prior to the first meeting. Thus everyone enters the roscas knowing her position; there is no uncertainty to resolve. This implies that savings for the purchase of an indivisible good cannot completely explain rosca structure. The last person to receive knows she is last, and she will therefore not receive the pot any sooner than she would by saving

alone. If the motivation for roscas were purely savings, or saving for an indivisible good, then the last person would never join the rosca, the second-to-last would also not join, and the rosca would unravel. Something else is motivating participation. This argument is strengthened by the fact that sixty-four percent of roscas use the same order of allocation as was used in the previous round. So the person in last position knows she will be last in the next round as well, dashing her hopes of getting the money sooner by obtaining a better position in future rounds.

There is also direct evidence that roscas are not formed solely to purchase lumpy durable goods. Over half of rosca participants do not use their funds to purchase an indivisible good. Sixty percent of members use their rosca winnings for more than one purpose, and twenty percent use their winnings for more than two purposes. In addition, the expenditures generally favored by rosca participants (school fees, food, and household items such as plates and cups) are often divisible. Members who purchase divisible items or more than one indivisible with their rosca money might expect on average to get one of their items sooner by saving alone than by waiting their turn in a rosca.

What determines the order of allocation? As noted above, the main alternative to a random rosca in the sample is not bidding, but a process of negotiation in which the group jointly decides the order of allocation on the basis of need, good behavior, or some other characteristic. This order has the benefit of allowing the rosca to take into account individual needs, riskiness, and previous rosca performance, but is more costly to design, both in terms of time and information.

Groups that choose random allocation tend to be wealthier, better educated, more heterogeneous, and have weaker social ties among members. Ethnic diversity and the proportion of members that are close relatives are negatively associated with the use of random allocation. This suggests that groups with better outside options, lower levels of information about other participants, and weaker social ties are more likely to use randomized allocation. Randomization minimizes the start-up costs of the rosca and lowers the transactions costs of administering the rosca.

Roscas and Commitment

The strongest indication that the motivation for roscas is the enforcement of disciplined savings is the widespread use of a commitment mechanism by rosca groups. In half the groups interviewed, members are asked to specify to the group in advance how they will use their rosca winnings. Of the groups that use this system, eighty-two percent either go with the member to purchase the item, or visit the home to verify that the expenditure was made as planned.

If the sole purpose of joining a rosca is the expectation of receiving funds earlier than by saving alone, it is difficult to see why this form of inflexibility would be necessary. The use of this commitment mechanism is not associated with groups in which a higher proportion of husbands live at home, suggesting that isolating funds from one's spouse is not the main motivation for the commitment strategy. This is also supported by the existence of groups composed entirely of widows and groups composed entirely of married couples. The use of a commitment strategy is associated with roscas where a higher proportion of participants have a regular source of income, suggesting the need to take cash out of circulation on a regular basis. Roscas with a higher proportion of younger members also tend to use a commitment strategy. These may be women who have less

“voice” in their household and therefore greater need for a commitment mechanism.

Levels of education are negatively associated with commitment, indicating perhaps more outside options for savings and more bargaining power for these women. Finally, groups with participants drawn from different age groups are less likely to use a commitment strategy. This is a result of different life-cycle needs. In many of the groups that use a commitment mechanism, the group agrees on a particular type of purchase for the round, such as household items or house construction materials. It may be more difficult for these groups with members of different ages to agree on a common purchase.

Sustainability and Sanctions

How are roscas sustained? In the theoretical literature the main concern is the sustainability constraint for the first person to receive funds, as that person has the largest incentive to defect. From this perspective, if the incentives for repayment hold for the first individual, they will hold for everyone else in the rosca (Besley, et al, 1993). But the roscas in this sample are all repeated; as soon as the current round ends another round begins. Thus the benefits of future participation encourage participation in the present: the shadow of the future looms large (Axelrod, 1984). As noted above, this is a strong argument for the savings rationale for roscas, as otherwise the person in the last position has no incentive to join. It also suggests that in these forms of rosca organization, the incentive constraint matters for both the first and the last person to receive funds. The first person must have incentives to repay her loan, but the last person must have the incentive to join the rosca. That incentive is enforced savings.

The way in which roscas deal with the issue of default also supports the savings hypothesis. In many models, the mechanism for sustaining participation is the exogenously given cost of sanctions. In the theoretical literature, this cost is set high enough to sustain participation, even in a finite game. There are examples in the descriptive literature on roscas in which the threat of dire social sanctions is so severe that members choose to steal or sell their children into prostitution in order to meet their obligations. (Ardener and Burman, 1995). Such severe penalties are not seen in western Kenya or in many parts of Africa.

It is quite common for individuals to miss a payment; on average 18 percent of members miss a payment at a given meeting of the rosca. Only 9 out of the 70 groups are able to maintain a perfect payment record for the cycle and twelve percent of rosca rounds finish with at least one member in default. Similarly high rates of default are reported for roscas in Ghana (Aryeetey and Gockel, 1991). This is again inconsistent with the theory of roscas as financing indivisible goods. With this motive, roscas would not be sustainable with such high rates of default as individuals would not participate. They would be better off saving alone.

These mixed payment rates, however, are consistent with a savings plan with some built-in flexibility. Consider the typical strategy used to deal with default. Half the groups in the sample implement a “tit-for-tat” policy that works as follows: if member A does not pay when member B receives the pot, then member B does not pay when it is member A’s turn. This becomes in essence a flexible deposit system. Individuals who hold a late position in the cycle, but have been unable to make payments along the way receive less money when their turn comes. This system also economizes on the social and transactions costs of investigating a member’s non-payment and subsequently sanc-

tioning them. Note that it is unable to deal with cases where individuals default after they have received the pot, except by excluding them from future rosca rounds. The tit-for-tat system is an ideal way to lower transactions costs when the system is designed for savings. It is not consistent, however, with saving to purchase a durable good, as members cannot be sure of receiving a fixed amount.

Groups with higher transactions costs for administering sanctions are more likely to use the tit-for-tat strategy. Roscas with a larger number of members are more likely to use strategy, while groups where at least half the members live within a five minute walk of each other are less likely to use tit-for-tat. Groups with a higher proportion of members with no off-farm income are also less likely to use tit-for-tat. It may be that these members who do not have responsibility for a small business or formal job have lower costs of using informal sanctions.

Conclusion

The available evidence on savings in sub-Saharan Africa suggests that roscas may be an important form of savings mobilization in a region that is characterized by extremely thin markets for land, labor, and credit. The data from Kenya show that individuals do not join roscas to speed their accumulation of savings to purchase an indivisible good, rather, the rosca commits individuals to a particular savings path, and in many cases 'binds their hands' through a commitment to making a particular purchase. The prevalence of roscas and their use among the relatively poor show that the poor can and do save, and constructing savings mechanisms to meet their needs could have a high payoff in financial market development in rural areas.

How do roscas perform? The data show that the performance of Kenyan roscas in terms of rates of default on obligations is quite variable and relatively high, at least in comparison to the rates of payment often cited in the microfinance literature. But the "performance" of these organizations depends on their goal. If the goal of the group is to commit themselves to saving, then the percentage of members who miss payments may not be the correct measure of performance. This research suggests that the fixed deposit savings schemes advocated by some group lending programs should be approached with some caution, particularly when they are intended to serve the poorest members of a population.

Roscas work well because they combine a mechanism for commitment with a system of forgiveness in cases where members cannot in good faith make a payments. The tit-for-tat sanction structure is in essence a flexible deposit program, where one member deposits less now, and receives a lower level of savings in the future. When microfinance institutions must meet external profitability and sustainability constraints, it is possible that the need for high payment rates will conflict with the needs for flexibility among the poor.

The research also suggests that lending institutions would do well to capitalize on existing groups in designing group lending and savings schemes. Roscas tend to select the organizational structure most suited to members' needs. Groups with lower outside options but more social connections use a method of allocation that is time consuming, but better able to allocate funds to meet member preferences. Groups also appear to be more effective in maintaining discipline when they are relatively homogenous. These are all factors that might be difficult to assess by an external agent. More

objective criteria, such as group size or length of experience, do not appear to affect payment rates in roscas, suggesting that it may be difficult to find 'objective' criteria to gauge potential performance.

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The Self-Employed Women's Association's (SEWA) Rural Savings and Credit Program in Gujarat, India

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Introduction

The limited capacity of conventional international development schemes to alleviate poverty has led to a burgeoning interest in microfinance, the provision of financial services to poor, self-employed people. The formal banking sector has generally been reluctant to lend to the self-employed, especially artisans and street vendors. In developing countries, banks have typically served less than 20% of the population (Berenbach and Churchill 1997). Banks often consider poor people to be financial risks because they lack access to collateral or guarantors. In addition, the administrative cost per borrower is high because the loans sizes are small. Women, with lower literacy rates and less experience with banks, are particularly disadvantaged. In many countries, social norms also inhibit women from even leaving their villages to travel to banks.

Without access to formal banking services, the self-employed are forced to turn to exploitative moneylenders, relatives, and other informal lenders for their credit needs. Moneylender is a general term that refers to anyone who lends money with interest. They are often landowners, employers or others who wield power within a village. Many moneylenders charge exorbitant interest rates, ranging from 4% a month in the villages of Gujarat India, to as high as 20% a week in parts of the Philippines (Berenbach and Churchill 1997). Informal lenders may also require the loan amount to be fully repaid at once, which can leave borrowers permanently indebted to lenders.

Although moneylenders may charge exploitative interest rates, they offer several advantages to poor borrowers. Unlike banks, moneylenders have near perfect information about borrowers. They also do not have high transaction costs and can provide money quickly without any formal paperwork. They may also allow a borrower to repay the loan on a flexible basis, or allow him or her to work off the loan. Finally, moneylenders may offer an unlimited loan and may not require collateral.

Microfinance first developed out of the recognition that the self-employed, especially women, need access to credit at affordable rates and on flexible terms. By offering financial products through novel delivery mechanisms, microfinance programs attempt to combine the advantages of the formal banking sector and the informal sector. Microfinance institutions (MFIs) can assume a variety of forms. These include non-profit microcredit programs that act as financial intermediaries between banks and borrowers, cooperative or government banks catered towards the poor, and commercial banks that operate microfinance units.

Many MFIs rely on self-help groups, which are savings and credit groups at the local or village level, usually comprised of women. Self-help groups are often considered to be the most effective mechanism for delivering financial services to the poor. Group size ranges from 5 to 50 women. In most microfinance programs, members regularly deposit a fixed amount of money into a bank account, eventually enabling women in the group to take out loans. The self help group mechanism provides economies of scale by reducing the administrative cost per borrower. It eliminates the need for traditional collateral

requirements. Since group members are usually not eligible for new loans until other members have repaid theirs, peer pressure helps to ensure loan repayment. Thanks to mutual support from their peers, borrowers can be liberated from historically dependent relationships, and can build broader social networks

SEWA's Rural Microfinance Program

The Self-Employed Women's Association (SEWA) is a non-governmental organization which organizes and empowers women through labor union and economic development activities in Gujarat, India. In 1974, SEWA founded SEWA Mahila Sahkari Bank, Ltd. (SEWA Bank), an urban cooperative bank that offers financial services to poor self-employed women. SEWA Bank was established through the initiative of SEWA members who wanted a safe and accessible place to deposit money and secure loans. Regulated by the Reserve Bank of India, SEWA Bank offers a diverse range of savings, loans and insurance products to members. As of March 1998, SEWA Bank had over 22,000 share-holding members, 87,000 depositors and over 5,000 current borrowers. In addition, deposits totaled over Rs.152 million, (US\$3.7m) (Chen and Snodgrass 1998). The repayment rates are around 96% for urban borrowers and slightly less for rural members.

SEWA Bank uses innovative techniques to meet the needs of its poor, self-employed members who are often unable to read or write. An illiterate woman can sign documents with her thumbprint since her photograph is in both her passbook and the bank's ledger. SEWA Bank also designed a loan repayment system with the needs of its members in mind; borrowers make 33 monthly installments over a three-year period.

In order to accommodate rural members who are not able to visit Ahmedabad, SEWA Bank works with the district associations of SEWA to offer financial services to women organized into village-level savings groups. SEWA's rural banking program, which began over a decade ago, is based on the self-help group concept. SEWA savings and credit groups play an instrumental role by reducing SEWA Bank's transactions costs and eliminating the need for collateral.

Each savings group has two leaders who are responsible for holding meetings, maintaining the savings groups account book, collecting deposits and coordinating payments with SEWA organizers. Elected by their fellow group members, savings group leaders tend to be more educated and outspoken than other village women.

The SEWA district-level associations act as financial intermediaries between savings groups and SEWA Bank. SEWA Bank lends to the district associations at 17%, the district associations lend to the savings group at about 21%, and the savings group lend to members at about 24% (inflation in 1997 was approximately 7%). Although these rates may still seem high, they are far more reasonable than moneylender rates. They also enable SEWA to cover some of its administrative costs. While organizers initially play a large role in establishing the self-help group, the goal is to have the savings groups act as "mini-banks" within each village. By offering banking services at the doorsteps of the village women, the groups provide a convenient, affordable and safe alternative to moneylenders.

Objectives

The goal of this study was to assess the social and economic impact that SEWA's rural savings and credit program has had on the lives of rural, self-employed women. This research focused on the following questions:

1. Through SEWA savings group participation, do women become less dependent on moneylenders, relatives or informal sources for credit?
2. Do poor village women have a need for savings facilities? Do SEWA savings groups meet this demand?
3. Do women think that participating in SEWA savings group has improved their welfare or empowered them?
4. Why do members drop out of groups? Why do groups close down?

Methodology

The study was commissioned by SEWA and made possible through a US Fulbright scholarship to India. It was carried out between December 1998 and 1999 by the author and SEWA Academy, the research wing of SEWA. The fieldwork was focused on two rural districts in the state of Gujarat, Kheda and Banaskantha. These districts were chosen because they are socially and economically distinct, but also have two of the more mature and successful SEWA savings group programs.

The data for this study was collected through a pre-tested survey questionnaire containing 458 close-ended questions and 1 open-ended question. Through a two-stage stratified sampling process, 470 women were randomly selected for interviews: 205 women participating in the SEWA microfinance program; 201 women who were SEWA members but did not participate in savings groups (herein referred to as 'non-members'); and 64 leaders of the savings groups.

The sampling was as follows: in each district, 21 open savings groups and 12 defunct groups (i.e. the group had either stopped saving but could not withdraw due to outstanding loans *or* the group had closed their SEWA Bank account) were chosen. From each of these 66 savings groups, three randomly selected savings group members, one group leader and three non-members who lived in the same villages as the savings group members were interviewed. In order to distinguish the impact of the savings group participation from that of other SEWA activities, such as embroidery or dairy cooperatives, it was important that the "non-members" were women who also participated in SEWA activities. Savings group leaders were included in the sample in order to assess whether leaders gained more from the program than did ordinary members. The leaders also provided greater perspective on the problems faced by the savings groups.

A team of trained 'grassroots' researchers administered the survey questionnaire. They came from the Kheda District Self-Employed Women's Savings Group Association and the Banaskantha DWCRA Mahila SEWA Association (BDMSA). Focus groups, case studies, semi-structured interviews with key SEWA leaders and literature review supplemented the data gathered through the survey. This article summarizes some of the main findings and recommendations to SEWA that resulted from this study.

Results

The three sampling groups, members, non-members, and leaders, all exhibited similar socio-demographic characteristics. The differences between members and non-members were not statistically significant (95% confidence). The majority of women in all three sampling groups were Hindu (84%) and married (87%), with an average family size of 5.5. Almost all of the women in the sample owned their own houses (94%) and jewelry (87%), a common asset in rural areas. Over half owned land (53%) and livestock (56%) and about one quarter (24%) owned trade tools. The only statistically significant characteristic was education. Leaders were more educated than either members or non-members; 60% of the leaders had attended at least some school, while only 30% of members and 33% of non-members had. This result is not surprising considering that savings group leaders are often chosen because they are the most educated women in the village.

Loans

In order to assess whether the SEWA savings groups fully met the credit needs of savings group participants, it was important to determine whether the women were still dependent on moneylenders and other informal sources for credit. Approximately 20% of the loans taken by members and leaders were from the savings groups. SEWA had recently introduced into a few groups the internal lending system, which is based on the idea that a group can lend its savings to a woman in need. Only one woman in the study had taken a loan through the internal lending system, which suggests that the internal lending system needs to be strengthened. Nevertheless, the women who received loans did report benefit from them.

This study also revealed that participating in a SEWA savings group did not significantly reduce a woman's need to seek out moneylenders, employers, relatives and other informal sources of credit. In fact, the percentages of all loans taken from moneylenders, relatives, employers and other informal sources were not statistically different (95% confidence) between the three sampling groups. Savings group members and leaders still relied heavily on moneylenders, despite their high interest rates and collateral requirements. Loans from informal sources, such as moneylenders and employers, could be secured faster and more readily than from savings groups. Many women also had access to larger loans and more flexible repayment rates when they borrowed from moneylenders. In fact, some savings group members in the Banaskantha district did not even try to take loans from the SEWA savings group because they were not able to repay them monthly. Since their incomes were dependent on agriculture, these women took loans from their employers, who accepted payment on a seasonal basis. Some women also repaid their loans by working extra time for their employers or by having their children work.

These findings do not diminish the important role that the SEWA savings groups play in offering women an affordable place to access credit. Rather, the results highlight the need to change aspects of SEWA's program, such as increasing loan size and frequency, in order to make it even more effective.

Taking loans- in their own voices

"We have been able to carry out our trade well because we got a loan. We can

also now carry our family responsibilities better. If we save a small amount over time, it gets accumulated.” (Savings group member from Kheda district)

“I took a loan two times and got my house repaired. I used to have a small hut, but now I have a small house. Thus, I have full faith in SEWA.” (Savings group member from Kheda district)

“Joining the savings group has had a very good effect on my life. I get a loan when I have the need for one.” (Savings group member from Banaskantha)

“When we require a loan, we do not get it. But then it is given when it is not necessary, so what is the point? Women should get loans when they require it. The amount of loans is also very less. So the members do not trust it.” (Savings group leader from Kheda district)

Savings

Contrary to the common perception that poor people are not capable of saving, this study revealed that poor rural women in India have a great need for savings facilities. Some women joined the SEWA savings groups in order to save for the future, especially for their children, old age or in case of an emergency. Women liked saving with the SEWA savings groups because it was often difficult for them to save at home or with banks. Many women also saved with SEWA because they felt pride at having assets in their own name.

Although many women were glad to save in the SEWA savings groups, the groups did not completely fulfill all their needs. Approximately 60% of members and leaders saved money in one other place besides the savings group, usually at home. Approximately 18% saved in two other places, typically at home and at a bank. These women often felt it was necessary to save in other places because their SEWA Bank savings were not liquid enough. A woman could not withdraw her savings from the SEWA group bank account without gaining permission from the entire group. In addition, the study revealed that some women wanted to save larger amounts than other group members. These findings suggest that SEWA needs to offer more diverse savings instruments with greater liquidity.

Saving with SEWA- in their own voices

“I like to save with SEWA. I am a widow with the responsibility of two children. I have to provide for their food and education, but when I think of their future, I save Rs. 10 every month.” (Savings group leader from Kheda district)

“If we go to the bank to put Rs.10, nobody would open an account for us. But here we can do small savings. We can also take a loan against our capital. But the banks do not give us loans. Nobody bothers about poor laborer women.” (Savings group member from Kheda district)

Impact on Welfare and Empowerment

To assess the impact of the SEWA savings group participation on their welfare and empowerment, members and leaders were asked questions regarding: their health, nutrition, level of knowledge / literacy, children’s education, ability to go where they want, sense of pride, ability to give an opinion during a conversation, ability to speak in public, family’s perception of them, and village’s perception of them.

These questions were based on SEWA's 'Ten Questions,' which the organization uses to gauge the success of its programs (SEWA 1998). The interviewees were asked to evaluate whether these parameters had increased, decreased, or remained the same since joining the SEWA savings groups and/or other SEWA activities.

The qualitative evidence indicated that the lives of women improve a great deal when they participate in SEWA savings groups. The findings also revealed that overall, leaders benefit more from savings group participation than do members. This difference may be attributed to the fact that leaders receive substantially more training and are much more involved in SEWA activities than ordinary members. In addition, the benefits that members and leaders received from the savings groups were intertwined with their perception of other SEWA programs.

All three sampling groups were asked the same questions with respect to the other SEWA activities in which they participated. The impact of other SEWA activities on the women's overall welfare and empowerment was greatest for leaders; members were second and non-members, last. There are two possible explanations for this finding. On one hand, participation in a savings group may improve a woman's perception of other SEWA activities or enable her to take more benefit from these other activities. On the other hand, members and leaders may possess certain characteristics that non-members do not have which make them more inclined to seek out benefits. These women may have joined the savings groups because they were more motivated than non-members to improve their standard of living.

Impact- in their own voices

"I have a lot of faith in SEWA. SEWA is my mother. I have benefited a lot. There is now land in my own name and due to my leadership experiences, I enjoy benefits both at home and outside too. Everybody gives me respect. After joining SEWA, my income has increased and my health has improved. My food habits have also improved. Before doing savings, I was illiterate, but after that I learned how to read and write." (Savings group leader from Kheda district)

"Since we joined SEWA, we have gotten embroidery work. We started saving and then the childcare services also started. Now I am a leader of the village. I give embroidery work. I get loans for other women and also help them benefit from insurance. I also get people treated through SEWA's mobile dispensary." (Savings group leader from Banaskantha)

Problems with Groups

The study revealed that the most common problems savings groups faced were that members could not withdraw savings, did not receive any loans, or that other members failed to repay loans or deposit savings regularly. Other reasons that groups closed included the following: members no longer trusted SEWA or the leaders, tension existed among members, family pressure, members could not attend meetings, they did not receive enough interest on savings, or because the group leader moved away.

Members and leaders sometimes lost trust in the SEWA savings group because they were dissatisfied with other SEWA activities in the village. For example, one group closed because the women could not deposit regularly since they did not receive enough embroidery work from the SEWA cooperative. Below are some examples of

problems that women in the savings groups faced. Most members indicated that they would rejoin the savings groups if they restarted and/or if they got their savings back. Most leaders said they would rejoin if they received their savings or if SEWA organizers came to the village. Approximately 15% of leaders indicated that nothing could make them rejoin. The next section offers some recommendations for addressing many of the problems faced by savings groups.

Problems- in their own voices

"I have full faith in SEWA, but at present our savings group has closed down. The members have lost faith and now we want our savings back. We can do savings, but we have not seen any benefit in it. Some members got loans and some did not, so all members lost interest and our group broke down. We do not know anything about it and they do not show any accounts." (Savings group member from Kheda district)

"Our savings group was not functioning for about 3 years, but within the past month, it has started functioning again. One woman did not get a loan, so all of them lost faith and they stopped saving. All of them got their savings back, so now they have regained faith. This month, 13 members have decided to join and paid the savings. Now more are coming to join the group." (Savings group leader from Kheda district)

"We did not have money on time so could not give it when the savings person came every month to collect the money. Then the SEWA savings organizers did not come to take the money and we had to stop working in order to go deposit it." (Savings group leader from Banaskantha)

Recommendations

Several recommendations for SEWA resulted from this study. First, SEWA Bank's rural microfinance program should increase access to loans in order to compete more effectively with local moneylenders. SEWA could achieve this goal by reducing the size of the savings groups from 15-25 women to 5-10 women. Smaller groups may enable more women to gain access to credit and help to enforce the "peer pressure" mechanism of group lending. If group sizes were smaller, women might also be able to withdraw their savings or change the size of their savings deposits more easily.

Second, SEWA Bank should offer loans that can be repaid seasonally or on a more irregular basis. The current 33 month repayment scheme was developed with urban women in mind because they receive income on a regular basis. In contrast, rural women are dependent on agriculture and earn money seasonally. These women will not benefit from SEWA loans unless they can also make repayments on a seasonal basis.

Third, the SEWA district level associations should increase the caps on the loan size. The SEWA association in Kheda district, for example, only allows the savings groups to take loans that are three times the size of the group's savings. These limits need to be increased in order to improve women's access to loans.

Fourth, the process of depositing and withdrawing money from the SEWA Bank group account should be made faster. Groups need to be encouraged to hold yearly meetings to decide what they want to do with their savings and interest earned. In addition, the paperwork required for withdrawing the savings needs to be re-evaluated.

Fifth, SEWA should encourage more groups to adopt the internal lending system. By using their savings as lending capital, groups will be able to become more self-sufficient.

Sixth, rural members should be given the option of depositing more money than they are currently depositing with their savings group. SEWA Bank could allow rural members to avail of the different long-term savings schemes offered to urban members (to plan for marriages, children's education, etc.). Opportunities to deposit twice yearly (after harvests) into individual accounts is one way to achieve this goal.

Lastly, it is important to recognize that leaders' and members' perception of the savings groups are linked to their perception of other SEWA activities. If members are having trouble paying deposits regularly, SEWA needs to examine how well the SEWA-related income-generating activities in the village are functioning.

Conclusion

This article shared the results of an impact assessment study on the Self-Employed Women's Association (SEWA) rural savings and credit program. It has shown that SEWA's rural microfinance program has had positive impacts on the welfare and empowerment of savings group participants. In particular, the qualitative evidence revealed that women benefit a great deal by participating in the savings groups. However, the study also indicated that the microfinance program has not managed to reduce women's dependence on other informal sources of credit, such as moneylenders, relatives, and employers. Although all women participants should be able to secure loans from SEWA Bank, in reality, only a fraction of women actually do so. In fact, the majority of loans taken by women were from moneylenders. This study highlighted some of the problems that cause savings groups to close, like the inability to take loans or withdraw savings.

These findings do not imply that microfinance is an ineffective means of economically empowering women. Rather, they suggest that methods of implementation are critical to a program's overall impact. Many of the recommendations that resulted from this study will help SEWA to refine its rural microfinance program. For example, by reducing group size, increasing loan amounts, and making repayment schemes more flexible, SEWA will be better able to meet the credit needs of savings group participants. Although adapting SEWA's rural microfinance program to meet the needs of members will be challenging, it is the only way to ensure that the benefits go to the intended recipients – the poor, self-employed women of Gujarat, India.

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Funding Strategies for a Nonprofit Music Center: Overcoming the startup challenges

Anthony R. Chávez

Small, young nonprofit startups with little capital need to develop fundraising strategies that account for their resource constraints. Ethos-Inc. ('Ethos' in this article), a Portland, Oregon nonprofit music education center, began in October 1999. Its growth has created an immediate need to increase staff and develop its programs. In order to raise funds effectively, Ethos must demonstrate focus, vision and a sense of reality in its grant applications. Also, it must build community partnerships within the Portland Public Schools Foundation which provides network opportunities that increase access to funding. Lastly, it must utilize its media strengths to generate local publicity.

Ethos draws upon the successes of music centers in major cities that, through their services, have educated students on cultural history and math, introduced youth to arts education and revitalized urban neighborhoods (Lewis, 1999a). Music education programs in Portland's public schools are under siege. State funding for public schools has been cut by 21 percent since 1990 and music education programs are some of the first programs to be discontinued (Ethos-Inc., 1999). The cuts come at time when studies link music education with greater academic achievement, increased self-esteem, higher SAT scores and improved cognitive development (American Music, 2000). Music can also reach at-risk youth, instill self-discipline and increase cultural understanding (Ethos-Inc., 1999).

As a volunteer-driven organization, Ethos is dedicated to ensuring that every child in Portland has an opportunity to explore music education. The services include low-cost music lessons, multicultural music presentations, instrument drives, artist in residence programs and other initiatives. The services target youth in underserved school districts. In addition, they introduce students to different types of music and cultures, while integrating history, science, social studies and math (Ethos-Inc., 1999).

In December 1999, Executive Director Charles Lewis needed to explore ways to effectively tap into funding sources. Ethos began low-cost music lessons and instrument drives in October, but lacked the capital and staff to develop its other programs that would help Ethos achieve its mission. Like numbers of nonprofit startups, Ethos had a valuable service, little financial cushioning and only one full-time employee in Lewis. Music lesson enrollment grew from 15 students in October to about 350 in April. Ethos increased the number of volunteers for the program, but without permanent staff, Lewis had to manage the day-to-day operations as well as direct the organization.

Ethos is in a catch-22 in its attempts to raise funds. In order to do so, it needs money to afford the staff that will allow Lewis the time to apply only for grants. Only a year old, it struggles to succeed among foundations that seek evidence that an organization is established in its community and demonstrates previous funding from other sources (Friendly Guide, 2000). New organizations that start from ground zero encounter the same problems.

Objective

The purpose of this paper is to illustrate Ethos as a case study for small, young nonprofits with little financial capital that seek manageable fundraising strategies. To evaluate fundraising potential requires researching Ethos and synthesizing the information into a framework that pinpoints the organization's fundraising strengths and weaknesses. It also requires accumulating some knowledge on applying for grants, the status of music education in Portland, community support sources and anything potentially relevant to Ethos and fundraising.

Strategic recommendations are based on combining and applying Ethos' strengths with its community resources, while accounting for their feasibility. Each strategy lists specific steps to guide and ensure implementation. Finally this paper applies the Ethos case study to fundraising management for similar nonprofits.

Background on Ethos

In his masters' thesis (1999), Lewis illustrated the power of music as a remedy to social problems in communities. He saw an opportunity to replicate this success to youth living in low-income, at-risk areas. Upon a visit to Portland in December 1998, he incorporated the idea and named it Ethos-Inc. When Lewis returned to Portland in June 1999, he established support with local government and education officials. He also prepared the logistical and legal groundwork to launch two of Ethos' programs. Lewis admitted he did not have a lot of hands-on experience in nonprofit management, but his passion for service, willingness to learn and relentless work ethic had always brought him success in his endeavors. Lewis had big goals and was positive that, based on his previous research, Ethos could contribute toward Portland's educational solutions.

In October 1999, Ethos hosted its first instrument drive and session of low-cost music lessons. The lessons provided students an avenue to learn about music and play an instrument in the absence of school arts programs. The instrument drives ensured that students who could not afford an instrument would never be turned away from lessons.

Various community centers agreed to donate space for the lessons. Students had the opportunity to play the keyboard, guitar, flute and violin, as well as take voice/choir lessons. The classes would meet once a week for eight weeks during the session. The instructors were comprised mostly of recruited volunteers with backgrounds in music and teaching. Students were taught a range of basics that included instrument parts and functions, music literacy and theory and practice techniques. On completion, Ethos would evaluate its program by sending surveys to parents and the music instructors.

As enrollment increased for lessons, so did the need for volunteers. One university student, Adam Reid, heard about Ethos through a friend and decided to volunteer as part of a class project requirement. He organized and directed Ethos' first Music Marathon, a concert promoting local bands. The ticket proceeds went directly to Ethos.

During the project, Reid recruited two other students in his class who eventually became volunteer voice instructors after the course ended. Community members, teachers and students also would volunteer, and some would enjoy their experience so much that they recruited others.

Ethos' innovative programs did not attract only volunteers. On November 14,

Ethos was featured on the front page of the Metro section of the *Oregonian*. In December, radio station Z-100 interviewed Reid about the Music Marathon and Ethos' work in the community. The radio host praised Ethos for providing an important service in the community. As Ethos continued growing and Lewis worked on new plans, it became harder to find the time to research and execute fundraising. After a \$5,000 grant in October, funding from the foundations slowed down.

Over the next three months Lewis worked on six applications and received no notification on any award. A grantwriter suggested that Ethos' estimated \$230,000 budget, from \$0 a year ago, may be daunting for potential donors. Anxious to fund Ethos' growth, Lewis wanted a strategy that would increase his funding sources and odds of success.

Evaluating Ethos and Its Fundraising Ability

The first step toward developing strategies requires understanding what factors enhance as well as hinder Ethos' funding potential. Public policy uses an analytical framework called the Strategic Triangle to assess the performance of an organization and its services. The theory basically states that an organization must possess public value, legitimacy/political sustainability and operational feasibility in order to succeed (Moore, 1995).

When an organization meets these criteria, the incentives for outside financial support appear. By addressing an important community need, an organization demonstrates the value of its services. Support from the groups affected by those services and previous funding demonstrate legitimacy and sustainability. Lastly, strong internal management, a realistic budget and committed volunteers make it easier to plan and execute services effectively. Applying the theory to Ethos allows one to identify its fundraising strengths and weaknesses.

Value - Ethos' innovative music programs and its belief in music's social benefits provide multiple values for multiple groups. Students aside, Ethos' services also benefit:

Schools - Ethos provides schools the arts education and staffing they need. It also provides innovative methods of teaching different disciplines.

Volunteers - By teaching music/music education, organizing events and making a difference in the lives of youth, volunteers gain leadership skills, inspiration toward community service and, for students in arts or education studies, academic credit.

Parents - Music lessons allow parents to watch their children learn, experience the richness of music education and have direct access to observing teaching quality.

Legitimacy/Political Sustainability

Ethos establishes strong public legitimacy because arts education is important in Portland. Parents (Crombie, 1999), public officials (Lewis, 1999b), students (Connections, 1999) and the Portland Public Schools district (PPS) support bringing back arts education to schools. Ethos has some financial sustainability from fee revenues of the low-cost music lessons; however, its financial support within the community, i.e., grants, is not where it wants to be.

Operational Feasibility

Ethos does possess some operational advantages, such as its strong volunteer base and use of old instruments and donated program space, to manage its overhead expenses well. Ethos' threats to operational feasibility are its lack of resources and time, which result in:

Unorganized management - The absence of a detailed blueprint for growth makes it extremely difficult to communicate how Ethos expects to meet its program and financial objectives.

Unrealistic budgeting - This notion may lead potential donors to suspect that Ethos does not have a good assessment of its goals and financial capabilities.

Staff Shortage - Although volunteers help to execute program services, managing and operating them require full-time employees.

Ethos' innovative and valuable music services benefit Portland youth as well as other groups. This gives Ethos a competitive edge because no local organizations of its kind do quite what Ethos does. However, if Ethos has an attractive service broadly supported by the political environment but lacks the operational capacity to achieve it, funding proposals will be rejected as unfeasible or funders will find a different institutional vehicle for accomplishing it (Moore, 1995).

Research on the environments and institutions relevant to Ethos and fundraising, combined with knowledge of the organization, should uncover potential solutions that overcome the resource barrier toward enhancing operational feasibility.

Grants and Foundations, Community Networks and the Media

The Foundation Center, a nationally recognized authority on foundation and corporate philanthropy, publishes an online guide to funding. Within the guide, it offers points to consider when applying for funds. Some of those guidelines include:

- An organization should be well known in its community and address an existing need;
- Sound fiscal management, a strong, involved board, committed volunteers, qualified staff, and a realistic budget are all very important considerations;
- Although many funders consider general support, others want to support specific projects or activities;
- In grantseeking, personal contacts usually do help. However, demonstrating that your organization has strong leadership often will go further toward securing a grant than personal contacts; and
- Foundations that support similar projects and are located in the organization's geographic area should be considered as prospects (Friendly Guide, 2000).

The Portland Public Schools Foundation (referred to as the 'Foundation' in this article) supports the last point. Merced Flores, PPS planning coordinator, says the Foundation's network provides opportunities for nonprofit representatives to promote their work to the community "movers and shakers." Networking within the Foundation is akin to applying to 100 potential donors with one application, as members and volunteers seek to create and finance good ideas.

The Foundation is dedicated to: 1) building a stronger and deeper base of community support for quality public education; and 2) leveraging significant resources

to encourage and support innovation, excellence and equity in the City's schools (Connections, 1999). The Foundation was established to support the initiatives and goals of PPS. PPS has suggested several strategies to achieve the goals that support its mission, three of which match well with Ethos' objectives. They are to create partnerships with stakeholders, eliminate the achievement disparity of low-income children and children of color and provide the means for each school to implement a plan that meets PPS's strategic objectives (Connections, 1999).

The Foundation has built a diverse board of directors, comprised of influential school, advocacy, business and civic leaders who support the PPS mission and represent access to financial sources. It also enlists the participation and input of the community for various PPS projects. The Foundation is an ideal place to finance initiatives for Portland's schools. Schoolhouse Supplies, an organization that provides study tools for needy students, approached the Foundation for support. Since receiving sponsorship, the organization has been pleased by the response of donations of Portland businesses (Connections, 1999).

Beyond the network of Portland's education advocates, the media provides excellent fundraising opportunities by publicizing ideas to mass audiences. Timm Locke, APR, Portland Metro Chapter President of the Public Relations Society of America, says education is a visible media issue in Portland, especially in non-core areas like arts and sports. He adds that good publicity is key to raising large funds because major donors pay attention to name recognition. Locke relates the effects of positive media exposure to his own nonprofit affiliation as a board member for Portland's Habitat for Humanity, saying "When Habitat makes the news, the number of phone calls for support and donations increases every time."

Public relations firms take on causes pro bono because they enable firms to contribute to the community and exercise their creative abilities, Locke states. From the author's professional public relations experience, firms also donate work for the opportunity to be associated with a successful cause that enhances their reputation in the industry. Portland's foundations, education advocates and media are viable fundraising sources for Ethos as long as it recognizes its weaknesses and positions its strengths to complement the objectives of these three sources. With that, this article lists three fundraising strategies with implementation steps.

Demonstrate Focus, Vision and a Sense of Reality in Grant Writing

Step one - be specific and detailed about programs pertaining to funding. Ethos must convince their potential donors that the only factor preventing its programs from success is the money needed to start it, and that everything else is in place or has been taken into account. The clearer Ethos can communicate this, the more it credits their operational abilities. A good example of detailed description is seen in Ethos' application for the Lorene Sails Higgins Charitable Trust.

In it, Ethos demonstrates the operational capacity and preparation to put a grant to good use if awarded. First, the application focuses on one project for funding, the low-cost music lessons. Then, the application demonstrates Ethos' preparation for the program by mentioning numbers of students expected to be served every quarter for a year, locations that donated lesson space and the volunteers and staff that would work on the program. The result was a \$5000 grant. This application follows the Foundation Center's

guidelines that include focusing on a specific program, conveying a sense of organization and demonstrating strong staffing and fiscal management.

Step two - develop a timeline that includes programs, services and expected availability of resources. A timeline illustrates an organization's ability to operate and plan by allowing one to see where the organization is, where it wants to be and how it plans to get there. When Ethos requests large amounts to fund multiple initiatives, a timeline explains how Ethos plans realistically to manage the programs that need funding while operating within a given set of resources. A management strategy need not be in place before designing the timeline; the chronological brainstorming can help Ethos to develop its organizing.

Step three - request funding amounts that reflect a "realistic" number of executable programs within a year. One of the first suggestions Ethos' grant writers made to Lewis was to cut down on the number of programs he was proposing to fund this year. Ethos should pursue funding for all its programs in the long run. However, applying the two previous steps might indicate that a limited number of programs is operationally feasible in 2000.

Build Community Partnerships in the Portland Public Schools Foundation

Step one - stay informed about and participate in future Foundation functions. By involving itself with the Foundation, Lewis can market Ethos to Portland's major arts advocates and donors. Since Ethos' objectives match well with those of PPS, opportunities for support are likely among the Foundation and its supporters. To illustrate the potential, assume that Lewis participated on the Action Planning Team that focused on eliminating disparity among children of color or low income. According to Flores, he would have worked with the County Commissioner or with an African American community leader who has the "ears of the local foundations and the Portland Chamber of Commerce." Indirectly, both influential members seek to support what Ethos offers.

Step two - participate in the Foundation's art funding task force. Foundation Executive Director Cynthia Guyer likes Ethos' passion for music and wants Lewis to participate on an upcoming task force that will examine how the community can raise money for art programs for the next three to five years. Guyer says members of this committee will have many opportunities to work with and meet Portland's biggest donors in the arts. Guyer adds that the Foundation publicizes its committee members to potential donors. Flores says volunteers on the Action Planning Teams contributed about five hours a week, which is what can be expected for this project. Ironically, the task force offer was mentioned only because Ethos was brought up in the interview with Guyer, who last met with Lewis in the autumn of 1999. This exemplifies how Lewis' increased workload has hampered his ability to network in the community and find funding opportunities.

Utilize Strengths to Increase Local Media Exposure

Step one - seek a local public relations firm to do voluntary publicity work. Ethos' services and volunteer-driven operations provide material that attracts news media, but it needs professional guidance and support to make effective use of its potential. Ethos' attractive elements include:

Photography - Ethos takes photographs of its activities, volunteers and events

in a time when news media is becoming increasingly visual. Ethos has a competitive advantage over other organizations that do not use graphic art in their media material.

Education, children and innovation - Ethos focuses on education and children, the former subject is currently salient and the latter is always of media value. As long as Ethos offers innovative approaches to music and music education, it will continue to generate public interest (The Oregonian, 2000).

Entertainment - The increase of local entertainment guides in major papers and online sites demonstrate community interest in music arts. Ethos plans to host Music Marathons and multicultural music performances several times throughout the year (Lewis, 1999d). These media elements are also the same factors that would attract a public relations firm in sponsoring a project pro bono. Ethos should consider established firms located nearby to narrow the list of potential candidates.

Step two - prepare to present and market Ethos. Before approaching the firms, Ethos should prepare a presentation kit that includes:

- a cover letter explaining Ethos' purpose and its strength as an organization (use Strategic Triangle evaluation);
- a listing of news clips or hits;
- information about its Web site and virtual press kit; and some photos of Ethos activities.

Then, Ethos should call prospective firms, explain its publicity objective and arrange to send the kit.

Conclusion

The recommendations offered to help Ethos fundraise more effectively apply to similar nonprofit startups. Big visions and passion can underscore the need for operations management and planning. For nonprofits with small capital and no track record, they must utilize their community resources with their organizational strengths and add a feasible approach. Such strategies should improve operational feasibility, reiterate public value and legitimacy and create a promising product that will attract more funding.

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Kerala's Building Center: Taking Technology from Lab to Construction Site

Tara Sharafudeen

Introduction

Shelter remains a basic human need and a major determinant of the quality of life. Millions in the developing world are denied this essential amenity. The acute shortage of housing in developing economies has been exacerbated by the population explosion. Housing remained a low priority until recently, due to preoccupation with other developmental issues.

Burdened by a burgeoning population and the intensified pressure on land, policy makers acknowledged the central role of housing in providing a good living environment. Given the magnitude of this problem and resource limitations in developing economies, neither governments nor conventional technology alone can tackle this issue.

The Kerala State Nirmithi Kendra (Building Center) offers an innovative method to address the housing crisis in the developing world. It transfers cost-effective construction technology from the research lab to the building site. Founded in 1985, it became a national model with its incorporation in the National Housing Policy and the Eighth Five-Year Plan of India. The Government of India proposed in 1988 to establish similar centers in all districts in India. Four hundred and fifty centers have been set up since. A network of similar centers is being developed through the Global Nirmithi Net (GNN), to spread global best practices in the area of habitat. It has been recommended as a model suitable for all developing countries by the United Nation's Center for Human Settlements (UNCHS), (Resolution No. 14/16, 14th session, 1993). In 1996 it was recognized as a Global Best Practice (GBP) in the field of cost-effective and environment-friendly technology (CEEF) by the Istanbul UNCHS meeting at Habitat-II.

There were, however, several problems and strategic issues that had to be dealt with before reaching this degree of acceptance. The crucial issue was the lack of an overreaching mission and the existence of a product centered culture, with the firm belief that the mere offer of cost-effective housing technology was by itself enough to attract the customer. This study focuses on the strategic aspect of influencing the consumer to make the transition from a conventional to an innovative technology by emphasizing the customer's perception, needs and wants.

This paper will examine why cost-effective housing technology is important to developing countries. It shall consider why transfer of such technology from lab to field is critical to solving the housing crisis. It will look at why the mere transfer of technology by the building center was not enough to enable transition from conventional to cost-effective technology. Finally, it studies the strategic weakness of the effort and offers a solution that made it possible for the customer to make the transition from conventional to innovative technology. While the focus is on the Kerala Nirmithi Kendra, the recommendations are easily transferable to other building centers and to the marketing of grass roots innovation worldwide.

Situation

Cost-effective housing has tremendous value for a developing country like India. Apart from the cost savings, the technology is environment-friendly, preserves scarce resources, and is suitable for local adaptation and production. It enables millions for whom resource constraints and spiraling costs have put conventional technologies out of reach to fulfill the basic need for shelter. The backlog of housing in India stood at 41 million at the turn of the century. The population explosion and concomitant mushrooming of urban slums since then have exacerbated the situation. The situation is not much better in rural areas, where the housing stock is of poor quality. Research, into cost effective materials and technologies has been conducted for decades, yet its results are not available to the layperson. The United Nations Center for Human Settlements (Habitat) stated:

“In principle most of the materials currently imported can be replaced by locally produced cheap materials.... The problem is that the knowledge about production of innovative building materials, which can be locally produced, is limited to a few laboratories and research institutions. Most building research institutions in developing countries lack the comprehensive structure required to translate their findings into commercial production. The link between investors, manufacturers, and research institutions is at times non-existent” (Global Report on Human Settlements, 1986).

The Building Centre offers a bridge between laboratory and building site for emerging technology. This non-profit organization’s mission is to transfer low cost construction technologies from lab to field by training masons, architects, and engineers in these techniques and imparting training in the production of low cost materials.

It also aims at mass dissemination of this technology, through construction, consultancy, and promotion. Training of rural masons began in 1986, and by 1992 there were more than one hundred centers. Though more than one thousand houses had been built, there was limited impact and broad based acceptance was lacking. There was a need to gauge the real impact of the movement at the field level.

Problem: The Initial Strategy had Limited Impact

The initial strategy of the organization had been to encourage professionals to accept new technology in construction, based on the premise that this would demonstrate the viability of the technology and thereby lead to widespread adoption. It was hoped that this adoption process would accelerate until the entire channel from masons and consumers to entrepreneurs was converted. The ‘trickle down theory’ of sustained work at the grassroots level did bear some fruit but only after a prolonged period. The long delay in adoption could be problematic when detrimental trends like low quality ‘me too’ products begin to appear in the market place. The early momentum could be easily lost when efforts were dispersed or drawn out. It was imperative to accelerate the spread of this cost-effective construction technology.

The Nirmithi Kendra had to rely on its own resources to achieve this goal. The study revealed that though the Building Center lacked the resources necessary to push the technology at this stage, there had been no attempt to leverage resources by networking with other organizations. The fundamental problem, however, was the lack of a coherent focus. The organization’s activities were disjointed, requiring strategic integration around a core mission.

The organization was attempting to get consumers to adopt an innovative technology. Effective marketing was fundamental to its success. However, it lacked a well-defined marketing effort. Marketing was restricted to occasional press reports, exhibitions, and videos. There was little attempt to understand the customer. The Nirmithi Kendra staff frequently pointed out that people in a state with the highest literacy rates and newspaper readership in the country should see the obvious benefits of the new technology.

Further, despite the elevated position of women in Kerala society, with its matrilineal and matriarchal tradition, they were largely overlooked by the Building Center.

The Survey and Issues Raised

This three-month study included field visits and interviews with technology adopters, masons, architects, engineers, entrepreneurs, functionaries of the Building Center, and officials of government and financial institutions. It was conducted in 1992. The sample size was 104 persons drawn from different categories; 41 were functionaries of the Center (Engineers, Overseers, Master masons, and other officials), while 43 were trainees. The remainder were architects, opinion leaders, and district and financial officials. The survey raised several issues:

1 The Vicious Cycle

The evaluation examined the organization after seven years of operation. At that time, the service appeared locked into a vicious cycle. As the technology was not popularly embraced, entrepreneurial support was limited. Product marketing was limited due to lack of acceptance and poor distribution channels.

As a result of lack of exposure and the non-inclusion of the technology in national building codes, engineers and architects did not embrace the technology, which made the government reluctant to back it. At the time of the evaluation, staff at the Nirmithi Kendra appeared both unaware of and unable to break this cycle.

2 The Lack of a Customer Orientation

The prevalent culture was product centered. It was felt that the need for cost-effective housing technology was obvious, and the mere existence of an offer was enough to clinch the sale. There was no need for a specialized marketing function. Marketing was seen as an expensive drain on meager resources that reeked of crass commercialism, at cross-purposes with the organization's noble mission. Performance was measured in terms of houses built and persons trained, not in terms of customers satisfied. With an offer that was hard to refuse, it was the customer that needed educating. The marketing challenge was seen as one of eliminating the ignorance of the general public about the technology. Since the marketing issue was formulated in terms of eliminating ignorance and conveying the benefits of the technology in layman's language, the employees that handled the organization's interface with the public were engineers, who were often unaware of the marketing issues involved. The market was generally seen as a monolithic entity, and a single strategy was deemed adequate to the marketing effort. The organization had made no systematic effort to study the customer's needs, wants, or perceptions, nor had any attempt been made to build a customer database or to conduct any other form of marketing research. The organization assumed it had no competition. Conventional

technology was not seen as a competitor to be aggressively challenged.

3 Misconceptions and Strategic Mistakes Persisted

There was a growing awareness of the organization's activities over this period. Users surveyed were largely satisfied with the technology. However, several misconceptions regarding the cost-effectiveness and durability of the innovations persisted in spite of attempts at educating the public. Low cost was often presumed to be synonymous with low quality. Given that the technology made optimum use of materials in order to reduce costs, several considered the structures to be inherently unsafe. Low quality 'me too' products were becoming associated with the Building Center and the public was not aware of the difference.

Engineers and architects were reluctant to push technologies that had not been tested by time, given the lack of exposure and of technical literature. The new technology was not taught in technical institutes. A severe handicap was the fact that the technology was not included in the government's building codes. This limited bidding for work in the public sector, and obtaining loans from financial agencies for construction.

Training was having a marginal impact on skills generation. Skilled masons, who played a crucial role in selecting the technology used for construction in the state, were not being trained. They were only being recruited for construction sites. Experienced masons could also accelerate the transfer by training others in this technology. Unskilled trainees who were being trained took longer to learn than masons. They required considerable on the job experience to be able to undertake independent assignments after training.

Training in the production of alternate materials had not resulted in entrepreneurship development. Dearth of marketing avenues made those trained in production reluctant to start their own units. Distribution channels to sell these materials also did not develop due to the low production of materials. These problems were not understood and therefore not addressed by the organization.

The Basic Challenge

The basic challenge faced by the organization was clear. It had to get consumers to adopt this technology. When they were ready to do so, the materials and masons, architects and engineers to enable them to utilize this technology would have to be easily accessible or the transaction would not take place. The first step called for concerted efforts to influence the consumer to buy into the idea of cost-effective technology. The second and third called for the development of entrepreneurs and channels of distribution and the training of masons and others. The government's endorsement by incorporation of the technology into the Building Codes was crucial for wider acceptance. These issues were interlinked.

If the Building Center was to be effective in getting people to adopt this innovative technology, it needed a strong marketing focus centered on the customer. It required distributors and practitioners to give its target markets access to this technology and government endorsement for wider acceptance. This insight was the catalyst to jump-start the organization to actively work towards realizing its mission.

Defining the Mission

The survey uncovered a distinct absence of product understanding and corporate mission. The staff was not clear about what need the organization was satisfying and why it was in existence. For instance, some engineers there were of the view that they were working for a construction agency that cut out the middleman. They did not see the Building Center as its founders did, standing for something more than the technology that it propagated. Construction was not its fundamental aim and was undertaken only in terms of promotion. In the long run the organization wanted the private sector to use its technology with trained masons applying the technology and entrepreneurs marketing its products.

The basic need it was satisfying was the fundamental need for shelter, through affordable and acceptable housing. The organization listed as its mission the transfer of technology, implementation of training and dissipation of these technologies, but neglected to explicitly recognize that these were just the means of achieving the broader goal of "providing the know-how, the means, and the resources to fulfill the need for affordable and acceptable housing." This mission utilizes its competencies and allows it to cut out all tangential activities.

The Building Center needed a clearer perception of its mission. The organization was led through a mission-defining exercise that focused on the underlying need it was trying to satisfy. The core strategy would flow naturally from the mission and an understanding of the Building Center's environment, its strengths, weaknesses, opportunities, and threats. The basic strength of the organization is that it has the expertise and the basic structure to meet the need for cost-effective housing. It has a first mover's advantage and is the only organization offering cost-effective housing techniques on a mass scale. The users of the technology were generally satisfied with the organization's offer. It is relatively flexible in its structure and is supported by some dedicated personnel. It enjoys a good relationship with the government.

The overriding weakness of the organization was its strategy and tactics. These were remediable. The Building Center lacked a clear focus and well defined organizational systems. Strategy was formulated in a hit-and-miss fashion. The organization had begun to pursue tangential projects in a haphazard and opportunistic way. Departing from cost-effective housing technology, it had embraced projects like mud sculpture. Though minor, these diversions detract from the mission and defocused the market image.

Recommendations

The goal of this exercise was to re-focus the organization. This required the abandonment of all tangential activities. In 1997 a four-month study was conducted to gauge the impact of this reorientation.

Customer Orientation - The organization moved to a customer orientation. The attempt to understand the customer has yielded great dividends. The employees handling the housing guidance cells were trained in marketing to the customer and customer wishes were accommodated while making building plans instead of merely pushing the technology.

Market Research - The organization started to collect and analyze customer data in order to improve its offer. This served as a basis for meaningful segmentation. A cardinal aspect of this new attitude was to develop and obtain customer feedback with a

well-defined survey.

Segmentation and Targeting - Income is a great divider in a developing economy. The marketing effort is now focused on the low and middle-income groups. The institutional market is also being targeted. This has resulted in the construction of public buildings, which has increased the visibility and credibility of the technology.

Communication - Since the organization is trying to push an innovative product, communication is crucial to induce first time behavior. In an effort to build better relationships, communication strategies are now aimed at all the organization's stakeholders from customers and the general public to media, government, and technical institutions. Information for potential customers is targeted to those who influence the decision-making process. Literature explaining the technology in layman's language has been developed.

Political Lobbying - Efforts at lobbying the government are now paying off. Certification has been obtained from the Indian Standards Institute for materials, and the government is now actively looking into the issue of including the technology in the Building Codes.

Focused Training - Programs aimed at skilled masons have been started. Manuals have been prepared and training standardized.

Entrepreneurship Development - Programs have begun in cooperation with the Small Industries Development Institute.

Creation of Distribution Channels - Channels of distribution are now being developed. Changes were made in the organizational structure to accommodate this effort. These included setting up a separate marketing function and building systems for evaluation and control.

Increased attention to women - Though women spent most of their lives at home and have a lot invested in it, they are rarely consulted when it comes to habitat. In order to empower women in relation to their habitats; women were trained as masons—an occupation that was traditionally reserved for men. Women's construction teams with masons, engineers, and women architects were started.

Habitat education has emerged as a focal area. The Nirmithi National Institute of Habitat Management was started, offering diplomas and an MS in habitat technology. An Indian Council for Habitat Education was formed to network educational institutions and start courses in habitat education. To ensure greater community participation, centers were started in the panchayats (smallest local body), which are managed by concerned citizens.

The organization continues to flourish; six thousand houses have been built, and ten thousand people have been trained. The movement has assumed a larger role as an advocacy group for environment-friendly habitat. A new construction culture has been fostered and is disseminating through the field. A trained cadre of professionals committed to cost-effective and environment-friendly technology has emerged.

What once seemed an insurmountable challenge has become an opportunity to realize the precarious dreams of millions for basic habitation.

Neighborhood Balance Sheets Assess Local Economies

Kenneth A. Meter

Frustrated with four years of negative responses from developers, a south Minneapolis business association turned to a new tool in economic analysis, the 'Neighborhood Income Statement and Balance Sheet' study produced by Crossroads Resource Center. The Balance Sheet showed merchants their low-income neighbors held more spending power than they had believed. Moreover, the vast majority of these consumer dollars flowed away from the neighborhood.

Reviewing these findings, the business leaders began to see that the most fruitful development of their commercial intersection might involve making better use of existing community resources, and learning to cooperate better, neither of which required an outside investor. Further, the investment they did solicit served their goal of building a stronger community. Within two years, the association had constructed a new 'Latino Mercado' in an underutilized commercial block. This indoor marketplace created business ownership for Southside residents, a destination draw for regional consumers, and a more positive image for the entire commercial district, all at once.

The study that opened the merchant's eyes to these possibilities, the 'Neighborhood Income and Balance Sheet', appears to be the first in the nation to provide such thorough economic analysis of neighborhoods. Its premise is that neighborhoods must perform their own accounting of local economic conditions if they are to achieve neighborhood goals. In this respect, a community is no different from a family that must balance its checkbook and review its portfolio to learn if it is gaining or losing ground.

In any given development project, each investor performs its own calculation of risk and income, and each municipality projects tax revenues. Each producer and consumer using the development engages in its own accounting. Neighborhoods, however, typically neglect to measure their own economic assets, and neglect to set goals for strengthening their local economy. Unless they do so, especially in a competitive environment, economic and social impacts on the neighborhood are more likely to be negative.

To address this opportunity, Crossroads Resource Center has produced five studies of low and moderate income areas of Minneapolis and St. Paul since 1993. The Balance Sheet studies show that these areas endure staggering losses of resources each year and suggest that the most effective community development strategies involve reversing this loss through recycling existing income, strengthening existing economic assets, building new social linkages, and creating new paths that allow wealth to take root in a given community.

When combined with training and consultation appropriate to local conditions, Neighborhood Balance Sheet studies have been highly useful in shifting the tenor of neighborhood-based planning away from a narrow focus on construction of a given piece of real estate toward a more long-term view of building the economy of an entire locale. Crossroads' studies have encouraged business leaders to take a fresh look at their role in building the surrounding community, have led to innovative, resident-inspired community planning, and have allowed residents to negotiate more effectively with investors.

Findings of the Balance Sheet studies

The studies completed to date cover a total of 13 Twin City neighborhoods. Each has been produced in close cooperation with a local resident organization, drawing upon resident volunteers to assist in framing questions and performing research. In each locale, at least five different economic 'sectors' have been identified: residential, commercial/industrial, non-profit, medical providers, and informal. Data are of course not as precise as a specific organization could collect for an internal accounting. Some desired data are unavailable, and there is some overlap among sectors. Nevertheless, the studies offer reliable and useful summaries of economic activity in each locale.

The beginning point of each study is to define what is already strong in each locale. Each begins with an historical sketch showing the core events and issues that create the prevailing context, and define the local character of the neighborhood as residents view it. Each lists existing civic organizations, non-profit institutions, public agencies and businesses.

Next, the Balance Sheet studies measure existing economic assets, which are substantial. Each neighborhood studied, for example, earns three of every four dollars of household income from wages and salaries — the same ratio as for all residents city-wide — despite the outside perception that these communities are 'welfare dependent'. In fact, each neighborhood pays more taxes each year than it receives in welfare benefits, paying a total of \$91 million more in taxes than is received as public assistance income. Welfare income ranges only from one to ten percent of aggregate household income. One startling finding was that the Phillips neighborhood, one of the poorer neighborhoods in the city and one often viewed negatively by civic officials, pays \$12 million each year in property taxes making it the second-highest tax contributor of Minneapolis' 84 residential neighborhoods.

These five studies also show that there is sufficient income in each of these low- and moderate-income locales to cover essential goods and services for neighborhood residents. All told, more than \$3 billion of commercial and personal revenue flows each year through these 13 neighborhoods, an average of \$40,000 per man, woman and child. The combined population of 85,000 residents spent a total of \$879 million in 1989 — well over \$10,000 per capita.

However, very little of this income helps to build wealth in the locale. Three of every four consumer dollars, a total of \$645 million *each year*, are spent purchasing life essentials that are not available from community vendors. Such an outflow would not be destructive if a compensating inward flow of revenue were present, but no such offsetting flow exists. By far the largest stream of money away from these neighborhoods is devoted to housing costs totaling \$240 million, or 27 percent of all expenditures. Most of this money, once spent, never returns.

Rent, of course, is a primary drain of financial resources. For example, in the Phillips neighborhood, 86 percent of all housing is renter-occupied, despite the fact that aggregate resident housing expenditures amount to one-sixth the value of *all neighborhood residential property* each year. Most rent payments are made to absentee landowners who do little to reinvest in the community. Compounding the issue, Minnesota property tax laws charge higher tax rates for non-homesteaded property, meaning that tenants of absentee owners pay a double tax burden, often with no sense their investment in taxes is returned by adequate, prompt or respectful city services.

Whether home *purchases* actually help build a stronger community economy is open to question. Clearly, buying a home is one of the few routes available to residents wishing to build equity. In a rising market, a buyer may gain handsomely, especially middle-income buyers who can take advantage of tax deductions that subsidize their purchase. Home ownership also promotes a different quality of personal investment in the community. However, in a market where home prices are low and/or falling, the financial mechanisms through which low-income residents make home purchases often weakens the financial strength of the community as a whole.

This happens because most home purchasers make mortgage and interest payments to the secondary market. Since few of these secondary lenders reinvest in low-income communities, most of these mortgage payments leave these neighborhoods for good. Lenders argue that the secondary market makes it possible for local lenders to reinvest in low-income communities, but such reinvestment does not appear to be happening. The historic link that lenders once offered, recycling interest payments to help build the surrounding community, has been broken. More money flows out as interest payments than builds resident-owned equity.

A ten-year review of Home Mortgage Disclosure Act (HMDA) lending in Phillips showed that despite the Community Reinvestment Act, total lending remained constant at about \$5 million per year from 1980 through 1989, while the cost of living rose 78%. Simultaneously, the number of lenders declined drastically — from 22 banks to four — due to mergers. Local borrowers lost substantial ground.

In addition to housing costs, day to day purchases take a toll. Low-income consumers in these communities buy a total of \$123 million of food each year, the vast majority of which is purchased from outside vendors. As families with small food budgets turn more frequently to fast food purchases, this erosion deepens. An additional \$157 million per year, or one of each five dollars earned, pays for transportation costs. Virtually all of this leaves the community, suggesting that reducing travel costs could be an effective way to free up local consumer dollars for use as investment in the locale. Developing walkable workplaces, fostering home-based businesses, opening better transit access, and creating resident-owned, low-cost livery services are all steps a neighborhood could take to reduce the need for cars — which in turn could reduce other costs for fuel, public infrastructure, insurance, and perhaps public safety and health care.

Each study has also identified internal structural concerns in each neighborhood economy. Over 6,000 households in these five neighborhoods earn less than \$10,000 per year. Vast disparities in income exist, with highest wage earners bringing in well over 20 times as much as the lowest. Real income plummeted 15 percent from 1980 to 1990 due to increased costs of living. White residents earn a disproportionate share of neighborhood income, and control more wealth, than people of color (Oliver and Shapiro 1997).

Commercial activity is stronger than expected, with a total of more than 1,200 businesses operating. Still, there is often more purchasing power in residential households than in the commercial sector. In many neighborhoods, a once-thriving industrial sector had eroded. Moreover, in most neighborhoods, the only gains in the workforce came from self-employment — an opportunity often neglected in community planning. Ironically, the Camden study demonstrated that it was precisely those locales surrounding industrial firms where unemployment was the highest. This again suggests that building new linkages within the community could play a strong role in community development.

Non-profit sectors also play key roles in building the local economy. In Frogtown and Dayton's Bluff, some nonprofits have strong financial reserves, and many build the capacities of local residents, helping to create stability in each locale. Community planning efforts in Camden were somewhat limited by a relative lack of citizens' organizations with experience in constituency-building and negotiation.

On the other hand, the Phillips study raised the question of the extent to which neighborhood non-profits actually benefit community residents. Home to 74 non-profit corporations running more than 130 different programs, Phillips may have more than its share. Certain non-profits have established considerable reputations for serving poor people — in fact several have sought significant capital donations to expand their facilities due to the deepening of poverty in recent years. However, few of these institutions can demonstrate a clear positive financial impact on the neighborhood. In many cases, professional staff who live elsewhere collect salaries, while residents receive specific services but few lasting resources. The Balance Sheet studies propose that funders ask non-profits to document the extent to which they build capacities among community residents. Balance Sheet studies also focus on informal sector transactions. While of course precise data are not available, Crossroads' studies estimate barter activity by gauging the number of hours that neighbors spend trading skills and services with each other. These conservative estimates indicate that a total of \$253 million in informal activity is generated each year, from minimal investment. Such barter activity turns out to be the most fruitful way for each locale to build new wealth at the present time. Drug trafficking, an informal sector activity that is often viewed by outsiders as central to these inner-city economies, is shown to be of relatively low financial import, on the scale of a few million dollars for all five locales combined. Black market sales are still lower in value.

Analysis of findings

In effect, low-income consumer spending reinforces economic relationships that drain financial resources away from their communities, widening income and wealth gaps. These flows of money are far larger than any program of compensating public transfer payments that can be imagined. Often, thoughtless new development, by saddling local homeowners and businesses with even greater debts, merely deepens these losses, and creates conditions in which long-term local residents are placed at a disadvantage, or even are forced to move away (Gunn and Gunn, 1991).

A more defensible strategy would be to develop in ways that do not rely totally upon outside investment. Building new links of cooperation among neighbors, for instance, can recycle existing dollars and strengthen the community fabric, making a positive impact both socially and economically. Developing new community businesses that allow more residents to make a living exchanging goods and services with each other does not require significant new sources of income. Rather, it requires targeted investment that builds strong local marketing options.

Ultimately, beneficial development could be undertaken that actually reverses these financial drains. While external investment may be required to prime new financial pumps or to create alternative financial structures (such as revolving loan pools that would keep mortgage payments cycling within a given community, public incentives that promote community reinvestment, targeted investments to generate local investment and increase local multipliers, external support of Individual Development Accounts, and so

forth), *the main purpose would be to re-direct the flow of income already present within the community.* Developing marketing structures that recycle this money within the locale and promote the building of local wealth will do more to advance such communities than would transfer payments, that might tend to promote dependency.

For example, one Phillips hospital spends more than \$31 million per year buying supplies, nearly all of this outside the neighborhood. This amounts to nearly one-third of the aggregate revenues of all of the other 275 smaller businesses operating in the community. If this hospital were, for example, to invite retired executives to assist young neighborhood entrepreneurs to establish businesses that sell supplies to the hospital, this could have a significant impact on neighborhood income. If even ten percent of these purchases were devoted to neighborhood vendors, total neighborhood business revenue could rise three percent.

Principles of community wealth creation

To build paths for money to recycle in these communities, and to take root as locally-owned wealth, requires solid, locally-defined strategies suited to each particular locale. Necessarily, such planning must both reflect the wisdom and inspire the investment of local residents. Crossroads has identified a series of principles for neighborhood commercial and industrial development that offer hope for building stable communities in the long term. These principles include:

1. *Build community capacities as part of the planning process.* Engaging local residents fruitfully not only allows their expertise regarding local conditions to be incorporated into development, it also increases their buy-in to the ultimate project (Kretzmann and McKnight, 1993).

2. *Strengthen existing economic assets and build new ones.* We find that examining assets *first* leads to more optimism, and more locally-appropriate solutions, than if needs are assessed first. Existing assets should be enhanced, not undermined, by new development.

3. *Foster new investment and ownership opportunities for local residents.* If residents are to become more effective *citizens* rather than simply more efficient *consumers*, they must have a stake in the productive economy. Building *livelihoods* (business ownership) for local residents gets closer to this goals than does a narrow focus on job creation. Targeted entrepreneurship training for local residents may be useful.

4. *Build structures that allow money to recycle within the community.* Each of the neighborhoods studied has a history of prosperity, typically dismantled by mobility and by public incentives that promoted development elsewhere. Increasing the economic multiplier also builds community social networks.

5. *Cluster compatible (or mutually dependent) businesses in each locale to increase loyalty to place.* This strategy has been highly effective for regions in Europe, for example.

6. *Consumers must also commit to buy from local businesses.* Development is a two-way street. If new or renewed local businesses are to thrive, consumers must support them. This is more likely if residents feel their vision and needs have been addressed. This is another good reason to engage local residents and business owners as stakeholders with a *bona fide* role in planning. As neighborly relationships are built offering information

exchange, mutual assistance, and accountability, new community cohesion is built, aiding in local hiring and purchasing.

7. *Ongoing community organizing and public education campaigns* help to increase cooperation among various stakeholders. Such education efforts have been used successfully by Seward Redesign, a community development corporation in Minneapolis which holds a solid 15-year track record in community-based development.

8. *Local efforts are limited by global economic trends, but globalization also increases the need to strengthen local economies.* Some would argue that increased globalization makes local planning useless. In fact, globalization creates new opportunities, but also new competitive pressures that require strong public action at a local level.

The proper role of external private and public investment in these processes is to strengthen economic structures that promote recycling of money in each locale, and that lead to community wealth creation. Investment that merely operates as a short-term cash flow is more likely to produce inequality or dependence. Examples of appropriate investments include support of Individual Development Accounts, and investments that increase local ownership of homes and businesses or foster other reinvestment in the community.

Note that this is not a call for support of blindly 'free' market relationships. Low-income communities are wounded by decades of public policies that incited the mobility of capital. It would be naive to expect that the impact of these subsidies could be reversed simply by market mechanisms. Rather, this reversal will require conscious public policy, and will demand that local communities erect solid but permeable borders to protect local assets and resources. In turn, these local boundaries have to be respected by regional and global institutions.

Conversely, neither is this an argument that such neighborhoods should cut themselves off from other locales in an effort to be entirely self-contained. Clearly, any local economy has much to gain from regional and global partnerships — as long as the community does not lose in the exchange. Low and moderate income neighborhoods do have the potential to offer useful products and services globally.

Implementation

Neighborhood Balance Sheet studies have fostered effective action in each locale. One solid example is the business association mentioned at the beginning of this working paper, which used the Powderhorn and Phillips Neighborhood Balance Sheet studies for innovative planning at their commercial node (Bloomington Avenue and Lake Street, bordering both neighborhoods). Outside developers saw too little potential for investing in the community, citing their opinion that disposable income was too low, and fearing that suburban shoppers would not come into the neighborhood due to their perceptions of crime. This is perhaps an accurate assessment from the point of view of developers whose livelihoods depend upon creating new extractive flows from the community. After being introduced to the Balance Sheet studies, the business group launched a new economic development effort aimed at developing existing community assets, rather than focusing first upon attracting outside money. If there was not enough disposable income to convince an outside investor there were profits to be made, perhaps there was enough income in

the community to help local residents earn a better livelihood.

The first steps involved better cooperation among the businesses themselves — itself a type of community wealth. Knowing the neighborhood is safer than outsiders view it, the merchants took steps to reduce risks, adopting a lighting plan, an ‘eyes on the street’ design approach to assure that street activity was seen by local shopkeepers, and coordinating more effective police enforcement. The merchants rapidly adopted a unified set of voluntary architectural design standards for new and redeveloped properties. With input from the community, the group adopted a master plan with a focus of “arts, culture, ethnicity and retail” for their corner. A 75-year old ethnic business decided to expand, as did a local bakery. A new cultural wellness center was developed, a new gas station/convenience store, and several new ethnic businesses opened. A respected theatre company, long-established drug store and branch bank made substantial new investments.

Soon, when a group of 22 Latino entrepreneurs graduated from a business training program, looking for a space in which they could cluster together in a culturally interesting enclave, they found that Bloom Lake had both an underutilized property and a focus on ethnicity and culture that would make a perfect fit. The resulting \$1.5 million project, the ‘Latino Mercado’, will open this fall. Importantly, this approach to the creation of community wealth arose from exceptional voluntary cooperation, not out of a funded program. An energetic community vision attracted both private and public dollars. The result is a strengthened core of businesses with a lasting and newly reinvigorated stake in community sustainability — far more committed to the long-term viability of the community than outside investors would have been.

Further, the Phillips study helped the neighborhood association negotiate with officials of the Minneapolis Neighborhood Revitalization Program for an allocation of \$18 million in public investment. The negotiation turned when community leaders pointed out that the previous \$12 million offer over five years merely replaced the property tax payments the neighborhood makes in a single year. Prompted by the same study, one hospital hired the national accounting firm Arthur Anderson to assess the hospital’s economic impact on the neighborhood, then invested in housing redevelopment, and a jobs training program for local residents. Similarly, the Dayton’s Bluff neighborhood study added substantial credibility to an exceptional resident-written small area plan. The East Side Neighborhood Development Corporation in St. Paul’s Payne-Phalen area is using Crossroads’ *Local Economy Data Book* as the economic core of a \$400,000 redevelopment.

Methodology

Especially useful for urban neighborhoods, the Balance Sheet model should also be highly adaptable to suburban and rural communities, including watersheds or other ecological zones. Essentially the model adapts accounting principles for use by a neighborhood, relying strongly on the experience of local residents. It differs from a classic input/output study in that it does not attempt to be predictive. It has also been described as “a study of a micro-economy using macro-economic principles,” although certainly it is not formally in this tradition.

Crossroads’ Balance Sheet studies make use of all available data coded at a neighborhood level or smaller. Key to each study is Federal Census data from 1980 and 1990. Many residents now view these data as outdated, due to recent immigration and

economic changes. Nevertheless, these historic numbers serve as useful baseline and trend reports, and are often the most reliable local data available. Census data has been graphed, or mapped using Geographic Information Systems (GIS) software, to provide visual displays which have been used with great success in interactive community meetings where as many as 150 people have met together to cooperate in analyzing neighborhood trends and issues.

Other data sources include city and county tax records, state tax data, regional government transportation studies, federal studies of consumer spending patterns, federal and state tax reports of non-profit financial data, visual surveys of local businesses including home-based businesses, historical city directories to show the change in the local business context, county welfare payments data, police department crime data, day care providers' network information on day care slots, and Home Mortgage Disclosure Act (HMDA) mortgage lending data. Original resident or business surveys have also been performed as needed. As the studies have become more known, public agencies have increasingly begun to code and report data on a neighborhood level, facilitating more extensive analysis.

Conclusion

Neighborhood Balance Sheet studies have effectively helped shift the approach to community development for many in the Twin Cities toward one that is more about building community and less narrowly limited to investment in a particular piece of property. By recognizing the assets that low and moderate income communities already have, Balance Sheet studies have paved the way for more positive and less destructive development that offers greater returns, and allow needs to be addressed from a position of strength rather than despair.

Studies have also brought together stakeholders in new ways, and have fostered more constructive planning. By doing so, they have laid the groundwork for innovative efforts in reversing the drainage of money these studies have identified.

Investing in the Inner-City: A Model for Parallel Growth

Alexandra Blain and Stacie Olivares-Howard

Introduction

Several organizations have joined forces to encourage successful private investment in America's low-income neighborhoods. The partnership between small business, government and Community Development Corporations (CDCs) successfully capitalizes on the often under-valued economic attributes of low-income neighborhoods. These neighborhoods emerge as viable commercial markets because of these partnerships.

We identify successful inner-city business pioneers in the Roseland and Little Village neighborhoods of Chicago, Illinois and the East Lake neighborhood of Oakland, California. We focus on the characteristics of their internal operations and external environment and the conditions that fostered or hindered their success. We consider the influence of federal, state and local programs on internal operations and in the external environment.

Our case study research method profiles four 'mom & pop' businesses in low-income neighborhoods. Through a combination of interviews and analyses of government programs, we identify the conditions that foster or hinder the success of these small inner-city businesses.

We introduce the concept of *parallel growth*— the building of community wealth in parallel with the growth of a business— as a criterion for the selection of successful inner-city businesses. We recognize that there are several criteria used to measure the success of small business operations such as sales, customer base, expansion potential and bottom line profit measures. However, small business operations that operate in the inner-city are often subject to unique environment challenges that must be overcome for their business to develop. Specifically, we refer to an exaggerated perception of crime, a lack of physical infrastructure, and an under-investment in human capital. As such, we assert that a commitment to parallel growth by 'mom & pop' businesses in particular is essential to community revitalization. We identify three categories in which small businesses must demonstrate a commitment to parallel growth:

1. *Employment* - Employers must hire qualified community residents and encourage professional development of employees.
2. *Community Investment* – Employers must maximize the use of local suppliers, hold active membership in a local merchant's association, and possess a willingness to create partnerships with local community organizations.
3. *Product and Service Delivery* – Employers must provide quality products and services that target local consumer demand and provide an economic and social benefit to the community. This is in contrast to the potentially predatory businesses that often dominate the business mix of low-income areas, such as check cashing vendors and liquor stores.

Problem Definition

Limited access to debt and equity capital prevents small businesses from developing or expanding in inner-city markets. Banks, a traditional source of small business debt financing, seldom lend in the inner-city market due to bias, a poor understanding of

inner-city business and low profit margins from relatively small loans and high transaction costs. Successful inner-city businesses often lack the sophisticated accounting and financial planning tools to demonstrate the value of their business and secure financing in the capital markets.

Despite numerous attempts by federal, state and local government to increase access to capital in inner-city markets, small businesses remain undercapitalized. Government sponsored small business financing programs may be earmarked for the inner-city market, but implementation problems can prevent funds from reaching many small businesses. Government agencies, CDCs and other entities charged with implementing and disbursing capital often lack the resources to market programs to inner-city businesses. Small businesses may not have the human resources required to complete numerous applications.

Through referrals, research and personal contacts we consulted with several organizations to identify socially responsible businesses in low-income neighborhoods in the East Lake area of Oakland and in the neighborhoods of Little Village and Roseland in Chicago. In Oakland and Chicago, ten businesses were considered, including restaurants, supermarkets as well as a fish fry market, a café, a large Mexican candy import/exporter, a bookstore, a telecommunications store and a high end men's retail clothing supplier. Despite the miles and demographic characteristics that separate and distinguish these two cities, we found that successful businesses in the Roseland, Little Village and East Lake neighborhoods shared many characteristics. We highlight the shared characteristics of four small businesses from the restaurant, candy and men's retail clothing industries and the conditions that foster or impede their success.

Chicago, Illinois

In addition to being a center for large businesses, Chicago also has a thriving small business community. According to a recent article of the Journal of Business Strategy, Chicago ranked second in overall business climate when compared to nine other large and mid-size American cities. When compared to 53 cities worldwide, Chicago ranked ninth using a composite index based on: the number of international air destinations, cost of living, diversity of worker skills, gross domestic product (GDP), population, number of Fortune 500-ranked global headquarters and unemployment rates (City of Chicago, Department of Planning & Development, 12/99).

"On December 21, 1994, the City of Chicago was designated as one of six urban Empowerment Zones (EZ) by the U.S. Department of Housing and Urban Development (HUD). The three non-contiguous communities that make up Chicago's EZ are the near West Side, *Pilsen/Little Village* and the near South Side. Federal benefits for a small business within an EZ are: \$100 million in Social Service Block Grant (SSBG) funding, tax credits for hiring EZ residents, accelerated depreciation of capital equipment purchases, consideration for waiver from federal regulation, and new tax-exempt EZ bonds" (City of Chicago, Department of Planning and Development, 12/99).

The City of Chicago also has a façade improvement program that provides up to \$5000 in matched funds to small businesses for storefront remodeling.

Little Village, Chicago. The 26th strip in Little Village is second in sales to Michigan Avenue. With 98% of its population of Mexican heritage, Little Village is one of

the largest Latino communities in the United States. Of the residents, 72% are foreign-born, 48% communicate in Spanish and 42% are 16 years of age or younger (Social Compact. 12/99).

Roseland, Chicago. Roseland is located on the far south side of Chicago, approximately 12 miles south of the loop. It spans from 100th to 121st on Michigan Avenue, Roseland's primary commercial corridor. Roseland is 99% African-American and 27% are under eighteen years old. Today, vacant land, deteriorating building stock, and a lack of variety in retail establishments characterize the commercial strip (Neighborhood Housing Services of Chicago. 1999).

Oakland, California

Oakland is the eighth largest city in California with a population of 382,000 and the fourth largest economy in the United States (City of Oakland). With a rich cultural mix and proud history of ethnic heritage, Oakland encourages entrepreneurship within its diverse Central American, Korean, Vietnamese and Yemen immigrant communities and institution-building among its established African American, Mexican American and Native American populations. Oakland boasts several economic development partnerships and a diverse business community.

East Lake, Oakland. East Lake's commercial businesses serve a multiracial working class neighborhood of Asians, Latinos and African Americans. Ethnic restaurants, auto repair shops, ethnic grocery stores, beauty shops, and garment manufacturers comprise the majority of its current business mix in the East Lake district. Despite East Lake's cultural wealth, racism, cultural mistrust and public/private disinvestment impede business development and operation. With at least ten languages spoken in East Lake, language barriers tend to complicate communication between neighbors, businesses and local government.

The small businesses selected demonstrate a unique understanding of their niche market, a commitment to operate within their low-income communities and a passion for delivering their products and services. Edward Rodriguez, owner of Dulce Landia, the Mexican candy import/exporter, when asked about the key to his success responded: "We don't just sell candy, we sell a remedy to nostalgia."

Conditions for Success

Property Ownership - Property ownership encourages businesses to remain in their neighborhoods. Property ownership gives business owners a tangible financial stake in the development of local infrastructure. Business and property owners 'buy-in' to the community through their direct real estate investment, and indirectly by signaling their desire to foster long-term customer relationships. Further investment in the community's infrastructure, such as adding new streetlights, increases the perception of safety within the community and attracts new customers.

Member of Merchants Association and CDCs - The businesses we profiled are active members of their local merchant's associations or CDCs. These organizations provide a forum for linguistically and culturally diverse business owners to discuss shared interests and develop cohesive partnerships. The East Lake Merchant's Association in conjunction with the East Bay Asian Local Development Corporation (EBALDC), for example, are

committed to create “new street banners, new lights for the park, new street trees and storefront improvements.”

Government Programs - The small businesses profiled acknowledged two government programs as conditions that fostered their success: the North American Free Trade Agreement (NAFTA) and the National Main Street Program. NAFTA minimizes delays in product delivery and import-export compliance costs. The National Main Street Program provides matching funds for the renovation of storefronts in historical downtown areas to encourage economic revitalization.

Intergenerational Business - Three of the four businesses were intergenerational. The children of the business founders had already assumed management of business operations, or were currently employed in the business and receiving on-the-job management training.

Access to family capital – With the exception of one business that secured financing from the Small Business Administration, the small businesses profiled relied on their own personal savings to found their businesses. Only one business secured a bank loan to finance its expansion.

Exaggerated Perception of Crime

Inner-city businesses are often undervalued because of an exaggerated perception of crime. Vandalism, blight, vacant lots and inadequate street lighting discourage community gathering and retail activity. Many perceive downtrodden areas with these characteristics as areas for prostitution, loitering and drug dealing. Attracting customers from within and outside the community can be a formidable challenge for businesses operating in severely economically depressed areas.

Under-utilization of government programs

Business development programs offered by the city are under-utilized for three main reasons. First, business development programs do not adequately target the small business they intend to serve. Second, when small businesses do qualify, owners usually endure a lengthy and detailed application process that consumes valuable human resources. Lastly, interested parties often find application questions complex and intrusive and perceive local business development programs as paternalistic.

Inadequate public infrastructure

The under-enforcement of municipal codes and the poor maintenance of public areas and parking spaces exacerbate the challenges created by an inadequate public infrastructure. Many commercial properties in the inner city do not comply with municipal code. Businesses defaced by graffiti or located next to vacant lots have no incentive to maintain their exteriors if the city does not actively prevent the deterioration of neighboring commercial and residential lots. Municipal code enforcement is not regular or uniform. Off-street and metered street parking is scarce or unavailable in many inner-city communities. Replacing on street parking with adequate off street parking will prevent traffic congestion and encourage residents to shop at local businesses.

Conclusion

Small businesses understand the retail demand of neighborhood consumers, but may lack the internal performance measures and automated systems necessary for expansion. CDCs and local government can partner with volunteer corporate advisors to help small businesses expand. We believe national and local for-profit and non-profit organizations can leverage the expertise of their corporate boards or board members.

Many national and local business development programs are under-utilized because inner-city small businesses are not aware of them. Private organizations committed to community revitalization can form marketing partnerships with CDCs to target 'mom & pop' businesses. Language and cultural barriers may be overcome by investing in cross-cultural and multilingual marketing strategies. Beyond the scope of the small businesses that we profiled, we also note the need for financial resources and basic community services in inner-city neighborhoods. Many initiatives now try to meet social and economic needs by creating financial incentives for business. Future considerations for inner-city revitalization should consider stimulation of economic investment through entrepreneurial development of local community residents.

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Strategic Alliances Between Boston and its Universities

Lauren Budding and Elizabeth Humphrey

Introduction

Universities and their affiliated medical institutions play a critical role in building and sustaining Boston's diverse economy. Boston's thirty six higher educational institutions are among the largest employers in the city. They provide an educated workforce, attract hundreds of millions of dollars of R&D funding, and serve as a magnet for the fastest growing industries like software, communications and biotechnology.

Despite the recognized economic importance of the universities, they are often overlooked as a resource and a partner to advance the City's economic development objectives. Even in Boston, which has the densest concentration of higher educational institutions in the country, the City taps the rich resources of its universities only at their margins. Those partnerships that do exist tend to be reactive and ad hoc.

While there has been renewed interest in the role of educational and medical institutions in cities across the country (Harkavy, Wievel), the majority of the initiatives emerge from academic institutions. To the best of our knowledge, no big city mayor has yet made a strategic alliance with universities a major part of a city's economic development agenda. Furthermore, no book, road map, or prescriptions exist on how to build a strategic alliance between universities, their affiliated hospitals and the government of their host city. Mayor Thomas Menino asked us to recommend ways to think about a more proactive role for the City in leveraging the economic impact of Boston's universities. This analysis provides a framework for examining what strategic alliances might look like, and then recommends actions to achieve them.

Methodology

The existing literature on university strategic alliances and economic development contains no examples analogous to Boston – a thriving city with tremendous intellectual capital. Consequently, our research consisted of collecting and analyzing qualitative data specific to Boston and conducting interviews with more than 30 subjects: senior administrators from a core group of universities, city officials identified by our client, and a selected group of business and civic leaders.

In order to benefit from the lessons learned in other successful, cross-sector alliances, we drew on 'best practices' from case studies of other partnerships to contribute to our understanding of the needs and benefits of long-term alliances between these institutions. Our analysis was based on our understanding of the city's goals, the potential added-value of the universities' resources and the institutional agenda of the universities themselves.

Existing Partnerships

Boston has a rich history of personal and institutional relationships with its universities. Many of these relationships have been quite successful, but with a few exceptions, they are limited to one specific deal or project. In thinking about how to build closer partnerships, we relied on a typology of partnerships developed by Jim Austin of

Harvard's Business School:

- Philanthropic, which depend on the generosity of one partner;
- Transactional, which involve a two-way exchange of benefits; and
- Integrative, which consists of ongoing relationships focused on achieving the core goals of both parties.

Most of the existing relationships fall into the first two categories. These philanthropic and transactional partnerships are often at the periphery of the respective partners' mission and strategy. Integrative partnerships are rare because they require more managerial complexity, more resources, and interactions at all levels within each organization (Austin 2000). There is one outstanding example of a strategic, ongoing partnership between the City of Boston and Boston University Medical Center. At a time when the future of health care delivery to a large segment of the urban community was in doubt, Boston University took over the management of the Boston City Hospital, ensuring that high quality medical care remained available to all residents of Boston. This example demonstrates the key feature of a strategic alliance: the partnership supports the central mission of each organization and lies at the core of each institution's organizational strategy.

Findings

The purpose of our primary research was to determine whether there were opportunities for similar strategic partnerships, and to identify possible obstacles to achieving them. The first step in assessing a potential partnership is to understand the exchange of benefits – what each side has that the other side wants. Each institution, including the City, comprises a variety of interest groups, each with different preferences. While interest groups differ in their valuation of the benefits of cooperation, our interviews revealed a basic consensus about what the benefits of a closer partnership might be.

For the City, these benefits may include long-range thinking, research expertise and new perspectives on management and policy questions. They could also include access to university networks, technological resources, new funding sources, technical expertise, workforce development, job growth and volunteer labor and research dollars.

The universities might gain support for their institutional agendas, laboratories for experiential learning for students and faculty, access to city decision makers and political networks, broad recognition of their civic commitments and access to new funding sources. Universities sponsoring new business could also gain regulatory support for such initiatives, joint planning to support their physical development, laboratories for research ideas, and promotional support from the Mayor for new business centers. Most interviewees were enthusiastic about the potential of more strategic partnerships between the City and one or more universities, but cautioned that:

-Both the City and the universities need to better understand the multiple interests that exist within their partners' institutions as well as the constraints that bind them.

-The city often failed to recognize the universities' capacity to deliver when requesting help. The City's "asks" were often too vague, difficult to respond to and focused on city priorities without regard to individual universities' practical expertise.

-For many of the university administrators, the Mayor was the only contact in

City Hall. While many interviewees praised the Mayor's effort to build institutional relationships, they identified the need for staff capacity to manage relationships on a daily basis.

-Certain issues and challenges with current relationships exist, but most can be resolved if each side is committed to working together.

While many of the issues noted above can be resolved, other differences are less negotiable. These differences are integral to the City's or universities' function, and while they will complicate any joint venture, a lasting partnership must incorporate them into its design. In fact, if the challenges are addressed appropriately, these differences can actually create value. Two of these challenges are structural. The first is that universities and city governments work on different time horizons. University administrations often plan for centuries, while the City works on the next day's agenda. Even faculty and students think of projects in terms of semesters and school years, which frustrates city staff who may need research turned around in a month. The second challenge is that the power at universities is decentralized. The role and power of university administrators are more limited than those of executives in government, and Presidents have limited power to set institutional agendas. As Peter Szanton put it "universities may have presidents, but presidents don't have universities."

Another pair of challenges arises from academic norms. Consumers of research who work for the City noted that university research is often not helpful. Academic research imperatives often conflict with the City's pragmatic or political information needs, and consequently academic work often appears detached and irrelevant to policy makers. Finally, universities fail to provide faculty incentives for practical, applied research. Academia rewards new, generalizable facts with publication and – eventually – tenure. The City is more interested in useful, specific findings, and it is difficult for faculty to get credit for this type of work.

Recommendation: The Essentials

We recommend several steps both to overcome the barriers identified in our findings and to promote the interests of the universities and the City. A major component of all of the proposals is building relationships deeper in the administration and across the universities. Our findings indicate that establishing mechanisms for the city to identify opportunities for joint ventures on a regular basis is more important than any specific project or deal. The first group of recommendations is designed to overcome existing barriers to partnerships by improving communications between the City and its institutions. More effective communications between the institutions and the City will increase understanding, provide focus for the 'scattered' efforts of the universities, and identify new, fruitful areas for partnership. These 'essential steps' work towards three goals - clearly communicating interests and goals, demonstrating commitment from the top, and getting specific.

Clearly communicating interests and goals

Our findings showed that communication between the city and universities failed for two main reasons: either people were too busy to pay attention to an issue beyond their immediate responsibilities, or the institution failed to consider and articulate its own interests. Recommendations for clearer communication include the following:

Designation of a university liaison in the Mayor's office - By creating additional staff capacity to manage university relationships, the City could claim a stronger, more consistent voice in shaping the institutions' civic engagement efforts. It would also ensure that someone in City Hall was responsible for thinking about how to take advantage of the universities' resources — including their development plans and their research and technical capacity — to advance the city's agenda. In order to be effective, this new position must be carefully designed. If the person does not have a clear position of authority in the Mayor's office, including other specific, high-level responsibilities, he or she would be in danger of being ignored. Who fills the job is also important: the person needs a sophisticated understanding of university operations and city politics, and must be accepted in both communities.

Identification of long range issues - The City should regularly identify larger, long-term issues it expects to grapple with in forthcoming months and years. While universities have the research capacity and intellectual resources to help with long-range planning, the City must think ahead in order to take advantage of their skills. This task will require precious staff time, but it is an essential prerequisite to beginning to 'thinking big' on important issues.

Creating a University Roundtable - An annual meeting led by the Mayor would provide a forum to present the City's agenda to all of the university and college presidents and talk about the potential for joint ventures on projects. Convening such a meeting would send a strong signal that the Mayor was interested in cooperation. Any meeting has the potential to devolve into a 'show-and-tell' session or a forum for 'talking heads', and this is especially true when many of the participants are competitors. Facilitating real communication requires dogged, skillful staff work and a real commitment on the part of participants.

Demonstrating commitment from the top

Building the city's capacity to cultivate and direct university resources requires the Mayor's leadership and the commitment of city resources. Demonstrating that commitment requires the Mayor's willingness to use the bully pulpit to signal to his employees and to the university community that collaboration is important.

Claim the issue publicly - We recommend that the Mayor publicly announce his intentions to build closer relationships, as part of building the capacity of his administration and leveraging the vast resources of Boston's higher educational institutions. This announcement would signal to the university community and to city employees that the Mayor cares about collaboration. Several of our interviewees noted that there was substantial support for the Mayor's desire to work more closely with universities. Because the results of these partnerships are relatively untested, the Mayor needs to be careful about making claims about their success.

Elicit commitments from Presidents - Regardless of the popularity of praising 'bottom up' faculty and student initiatives, there is *no substitute* for strong leadership from the top of the academic institution. The Presidents' offices have the power to create incentives to mobilize faculty and administrators; they also provide validation and constant attention as to how the concept of a community/university partnership will be implemented in all parts of the institution. Involving the Presidents improves the likelihood that universities will be responsive partners. Enlisting them directly will encourage Presidents

to identify new ways to contribute to the city's objectives, including faculty incentives for participation in partnerships.

Create an awards program - One way to promote the efforts required for partnerships would be to develop a highly visible award to recognize both city employees and members of the university community who have built bridges between the institutions. The awards would highlight the importance of joint partnerships while inspiring effort by creating a competition for good ideas. The City already has a multitude of award programs. Instead of a completely new program, a new partnership category could be added to an existing award.

Getting specific

The most important drivers of strategic relationships are clear expectations, clear goals, and clear benefits built on solid understandings of the expertise and interests of each partner. Focusing on tangible results and early successes will help overcome the inevitable skepticism and suspicion that surrounds any new effort.

Define joint projects carefully - When approaching the universities on any potential partnership, make proposals as specific as possible. Focusing requests makes it easier for the institutions to respond constructively. Specificity allows each party to assess its real capacity to deliver, and increases the likelihood that both parties will understand expected outcomes and produce tangible results. The main barrier to this suggestion will be the staff time it requires. Unless it is someone's responsibility to identify, define and manage projects productively, project definition will remain a low priority.

Recommendations

Suggested Partnerships - The 'suggested partnerships' point to the types of alliances that could promote the economic development interests of the City by leveraging the universities' strengths. Each of these projects can stand alone, but they are best considered as elements of a larger strategy to engage universities in helping pursue the goals of the City and its citizens.

Planning for the New Economy: Universities as Research Engines - As the city considers the optimal mix of jobs, housing, and services in its future economy, the universities can supplement the BRA's research department by developing answers to specific questions and framing issues for further consideration. The main benefit of this partnership for the City would be the ability to draw on the universities' research capacity to work on the 'big picture' questions that the City may not have the time or resources to investigate. Incidentally, the partnership would require the City to be more proactive in its economic development planning in order to guide the universities' work. The universities would benefit from useful, interesting research opportunities for students and faculty. In order to realize these benefits, the City and universities should anticipate difficulty meshing practical research needs with academic imperatives, and be prepared to work through any conflicts that may arise.

Planning for the New Economy: Universities as Development Arm - To prepare for the growth of these industries and give the city a stronger voice in shaping their development, the city could partner with the research universities to spur neighborhood revitalization by identifying underdeveloped areas of the city where those industries can

expand. This effort could benefit the city by guiding 'captive' development to suit public objectives. In return for supporting university-related businesses, the city's residents could benefit from the universities' job creating capacity. There is one important consideration for the City: the risk of the appearance of regulatory capture. The City could be seen as 'coddling' the institutions if it is not clear that the Mayor is leading the process from which the city benefits. Universities focused on their own enterprises, may need consistent encouragement to put common good ahead of their limited self interest.

Boston Fellows Program: In partnership with the universities, the city could create a prestigious, one or two year paid fellowship to attract some of the region's best graduate students to work for the City of Boston. Such a program would improve the City's access to one of the universities' greatest economic impacts – the ability to attract the world's brightest minds to the area. An obvious benefit of this partnership is that it will attract young talent to work in the city administration. But even as the Fellows come and go, their presence will allow city administrators to build ongoing professional relationships throughout universities, increasing mutual awareness of issues and resources. A fellowship program would require an ongoing commitment from the City. Recent research (Brown 1999) on similar programs shows that they require significant staff time to coordinate the program and work with department heads to define concrete projects. The effectiveness of the program depends on the willingness of department leaders to support the fellows and engage them in vital issues.

Conclusions

Building true strategic alliances takes time. A partnership that begins next month with limited objectives and one or two universities can develop into a more robust network that supports Boston's economy and guarantees educational and economic opportunities for all Boston's citizens. This long-term focus will be difficult to maintain. Though true partnerships take time to develop, there are more immediate actions that can promote better communication and coordination between the City and its universities. This paper suggests only a few of the actions that can help pave the way for multi-level, multi-objective strategic alliances.

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ETHICS CULTURE REFORM

Prior Informed Consent of Project-affected Indigenous Peoples

Aaron Goldzimer

“Indigenous peoples must consent to all projects in our territories. Prior to consent being obtained the peoples must be fully and entirely involved in any decisions. They must be given all the information about the project and its effects. Failure to do so should be considered a crime against the indigenous peoples...”

Paragraph 61, The Kari-Oca Declaration and Indigenous Peoples' Earth Charter (1992)

“I am most unhappy that development projects displace tribal people from their habitat, especially as project authorities do not always take care to properly rehabilitate the affected population. But sometimes there is no alternative and we have to go ahead in the larger interest”.

Indira Gandhi (cited in Colchester, 1999)

Introduction

This paper summarizes a large study prepared for the World Commission on Dams. It assesses one proposal for dealing with the conflicts between large infrastructure projects and indigenous peoples: the proposed standard of Prior Informed Consent (PIC). While it focuses on projects affecting indigenous communities, some of the findings will be applicable to broader contexts.

This study is not a comprehensive review of the evolution, philosophical or legal basis, or practice of PIC. Rather, it examines three cases to better understand the operationalization of PIC in the context of project-affected indigenous peoples. Because this study does not compare PIC to other decision-making methods, lessons will be primarily operational (what works and what does not when implementing PIC), rather than an assessment of PIC relative to other options.

Methodology

With the help of the literature and experts from the multilateral development banks, non-governmental organizations, and academia, I have identified several important issues related to prior informed consent in the context of project-affected indigenous peoples. In this summary paper, I have included a cursory discussion of five of these. Next, I have compiled or abstracted from three case studies from which I draw lessons regarding prior informed consent. The origins of the first two of these cases—Australia and the Philippines—represent the two most important experiences to date in legislating the right of prior informed consent for indigenous peoples. The third case, from Peru, involves a corporation's voluntarily seeking a 'license to operate' from local indigenous communities.

This study's primary discussion lens and criterion for analysis is the effective protection of the welfare of affected indigenous peoples—since it is assumed that this is the objective of PIC. The implicit standard is whether the welfare of affected indigenous peoples is at least maintained at the level that existed prior to the PIC process.

The Problem: Project Impacts on Indigenous Peoples

Indigenous peoples have frequently experienced severe and negative impacts from large development and infrastructure projects, such as mines, dams, and oil exploration and development. Resources used for hunting, fishing, gathering, and agriculture have become polluted and degraded. Communities have been displaced by projects and forced to compete with other communities over fewer resources. Project roads have opened access to colonists who exploit the timber, minerals, and land of indigenous areas. Ethnic tension, violence, and competition for resources have ensued. Many projects affecting indigenous territories have also been accompanied by severe human rights abuses by project sponsors or others, including intimidation, physical abuse, and murder in an effort to eliminate opposition or appropriate resources.

Furthermore, these impacts often take place in a context of social, political, and economic marginalization of indigenous peoples, wherein the concerns and rights of indigenous communities are not fully respected. This both adds to the intensity of project impacts and makes it more difficult for indigenous peoples to avoid them or seek redress.

One Solution: Prior Informed Consent

Responding to this situation, indigenous peoples have demanded that their prior informed consent (PIC) be required before such projects are implemented. Increasingly, international legal instruments have also begun to call for such a standard. Prior informed consent gives indigenous communities *the power to veto projects and to negotiate under what conditions they can proceed*. It requires that indigenous communities be fully informed of all project risks and impacts and that their consent be acquired before the implementation of any project.

There remains, however, much confusion surrounding the concept of prior informed consent and how it should be operationalized. In fact, the first major finding of this study has been that there is apparently no significant theoretical or empirical work specifically addressing the concept of prior informed consent in the context of project-affected peoples.

Much of the work that does exist involves PIC in the context of using and researching indigenous knowledge and biological resources. Coming mostly from that perspective, Posey and Dutfield (1994) offer nevertheless a fairly general definition of prior informed consent:

“The consent of a party to an activity that is given after receiving full disclosure regarding the reasons for the activity, the specific procedures the activity would entail, the potential risks involved, and the full implications that can realistically be foreseen. Prior informed consent implies the right to stop the activity from proceeding, and for it to be halted if it is already underway.”

Among the activities that require PIC, Posey and Dutfield and the World Wide Fund for Nature (Oviedo) include:

- The extraction of biogenetic materials and minerals from local communities or the territories of traditional communities, whether or not the communities have legal title to these lands;
- all projects affecting local communities, such as construction works, colonization schemes, and protected areas; and

- extraction of renewable or non-renewable resources from indigenous communities or their territories.

Key issues in Prior Informed Consent

There are several important issues and questions raised by the notion of prior informed consent in the context of project-affected indigenous peoples. A more complete list and discussion can be found in the full study. Some of these issues are:

Decision-making in the inter-cultural context. Indigenous communities having little experience with the dominant culture are likely to have meanings and processes of 'informing' and 'seeking consent' very different from those familiar to nation-states, corporations, or multilateral bodies. These indigenous decision-making processes must be respected. In many indigenous communities, these norms require building a reciprocal relationship before ever (and perhaps never) escalating to actual project negotiations. At all moments, communities must approve of the terms of this relationship (Laird & Noejovich, 2000).

Prior informed consent from whom? Because communities are not homogenous entities, acquiring prior informed consent can be problematic. Communities consist of often-competing individuals and factions, with diverse interests, perceptions, and varying abilities to assert their voice in the prior informed consent process. These divisions are vulnerable to exploitation—intentionally or not—by external actors with their own agendas. Any PIC determination, therefore, should be broadly representative (Laird & Noejovich, 2000). It may be advisable, then, to think of prior informed consent more in terms of 'prior informed consensus'.

Informing adequately. In a changing, complex intercultural environment, adequately informing indigenous communities about complex projects is exceedingly difficult. Although there are some techniques that facilitate this, there are difficulties foreseeing all project impacts from the outset. Thus, rather than just a one-time contractual event, PIC should be regarded as a continuous, iterative process of communication, negotiation, and consent (Laird & Noejovich, 2000).

Costs and time. The prior informed consent process requires additional time and expense. These factors may have to be incorporated into project cycles and budgets (Laird & Noejovich, 2000). On the other hand, some observers point to instances of budgetary savings and accelerated project implementation due to local communities' supporting and assisting projects rather than opposing and obstructing them.

Veto power and political feasibility. An indigenous veto over the exploitation of resources that many consider part of their national patrimony and essential for economic development may make PIC politically difficult to implement. However, there is evidence that some indigenous peoples do choose to negotiate over the exploitation of resources in their territories—and do not necessarily exercise PIC's 'veto power'.

The History of Duress in Australia's Jabiluka Project

The Aboriginal Land Rights (Northern Territory) Act of 1976 provided for the right of prior informed consent concerning mining on Aboriginal lands. It created the Northern Land Council, directly elected by Aborigines, which is charged with consulting with Aborigines, negotiating on their behalf, and managing the prior informed consent process (The Northern Land Council, 2000). This process of consultation and negotiation

has become relatively systematized (Uranium Research Group, 2000a) [URG]. Despite significant flaws resulting from legislative amendments and a 1992 Supreme Court decision, the process has given Aboriginal communities the ability to prohibit or negotiate the parameters of mining on their lands (URG, 2000b). Aborigines have consented to mining on roughly 18% of their eligible land in the Northern Territory, with roughly another 18% under negotiation (URG, 2000c). Many of these agreements seem to have been consummated and executed successfully, and today many see indigenous land rights in Australia's Northern Territory as the strongest in the world (O'Faircheallaigh, 2000; Land Rights News, 1996).

In the period leading up to its 1982 agreement to a uranium mine at Jabiluka, however, the Northern Land Council was young, inexperienced, under significant pressure, and possibly insecure about its very survival as an institution. These factors may have reduced its accountability to its indigenous constituents. Its non-indigenous legal advisors and negotiators allegedly conducted the prior informed consent process in a way that misled, misrepresented, and pressured indigenous communities. At least some Aborigines—on whose behalf the NLC was supposed to be acting—felt cowed and harassed into submission.

The problematic circumstances of the 1982 agreement have helped to propel nearly two decades of controversy surrounding Jabiluka (Tyler, 2000). The case study reveals the following assertions from the local Aboriginal community concerning the prior informed consent process at Jabiluka (Gundjehmi Aboriginal Corporation, 1997):

- Misrepresentation, manipulation, and pressure from the Northern Land Council.
- The threat that the mining corporation would oppose Aboriginal land claims if communities did not agree to negotiations.
- Alleged conflicts of interest in the Northern Land Council, since its legal fees were paid by mining companies and NLC funds were tied to mining royalties.
- The clash between the mining corporation's expectations of quick and efficient decisions and the deliberate process of Aboriginal decision-making.
- A feeling of harassment and exhaustion in Aboriginal communities, brought on by the consultations, the endless meetings, and the speed of events.
- A sense among Aborigines, due to the constant pressure, that opposition to the project would be futile.
- Numerous irregularities in the negotiation and consultation process, including a lack of understanding of what was happening on the part of some Aborigines (particularly the elderly).
- Division within Aboriginal communities regarding the project, with those Aborigines living farther from the mine site typically being more supportive of the mine.

Politics, Inadequate Funding, and Alleged Abuses in the Philippines

The 1997 Indigenous Peoples Rights Act provides for the right of prior informed consent with regards to projects affecting indigenous communities. The Act created the Presidentially-appointed National Commission on Indigenous Peoples, charged with certifying whether proposed projects have obtained the prior informed consent of affected communities. The Act has attracted a fierce legal and political backlash. Opposition has come from industry and government agencies, provoked by the transfer of rights to

indigenous peoples and by the potential costs of agreements. In addition, the President recently froze the Commission's operational funds and created a Task Force to duplicating many of its functions. Since its passage, the Act's implementation has been marred by a lack of funding, political conflicts, and allegations of wholesale abuse. The analysis reveals the following:

- Multiple allegations of deceit and manipulation by project sponsors and the Commission, from physically intimidating indigenous communities to issuing inappropriate certifications of consent.
- A serious budgetary shortage for the Commission. The Commission's 1999 budget was approximately US\$10 million, of which over 75% was devoted to personnel and scholarships as opposed to mission-critical program expenses. Also, mining companies covered some of the Commission's expenses, leading to allegations of conflicts of interest.
- Project sponsors are in charge of obtaining prior informed consent, which is then certified by the Commission (Thompson, 1998).
- Violation of the principle of broadly representative consent. There are numerous allegations of corporations' consulting with tribal chieftains but not with their communities; appointing their own indigenous 'representatives' to sign consent agreements with; etc.
- The threat of a cut-off of Municipal funds if consent to the San Roque Dam was not provided.
- Lack of clarity regarding roles and responsibilities in the PIC process and regarding what is required in order to demonstrate prior informed consent.
- Vital technical, legal, and political assistance provided to affected indigenous communities by NGOs, church organizations, and other members of civil society.

The 'License to Operate' in Peru's Camisea Project

Shell's Camisea project in Peru is considered by many to be one of the best actual examples of consultations between an extractive firm and affected communities. These consultations ultimately seemed to result in community support for the project—which Shell referred to as its 'license to operate'. However, the case was not an explicit example of prior informed consent, as it is not clear whether Shell would have withdrawn from the project if community support was not forthcoming.

Also, the project never reached the full implementation phase; and there are many observers who object to the positive, commonly-held perception of Shell's conduct in Camisea (Kretzmann & Wright, 1997). Nevertheless, many agree that the consultations in Camisea at least represent an improvement over past practices, and the case (May et al., 1999) is analyzed in this study for its lessons in that regard. These lessons include:

- The importance of early and continuous consultations.
- The recognition of the need to consult with *entire* communities, *all* affected communities, and their formal and informal institutions.
- The important role of NGOs, in building the capacity of indigenous communities; in providing social, environmental, and technical input to Shell; and in monitoring and advising Shell's consultation processes, project activities, and project impacts.
- Difficulties with inadequate training of community liaison staff.

- Internal conflicts within Shell—and between Shell and its contractors—regarding Shell’s prioritization of community concerns.
- A recurring corporate learning process whereby hesitant operations personnel gradually became convinced to incorporate community concerns and then ended up being able to do so at much lower cost than originally expected—reinforcing their commitment to social goals. Early consultations allowed time to incorporate these community concerns into project design (and redesign). One notable example of this process was when well clusters were redesigned in order to allow 100% helicopter and river transport and, therefore, no road construction—at very low incremental costs.
- A reluctance to create dependencies on the company that could not be fulfilled.
- Estimated incremental costs for all social and environmental efforts, consultations, community contracts, and social capital/development initiatives of roughly US\$6 million—or roughly 2% of startup costs. This 2% share was expected to remain constant during the full implementation phase. An NGO has estimated that the risk reduction and other benefits to Shell have exceeded these costs.

Recommendations

Mindful of potential bias in both sample and sources, it is not possible to derive definitive conclusions from just these three cases. Nevertheless, some themes have emerged regarding how best to operationalize PIC. Highlighted below are the most important implications for policy and implementation.

1. *Make Implementing Institutions Independent and Accountable to Indigenous Peoples.* In both the Australian and Philippines cases, a centralized institution was created to manage aspects of the prior informed consent process. In the early years of Australia’s Northern Land Council and currently with the Philippines’ NCIP, the lack of accountability of these institutions to their indigenous beneficiaries was one of the principal reasons for their failures to effectively implement prior informed consent.

During the PIC process for the Australian Jabiluka mine—in the early years of the Northern Land Council—the NLC was young, under intense political pressure, and insecure about its very survival. The NLC allegedly managed the PIC process in a way that misled and pressured indigenous communities—on whose behalf it was supposed to be acting. Later, however, when the NLC became more securely institutionalized and accountable to its indigenous constituents, it became a primary force behind what many consider to be, in the Northern Territory, the strongest indigenous land rights in the world.

In the Philippines, the National Commission on Indigenous Peoples is accused of widespread negligence and abuse of its responsibility to ensure the prior informed consent of indigenous peoples affected by projects. Its members are Presidential appointees, greatly reducing their accountability to indigenous people. The institution is also under significant political pressure, as evidenced even by the President’s recent move to freeze its funding and duplicate its functions.

Thus, perhaps the most important factor in assuring effective implementation of a prior informed consent regime is the accountability and independence of its implementing body. Along these lines, the following should be considered:

- *Direct election of the institution's governing body by indigenous people.*

This is the most obvious possible reason behind the striking difference between the accountability of the NLC in its later years and the lack of accountability of the NCIP. NLC members are directly elected by indigenous beneficiaries, whereas NCIP members are appointed by the President, with all the opportunities for patronage that that allows.

- *Ensuring recourse to the courts for indigenous communities.* If indigenous communities alleging misconduct in the PIC process were given recourse to the judicial system, this would clearly introduce another level of accountability for PIC-implementing institutions.

- *Ensuring institutional independence and security.* Political pressure and institutional insecurity were additional possible factors behind the failures of both the NLC and the NCIP. Both in the NLC (early years) and the NCIP, intense political pressure and the perceived tenuousness of institutional existence may have made these institutions more accountable to their public and private overseers than to their indigenous constituents. The insecurity of existence has become more than a threat in the Philippines, as evidenced by the President's recent suspension of NCIP funds. Any measures increasing institutional independence and security would, then, help encourage accountability. Options might include Constitutional reforms affirming the legitimacy and independence of the PIC-implementing institution; independent funding mechanisms; and reducing external leverage points over the institution (e.g., the 'national interest' escape clause in Australia). Also, strong support from the executive branch for the institution and its mission—perhaps even a public relations campaign—might help lessen public and private pressure and opposition.

2 *Fund PIC-Implementing Institutions Adequately.* In both Australia and the Philippines, sources and levels of funding played a possible role in the unwillingness or inability of the NLC and the NCIP to implement the prior informed consent process effectively. In the Australian case, the difficulty and expense of the tasks that the NLC was charged with at its inception, the fact that its funding was tied to mining royalties, and the fact that the mining company paid the fees of its negotiating team—all of these factors were implicated, justly or unjustly, in the NLC's failures at Jabiluka.

In the Philippines, we saw that the NCIP did not really have the financial wherewithal to fulfil the most crucial parts of its mission and that the NCIP also accepted corporate reimbursement for expenses incurred, potentially risking its integrity. Adequate funding also would help to ensure that institutions remain independent and accountable to the indigenous communities they are intended to serve.

3 *Do Not Put Project Sponsors in Charge of Acquiring PIC.* Despite the fact that our most positive case involved a corporation (Shell) voluntarily undertaking a very extensive process of consultations, our Filipino cases demonstrate that putting project sponsors in charge of acquiring prior informed consent is not a viable approach.

In the Philippines, project sponsors are responsible for obtaining prior informed consent from affected communities, which NCIP then certifies. The long history of deceit, manipulation, and abuse involved in agreements between indigenous peoples and interested parties—in the Philippines and elsewhere—suggest that this approach is doomed to failure. Other models can be conceived that may be more promising:

- *The Australian model.* The Northern Land Council (in its later years) is a centralized, representative institution of the Northern Territory's Aboriginal population that has the technical and legal capacity to negotiate agreements and facilitate the prior informed consent process. Thus, it acts as a buffer between mining applicants and indigenous communities, managing the PIC process such that indigenous communities are able to make free and informed decisions.

- *A Regionalized version of the Australian model.* In countries where indigenous communities are more dispersed and diverse than in the Northern Territory, one can envision a system of regional institutions (Regional Land Councils?) that might allow greater familiarity with and accountability to local communities, as well as permit smaller workloads than a single national institution. With this model, it would be especially important to implement measures of oversight and accountability to ensure that regional institutions are not co-opted or corrupted. This might involve retaining a national council as a first recourse for complaints by local communities. A national council could also be retained as an additional technical and legal resource for regional councils (Von Sturmer, cited in Gundjehmi Aboriginal Corporation, 1997).

4. *Institute Clear Guidelines and Effective Enforcement.* Another key difference between the cases of Australia (in later years) and the Philippines is that a relatively clear PIC process and procedure is available in Australia. In the Philippines, questions and uncertainty abound as to what is required of whom in the PIC process and what is required in order to demonstrate prior informed consent. While flexibility needs to be preserved in order to accommodate diverse indigenous communities and their decision-making processes, these types of ambiguity only serve to generate conflicting interpretations and complicate enforcement. Therefore, roles, procedures, and responsibilities should be clearly delineated as much as possible. Also, the entire PIC regime is meaningless if compliance of all parties is not effectively monitored and enforced. Projects should be subject to cancellation if compliance with agreements and procedures is lacking.

5. *Ensure Proper Implementation.*

- *Allow indigenous communities to guide their own decision-making process, at their own pace.* Particularly in Jabiluka, we saw the clash between the mining company's expectation of quick and efficient decisions and the harassment felt by indigenous people. The constant onslaught of meetings and negotiations contributed to a sense among Aborigines that opposition was futile. As one observer described the Aboriginal experience, "They believe they will be harassed continually until they agree to mining" (cited in Gundjehmi Aboriginal Corporation, 1997). Longer consultation processes and the expense that they imply must be built into project cycles and budgets. The Camisea project demonstrates the scale, continuity, and duration of efforts required to consult adequately with indigenous communities—and some allege that even this effort was inadequate.

- *Ensure that consent is broadly representative—or prior informed 'consensus'.* In our preliminary discussion, we noted that factions and divisions can be present within indigenous communities, raising the question, "Prior informed consent from whom?" All of our cases then bore out this challenge and its potential for manipulation.

In Jabiluka, there seemed to be a division between indigenous communities farther from the mine site, more supportive of mining, and those closer to the site. In the Philippines, a corporation allegedly fabricated its own indigenous 'representatives' to deal with; and a tribal chieftain was consulted without consulting his community. In Camisea, Shell first dealt with only a community President and then progressively came to the realization that it would have to deal with all communities and their formal and informal organizations. There may be no single standard that can be applied in all cases. Options include a majority in a secret ballot, an absolute consensus, or a majority as long as the dissenting minority does not bear a disproportionate share of project impacts. Ensuring some breadth of 'consensus' may also have to be weighed against the imperative to follow indigenous decision-making processes. Nevertheless, the minimum standard should be to ensure that a determination of consent is broadly representative of affected communities and all of their factions.

- *Ensure that indigenous communities are informed.* A necessary condition of PIC is that affected communities understand the full nature of what is being proposed, its risks and impacts, its alternatives, etc. In Jabiluka, this condition was apparently not met—especially in the case of elderly people. Though some alleged that it was not met fully in Camisea either, the Camisea case gives us an idea of the intensity and continuity of efforts that are required to approach this condition.

- *Prevent threats and other forms of pressure on indigenous communities.* In Australia, a key factor that propelled the Jabiluka negotiations was the threat that the mining company would oppose community land claims if negotiations were not commenced. In the Philippines, we saw national officials threaten a cut-off of Municipal funds in response to opposition to the San Roque dam. The threat of force has also been alleged in the Philippines. These forms of pressure contribute to the impression that communities will not be allowed a free and fair decision and that their opposition may be futile, vitiating the PIC process. Measures should be promulgated to prevent these types of threats and pressure, perhaps by criminalizing them or instituting some process to hold actors accountable for these actions and whereby consent obtained in such a manner can be declared null and void.

- *Provide appropriate training.* Staff involved in a prior informed consent process should be trained in communication, conflict resolution, negotiation, and cultural sensitivity skills—and perhaps selected with these attributes in mind (May et al., 1999).

- *Retain personnel.* When implementing a prior informed consent process, minimizing turnover of staff is important in order to preserve personal relationships and understandings of local communities and in order to ensure that commitments to communities are kept.

6. *Recommendations for Project Sponsors: Lessons from Camisea.* Though ideally project sponsors will not be in charge of acquiring PIC (see Recommendation 3, above), they might find themselves in that situation. Even if they are not, they will still be important participants in the PIC process and will need to know how to participate effectively. The University of California study of the Camisea project (May et al., 1999) had these recommendations for project sponsors wanting to be good partners in a PIC process:

- *Begin discussions early.* This allows time to develop a reciprocal relationship

of trust with communities and to incorporate community input into project design. In Camisea, the redesign of the well clusters for the “no-road” alternative would not have been possible without a sufficient time window.

- *Commit early-on to high standards of consultation and socio-environmental performance, and internalize that commitment.* Top management must make this commitment and communicate it forcefully. It must also be incorporated into incentive structures. Once the commitment is made, it is often surprising how well innovation, learning, and design can accommodate it—as in the well cluster example. Once engineers and operations staff understand the commitment, they often begin to “own” the design and operational challenges presented—further bolstering their own and the corporation’s commitment. Encouragement of flexibility and creativity is crucial for this process.

- *Involve engineers, managers, and operations staff in consultations.* This increases understanding of community concerns within operations staff and allows them to diffuse it to other operations personnel.

- *Anticipate internal conflicts.* They are to be expected, since prioritizing community concerns may be new to many staff. This is fertile ground for organizational learning.

- *Always deal with communities fairly and openly to help develop relationships of trust.*

- *Be careful to only promise what can be delivered in order not to jeopardize credibility with communities.*

7. *Encourage and Facilitate Civil Society.* In all of our cases, NGOs, indigenous federations, church groups, and other members of civil society were extremely important in numerous aspects of the PIC process. In Camisea, they acted as stakeholders with crucial social, environmental, and technical input; and as partners that monitored and advised both the consultation process and project activities/impacts. And in all three cases, they acted as crucial voices helping to bring deficiencies in the PIC process to light and—through technical, legal, and political assistance—holding project sponsors and governmental agencies accountable. Without these organizations, we would likely not have even known about the alleged failures discussed in this paper. Wherever possible, these members of civil society should be encouraged and facilitated in serving this vital public role.

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The Nigerian Legislature: Articulating an agenda to combat corruption

Oby Ezekwesili

Introduction

The legislature of Nigeria is one of the three critical pillars for the survival of our new democracy. Thus its involvement in the combat of corruption is fundamental to the success of any well-defined anti-corruption agenda. The negative impact of corruption in undermining trust in political institutions and public officials, distorting government policy against the best interests of the majority and impeding economic development is generally acknowledged. Even more, is the consensus that corruption has a more devastating impact on an emerging democracy because the abuse of public office is a subversion of popular confidence in the idea of democratic government. Only a democracy that guarantees accountability to the people through the operation of a legislative body that is guided by integrity of purpose and action would justify the rage of the people against the inherent unaccountability of military rule.

The legislature is the institution of government that represents and holds the largest and wide spread mandate of the people of Nigeria. The strength and legitimacy of the legislature is defined in its role as the body through which the people extract accountability of the executive branch of government. The legislature by its constitutional role has substantial power in the process of determining government policy. As the law-making organ of state, the legislature has the important role of determining the best laws for crucial national issues like the systemic corruption Nigeria faces. Equally, it has the power under the constitution to appropriate money to implement laws, consider presidential appointments and ratify treaties, and all of these represent avenues through which the legislature can hold the executive branch accountable.

Yet perhaps, of more significance to accountability is the over-sight function of the legislature which acts through several committees hearing, field trips, investigation to inquire into how effectively the executive branch is administering laws that the custodians of the peoples mandate has approved. As watchdog, regulator and representative, the modern legislature and legislators are at the centre of the struggle to attain and sustain good governance and fight corruption. However to be fully effective in these roles, the institution of the legislature and it's individual membership must possess high-level integrity.

This paper will explore the components of an effective legislative agenda in curbing corruption through accountability and transparency instruments. The necessary symbiosis of a transparent legislative actions and an engaged and proactive civil society is advanced as the overarching element for democracy that is free of systemic corruption.

Preparatory work for participatory and transparent democracy

The quality of our democracy would as in other successful democracies be a function of the participation of the people. It is the people who through the ballot box determine the definition of the democratic process, for it is after-all their participation in the electoral process that gives legitimacy to the exercise of power by their elected representatives.

The source of the sovereign authority for Nigeria while recognized in the flawed militarily drafted 1999 constitution as inherent in the people only translates to a reality if the people understood and acted accordingly.

Building popular support for our democracy

The auspiciousness of the involvement of our people in bringing military rule to an ignominious end must be sustained through massive political and civic education in the period leading to elections. Multiple tools and organizations should be brought together in this venture to galvanize the participation of the people in elections and in the democratic process. Voter participation of the highest percentage and the recognition by the people that to engender good governance they must continue to influence the democratic process after elections must form the core component of this pre-election national awareness campaign. Once political activities are officially flagged off, the media, political leaders and community associations must be encouraged to participate in political education at the grass root level. Particular attention must be given to the involvement of women in the political process as it unfolds. Particular attention must be given to the involvement of women in the political process as it unfolds considering that women represent over 50% of our population yet remain under-represented in governance.

The education of the majority rural populace on the worth of their vote is crucial. Many of rural dwellers hardly understand the operation of state and thus cannot exercise any form of accountability from their elected representatives. A process of massive civic education in the over two hundred and thirty languages is a process that must receive priority attention from the elections commission and civil society organizations.

In Nigeria, civil society has enlarged significantly to include the vibrant media, religious groups, professional groups, non-governmental human rights organizations, pro-democracy groups, social service providers, youth groups, market men and women associations, ethnic associations, traditional councils, cultural associations, environmental campaigns, business and trade groups and many others. The evolution of networks and collaborative frameworks among these along the lines of thematic mandates would enhance their individual and organizational capacity to engage the legislature. To this end, the umbrella organization, Transition Monitoring Group that civil society formed during the democratic transition must enhance its institutional capacity to continue the growing democratic process. The active and effective participation of genuinely independent policy think tanks in the democratic process would help facilitate the capacity of civil society to engage the legislature in the policy making process. Think tanks as other research and institutions are an important link in the chain of democracy. Through the information, training and dissemination activities of think tanks, democracy is generally nurtured by transparency, disclosure, accountability and awareness.

The process of mobilizing public opinion to change the apathetic public attitude to corruption must become part of the mandate of a properly organized civil society sector. The Nigerian society must be re-oriented toward intolerance for unaccountably wealthy individuals within the communities that make up our nation. Active mobilization of public opinion and the raising of awareness must be structured with clarity of focus and targets. The claim and defence of ethical value by the public must be primus for the civil society who through civic education should be awakened to their power of recall when exercised

over elected representatives. The role of a free and independent media in informing the public, exposing corruption and fostering public debates on accountability is the most important weapon of control that is available to civil society in its partnership with the legislature.

The political system

The political system comprising, the electoral system, political parties, the media and civil society must be structurally sound to provide the solid base for our political transition. The Election Commission to be set up must be independent and possess entity credibility that derives from the integrity of the members appointed to it. The person appointed to the position of Chief Election Commissioner must be of impeccable character, strong and independent. The impartiality of the Commission must be further entrenched in its power to recruit its staff, independent of the civil service. The staff of the Commission must be given the proper training and empowered with the skills of election logistics and voter registration. The voter registration exercise must on its own be structured to ensure transparency, accuracy and efficiency. The voter lists, accessible voting booths and voting day procedures must be in place long ahead of the elections and the later must be well known by the people, media and political parties.

The party system should encourage inclusion and pluralism and therefore a multi party system seems most appropriate. A provision that a party should have at least 25% membership in at least two-thirds of the region would not only help achieve the building of nationally spread parties but would also discourage frivolous fragmentation of parties and the confusion it portends. Political parties must be able to facilitate the electorate's identification of different political persuasion, and to enable those aligned with a certain persuasion to organize their arguments and present their case to the people. The Election Commission should also be empowered to preside over free and fair elections within party congresses to carefully ensure the separation of parties from government.

The funding of political parties would need the highest standard of transparency in order to avoid hijack of the political process by a certain kind of people and also the corruption inherent in allowing financial lack cause these bodies to rely on doubtful or sometimes unlawful measures to raise funds. It is therefore efficacious to explore methods to mitigate their financial difficulties by offering public funding. This has the major advantage of promoting policy-oriented politics and party-oriented politics rather than politicians-oriented politics. There is inherently a 'public' character of political parties, which makes the case for providing public subsidy through funding of parties in order that they may effectively play the role of a mediator between the electors and the legislature.

The transparency of campaign expenses is equally integral to the over-all cleanliness of the political system. The Elections Commission can through a well - formulated guideline exercise effective control on campaign finance. Hence the need to build into the institutional needs of the Commission, a capacity to monitor campaign expenses of candidates through the mandatory financial statements to be filed by each candidate.

The participation of civil society and international observers in monitoring the electoral process has proved a veritable means of reducing electoral fraud in several elections around the world. We must seek the assistance of international bodies like International IDEA and the UN for capacity building support and election monitoring.

Constitutional issues

The first test of legislative response to the aspiration and needs of Nigerians shall be predicated on how it handles the raging discontent with the 1999 constitution handed down by the last military regime. The many provisions of this constitution have weakened the power of states while depositing over-riding power in the federal government. The federating units have myriad of dissension on the provisions with regard to power sharing, revenue allocation, state security and related issues.

More glaring an omission are provisions targeted at corruption prevention and detection. The reason for this is best understood within the context of the magnitude of corruption that the various military governments perpetrated and for which they are less wont to having constitutional sanctions. It thus behoves the legislature to initiate the process of constitutional amendments and enlargement that would adequately reinforce the dividend of transparency that democracy is associated with.

Legislative mechanisms for countering corruption

The laws necessary to be enacted shall depend on the adequacy or otherwise of existing laws and constitutional provisions relating to prevention of corruption. Yet, one takes the liberty to suggest that specific anti-corruption laws are recent developments in many countries, and would hardly have been a priority of the corrupt military establishment that suspended the constitution. Therefore, the enactment of a comprehensive set of laws which incorporate the core principles like selflessness, integrity, objectivity, accountability, openness, honesty and leadership as the expectation of the people from public office holders is fundamental to establishing a value system for the nation. These then become the engine for a national anti-corruption agenda. This is possible where the enactment of laws is complemented by the institutionalising of independent agencies capable of enforcing such legislation, against all who breach it, free of political influence or bias but with adequate recognition of the need for continued protection of human rights.

The law must criminalizes the offering, soliciting, the giving and accepting, of a bribe. It must enable tracing, seizure, freezing and forfeiture of the illicit earnings from corruption. It must require regular declaration of the assets, income, liabilities and lifestyles of decision-makers and other public officials who hold positions that empower them to transact with the public. Finally it must guarantee citizens access to state information and establish the institutional framework for its enforcement.

Executive accountability

As previously highlighted, the role that the principle of separation of power bequeaths to the legislature over the Executive is the accountability of the latter to it. Hence one of the principal functions of the freely elected representatives of the people is to hold the Executive accountable on a continuous basis. It does this by subjecting the executive to public scrutiny through debate, question times through the apparatus of Select Committees of the legislature.

The political will to challenge whenever necessary the Executive is what gives reality to the constitutional authority that the legislature possesses. In their discharge of this function however, the expectation is that the legislature will avoid interfering in the day-to-day business of administration and this check can be articulated in a Parliamentary Code of Conduct as a means of safeguarding the stability of democracy from ill-motivated

and malicious 'scrutiny' by members of the opposition.

The Public Accountability Committee of the legislature is the most powerful vehicle for oversight function of the body. The use of open sessions to demand explanation on wide ranging accountability issues from public officials is perhaps the hallmark of the openness and transparency of a democratic polity. These sessions empower the legislature to expose corruption and executive irregularities through the instrument of immunity. This first among the many Select Committees that are critical to the effective discharge of the accountability function shall need to be strengthened in their capacity to generate the optimal results.

This would include ensuring that they can obtain every information and advice required both within and without government for their analysis, decisions and actions. The extra sources include academics, think tanks, private sector, the media, trade unions and other civil society organisations and therefore require that the legislature be independent of the Executive in obtaining the financial and staff resources required.

The collaboration between the Public Accountability Committee (PAC) and other independent agencies of state charged with related accountability functions cannot be overemphasised. For instance, it has been revealed that in democracies where the Public Accountability Committee and the office of the Auditor General are strengthened in their roles and have an effective partnership, Executive accountability is enhanced. It is the PAC and not the National Assembly itself that provides the forum for the detailed consideration of the nation's audit report that usually emanates from the office of the Auditor General.

An independent anti-corruption body

Nigeria has a problem of systemic and endemic corruption, which thus means that hardly any existing institution has been spared by this corrosive phenomenon. The establishment of independent Anti-Corruption Commissions have in recent time become a critical component of the comprehensive anti-corruption strategy of countries with similar features like Nigeria. It usually comes into existence with the passage of an independent Anti-Corruption Act by the legislature. It has come to represent a concrete proof by a new government that the tolerance of corruption that was prevalent would attract serious sanctions in the new order- a clear signal of a break from the past.

While the Hong-Kong Commission was established at a time when the government wanted to retain the confidence of foreign investors, the main reason for its creation was political, "to persuade citizens that an agency independent of the police and the civil service was more likely to be effective than the existing system"

The Anti-Corruption Law through which an IACA derives legitimacy should contain important rules, regulations and organizational charters establishing a comprehensive anti-corruption framework. The main components of such a law would include sections, provisions and directions to:

- Protect whistleblowers and other information providers
- Evolve corruption-free government expenditures and procurement
- Establish and manage the anti-corruption organization
- Strengthen citizen watch groups and public participation in anti-corruption movements
- Reinforce detection and punishment of corrupt practices

- Enhance codes of conduct for public servants
- Cooperate with civil associations for anti-corruption
- Mount education and public information campaigns to enhance public awareness and involvement in the effort against corruption.
- Establish and manage a corruption reporting and information centre.

The Anti-Corruption Commission entrusted with the implementation of the anti-corruption legislation must possess the following:

- Committed political support at the highest levels of government;
- Political independence sustained by continuing public pressure;
- Adequate access to documentation and to question witnesses
- Leadership that is publicly perceived as being of the highest integrity and personnel of the highest professional ability; and
- Accountability, preferably to the legislature.

Two major areas of caution in the establishment of IACC are the possible violation of human rights by the commission and the paradox of the agency itself becoming embroiled in corrupt activities. No less significant is the possibility of over-lap of the functions of the Commission and those of existing crime prevention agencies like the Police and Department of Public Prosecution. While critical, these may not be a problem if the articulation of the functions and accountability mechanism over the Commission itself by congress adequately anticipates these and provide accordingly. The Hong Kong experience is instructive in articulating a stringent system of checks and balance to minimize the possibility of abuse of power by the IACA. The law can provide for the setting up of two –type advisory and supervisory committees. One of these should have membership that is drawn from all sectors of the community and appointed by the President subject to the confirmation of the legislature; and the second, membership of legislators.

The empirically validated success of the anti-corruption agency in places like Singapore and Hong-Kong highly recommends a similar institution for our country. This is so only to the extent that the legislature accords the highest priority to an independent and comprehensive anti-corruption law and agency. Today, the cost of implementation of such laws and institutions attract technical support or grants from international bodies like Transparency International and the World Bank as part of the global effort to curb the adverse effect of corruption on development initiatives. The ideal should be to create an agency that though organizationally weighted toward operational investigations, also comprises preventive and educational departments as well as having intelligence, complaints and advice capabilities.

The legislature in addition has a huge repository of international Best Practices to draw from in crafting adequate range of laws to combat corruption in the land. The establishment of properly focused independent anti-corruption agency may provide an effective means of promoting probity in government and protection of state income and expenditure, building up a public service ethic and encouraging better administrative procedures, offering a means of public redress and promoting good practice across the public sector, and thus beginning to make the machinery of government work more productively and efficiently with a concomitant benefit of improving the reputation and performance of the public sector.

Legislative accountability

While constitutionally empowered to hold the executive accountable, legislators must also be held accountable for their exercise of power. This raises the issue of managing the political corruption that may occur between individuals within the private, the public and the political sectors. In each of these cases, corruption may involve payment of money for a particular decision, and or 'favours', which does not involve direct financial advantages, e.g. patronage in the distribution of posts. The predominance of professional politicians in parliamentary democracies has a huge impact on corruption. Professional politicians have practically become salaried officials whose income is derived from fees for certain services- tips and bribes are merely an unregulated and formally illegal variant of this category of income.

However the Janus face of politics is illustrated by patronage in the distribution of posts. Posts are handed out with the aim of stabilising relationships of power. All political disputes therefore centre not on matters of policy but also on posts. The repercussions on the community of patronage in the distribution of posts are generally under-estimated. Well-educated and honest officials are gradually displaced and the technical capacity of the government is undermined, while corruption is made more likely.

The centrality of the legislature to politics thus places legislators squarely in the arena of potential conflicts of interest. As custodians of public trust acting in the common good that is, in the public interest, becomes an overarching obligation legislators must endeavour to discharge. Hence the practice of transparency by the members of legislature becomes a *sine qua non* for the integrity of the larger political process and institutions. There are a range of mechanisms that enable legislative accountability, most of which derive from a high expectation of the people that their elected representatives do at least possess standards of personal integrity that justifies the morality pedestal legislators function from. It falls on legislators themselves to be their own judge.

The openness of the legislative process to the public and press is an empowering aspect of public accountability of legislators and their body. For, this act of access and transparency has a deterrent effect on the conduct of the institution and its membership and hence restricts corruption in the democratic process. It has been empirically established that corruption is less in countries with free press. It is easy to see why this should be so since secrecy is what allows corruption to flourish. Thus our legislative process if handled in an inclusive manner provides all stakeholders accessibility to process and decisions. The legislature is the natural place to reveal and combat violations. Democracy and its accoutrements, such as the freedom of opinion and expression, are among the powerful mechanisms for revealing and combating corruption in pluralist societies. The connection that the rest of society has to government is centred on its connection to the legislature and for this access is *primus*. The process of building public support and confidence in the legislative bodies is a continuous one. Allowing civil society to be the driving force against corruption by taking proactive and sustained action to raise the social morality standards is key to the sustainability of our democratic process.

Immunity and privileges

The necessity of immunity and privilege to legislators for purposes of enabling them discharge their duty in the face of a corrupt administration is undoubtedly one of the instruments of accountability. However, it is very crucial that these be as narrowly defined as possible to prevent any possibility to undermine of the rule of law that a potential

inequality before the law may promote. Any immunities and privileges granted must never enable the corrupt to shelter behind them, out of the reach of enforcement authorities. Still, the determination of legislators to protect their rights and to utilize the tools made available to them by the constitution, regardless of any obstacles or frustrations they may encounter, is the only true guarantee that corruption and the misuse of power will be resisted.

Code of conduct: This is an essential element of any legislative body; both for the respect of the institution and for the protection of the members themselves. These codes articulate the standards that should guide actions of the institution and its members. Clearly, codes aim at prescribing such standards that remove the potential for conflict of interest or require disclosure of a private interest when it conflicts with the duties of office. They also provide a standard against which the public judges allegations of improper conduct. Key aspects of any code are provisions regarding; prohibition on the use of influence; prohibition on the use of confidential information; no compensation for services rendered as a legislator; regulations of political donations to legislators. This is exemplified by the South African ANC Code of Conduct for Elected Members.

Conclusion

The principles of separation of power and checks and balances generally uphold any successful democracy. Yet, ineffectiveness on the part of any tier renders these fundamentals worthless. Even then, the legislature among the three tiers represents the widest cluster of the wishes of the people and so is closer to them. It is this special standing with the people that stands the Nigerian legislature in the greatest stead to articulate the optimal agenda for curbing the current endemic corruption that has been the bane of our past democratic experience. In defining an operational strategy for effective performance of this constitutional mandate, a wide range of legal, political and social instruments, structure and constructs are available to the Nigerian legislature. Whether in its law making, oversight over the activities of the executive, conduct of the legislature and its members, the overarching goal of a successful legislature is to foster stability of the democratic process. The recognition that only a political landscape where the people are effectively engaged as vanguards for good governance become sustainable and consolidated should provide an impetus for the Nigerian legislature to strive to enjoy the kind of moral authority that an empowered citizenry bequeaths.

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Civic and Social Engagement of Congregations: How Parishes Might Engage Welfare Reform

Tim Mathern

Introduction

Considerable attention is being given to faith-based organizations as providers of social services and actors in social justice efforts. Considering the charity and justice teachings of the church and the needs of the poor, a renewed involvement of the church is welcomed. My experience has shown a disconnect between church teaching regarding social justice and the application of these teachings in congregational and political life. This is apparent in the debate about welfare reform.

Welfare reform and its policy to involve faith-based organizations may be a cruel ploy to relieve government of its responsibility to those who are poor, or it may be an opportunity to reconnect religious people with real situations of persons who are poor. This connection may lead people to acts of charity and of justice, which includes informed political engagement.

This paper asks congregations to take on social justice activity, it explains why this makes sense and recommends a model for a Catholic parish to follow. A social justice parish is one that promotes the well being of the vulnerable by changing established social structures and institutions. Congregations are chosen as the setting for social justice efforts because they are mediating institutions in American culture. Examples are noted to demonstrate how different religious traditions lead to different ways of social engagement. To ground this discussion, social ministry is tied to a changing public policy matter, welfare reform.

Congregations as Mediating Institutions

Whether congregations are proper settings for activities related to welfare reform depends in part on their place in society. It also depends on the characteristics of specific congregations. Nancy Ammerman (1997) characterized congregations as being embedded in communities and inherently social. The congregation that does not adapt to community change ceases to serve.

Congregations represent multiple constituencies within a community. Beyond the denomination, they represent interest groups, various faith dimensions and persons of different demographic characteristics. Within a societal context, congregations are related to the market place, the state, and the voluntary sector. Although denominations range from conservative to progressive, common elements can be observed within each. Congregations create social and spiritual capital. They have social clubs, networks and schools. In addition they promote norms of behavior conducive to an orderly society.

There are strong arguments for congregations to be involved in delivery of social services or making of government policy. They number over 300,000 across the US (Ostling, 1999:12). They provide legitimacy as each represents a community-focused organization. Congregations provide capacity in terms of a gathering place well suited to the delivery of social programs.

Despite these advantages, there are several factors that often impede congregations from involvement in policy issues. The secular left objects to state and

church entanglement on constitutional grounds. In contrast, the religious right rejects collusion with government on the grounds that faith alone provides the answers to individual and social problems. There are concerns as to whether churches have sufficient resources to effectively impact the lives of the poor. Further, some believe that churches may lose their spiritual focus should they direct substantial resources to social concerns.

Addressing Charitable Choice, a welfare reform component, Coffin (1999:16) suggests that congregational response conforms to three typologies. *Separatist* congregations are concerned that such programs risk the autonomy of religious organizations and violate the rights of the poor to make choices. *Supporters* in contrast, see this as an opportunity to renew themselves through mutual support and transformation. Finally, *critically engaged* congregations provide social services, engage the poor and mobilize the broader community to participate in the formulation of community policies that address structural inequalities.

An ecumenical approach to other denominations promotes collaboration and improves social justice outcomes. Knowledge of other traditions can reinvigorate congregations and move them to adopt new methods or reinstate methods previously discarded. Also many congregations are simply too small to take on social programming alone. For them, it is essential to collaborate in this way to accomplish social justice goals.

For example, African American congregations emphasize that all people are equal persons before God. These congregations are activist oriented. While blacks for most of this country's history were not accepted as equals in society, they were equals in the churches they formed. The church became the only public place where issues could be discussed and shaped.

Roman Catholic teaching emphasizes the common good. The Church structures itself to a specific geographic territory, a parish. Although there is movement of members across these boundary lines, the parish as an institution has duties to all within that territory. The Catholic Church tends to see society as natural and good; therefore, the response to God is social (Greeley, 1990:45). For the Catholic, being involved in a social program or politics would be involving oneself in God's world, not leaving God's world. Separation between faith and everyday life is not acceptable (Vatican Council II, 1965).

Mainline Protestant traditions emphasize that all persons are responsible individuals before God. The individual interacts with and is a part of the market, the state, and the voluntary sector but more as an individual than that of being a member of a group. The specific church's identity is faint. The mega-Evangelical church tradition places emphasis on a personal relationship with Jesus Christ. Many mega evangelical congregations are entrepreneurial and independent from denominational control.

Moral Discourse and Welfare Reform Policy

The call to justice as expressed in the Bible, provides the primary rationale for a congregation's involvement in social policy and welfare reform. Religious congregations address morality directly. Brady (1998) outlined four forms of moral discourse regarding social justice: narrative, prophetic, ethical, and policy. Narrative moral discourse is recognized in biblical stories. The Creation story and the Exodus, help us understand among other things, that we are representatives of God. These stories also guide us in making policy decisions (God listens to the cries of the powerless).

Persons who interpret God's will also provide prophetic moral discourse. Amos, Hosea, Micah, and Isaiah are examples of prophets concerned about social justice. Similarly, today's prophets have a special concern for the powerless, as evident by their criticism of decision-makers and emphasis upon underlying causalities of poverty.

Ethical discourse presents arguments for moral judgements and provides definitions of moral terms. Ethics deals with the same issues as narratives and prophets, but the words used are not religious. Lastly, policy related moral discourse relates to the practical implementation of choices. In this type of moral discourse religious and political beliefs merge and are expressed in the form of government programs. The federal government passed a welfare reform bill entitled the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. Title I replaces the Aid to Families with Dependent Children program with block grants to the states. Other sections deal with income for disabled children, child support, immigrants, child protection, child nutrition, food stamps, and other programs. While there are numerous notable detractors of the Bill, experts agree "there is no politically feasible way of going back to the old structure, with its guarantees of assistance and federal regulation of state programs" (Bane, 1997:53).

Charitable Choice, one provision of the Welfare Reform Act, suggests an expanded role for religious organizations in providing welfare services to the poor and needy. Research shows that "although today only about 3% of religious congregations currently receive government funding for social service activity, perhaps as many as one-third express some interest in moving in that direction" (Chaves, 1999:1). The law protects the religious character of faith-based organizations that choose to accept funds and the religious liberty of those receiving services (The Center for Public Justice, 1997). Congregations under government contract could offer a wide range of services supporting welfare beneficiaries to become self-sufficient. These include job skills training, employment search, childcare, basic education and language training, nutrition education, services for pregnant teenagers, abstinence education, treatment and health services.

Charitable Choice seems to be here to stay. Both Vice-President Al Gore and Governor George W. Bush have given attention to faith-based organizations in their campaigns. Diverse institutional and ideological entities support faith-based activism. Corporate sponsors, such as Walt Disney Company and Atlantic Richfield are involved as are liberal and conservative foundations such as The Lilly Endowment, the Ford Foundation, the Pew Charitable Trust, and the Heritage Foundation (Kramnick & Moore, 1997:48).

Opportunities for Parishes

For decades Catholic institutions and human service agencies have received money from the government to carry out their mission. Processes are in place to accommodate government requirements and religious concerns. Involvement of Catholic parishes in social ministry fits the Great Jubilee of the Year 2000. A major feature is charity and justice noting that the Church's "social message will gain credibility more immediately from the *witness of actions* than as a result of its internal logic and consistency" (National Conference of Catholic Bishops, 1999:19).

The manner of involvement of congregations in charity and justice activities can be categorized in three ways; building community, providing a safety net, and shaping

the moral dialogue (Bane, 1999). Each requires a different level of engagement, creativity and resources.

Building community involves getting people talking. The search for solutions involves the poor, taxpayers, legislators and program administrators. Welfare reform speakers at education forums and faith sharing groups help to build community and create a common understanding of these issues. There needs to be language which expresses both the religious dimension of social policy issues and the pragmatic aspects of public policy implementation. Parish council and committee meetings are candidates for building community. Each is often made up of individuals with a full range of political views where common membership can serve to curb partisan discussion.

Providing a safety net with specific programs like emergency assistance, food banks, and Charitable Choice programming is an additional manner of involvement. San Miguel Lutheran Church in Texas won a \$70,000 government contract to provide computer, bookkeeping, and secretarial skills. A New Jersey Muslim organization received a grant of \$150,000 to help recipients improve their reading and job skills. In Louisiana the welfare department provided nearly \$149,000 to Faith and Families to help recipients find and keep jobs (Moore & Williams, 1999).

These activities have a three-fold consequence – persons with needs receive a service, members of the congregation have a way to act on their faith through social ministries, and there is an increased chance that people will get involved in justice activities. Social ministries:

“expose people to social and economic problems and solutions that often require interacting with agencies of the state and engaging in social action. This exposure can have a feedback effect that increases political engagement and imbues congregations with a sense of having a stake in the policy making process” (Greenberg, 1998:7).

Shaping the moral dialogue is achieved by clarifying the narrative, prophetic, ethical and policy aspects of any moral discourse. This is a critical aspect of social justice. These clarifications expressed through sermons, education and speaker forms can move the congregation towards advocacy and critical engagement.

Parish social concerns committees often seek issues in which lessons of social justice can be taught and experienced. Topics such as welfare reform bring social justice issues much closer to each family's reality and engage lay members of the parish. This aspect seems particularly important given the reports of Bane (1999:8), a participant in the welfare reform debate. Intense lobbying of Catholic organizations were “successful in modifying some of the most egregious provisions of the original legislation, [but] their larger efforts were not particularly successful. This was partly, I suspect, because their Washington efforts were not backed up by grass roots pressure.”

Model-Social Justice Parish

A social justice parish promotes the well being of the vulnerable by changing established social structures and institutions. It is critically engaged. Observing this parish, one would find that persons care for one another. Persons helping and being helped are in direct contact with one another in such a way that each is transformed. Members are involved in both public and private dialogue about community issues. This parish has a pastor supportive of social justice efforts and has effective lay leadership.

For effective involvement in social justice efforts, the parish must have its facts

in order. Staff and volunteer leadership of the parish are familiar with an up to date demographic study of the people and geographic territory within the parish boundaries and a separate demographic study of the parish membership. A demographic study gives information about socio-economic status, ethnic makeup, family status and other variables helpful in understanding the needs and opportunities of a community.

The parish should have a completed needs assessment. This describes needs of individuals and families that can give a better fit to parish programming than demographic studies alone. Realistic costs of family budgets, of program budgets, of government and church expenditures in social welfare efforts are documented. Decisions are made with these facts in mind to prevent misjudgments and allusions about what can be accomplished.

A model social justice parish expresses beliefs of its faith and the social teachings of the Church. Jesus' call to social ministry and the Church's interpretations are expressed often and explicitly. The Holy Spirit's presence in the people is recognized and called on. Clear social teachings are expressed in sermons and aligned with seasonal liturgical readings and song. Scriptural references and quotes from Church writings are printed, framed, and hung on walls of parish facilities.

A library of social justice teachings and resources is maintained for staff and parishioners use. Each of the committees of the church have relevant materials to work with that help express a social justice theme, e.g. liturgy committee, finance committee, education committee. An annual event is held where beliefs are shared by persons in and outside of the parish about social justice concerns. Cutting edge issues become the annual theme and draw for persons of the parish and those outside the parish. Controversy is welcomed and prepared for. This is an ecumenical event cosponsored by other parishes and other faith traditions. The joint planning is an opportunity to learn how faith is passed on by various religious traditions.

Expressions of moral reasoning are happening in parish life. Persons of the parish are involved in the community, translating faith beliefs into the market using language appropriate to the situation. Such persons are bilingual, knowing the theological words and also the public policy words that have the same meaning but need to be used in different arenas to respect the persons involved.

Each charity effort of the parish is evaluated annually, not just in what is accomplished, but also in determining what issue in society causes the need for the acts of charity. The persons being helped and those helping must work together to understand the root causes of social problems and find faith based sociological and economic solutions that the congregation can take action on.

There is recognition of the value of other points of view. This parish is a frequent host of personnel from Catholic Charities, the Catholic Conference, and other faiths to fully understand actions and to garner support. Partnerships are created with religious communities to tap into their long-term social concerns history, expertise, and the support needed for sustained efforts. Written policies that reflect a social justice orientation are in place in this model parish. The mission statement of the parish reflects this preference and direction.

The plan for staff time allocation and the parish budget are clear indicators of a policy to work on social justice. The budget has a mixed source of income including foundation and government grants. The parish views itself as working with these entities

in carrying out common missions.

Parish members have opportunities to directly fund social ministry activities. They participate in the activities where their contributions are made. They are given opportunities to develop a sense of stewardship and philanthropy. Regular education and orientation regarding legislative action and community organizing efforts is expected and rewarded. Time spent on these activities is considered parish activity not private activity. Clear policies are in place to deal with controversies so issues arising are dealt with consistently, forthrightly, and with little down time.

Decision-making bodies are made up of persons representing the parish and its social justice efforts. This involves special recruitment and retention activities for individuals and groups that find it difficult to serve. The physical plant of the parish is open to use by many groups as a reflection of the parish's social justice mission.

Being conversant with the facts, expressing religious beliefs, participating in moral reasoning, and actions supported by policy, are all essential ingredients for a parish to be critically engaged. There are many opportunities for parishes and congregations to respond to the call to social justice. Those who respond will benefit us all.

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What Do You Mean When You Say You Want to Make the World a Better Place?

Michael Rothman

For those who study and engage in public service, the deceptively simple wish to make the world a better place forms the basis of a career and, for some, a calling. But what do elected officials, volunteers, community activists or advocates mean when they say they want to make the world a better place? What do we mean when we talk about working for others benefit? At times confusing and at times misleading, the language used to express aspirations for a better world can have a variety of contradictory meanings. Indeed, the straightforward phrase, "Do you want help?" can sound generous, dangerous, or downright condescending depending on context. The words and metaphors people use to describe what they do reveal a great deal about their attitudes and values. By studying language, we are able to study the underlying, often unrecognized, reasoning behind the beliefs of a population.

This inquiry into language seeks to examine just what we mean when we talk about public service. Through a linguistic analysis, it develops five conceptual pairs that may be used as a framework for future analysis of perceptions of public service. The population studied in this case consists solely of youth, aged 11 to 22. There are three reasons for limiting this study to youth. First, we may assume that youth, unversed in the ways of grantwriting and public relations, lack some of the savvy and skill that would lead adults meticulously to select words that please their funders or constituents. This makes it easier to infer a direct connection between the language youth use and the beliefs it communicates. The assumption, however, that all youth language is transparent and naive, would itself be a naive assumption. We must keep in mind throughout this essay that some of what youth say reflects their deep-seated beliefs, while some of what they say reflects what they know adults want to hear.

A second reason for focusing on youth is for the educational value of youth involvement in public service. Adults who are interested in seeing youth develop an appreciation for trying to improve the world would do best to start by understanding the potential that already lies within youth. "The great problem of the adult who has to deal with the young," John Dewey writes, "is to see, and to feel deeply... the forces that are moving in the young; but it is to see them as possibilities, as signs and promises; to interpret them, in short, in the light of what they may come to be." When we study the language used by youth to discuss public service, we are thereby studying the possibilities that they possess. If these possibilities are understood and cultivated, youth are more likely to grow into adults with the same appreciation.

The third reason for limiting this inquiry to youth is that by doing so, we may shed light on insights that are otherwise lost on adults. In adult terminology, phrases like "buying into a program," the "cost of involvement," or "a sense of ownership" are as common in a nonprofit organization as they would be in a retail business. In a society where money is perhaps the only universal language, metaphors that make human services sound like business transactions are inevitable. Indeed, to many who work in the public sector, money metaphors are so pervasive as to be second nature.

This is true of dialogue among adults; children, however, apparently don't speak

this language. The same program director who might have used the phrases above with a peer, would likely have made a conscious effort to avoid using these words with a child. Few children would understand if their parents said that they wanted them to *buy into* the idea of cleaning their room, or to have a sense of *ownership* for their report card grades.

Language used by adults is often deemed inappropriate for youth. Conversely, there is language that youth use every day with their peers, but would never say to their elders. Some of this language is dismissed as “rude” or “obnoxious” by adults, and some as “cute” or “simple.” But in fact much of what children say is far more sophisticated and complex than adults give it credit for. The difference may be a matter of context, not maturity. For most adults, life is largely experienced in the workplace, where money and efficiency — economic considerations — reign. For children, life is largely experienced through contact with family and friends where giving and providing — service-oriented inclinations — are central. Perhaps in the arena of public service, then, some of the lessons to be learned travel from young to old, and not vice versa.

This study of the language youth use in discussing public service can help us to better understand the underlying beliefs and attitudes people have towards philanthropy; can help us to cultivate an appreciation for philanthropy among youth; and can help adults to better understand what youth can teach us.

Methodology

With these reasons in mind, the following inquiry was conducted into the ways youth discuss philanthropy. Language for the study was gathered through youth-written applications for the Marion County Youth as Resources program. Youth as Resources is a program to involve young people in developing and implementing their own service projects to address needs in the community. The program was started in Indianapolis in 1987, and has conducted twenty-two funding cycles since then. In each funding cycle, Youth as Resources receives several dozen applications written by youth groups in Indianapolis. Projects are funded based on level of youth leadership and significance of the community need being addressed. For this study, 45 applications from four different funding cycles were studied.

Key words used in response to questions about the youth projects were tabulated. In addition, the language used was studied to explore how such factors as word selection, metaphors, and phrasing affected the overall feeling of the application. In the process of analysis, patterns in wording and style became evident. This led to the development of five conceptual pairs that help to explain consistent similarities and differences in the way youth discuss philanthropy in their Youth as Resources applications, namely

- *helping-caring*, addresses the relationship between youth volunteers and those they are serving;
- *planning-feeling*, how youth conceive of and develop service effort;
- *change-relief*, how youth view the impact of service over time;
- *broad-narrow*, how youth connect their efforts and impact to the broader community, and fifth;
- *self-other*, how youth imagine the effect of service on themselves and others.

Helping-Caring

When Richard Turner analyzed the language used by professional develop-

ment officers, he found it riddled with militaristic imagery. Fundraisers spoke unerringly of “capital campaigns” that would “enlist volunteers” to help “target populations” within the “war on poverty.” To hear their words, fundraisers were an army of saviors, seeking to rescue society from the throes of suffering. This, Turner points out, is a male-dominated view, one that focuses on the responsibility of the strong to *help* the weak. Women, according to the research of various linguistic anthropologists, are inclined to discuss goals differently. As Carol Gilligan found in her seminal studies of how girls and boys discuss morality, while power and principle may guide typically masculine views of morality, *care* and human relationships guide the archetypal feminine view of morality.

This distinction between a *helping* approach and a *caring* approach to service was evident in the ways different youth groups discussed their philanthropic efforts. A major issue in any discussion of public service is that of the relationship between the service provider and the service recipient. Consider, for instance, the difference between the following two applications. In one, youth explain how they will help others to “have a better life and someone to *look up* to.” In another youth explain that “we hope to *bridge the gap* between youth and elders, to let them know we care.” Each application offers strikingly clear imagery. The first exemplifies *helping* language. This language implies a power differential between service provider and recipient. Youth place themselves metaphorically “above” those they are helping and promise to pull them up. The second example epitomizes a *caring* attitude. It focuses not on power, but on sharing— on “bridging the gap”— between service provider and recipient. In effect, youth taking this perspective place themselves metaphorically on the “same level” with service recipients and promise to bring them together.

Twenty-five of the applicants used language that had a predominantly *helping* tone. This left twenty applicants — or just under half of the total pool — who spoke with a tone of *caring*. Though not so common among adult grantwriters, the language of *caring* may in ways be a better justification for serving others than the language of *helping*. Bringing people together, though it may sound facile on paper, can do more good than trying to help them up. When we help others, we run the risk of reinforcing distinctions and establishing an unequal power dynamic where the haves remain “above” the have-nots. When we care for others, we help in a way that avoids this problem. Instead of setting server apart from recipient, caring brings them closer together. Instead of reinforcing power dynamics, caring reinforces equal relationships.

Planning-Feeling

When Thomas Bender explored the history of community in America, he found a recurring theme from the seventeenth century to the present day. Again and again, academics, writers, and politicians recoiled at the impersonal, distant feeling of society and yearned for a time past when the emotional ties of community were stronger. Bender suggests that in fact this is a false dichotomy. His research indicates that the impersonal efficiency of *Gesellschaft* co-exists with the communal feeling of *Gemeinschaft* in all societies at all times. At times, we may yearn out of nostalgia for the strong feelings of *Gemeinschaft*. But at other times, we yearn out of need and pragmatism for the strong planning of *Gesellschaft*.

These two contrasting yearnings result in two contrasting images of community service. We may start by considering the *planners*. These youth — or, in some cases, a

designated “executive committee” or “plan/proposal committee” — would write about their “goals” and “structures” to support the “project.” They would “estimate” and “approximate” numbers to describe their “program.” Highly planned proposals eschewed the banal trappings of emotion and honed in efficiently on the concrete steps of a plan. For instance, a group of students at a parochial school proposed this project to raise awareness about AIDS:

We will present a program made by our group on a wide-screen television to five high-schools. In the program, there will be eight different scenes. Each scene will perform incidents where teenagers are exposed to the issue of AIDS. These issues will be hypothetical but based upon facts on how a person may contract the AIDS virus and the effect it has on a person and others. Each scene will have four people.

Compare this to a group of youth who wrote, “We *would like* to provide toys and recreation for the residents of the battered women’s shelter. By doing this we *hope to* let them know that there are people who care and *are concerned with* their *well-being*.” The language used in this application elicits an immediate sense of the feelings and emotional connection of the youth involved. The exact nature of their plans, on the other hand, is vague at best. Using the language of feeling, youth write that they “hope to,” “want to,” or “would like to” provide a service. They look forward to “feeling proud,” experiencing the “satisfaction” of doing something that they will “enjoy.” When they use the language of planning, on the other hand, youth definitively explain that they “will” just do it, emotions aside.

Perhaps the most telling contrast between planning and feelings lies in two contrasting metaphors for the project. On the one hand, planners would often use words related to building and construction to describe their efforts. One group discussed “*structured* activities,” another emphasizes how their project was “*based on a strong foundation*.” On the other hand, some feelers personified their project, ascribing it human feelings. “The *clinic*,” one group wrote, “*will be happy to see us* and have us spend time with them.” Emphasis on feelings like “happiness” and “smiling” further highlighted the human side of these projects.

Change-Relief

There will always be a need for public service, it is said, because people will always need help when things go bad, and people will always believe that things can be better. These two phrasings provide two different visions of service. From one perspective public service seeks to alleviate suffering, responding to the day-to-day needs of others. From the other perspective it seeks to ameliorate suffering, imagining the possibility of a better world where today’s needs are no longer. While these two perspectives can go hand in hand, they can also be worlds apart. To a good Christian, charity for the poor is a noble effort to relieve suffering, even if it does not change the world. To a Marxist, on the other hand, charity is the opiate of the masses, an activity that appeases the poor so that real change will never come. These two perspectives — the language of *relief* and the language of *change* — could be discerned in the language youth used as they discussed their own philanthropy. It was most clearly indicated in discussion of goals over time and in the use of concepts tied to education.

Youth who wrote from a *relief* perspective tended to remain focused on their individual project over its circumscribed time. The beginning, middle, and end of the

project were the beginning, middle, and end of their service. *Change* language, on the other hand, highlighted a connection from present activity to an imagined future. Youth would, in some cases, recognize their project as one step towards a larger goal.

The language of relief predominated in 27 of the 45 applications — 60% of the total pool. While the language of change was strong in 18 applications, it was almost always accompanied by some concept of relief. It is evident from the language in the applications that the primary way youth can express their desire for change is through education. This connection needs to be recognized and cultivated if youth are to translate that emphasis on education into advocacy for change through other avenues as they become available.

Broad-Narrow

Through the contrast between change and relief, we saw how some youth viewed the impact of their efforts in the long-term, while others remained limited to the immediate timeframe of their activities. The contrast between a *broad* and a *narrow* view considers the scope of the project geographically and demographically. A related concept is that of public service as “public work” and the development of the “commons.” By this view, espoused by many cultural anthropologists, the difference between public service and mere service is a tremendous one. Service is a transactional deal that can easily take place in private. Public service, on the other hand, depends on the connection between the service and the larger public, so that the whole community can feel a part of the service activity and gain a sense of cohesion and commonality through mutual aid.

The nature of the Youth as Resources application may lend itself to a narrow interpretation of service. It is incumbent upon youth who are applying for a project that they alone are responsible for executing to show that they do not need anyone else’s assistance. Nonetheless, in one-third of the applications — 15 of the 45 studied — youth made explicit connection to a broader community that they would involve. “We hope to have everyone participate in this program,” one group wrote. Another looked beyond their effort to the entire community and its government, writing of their hope to “strengthen the ties between the community and the police and fire departments.” These reflect a broader view of the project and the connection of youth to their community. “The most important thing is the community,” a group of students at a public middle school wrote, “we want to get to know them and develop a bond.”

Self-Other

Youth as Resources is a program not just in service, but in service learning. This implies two goals. On the one hand, the effort benefits members of the community through service. On the other hand, it benefits the participants themselves by teaching them something. In order to be approved by Youth as Resources, a project must fulfill the first of these goals. But youth need not be explicit about the educational benefit to themselves. Nonetheless, many do write about the “self-confidence,” “learning,” “skills” and “benefit” that they would gain through their service effort. Many were careful to avoid giving the impression that they had selfish motives. In a manner typical of many applicants, a church group first explained the benefit to others, then added themselves as an emphatic afterthought, “...but I believe the people that will benefit the most are the youth and the adults that will work together on the project.”

We have already seen some of the ways that youth relate to the others that they

are serving through earlier scales. One important aspect of the ways that youth discuss others remains to be considered. Take, for example, the following contention. "We know that the elders at the Meridian Nursing Home do not have many visitors. We want to show them they have not been forgotten." None of these youth have ever been residents in a nursing home; none know from experience just what it feels like to be forgotten this way. In the language they use in this application, however, they show that they are able to step out of their own shoes and imagine what it feels like to be someone else. In psychological terms, this would be described as the youths' ability to empathize with others; in social science terms, it has been called the ability to exercise "social imagination" and "take the perspective" of others. In either case, it is considered a vital skill for mature social interaction.

Understanding others and understanding oneself are two key lessons that may be learned through community service learning. Youth who recognized the growth that they could experience through service were finding value in an activity that many adults do not understand. Youth who could identify empathetically and imaginatively with the people they were serving were exhibiting a skill that many adults lack. In a society where many people feel alienated and powerless, the ability to feel strength and connection in work with others is an important deterrent to social ills.

Conclusion

Public service is a complex notion. Often, people speak of "volunteering" to "benefit" the "community," "wanting" to "help" "others," or "bettering" the world. But what do we mean by this? What are the values and reasoning that lie behind what we say? By carefully studying language, we are able to gain greater insight into the values that it expresses. By listening specifically to the language used by youth, we as adults may discover values and motivations that have become clouded with age.

Through further exploration of the ways individuals write and talk about public service using the five scales developed in this paper—helping-caring, planning-feeling, change-relief, broad-narrow, and self-other—we may learn more about the language of helping others and what it means to both youth and adults. There is certainly much that can be done to make the world a better place, much that can be done to serve communities, and many approaches that can be taken to achieve the goals of public service. The ways we talk about achieving these complex goals can be confusing at times but, when understood properly, also highly revealing. Before we can best save the world, before we can best help one another, perhaps the best thing we can do is to listen.

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Health Care: The Next Frontier for ADR

Elaine M. Gause

Overview: This paper analyzes the current state of conflict between patients and managed care providers in the health care industry and suggests Appropriate Dispute Resolution (ADR) as a viable alternative. The focus here is on solutions to the consumer conflict; other concerns such as national economic impact or long-term provision of health care for all Americans are not included. The research is not an in-depth scrutiny of the causes of these conflicts; it advocates a system of ADR as one way of lessening the burdens on both patients and providers. The paper shows a clear need for more analytic research in this area, including quantitative cost analyses of managed care conflicts and their alternatives.

The passage of the Patients' Rights Bill by the US House of Representatives in November 1999 was a clear signal to health maintenance organizations (HMOs) that their procedures of dispute resolution remain woefully inadequate. Client dissatisfaction has been growing since the late 1980s when news began to spread about patients being denied care that was recommended by their doctors. The problems have become so extensive that health care has become a primary focus of the national legislative agenda, while the only solution that the recent Bill offers is litigation. This is bad news for America's crowded courts.

The health care industry is rife with conflict. Disputes between HMOs and patients, HMOs and doctors, doctors and patients, patients and hospitals, doctors and hospitals, and other related concerns continue to erupt. *Business Week* (Dunkin, 1998) offers articles like "Fighting your HMO" and *Health Care Strategic Management* (Smith, 1997) discusses "Resolving Physician-Hospital Conflict." A website that bills itself as "The Consumer Insurance Guide" (www.insure.com) includes a lawsuit archive listing hundreds of insurance-related court proceedings.

It is clear that the American health care industry must take steps to solve its problems. Millions of dollars are being spent to solve issues that emerge from the unwillingness or inability of HMOs to pay for treatment (Podziba, 1999). It is an extremely poor use of resources in an increasingly embattled industry. This paper suggests that designing appropriate dispute resolution systems for HMOs is the most efficient way to combat the crisis.

The National Planning Association's Committee on New American Policies outlined the problems with the American health care system (Seidman 1991). They found 'remarkable consensus' on the following issues:

- Excessive costs that rise faster than the inflation rate;
- Over 40 million people with no health care coverage, and at least as many with inadequate coverage;
- Unsatisfactory quality of care with inadequate assessment measures;
- Costly and inadequate long-term care; and
- No consensus on what should be done.

Managed care has been the industry's response to costs that have skyrocketed over the past twenty years. However, a recent analysis of health care customer satisfaction surveys found that HMO members are much less satisfied than people with traditional health care insurance (Birenbaum, 1997); one survey by Consumer Reports (1998) put the

frustration figure at five times that of traditional plans. The importance of these figures is magnified when one considers that approximately 75% of all private health insurance is some form of managed care (Iglehart, 1999). There are vicious circles; the more the public perceives a health care crisis, the more discontent they are with managed care. And the more the health care industry is confronted with rising costs, the more they turn to managed care. It is no wonder that conflicts between consumers and HMOs continue to escalate.

Public focus for the last twenty years has been on finding remedies to this obviously flawed system. However, while future policy has been the center of attention, developing systems to resolve *current* disputes has been virtually ignored (Matthew, 1999). This paper focuses solely on moving to a system that is available now; one that does not require either legislation or judicial decision to offer relief.

In traditional examples of client-supplier conflict in a free-market society, successful product providers rely on 'the customer is always right' policy, where clients wield influence because of their purchasing power. However, the situation with managed care does not lend itself to this course of action because:

- 1) Patients are generally not direct purchasers; managed care is primarily provided through employers;
- 2) Managed care companies claim that slim profit margins make it impossible to satisfy many patient and/or doctor demands, resulting in an ongoing struggle between quality and cost control (Studdart *et al*, 1999);
- 3) Neither doctors nor patients usually know the actual costs of health care when provided beyond the doctor's office - leading to a great asymmetry of information (La Puma, 1999); and
- 4) There is an industry-wide assumption that consumers do not have enough medical expertise to accurately assess their care (Birenbaum, 1997).

The last two circumstances have created a power imbalance between consumers and providers, which I believe has escalated the battle. This supposition is supported by information on 1997 HMO disputes where approximately 82% of HMOs said they either did not make data on expenses or benefits for representative conditions available or that they did not provide *any* cost or utilization data (HMO Industry Report, 1999). Experts in the field agree that provider-patient invalidation is common (Marcus, 1995); consumers simply do not have access to information about their health care. This asymmetry of information is perceived as an asymmetry of power, and anger increases accordingly (Susskind & Field, 1996). Thus the cycles of misunderstanding and escalation continue.

It is not surprising that there has been such a heavy backlash against HMOs. Without access to traditional purchaser power, and frustrated with the inability to solve disputes with managed care, clients have turned to litigation. Neil Shlackman, Director for Member Health Management for Aetna U.S. Healthcare acknowledges high levels of consumer anger and suggested the source may be "managed care's structure" (Diamond, 1999). The problem is significant - HMOs reached market saturation in 1998, controlling 70-80% of the available private health care plan market (Regional Market Analysis, 1998). In 1997 alone, 308 HMOs reported over *five thousand* appealed problems (HMO Industry Report, 1999). Recent surveys suggest that roughly half of consumers had some type of problem with their managed care plan in the previous year (Managed Care Magazine,

1999). On the other hand, HMOs' claims of impoverishment also appear to be valid. *Managed Care Magazine* (1998) announced that as of January 1, 1998, less than one-third of all HMOs were operating in the black. In an industry encapsulation, *USA Today* (Appleby, 1999) described the self-reinforcing trend:

"As employers demanded lower rates, insurers obliged. Money was saved by reducing payments to doctors, hospitals and other providers and by reducing the amount of time patients spent in hospitals. Now a number of medical groups in California and Texas are filing for bankruptcy, while health plans are raising rates to recoup their own losses [following large adverse legal awards]."

The managed care industry continues to oppose the Patients' Rights Legislation with precisely that logic; that an increase in litigation would necessarily lead to an increase in costs, further distressing the overall system (Hoff, 1999). The court system is ill suited for many health care cases for a variety of reasons. Of greatest significance, litigation is both costly and time-consuming (Rotarius, 1999), thus burdening both HMOs already teetering on the cusp of insolvency and ill patients with little time to lose.

Most forms of current legislation rely on increasing access to courts. Some versions do include third-party review of health care disputes, but the details on the 'hows' and 'whos' of administration are vague. They appear to be at best unenforceable, and it is doubtful if they will actually be passed into law. Historically, conflicts between health care providers and the patients they serve have primarily resulted in the filings of legal action (Rotarius, 1999). One can hope that legislated public policy will provide long-term solutions, but significant changes need to take place now.

A recent case in California illustrates the situation. David Goodrich, a San Bernardino Deputy District Attorney, died in 1995 from a rare form of stomach cancer. His wife, Theresa Goodrich, brought suit against their HMO, Aetna U. S. Health Care of California, claiming that Aetna had repeatedly denied or delayed approval for her husband's care in the two-and-a-half years before his death (Marquis, 1999). In January 1999, a jury awarded Mrs. Goodrich \$120.5 million dollars (\$4.5 million for medical expenses and loss of companionship and \$116 million in punitive damages). This was the largest award ever against an HMO (ABC News, 1999).

From the reaction to the verdict, it is clear that both the managed care industry and consumers see this as not just a single case, but as a catalyst for change in HMO policy. The LA Times (Marquis, 1999) reported that experts and consumer advocates said this decision could "force insurers to consider internal reforms and the attorney for the plaintiff referred to jury backlash when he said, "I think the meaning of this verdict is that people are just plain mad" (ABC News, 1999).

The Aetna case was unique in the level of compensation and the fact that punitive damages were awarded, but it is part of a national trend of court decisions favoring clients over managed care (Managed Care Magazine, 1999). Unless HMOs find a way to resolve disputes that is acceptable to both them and their clients, one can safely assume that the litigation caseload will continue to increase.

When political and commercial systems fail, solutions may lie in organic social technologies. The interest in the study of conflict and dispute management was renewed in the mid-1980s (Rahim, 1992), and subsequent organizational applications offer the best non-legislated, non-litigated answer to clashes between HMOs and patients.

The most significant process that has evolved as a result of conflict study has

been ADR. While the popular terminology for this acronym is Alternative Dispute Resolution, I subscribe to the less utilized but more fitting phrase, *Appropriate* Dispute Resolution (Susskind, 1999). In this description, the method of dispute resolution must be appropriate for the particular dispute or problem; there must be a fit between the process and the problem (Costantino, 1996). Leonard Marcus, former director of the Program for Health Care Negotiation and Conflict Resolution at the Harvard School of Public Health, provides the definition for ADR, to which this paper will subscribe, "ADR involves the use of a neutral third party to help the disputants reach a resolution. By definition this nonpartisan individual has not stake in the substance of the agreement. The task of the neutral is to introduce a process that can help the parties reach [a legitimate settlement]" (Marcus 1995). Note: Professor Marcus' definition was intended for *Alternative* Dispute Resolution. This paper co-opted it for *Appropriate* Dispute Resolution.

There are several ways and means of implementing ADR, but they are not necessarily interchangeable. Organizations applying ADR to conflicts need to carefully analyze the structure, frequency, and content of conflicts and select the apposite method of responding. Conflict management should be a system of responding to specific cases, not simply a one-size fits all remedy. There are numerous criteria for successful ADR – following are the six most critical. Managed health care meets each of them and is thus a suitable candidate for productive conflict management systems.

Identifiable Dispute Participants. The structure of managed care is one of individualized disputes; companies that are dissatisfied with their benefit limits are more likely to change plans than to engage in protracted disputes (Caredata Reports, 1998).

Types of disputes that are compatible with ADR. These conflicts generally involve one patient who is in unique circumstances. ADR is an individualized approach designed to gather information about a distinctive dispute and then assist the parties in finding a solution.

Valid reasons for change. The first portion of this paper's analysis laid out clear motives for HMOs to adopt ADR. These include increasing:

- Litigation costs in an environment of slim profits;
- Consumer discontent; and
- Willingness of legislators to set public policy for managed care.

Ability to adapt to new conflict management structure. HMOs have proven time and time again that they are willing to respond to market needs to stay in business. When employers demanded lower costs, HMOs were quick to provide bargains but as a consequence less and less money was available for medical care (Appleby 1999). That willingness to change, and the fact that managed care is a relatively young industry suggests that adapting to a new form of conflict management would not meet tremendous resistance; particularly once HMOs understand and accept the advantages.

Willingness of stakeholders to participate in ADR. It is clear that patients and their families would also be willing to participate in ADR. They are already entering appeals processes by the thousands; and these are procedures internal to the company with whom they are having the dispute. An alternative to either working solely within the HMO or within the court system should be welcome.

Potential gains from altering the system. Organizations need to be able to

quantify benefits to using a conflict management system. Public opinion changes slowly, but issues that relate to the bottom line are analyzed on a monthly or even daily basis. In addition to increasing customer satisfaction, potential cost benefits are described below. Cost comparisons between using ADR and fighting court battles can be astounding. Not only have the costs of outside attorneys and experts increased, but also so have those of in-house counsel through overhead and support services (Costantino, 1996). Court dockets are backlogged; it is not uncommon for a civil case to take four or five years to actually go to trial. In a health care situation, this time lapse is unconscionable.

Because there is a dearth of ADR systems in managed care, specific cost analyses that relate this program to litigation do not exist. However, general information on using a system of ADR shows a reduction in legal expenses of 50-80% (Carver & Vonda, 1994). Specific side-by-side comparisons of litigation and conflict management systems at Motorola showed 75% annual litigation expense reduction over six years (Galen, Cuneo, & Greising, 1992), and NCR reported a reduction of 50% in litigation expenses and a drop in its number of pending lawsuits from 263 to 28 between 1984 and 1993, following the systemic use of ADR (Carver *et al*, 1994). Litigation fees are only one source of potential savings noted in cost-benefit analyses of conflict management procedures; management time, turnover, and public relations issues also weigh in (Rowe & Ziegenfuss, 1993).

The available cost analysis information is persuasive. Stephen Goldberg analyzed 827 mediation cases in the 1980's and submits an average costs for those cases at \$330 (Ury, Brett, Goldberg, 1993). At 1999 figures that would place the average costs for a mediation at approximately \$500 per case. If all 5,000 problems in 1997 were mediated, that would be a total cost of \$2.5 million dollars, a drop in the bucket compared to the Aetna \$120.5 million verdict.

While the analysis is over-simplified, it is a starting point. Harvard Law School Professor William Ury's study of state mediation centers reported a success rate of between 71 and 88% (Ury *et al*, 1993). The State of California estimates that the cost of mediation is only 13% of the due process system (Ahearn, 1994). While exact cost data may be lacking, it is clear to see that when mediation is involved, a smaller number of cases are heading for the courts at drastically reduced costs. Court decisions against HMOs are beginning to snowball. Since 1995 the Supreme Court has handed down a series of rulings that has opened the door to more legislation and litigation (Sealey, 1999). ADR offers non-precedent setting solutions - each case is handled individually and resolved on its own merit (Matthew, 1999). This could be seen as a sole advantage in itself by HMOs who are feeling the effects of adverse jury and Supreme Court decisions. Public opinion and with it, jury decisions, are likely to continue to plague the managed care industry unless the system changes. Instances of severely ill persons being denied care by their HMOs have given rise to a media frenzy, which in turn has captured public interest. In an interview with Theresa Goodrich after the \$120.5 million verdict, a spokesperson on ABC News' Good Morning America said,

"I think it's absolutely appalling that HMO's value a dollar more so than a human life. I'm glad for your victory despite your incredibly unnecessary loss! I wonder how these people would feel if it were a member of their own family being denied medical care. It's refreshing to see the underdog win once in a while" (ABC News, 1999).

The public focus for redress, however, has not been primarily on national policy, but on compensating managed health clients like Theresa Goodrich. This is not likely to

change; the 'identifiable victim effect' illustrates that society is willing to spend far more money to ameliorate the suffering of individuals than it is to save victims statistically (Jenni & Loewenstein, 1997). When the media puts a face on the problem, people want to ease that particular person's pain; rather than considering prevention or policy.

This can be somewhat negated when HMOs use ADR. The media is generally not a factor in cases handled through ADR. Of the types of ADR available, nearly all can be completed privately. ADR can help HMOs avoid negative press as well as judicial precedents. However, in some cases it may not be in the HMOs favor to avoid judicial precedents. Until the recent tide of negative judgments, HMOs relied on precedents that ruled in their favor. They established clear rules for doctors and administrators, and using ADR may make those rules much more nebulous. There are tradeoffs to this system.

Despite the overwhelming evidence that managed health care has much to gain from using ADR, it is a little known and little used opportunity (Marcus, 1995). Historically, dispute resolution American-style has been for parties to negotiate internally, and then head to the courthouse to resolve the dispute through litigation (Slaikeu & Hasson, 1998). Managed care has followed precisely that pattern: A study by Chorda Conflict Management that examined one year of dispute resolution for one medical malpractice insurer found that out of close to four hundred claims, over half involved lawsuits, and only three were resolved through mediation (Slaikeu *et al*, 1998). Ury (1993) notes that often ADR is not implemented because of lack of interests-based negotiation procedures, lack of skills, perceived lack of resources, and obstacles in the organization or the larger environment. He specifically points out that HMO administrators may be rewarded for strictly following the rules, a potential obstacle to creative organization.

This industry is not alone in being slow to adopt the approach. Researchers have found that the system of conflict management has been the last to be recognized and developed (Costantino, 1996). This illustrates the point made by Aetna's Director of Member Health Management, that the source of consumer anger may be managed care's structure. The lack of a comprehensive, effective conflict management system is precisely what is missing in that structure.

Leaders in managed care need to acknowledge that current systems are not working. HMOs should move immediately to a centralized plan for ADR. Data on leadership suggests that honesty is seen as the most important attribute (Northrup, 1989), and therefore this could be the opening move in a new relationship between HMOs and the public. More importantly, this could be the only opportunity for HMOs to manage their own conflicts; evidence suggests that under the current system outside controls will continue to multiply.

But before HMOs announce plans to embrace ADR, a workable system must be designed. Conducting an assessment of the industry and types of disputes, as we have accomplished in the first part of this paper, is an initial step; analyzing the structure for managing those conflicts is the next. ADR assumes at the outset an interrelation between interests, rights, and power in the disputes (Ury *et al*, 1993). Health care disputes certainly fit these criteria:

- interests include providing and receiving health care with the least amount of possible cash outlay (a concern for both the provider and consumer);
- rights include the patients' right to adequate health care and the HMOs' right to set limits on services provided; and

- power of information on behalf of managed care, and of the media and national sympathy on behalf of the client.

A successful conflict management system should take these principles into account, and provide better outcomes than traditional solutions (which, in the case of managed care, are litigation and/or an outraged public). Authorities in the field of conflict management define 'better' in several ways. MIT Professor Lawrence Susskind (1999) focuses on the satisfaction of the group, the ability for an outside evaluator to determine if the process and outcome were fair, and a test of time for the 'wisdom' of the resolution. Professor Ury (*et al*, 1993) notes that 'better' encompasses four criteria: transaction costs, satisfaction with outcomes, effect on the relationship, and recurrence. Karl Slaikeu (1978), President of Chorda Conflict Management, stresses cost savings to the organization in terms of time, money, and relationships. All of these take into account the human and resource costs of dispute as well as the future implications of resolution.

A system for managed care should do the same. The industry's current focus is on the onslaught of litigation and the necessity of premium increases to offset court costs. Instead of this market-oriented line of attack, HMOs should instead examine ways to handle disputes so they don't end up in court. ADR provides that process.

Based on managed care's unique situation and the ADR definition, it is proposed that HMOs adopt a four-tiered, regional dispute management system. Funding options for the industry to consider include foundation grants, tiered contributions from HMOs, federal and/or state funding, and other options not listed here. While this paper cannot deal with the intricacies of funding such a system, it should include:

- 1) Consumer "hotlines" for information and brief advice;
- 2) Ombudsmen who are available to provide advice to HMO personnel, employer benefit representatives, and consumers;
- 3) Mediators who will assist parties in finding resolution to their disputes; and
- 4) Third party review panels that will assess disputes and render decisions in an advisory arbitration process.

All four elements embrace the concept of a 'neutral.' The systems should be set up on a regional basis rather than company by company. While some HMOs may elect to set up their own conflict management system internally, an outside system is also necessary to combat the level of distrust that already exists. A study by The Lewin Group (Downey, 1998) found that approximately half of the people experiencing what they believed to be problems with their health plans did nothing to try to resolve them because they thought that it was useless even to try to work with the HMOs.

We'll examine the system by component, beginning with consumer hotlines. The first – and to date only – such service in the country was established in Sacramento, with grants from charitable foundations. The area was chosen because approximately 67.5% of its residents belong to HMOs. The Health Rights Hotline serves about 1.5 million people, all of whom may use it no matter to which plan they belong. Counselors field between twenty-five and forty calls daily, indicating a patent need for and acceptance of the service (Downey, 1998). The nationwide need is also clear: consider the previous figures cited on over half of all managed health consumers reporting at least one problem annually with their HMO.

The Health Rights Hotline employs eight ombudspersons to answer telephone calls from consumers. When the situation calls for it, they also arrange meetings with the clients and/or physicians and/or HMO representatives to assist in dispute resolution. Peter Lee, a lawyer and director of consumer protection programs calls the program an 'unqualified success,' but cautions, "To be truly effective, the health care ombudsman must be totally independent" (Downey, 1998).

In a regional system the ombudspersons should function as 'negotiation coaches.' They must give factual, neutral information on disputes to providers, patients, and employers alike. The hotlines would be open to people from all three groups, providing information that they may be unable to locate elsewhere, and also neutral analyses of problems based on available records. A successful conflict management system "relies heavily on the collection and feedback of valid information to drive the change intervention process" (Costantino, 1995). The ombuds program is the logical place for that to happen.

The Sacramento Hotline bears a cost of approximately \$1 million per year (Lee *et al.*, 1999). One of the issues that may be holding back the development of these systems in managed care is that there is a significant cost outlay. Managed care is operating so close to the bone that it may be very difficult for them to justify spending money on such a system, even if many believe it will be less costly in the long run.

When information and advice can't solve the problem, turning to neutral, third party mediators is the next step. The mediator has control over the process, but disputants retain control over the outcome (Susskind, 1999). The process of mediation offers a useful, constructive framework for resolving health care disputes (Marcus, 1996). Its methods can balance the considerations of interests, rights, and power by managing the discussion and helping the parties to find common ground.

Mediation is generally private and voluntary and the mediators "facilitate concession-making without loss of face by the parties, and thereby promote more rapid and effective conflict resolution" than would otherwise occur (Rubin, 1980). In addition, mediation is a natural choice when the alternative may be a protracted legal dispute taking up dollars and time when both are critical in health care decisions (Marcus, 1996). Third party review panels that offer advisory arbitration are an alternative to mediation. Ury's defines advisory arbitration (1993): "While the arbitrator's decision is not binding, it provides the parties with information about the likely result if the dispute is taken to formal arbitration or court. The information encourages a negotiated resolution by reducing the parties' uncertainty about an adjudicated decision."

The use of advisory arbitration is recommended because it has the advantage of giving all disputants equal information about a likely outcome without forcing a decision upon them. It leaves room for further negotiation or mediation, should both sides be willing. The third party panels must also be entirely neutral with regard to outcome of the disputes. An added benefit of advisory arbitration is that transaction costs are generally lower than in binding arbitration or litigation because hearings are brief and predictions are delivered orally (Slaikeu, 1998).

This suggested process of approach does not include binding arbitration or court litigation; both of these options are assumed to be part of the traditional system that does little in terms of nurturing long-term relationships between disputants. It is understood, however, that not all disputes will be resolved through the use of ADR; these alternatives remain available to both HMOs and their clients.

Appropriate dispute resolution is the best answer for the crisis facing managed care today. Design and implementation of the system described above would be cost-effective and responsible, focusing on a partnership between providers and patients. Managed care has a very small window of opportunity to effect this change; there is still time to embrace ADR and embody conscientious leadership.

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INTERNATIONAL
TRADE AND FINANCE

The Asian Financial Crisis in Retrospect: The cooperative approach to crisis management

Ronald U. Mendoza

Introduction

In 1993, the World Bank published a report entitled *The East Asian Miracle* that praised eight economies that accounted for much of the growth in the Asian region for the past few decades. The *Bank* referred to these as the High Performing Asian Economies (HPAEs), composed of regional giant Japan, the four *Asian tigers*: Taiwan, South Korea, Hong Kong and Singapore and the three Newly Industrialized Economies (NIEs): Malaysia, Thailand, and Indonesia. Because of their ability to tap into international financial markets, solid export base, high propensity to save, and ability to attract vast amounts of foreign investment, these countries were able to achieve and sustain very high rates of growth. Hence when MIT economist Paul Krugman, predicted in 1994 that the Asian boom was going to slow down eventually because of diminishing returns from both technology and investment, many people scoffed at his seemingly preposterous prediction.

Of course, his comment came during a time when the development paradigm in Asia was the envy of the developing world and was expected to continue for many reasons. Japan was still a dominant economic power in Asia and it provided a strong backbone for the regional economy by purchasing the exports of the other HPAs and by providing these economies with much needed capital through lending and foreign direct investment. The Asian consumers were, and still are, renowned savers. During the early 90s, 40% of GDP went into savings in Thailand and Malaysia compared with a paltry 20% in Argentina and Mexico. The Asian regional growth rate consistently topped 5% over the past decade. How then could such a picture of unfettered optimism deteriorate so suddenly into the crisis that engulfed the entire region just three years later? In the words of Paul Krugman himself, "...what I thought I saw coming was nothing like the catastrophe that materialized." Indeed everyone, including the skeptics, was caught off-guard.

Conservative estimates given by World Bank sources place the total loss of wealth as of mid-1998 for Indonesia, Malaysia, the Philippines, South Korea and Thailand at US\$600 billion or about 60% of their combined pre-crisis GDPs. This estimated loss does not include the damage that could not be easily quantified such as the social and political ramifications of the crisis. Riots ravaged the Indonesian capital, Jakarta, in early May 1998, and the number of people under the poverty line in Indonesia quintupled from 22.5 million to 118.5 million as of mid-1998. On the other hand in South Korea, the number of *IMF suicides* (where a father would take the lives of his wife and children and then his own) rose as much of the population began to feel the economic contraction. In Thailand, some 800,000 workers were already laid-off as of mid-1998 and an estimated 4 million workers were expected to be unemployed by the end of that year. As regards the political aftershocks, Thai Prime Minister Chavalit Yongchaiyudh, South Korean President Kim Young-Sam, Indonesian President Thojib N.J. Suharto, and Japanese Prime Minister Ryutaro Hashimoto all lost their jobs following a wave of public sentiment against them for mismanaging their respective economies.

The first part of the paper will provide a brief overview of the key issues that surfaced in the aftermath of the crisis: destabilizing speculative attacks, management of

short-term capital flows or *hot money*, moral hazard in the banking system and the role of the IMF in the crisis. The second part will elaborate on the potential for regional cooperation in crisis prevention and management. Finally, the rationale for cooperation is developed in the context of the Asian experience, and the challenges of the *cooperative approach* are examined.

Issues in the Global Financial Markets

Four major issues can be identified as flashpoints that contributed to the financial crisis in Asia. The first involves the high risk of destabilizing speculative attacks on fixed exchange rate currencies. The second major issue deals with the increased possibility of financial collapse due to capital reversals or the sudden exit of *hot money*. Linked to this issue are the renewed arguments for capital controls, in order to temper the destabilizing effect of short-term capital. The third issue is the significance of moral hazard in the domestic and international banking system. Finally, the fourth, and quite possibly the most significant issue, focuses on the role of the IMF in the crisis and the current debate to re-examine the objectives of the *Fund*.

1 Speculative Attacks: In the years preceding the crisis, the US dollar had gained strength against the other major currencies in the world. Currencies like the Thai baht, the Philippine peso, the Indonesian rupiah, the Korean won, and the Malaysian ringgit, which were all essentially linked to the dollar, experienced a *real appreciation*, causing a deterioration in the trade accounts of the Asian economies. This prompted the market to anticipate an inevitable correction in the Asian exchange rates, and it did not take long for the first speculative attacks to start chipping away at the Asian reserves.

Due to the weight of relentless speculation in 1997, the pegged exchange rates of the rupiah, baht, peso, ringgit, and the won collapsed in spite of a spirited defense by the Asian central banks. Inevitably, interest rate hikes, designed to discourage speculators, could no longer be postponed. The first casualty to the relentless waves of speculative attacks was the Thai baht in July 1997, and by December of that same year, the baht, the rupiah, and the won had already fallen beyond any acceptable interpretation of the required correction that was anticipated before the crisis. By early 1998, exchange rate market contagion, which initially affected countries with over-valued exchange rates and vulnerable banking and financial systems, began to seriously affect even those with relatively strong fundamentals. The Taiwan and Singapore dollars were drawn into the spiral because of the threat of losing export-price competitiveness to the now *super-competitive* baht, peso, rupiah, and won. The contagion had mutated into a bout of competitive devaluations.

The speculative attacks on the Asian currencies during the crisis revealed the vulnerability of the pegged exchange rate regimes. In this regard, several proposals have recently been put forward. Blinder (1999) suggests avoiding fixed exchange rates as a general rule, and concludes that limited resources make any single emerging market central bank a poor match against global market players. Mistry (1999) agrees by finding that the massive size of funds being exchanged in the global foreign exchange markets easily overwhelms the capacity of central banks to intervene in defense of a pegged rate. However, while Blinder and Mistry still see a role for a middle ground in the spectrum of fixed exchange rate regimes, some argue for a complete departure from it.

Garten (1999) finds that the global financial markets will increasingly force emerging market economies to either float their currencies or establish a currency board: two exchange rate regimes on opposite ends of the spectrum. Sachs and Larrain (1999) support the argument for floating rates and cite the cases of Australia and New Zealand both of which easily absorbed the shock of the Asian crisis because of their freely floating currencies. The argument for a free float however, implies that the salutary effects on capital inflows is a small price to pay for allowing the exchange rate to absorb external shocks. Hausmann (1999) disagrees with this and cites a study by the Inter-American Development Bank that finds Latin American countries with floating exchange rate regimes ending up with financial systems that are 15 to 30 percent smaller than they otherwise may have been under a fixed exchange rate regime. Ogawa and Sun (2000) provide supplementary evidence in the Asian context. They conclude from their study that using a currency basket peg system will lead to depressed capital inflows when compared to a strict dollar peg system.

On the opposite end of the spectrum, a currency board offers an extreme form of fixed exchange rates; all of the domestic currency is physically backed by foreign reserves. This exchange rate regime provides the benefits of strong credibility and significantly lowers speculative pressure. However, the pound of flesh required in exchange for this credibility is the surrender of monetary independence. For many developing economies with already limited policy options, this is too steep a price.

In the final analysis of the exchange rate question, Frankel (1999) argues that policy-makers will still need to weigh the benefits and costs of each of these exchange rate regimes according to the specific circumstances of their economies. He argues that the general rejection of the middle ground can be explained as a rejection of where countries have been, but is not necessarily based on whether or not the polar extremes of a full float or currency board are significantly better.

2 *Hot Money and Capital Controls.* The global financial system has increased its deadly efficiency in swiftly punishing markets with actual or perceived weaknesses. In trying to stop capital flight, some Asian policymakers suggested re-imposing capital controls during the crisis period itself. Thai officials tried to do this in order to buy time, but their gambit failed. They soon discovered that the technology that made it so easy for capital to flow-in, also made the exodus virtually impossible to stop. The Malaysians on the other hand, had more success in re-imposing capital controls, which they did in September 1998. However, in order to avoid discouraging capital inflows in the future, most of these controls were quickly dismantled five months later. Both the Thai and Malaysian cases showed that re-imposing capital controls during a financial crisis was an unpalatable option for a country dedicated to an open-market policy. Not only did controls on outflows provide only temporary relief if any at all, it also ran the risk of permanently discouraging future foreign investment.

The devastating capital reversal in Asia has convinced many that there is a need for the regulation of capital inflows, particularly those that fall under the *hot money* category. The IMF and the World Bank now discourage emerging markets from dependence on these flows, which are driven more by speculation in short-term gains rather than by interest in long-term fundamentals. Ultimately, the positive impact of the liberalization of the capital account is contingent on an efficient allocation and absorption of capital

flows and a sustainable rate of inflow. Controls on certain types of capital inflows can be used to achieve this goal, especially in cases where the host economy has not developed adequate prudential regulatory mechanisms to discourage excessive speculation.

From the current literature on the Asian crisis, the consensus seems to point to the imprudent investment behavior prevalent in the Asian domestic financial markets and banking systems, as the root cause of the crisis. Capital reversals and speculative attacks were simply the method of the global capital market to punish this imprudence. The crisis economies caught the *Asian financial flu* through contagion, but the fact was that these economies were quite susceptible to contagion from the beginning. From Thailand to Indonesia to South Korea and even to regional giant, Japan, the common denominator that sank these economies into financial crisis was a fundamental weakness of their financial intermediaries.

3 *Moral Hazard in the Banking System.* Why international investors continued to pump money into the HPAEs (sans Japan) before the crisis, could be traced to two reasons. One was that the fixed exchange rate regime caused investors to underestimate their risks and undertake investments that were often not hedged against exchange rate movements. However, a more important reason involved the lack of transparency and the lax supervision in the domestic banking and financial systems of these economies. It was this absence of adequate prudential regulations that allowed the excessively risky lending by these institutions in the first place, creating an inflationary pressure on asset prices. Increasing asset prices then encouraged the market to place even more investments into these assets and prompted financial intermediaries to keep on supplying credit for these investments. Hence, a circular process sustained the overpricing of these assets, with the side effect of causing the balance sheets of these intermediaries to seemingly improve as the collateral on the loans were often the very same assets being speculated upon.

However, it did not take long for even the most rabidly optimistic investors to discover that this circular rationale for investment could not be sustained. As the glut in the construction sector of Thailand forced the first round of corporate bankruptcies, banks began re-assessing their high-risk portfolios, promptly ending the lending boom. Asset prices in the sector plunged, creating a knock-on effect on the collateral that these banks held. Finally, in the same way that these domestic banks began to cut down on loans to investors, foreign banks, which had considerable exposure to domestic banks and financial intermediaries in Asia, delayed rolling-over these mostly short-term loans and stopped making new ones. In short, the mechanism that inflated the bubble worked in reverse, causing an implosion.

The current consensus tends to view the Asian financial crisis as primarily a banking crisis, with *moral hazard* at its core, and only incidentally a currency crisis. The significant role that moral hazard played in making the Asian financial infrastructure vulnerable to implosion provides a good starting point in modifying regulations to make them more resilient to financial shocks. The guru of financial regulation, US Federal Reserve Board Chairman Allan Greenspan (1998) has suggested two possible improvements in the Asian banking system. The first one is to raise the capital requirements on debtor banks to reflect the nature of their funding (i.e. more short-term debt should require a higher capital requirement) and the second is to charge domestic banks a premium for the existence of a sovereign guarantee on these banks. Both of these policies effectively

shift more of the burden of failure to the domestic banks and encourage greater prudence in their management.

4 *The IMF: What was its role in the crisis?* As financial difficulties hit Asia in 1997, the IMF stood firm on its *tried and tested* emphasis on stabilization first before attempting economic resuscitation, when it designed rescue packages for Indonesia (US\$40 billion), South Korea (US\$60 billion) and Thailand (US\$17.5 billion). Many criticize the IMF for failing to quickly and decisively assure markets by disbursing adequate capital in the initial stages of the crisis. Furthermore, size of the initial disbursements seemed to be premised on a very optimistic level of debt rollover by foreign lenders. When much of the debt was recalled, the IMF failed to anticipate the massive liquidity crunch that followed.

Academics like Harvard's Jeffrey Sachs criticized the conditions attached to the rescue packages on several levels. First, the initial IMF deals required significant fiscal contractions. While this may have been appropriate in the Latin American variety of financial crises that involved large fiscal deficits, none of the Asian crisis economies exhibited this symptom. Second, the IMF loans were conditioned on a wide range of structural adjustment requirements that were seen to worsen the situation. Based on the argument that what happened in Asia was a temporary balance-of-payments difficulty, primarily caused by a debt maturity mismatch, the crisis could have quickly ended had sufficient capital simply been available. In fact, this argument was the primary driving force behind the Japanese suggestion to establish the Asian Monetary Fund (AMF) that would have lent to the Asian crisis countries with very little conditions if any. Sachs (1998) concluded that by prescribing massive and wholesale rearrangement of the Asian economies, "...instead of dousing the fire the IMF screamed fire in the theatre."

Yet another criticism of the IMF states that if the domestic banking systems of the Asian economies are to be blamed for moral hazard, then the IMF should share some of that blame as well. The proponents of this view point-out that when the IMF bails out economies in balance-of-payments crises, it is essentially rescuing the foreign banks that have huge exposures in these economies. Furthermore, since IMF loans are ultimately passed on as taxes to the population of the crisis country, excessive risk taking by international banks ends up being subsidized by the domestic population, who already suffer the most during crisis periods. Seen under this light, the IMF acts more like a loan-collector by punishing the crisis country through harsh conditions on its loans, while providing an implicit guarantee to the foreign banks regarding the collection of their loans. What results is *moral hazard* on an international scale. Because international debtor banks lose very little in the bargain, they are encouraged to again undertake excessively risky lending to emerging markets in the future.

The Rationale for Cooperation

The Asian financial crisis imparted an important lesson that did not receive adequate treatment in the crisis literature: the potential for regional cooperation in crisis prevention and management. One lesson from the two major financial implosions of the last decade (i.e. the *Mexican tequila* of 1994-1995 and the *Asian flu* of 1997-1998) was that contagion during these financial crises was an inevitable consequence of the increased interdependence of many emerging markets and of the technological development of the

international financial system. On the production side, economies could be linked horizontally as competitors or vertically as links on a production chain. On the consumption and investment sides, economies could be intertwined through trade and investment agreements. During the Asian financial crisis, these linkages enabled a quick transmission of actual (or perhaps, perceived) weakness among the more vulnerable economies first: Thailand, Indonesia, Malaysia, South Korea and the Philippines. However, once a critical mass of investors decided that a regional slow-down was inevitable, even the more robust economies fell prey to contagion (i.e. Singapore, Taiwan and Hong Kong). Clearly a convincing public good argument could be made for promoting regional financial stability in the case of the Asian crisis economies.

The Cooperative Approach to Crisis Prevention and Treatment.

The idea of regional cooperation could be broadly applied to two policy environments: during the crisis period itself to accomplish financial and economic stabilization and during the non-crisis period to promote crisis prevention. In a crisis environment cooperation provides real gains on several fronts. First, cooperation can decrease uncertainty in stabilization policies by limiting the scope of policy choices to those that are consistent with regional and international norms. Guitian (1992) explains that the loss of individual national autonomy is the price for increased certainty. In a crisis scenario, the gain due to enhanced certainty may well outweigh the cost because of the benefit of lesser speculation. Had there been a cooperative arrangement within the Asian region during the crisis, speculation on the policies individually chosen by crisis countries would have been limited, for the simple reason that there is less speculation when there are fewer scenarios to speculate on.

Furthermore, when policy options are limited to those that are sustainable in a regional context, the efficacy of the policy necessarily increases. For example, had the initial devaluations of the Thai baht, and the Philippine peso during the third quarter of 1997 not been followed by further devaluations of almost all of the Southeast Asian currencies, then these initial devaluations might have proved to be sufficient corrections for Thailand and the Philippines. However, because of the following round of devaluations, the adverse effects of region-wide currency market volatility immediately negated what little expansionary stimuli that had been expected from the initial devaluations of the baht and the peso. Hence, the decision to devalue during the Asian crisis should have been made in a coordinated manner that placed sufficient weight on the issues of national as well as regional stability.

The inter-linkages in a regional economy such as that of Southeast Asia provide a basis for more coordination of economic policies in order to prevent a *beggar-thy-neighbor* type of conduct during crisis situations. On this front, coordination increases the credibility of stabilization efforts by effectively limiting the range of adverse policy outcomes. Furthermore, in the language of game theorists, coordination can minimize *trembling hand* responses by lowering the possibility of potential mistakes that individual governments may commit in responding to regional shocks.

For example, there was massive speculation throughout the summer of 1998 that the Chinese would devalue the Yuan, potentially initiating another round of devaluations in the region. Fortunately China chose not to devalue, but the mere threat of that policy option had already induced destabilizing speculation in the stock markets of the Asian

crisis countries. More importantly the situation could have been much worse. Massive speculative attacks against the Yuan would probably have occurred if China had a more liberalized foreign exchange market. Had there been a binding cooperative agreement that explicitly committed China to a no-devaluation scenario, the region might have been transported to the *stable equilibrium* far more quickly. Instead, the threat of Yuan devaluation prompted investors and debtors to adopt a *wait and see* attitude for much of 1998, which significantly delayed regional economic recovery.

A third benefit from cooperation during a crisis period is that stabilization policies can be enhanced by the increased credibility from pooling resources. Net reserves for the Association of Southeast Asian Nations (ASEAN) were over \$100 billion in July 1997. If the reserves of China, Hong Kong, Taiwan, South Korea and Japan were added, total regional reserves available for intervention would have been roughly over \$500 billion. Historically, several financial crises were averted with adequate assistance from a country with a larger pool of reserves. For instance, Germany successfully helped France defend the Franc during the ERM crisis of September 1992. In much the same manner, the explicit commitment made by China to intervene in favor of the Hong Kong dollar effectively deterred further speculative attacks on that currency.

Theoretically, Obstfeld (1996) explained that most speculative attacks that could be averted occur during the time when the currency reserves of a country were in the intermediate range, where the peg collapses only if speculators do attack. Hence, despite the fact that the economic fundamentals could still be maintained, the peg might still be vulnerable to attack if not buttressed by additional reserves. Following this logic, a regional agglomeration of central banks could therefore *circle the wagons* by augmenting the critical reserves of any of its members in order to ward-off speculators. In this regard, the Japanese initiative to establish the Asian Monetary Fund (AMF) merits further discussion and examination. After all, it is important to note that for all the dependence of the Asian economies on the IMF, two thirds of the loan packages for Thailand, Indonesia, and South Korea were sourced within the Asian region anyway.

While a convincing case for regional cooperation during a financial crisis can already be made, the larger gains from cooperation may exist under a non-crisis scenario. In fact, cooperation during stable periods brings several important benefits.

First, regional *peer pressure* may be a more effective incentive for individual economies to *keep their houses in order* and practice transparency, when compared to the less-welcomed alternative of receiving pressure from an outsider like the IMF. Moreover, the credibility of the IMF has already been severely diminished by its recent track record that includes a series of bungled stabilization efforts. Because economies were burned in spite of IMF intervention, there is no compelling reason why the IMF should retain its monopoly as the *fireman* of the international financial system. Hence, regional agglomerations, such as the Association of Southeast Asian Nations (ASEAN) or the Southern Cone Common Market (MERCOSUR) in South America, can provide venues for the discussion of regional financial stability issues and the construction of regional agreements and mechanisms for ensuring that the policies of member countries are consistent with promoting regional stability.

Second, cooperation can also temper the unintended spillover effects of the economic policies of individual nations within the region. For example, a temporary decrease in Japanese interest rates, designed to spur domestic demand, may have the unintended

effect of increasing short-term flows to its neighbors. Or in another case, a major correction in the exchange value of the Chinese Yuan may cause a lagged ripple effect on other currencies within the region. Such scenarios underscore the need for some degree of consultation and coordination so as to minimize unintended regional effects of policy choices. If the G-7 coordinates its monetary policies to promote stability amongst its members and the world financial system in general, then regional agreements can do the same for the smaller scale of regional clusters of emerging market economies.

Third, a regional agglomeration can be directed at promoting more transparency and increased standardization of financial and trade regulatory frameworks. The ASEAN has already taken steps in this direction when its member nations concluded negotiations for the ASEAN Investment Area in October 1998. Furthermore, the ability to mobilize within ASEAN was tested when its members decisively approved an emergency measure in the December 1998 meeting in Hanoi to induce more foreign investment in the region through coordinated tax incentives. These two developments show that the ASEAN is a likely candidate agency for increased cooperative undertakings in the realm of international financial policy. It is both small enough to be flexible to the reality of its 10 member nations and large enough to enable sufficient scale effects from coordinated policies.

Finally, the rise of regional cooperative blocks provides an important step in international financial development. As it stands, the international financial infrastructure is skewed in favor of developed countries that make most of the rules and develop all of the relevant financial technologies and systems. Developing economies are relegated to the task of catch-up and possess negligible bargaining power in a multilateral system presided over by the IMF. Moreover, while the most developed economies are able to interact on more or less equal terms to promote developed country concerns through organizations like the G-7 and OECD, developing economies in financial distress are left to negotiate individually with the IMF. Hettne and Inotai (1994), Hettne (1998), and Mistry (1999) foresee the future of multilateralism in increased regional consolidation that develops sufficient bargaining power among the developing countries in the world economic system. In this respect, an increased role for regional agglomerations like the ASEAN is not only a necessary response to the Asian financial crisis, but also an important step in the development of a more equal, and hence more stable, international financial system.

Challenges to Cooperation

While the Asian financial crisis experience provides a clear case for cooperation, the road towards a cooperative effort in crisis prevention and treatment in Asia is still littered with obstacles. As regards the ASEAN, several challenges need to be met before any effective degree of cooperation and coordination can be accomplished.

The first hurdle is the policy of *non-interference* within ASEAN. For instance, while it was clear that the *foot-dragging* of the Suharto regime in early 1998 created negative spill-over effects for the rest of the region, there was no effort made by any of the Asian countries to nudge the Indonesian government towards concluding an agreement with the IMF. The ASEAN can undertake an important role in this regard by urging crisis countries to implement needed reforms while at the same time providing political and economic support to these countries in any negotiations with multilateral organizations like the IMF. There is a significant case to be made for increased involvement when previously internal or domestic issues develop into regional concerns. In the words

of Malaysian ex-Deputy PM Anwar Ibrahim, "ASEAN's direct involvement in the affairs of its members is but the application of an ASEAN solution to an ASEAN problem." Hence, the policy of *non-interference* needs to be supplanted by *cooperative involvement*.

Another possible obstacle to cooperation may lie in a potential rift between the upper economic tier members of the ASEAN (i.e. Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) and the lower tier members (i.e. Cambodia, Laos, Myanmar and Vietnam). While the top 6 economies of the ASEAN are already ready for increased openness to trade and capital flows, the remaining 4 economies have yet to develop the necessary infrastructure and institutions. The future of increased cooperation and unity within the ASEAN therefore lies in a more generous stance by the top 6 towards Cambodia, Laos, Myanmar and Vietnam. During periods of stability, the ASEAN has already established a good track record for supporting its less wealthy members through technical support and more concessionary terms in trade agreements. However during bouts of regional economic instability, this kind of support will prove more difficult to maintain.

But what is possibly the most serious impediment to increased cooperation within ASEAN lies in the turbulent internal political dynamic of some of its members. Presently, the East Timor issue and the abrupt transfer of power from Suharto to Habibie make political instability in Indonesia a cause for concern. Ahmad and Gohshal (1999) emphasize that stability in Indonesia, the largest and one of the founding members of ASEAN, is a necessary foundation for security and economic stability in the region. On the other hand, one of ASEAN's smaller members presents an equally daunting problem. The refusal to honor the election victory of Aung San Suu Kyi by the military regime in Myanmar and ASEAN inaction in this regard have had a negative impact on ASEAN's standing in international circles. US Secretary of State Madeleine Albright bluntly referred to the actions of Myanmar as a threat to Asian security in the July 1999 ASEAN meeting, effectively challenging the ASEAN to try and resolve the situation. Myanmar and Indonesia represent the two extreme cases, but the point made is evident: the strength of ASEAN depends upon how its members weather their individual political *growing pains*.

In terms of a larger pan-Asian regional agglomeration, there are more serious obstacles to cooperation that need to be overcome. One lies in the practicability of Japan as a lead nation in an Asian regional alliance. While its status as the resident economic power in the region is unquestioned, the political economy aspect of a regional agglomeration headed by Japan is still quite problematic, owing to its role in World War II. Also, the future political and economic evolution of China and Taiwan still represents a prickly issue. China will play an important role in the region by default because of its sheer size, but the technological and economic edge of Taiwan makes it a likely counter-balance to Japan in a regional agglomeration.

Conclusion

The likelihood of other potentially more virulent strains of the *Asian flu* still looms over the horizon, and the fundamental changes in the global financial system definitely outpaced the ability of policy makers to comprehend the nature and consequences of these changes. Therefore, if the HPAEs are to stay the course of opening-up its markets and participating in the global financial system, its regulatory agencies need to keep up by designing and implementing mechanisms to manage financial flows and encourage competition in their domestic financial systems.

What is needed is a departure from an over-emphasis on *laissez faire* economics, and a commitment to a sound and sustainable path to liberalization. Financial sector reforms that limit moral hazard and institutionalize the practice of transparency are required. As always, these reforms need to be founded on the bedrock of sound and sustainable macroeconomic policies. Also, prudential regulations that prevent maturity mismatch in debt structures and ensure adequate foreign exchange liquidity need to be pursued.

More importantly, there is also a clear case for promoting greater international cooperation in minimizing the dangers of the global financial system, which include the very real possibility of speculative attacks on pegged currencies and large-scale capital reversals. What the Asian crisis has uncovered is the increased stake of individual *emerging markets* in the stability of the regional *neighborhood*. In the short-term, the ASEAN is a good platform for developing cooperative measures in crisis prevention in the Southeast Asian region, despite the challenges that this organization still faces.

While the obstacles for a larger pan-Asian regional agglomeration do exist, increased development and interdependence within the region will necessitate the formation of a larger cooperative grouping that includes China, Taiwan, and Japan in order to accomplish the broader objective of Asian regional stability. Policies and regional pacts designed to accomplish all these objectives will make the Asian *emerging markets*, more resilient, if not more resistant, to potential crises in the long run.

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The Ecuadorian Financial Crisis: Bad Luck, Bad Policy and Bad Banking

Juan Carlos Pitarque

Introduction

Beginning in August of 1998 a series of shocks affected the Ecuadorian economy that brought activity to a standstill. Ecuador had only recently begun to emerge from the external debt crisis of the 1980s, which resulted in the so-called "lost decade" of development. After 1990, Ecuador had adopted a series of macroeconomic and microeconomic reforms, which increased exports, trade, and capital flows from the rest of the world. The standard of living, as measured in GDP per capita, was rising once again.

Nevertheless, by the end of 1999 Ecuador was in the midst of its worst economic crisis in recent history. The government was unable to meet its expenditure commitments; it could no longer raise funds in the domestic or international markets; it had defaulted on its external debt repayments which had been restructured as recently as 1994; sixteen domestic banks, including some of the largest institutions, had either been taken over by the State or were being liquidated; the real GDP had shrunk by approximately 7.3%; the local currency had depreciated by 67 % in one year; the annual inflation rate had reached 60.7% and the unemployment rate had doubled to 18.2% with underemployment at an additional 54.4%.

This study has the objective of identifying what the shocks to the economy were, whether their origins were external or internal, and why their effect was so detrimental to the economic activity of the country. It will ascertain if the financial crisis in Ecuador was a direct consequence of the international financial crisis that began in Thailand in July 1997 and subsequently spread throughout other emerging markets, from Asia to Russia to Latin America, and even to the United States. It will determine if the capital flight, which occurred in late 1998, was a result of a "contagion" effect from the international market upheaval, or if it was a result of poor domestic policies.

1. Bad Luck: The External Shocks to the Ecuadorian Economy

The Asian financial crisis of 1997, which later spread to Russia and Brazil in 1998, suggested that the individual financial crises in each country were not isolated events, but rather, in conjunction, part of a larger picture of a sharp change in investor sentiment. The World Bank states in its *Global Development Finance* report, "... as the deflationary effect of the massive import collapse in Asia became increasingly apparent, and as Russia defaulted, confidence faltered in emerging markets everywhere." An analysis of the Brady bond market for 1997-99 reveals that the Russian default of August 1998 had an immediate effect on Brady bond spreads for Mexico and Ecuador, as well as for all other emerging market countries. This instantaneous widening of spreads is evidence of the contagion across international financial markets. Those sharp changes in investor sentiment lead to the conclusion that Ecuador was, in fact, affected by the international financial crisis, by the so-called 'contagion.' This section will analyze three external factors: the size of the capital outflows caused in large part by the international financial crisis; the decline in oil prices; and the costs of the destruction produced by the "El Niño" weather pattern in the winter of 1997-98.

The Capital Outflow Shock: The Ecuadorian capital account reveals the path of the capital flows for the period 1989 to 1999. From 1989 to 1998 Ecuador ran large capital account surpluses, that reached 11.3% of GDP in 1989 and averaged 7.0% for the ten-year time period, thereby financing its current account deficits. However, after the Russian default on its external debt in August 1998, capital fled Ecuador as quickly as it had arrived. At the first semester of 1999, the capital account showed a deficit of \$756 million. This outflow was due mainly to short-term capital, but also because direct foreign investment, public sector debt and private sector debt all decreased their flow into Ecuador. In terms of the balance of payments, then, Ecuador had a measurable capital outflow in the first semester of 1999 of \$756 million. These capital movements determined that in 1998 Ecuador lost international reserves in a significant manner, \$395 million (19%). By September 1999, the reserves had declined by an additional \$424 million, to \$1.27 billion, the lowest level since 1993. Therefore, between 1998 and 1999 Ecuador lost \$819 million in reserves.

The Petroleum Price Shock: Ecuador's budget, exports and GDP are largely dominated by oil. Oil production and mining represent 14% of the Ecuadorian GDP, the third largest activity after agriculture (including agro-export activities) and manufacturing. In 1996, before oil prices began their decline, tax revenue from oil production accounted for 34% of total Government revenue. The average price continued to increase until January of 1997, when Ecuador received an average price of US\$20.46 per barrel. In 1997 oil prices began a sharp decline, the result of over-production by major oil producers, and the fall in demand for oil by the economies of Southeast Asia that were undergoing recessions as a result of the international financial crisis.

In December 1999 the average price per barrel reached its lowest point, US\$6.95. The collapse of the price of petroleum cost the Ecuadorian economy an estimated \$527.4 million in 1998, equivalent to 13% of 1998 exports, 13% of Government revenue for the same year and 2.7% of GDP. This amount was over and above the estimated \$235 million in lost export revenue in 1997 due to the corresponding price decline. Therefore, the overall cost to the economy from 1997 and 1998 was \$762 million, or 3.9% of 1998 GDP.

The "El Niño" Weather Shock: Ecuador's geographic position along the western coast of the South Pacific Ocean makes it vulnerable to changes in the seasonal temperatures of the Pacific Ocean. The "El Niño" weather pattern refers to the seasonal warming of the ocean in December of each year. The rains caused major losses to agricultural production and fishing activities in the coast, where export activities such as banana, cocoa, coffee, mangos, shrimp farming, tuna fish and other fishing were especially hard hit. Lost export income from non-petroleum exports declined \$431.3 million from 1997 to 1998, or 2.2% of GDP. Furthermore, lost production from non-export production of these goods accounted for approximately an additional \$400 million, placing the total loss of export and domestic income from production shortfalls at \$800 million.

Moreover, the economy was racked by major infrastructure damage, as highways, river embankments, ports, municipal water supply systems, irrigation systems, plantations, shrimp farm embankments, machinery and housing were destroyed. Ecuadorian estimates place these capital losses at approximately \$700 million. Therefore, the total cost to the Ecuadorian economy of the "El Niño" weather pattern was about \$1.5 billion, or 7.6% of GDP. This amount, in addition to the \$762 million lost because of the petroleum price shock, placed an already weak economy in a vulnerable position.

In summary, the contagion caused important outflows of capital in 1998 and 1999. Furthermore, a simultaneous drop in petroleum prices and altered weather patterns were enough to cripple the economy. There was a total of \$1.19 billion in lost export income, \$400 million in lost domestic sales of agricultural goods, \$700 million in damage to productive assets and infrastructure, and at least \$756 million in measurable capital outflows in 1998-99. These external shocks accounted for 9.4% of Ecuador's GDP.

2. Bad Policy: Flawed Domestic Policy

This section will examine Ecuador's domestic economic policies, in particular the debt stock and the fiscal deficit. Acting in a combined manner, these factors were internal shocks to the economy.

The Debt Stock: Ecuador's debt stock grew dramatically in the 1970s and 1980s to \$12.1 billion, or 123% of GDP. Under the Brady Agreement signed in Madrid in October 1994, the \$6.0 billion (54% of GDP) external debt was restructured, which also reduced the stock to levels considered serviceable by Ecuador. Nevertheless, the outstanding debt stock continued to climb. By 1998, it stood at \$16.4 billion or 83% of GDP.

In addition to the external debt stock, the government also had contracted large internal debts, both in the local currency as well as in US dollars. Though it is difficult to obtain historical data on the internal debt stock, current data indicates that the stock has grown from \$787 million in 1997 to \$2.08 billion in 1998 to \$2.90 billion in 1999.

Furthermore, the structure of the debt stock became increasingly short-term, not only placing large cash flow strains on the budget, but also raising the level of risk that at any given moment in time there could be a lack of available funding. This is precisely what happened when the international financial crisis struck Ecuador in 1998. Of the \$2.90 billion domestic debt stock, fully 80% was denominated in US dollars, and it was mostly short-term. More importantly, the level of short-term debt exceeded the international monetary reserves (138%). This was a significant policy mistake, as Ecuador did not have the liquidity to meet its short-term obligations if no additional financing was available. Default became inevitable.

The Fiscal Deficit and Exchange Rate Regime: The Ecuadorian government ran budget deficits for eight of the last ten years, averaging 0.85% of GDP. As petroleum prices dropped in 1997 and 1998, government revenues from the state oil monopoly declined. Because government spending did not contract accordingly, deficits continued to grow.

Ecuador had adopted a fixed real exchange rate system in 1992, as it sought to bring inflationary expectations down sharply. However pressure on the fixed exchange rate began to grow. In February 1999 the Central Bank had to float the exchange rate, and in March and April the exchange rate rose sharply. By October 1999 the real exchange rate index had fallen to 70.4 down from 120 the previous year, a 41% drop.

Therefore, there were two gross errors in exchange rate policy stemming from the use of a politically expedient and irresponsible expansionary fiscal policy from 1996 onwards. First of all, the use of fiscal policy in a fixed exchange rate regime compelled the Central Bank to use tight monetary policy to control the over-stimulus to the economy. This rise in the interest rate in turn led to increasing capital flows from abroad and a deterioration of bank balance sheets. Secondly, the fixed exchange rate system coerced the Central Bank to supply foreign reserves from its coffers, and thereby prop the exchange

rate up, when and if demand for the local currency declined.

In summary, this section of the study has established that Ecuador had executed bad macroeconomic policies in the years prior to the financial crisis of 1998, so that the economy was unable to defend itself from external shocks. The absolute lack of fiscal restraint had led Ecuador to possess one of the largest external debt stocks of any developing country, in relation to GDP. The service of this debt, in turn, led to growing fiscal deficits. Moreover, Ecuador also faced a "twin deficit" phenomenon of simultaneous large fiscal and current account deficits. By the end of 1998 the fiscal deficit stood a dangerously large 5.73% of GDP and the current account deficit at 11.0%. The critical nature of these deficit levels, in addition the use of a fixed real exchange rate system, created the conditions for a run on the reserves. The run, which took place in January and February of 1999, was ignited by the sudden growth in fiscal spending in December 1998.

3. Bad Banking: The Banking Crisis

An efficient system of financial intermediation of savings has failed to exist in Ecuador, in large part because of a failure to adequately regulate and oversee the banking system. There were clear signals of banking distress prior to the crisis, which were either not observed or not acted upon. This section will analyze two key weaknesses of the banking sector: the 1994 deregulation law and the declining quality of the balance sheets.

The Financial Sector Deregulation Law: In 1994 a new law was approved which attempted to modernize the financial sector in Ecuador. The legislators' intent in adopting the new law was to permit banks to diversify across product lines, clients and regions, and to eliminate some of the barriers to entry that had kept banking in particular isolated from the merciless winds of competition. However, in retrospect, it is clear that the law had several weaknesses that led to a heightened vulnerability of the banking sector. Among the major flaws were the following:

- A rapid deregulation of activities, that allowed banks and other financial intermediaries to enter new activities in which they had no previous experience.
- No timetable or guidelines to create a greater oversight capacity in the regulatory entity. In essence, banks were given more liberty to act but the regulators were not given a greater ability to supervise.
- Failure to address the political nature of the appointment of head regulator, the Superintendent of Banks, which has to be named by Congress.
- Failure to establish the principle of "consolidated supervision" whereby all entities are required to place at the disposal of the Ecuadorian regulators all financial information of their entire financial dealings anywhere in the world.
- The creation of a "black or white" test for the survival of banks, based on being above or below the 9.00% technical equity to risk-weighted assets ratio.
- Failure to set guidelines for risk management.

The Declining Balance Sheet Quality: As mentioned previously, the lack of a coherent fiscal policy to constrain fiscal spending led the Central Bank to use monetary policy to control the excessive fiscal stimulus. This action resulted in high nominal and real interest rates, which increasingly caused loans, which almost always were given in adjustable rates, to go unpaid. For the period 1995 – 1999 real interest rates on loans averaged 20.8%, but after having reached levels superior to 31% in 1995 and 1996.

These high real interest rates led to the inability by many bank clients to repay their debts. Therefore, the banks' past-due and non-performing loan ratios rose to historically high levels of 9.66% of the total loan portfolios, even before the effect of the "El Niño" weather pattern became manifest in 1998. By September 1999, almost 40% of all bank loans were past due or non-performing, a figure never seen in recent Ecuadorian banking history. For purposes of comparison, in the United States the corresponding ratio is below 1% for the banking industry. Furthermore, the ratio of non-performing and impaired loans to equity rose in 1999 to 116.4%. This ratio reveals that the banking system overall was technically insolvent, as the broad non-performing assets were greater than the equity the banks had.

The collapse of the banking system is without precedent in Ecuador. Of the 44 banking institutions that existed in 1996, by October 1999 16 were in State hands, among which were seven of the top ten banks ranked by assets. Fully 65% of the banking system's assets as of December 1997 were under State control. As of December 1999, the banking bailout has cost the Government \$2 billion, or 10.3% of GDP, just for the funds it has pumped in to capitalize failed banks. However, the deposit guarantee carries the potential for another \$2 billion to cover deposits that can be recovered. The lack of correct banking oversight, and the tolerance of poor bank management, will cost the economy approximately 20% of its GDP.

Conclusions

This study finds that the Ecuadorian financial crisis was caused by a combination of unforeseen external factors and domestic policy mistakes. The crisis was initiated by three external factors: the 1998 oil price decline, 'El Niño,' and the international financial crisis. These three shocks cost Ecuador 9.4% of its GDP: \$1.19 billion in lost export income, \$400 million in lost domestic sales of agricultural goods, \$700 million in damage to productive assets and infrastructure and at least \$756 million in measurable capital outflows. Domestic policy mismanagement left Ecuador unable to prevent the crisis. In general the policy mistakes involved managing a frail economy at the outer limits of safety margins. There was little room for adjustment to external shocks.

Other policy mistakes were excessive debt stock and a fixed real exchange rate system. Policy errors during the crisis included bailing out Filanbanco which led directly to the run on reserves in January and February 1999. A further policy mistake was the default on the external debt. Instead of defaulting on the external debt and the ensuing reputational damage, bondholders should have been approached earlier, in order to secure the foreign capital required to emerge from the crisis. Finally, the banks became a source of transmission of external shocks to the rest of the economy. A lax supervisory body failed to detect banking irregularities and fraudulent practices.

Lessons can be drawn from the Ecuadorian financial crisis. First, sound economic policy is essential for long-term growth. Second, fiscal policy in the hands of elected officials must be managed responsibly and under prudent guidelines. Fiscal prudence, in turn, requires broad political consensus so that the public finances are managed in the long-term interests of the economy rather than for the benefit of short-term political interests. Third, the economic volatility of developing economies demands that they attain higher levels of international reserves, liquidity and credit-rating. This will allow them to survive cyclical downturns without economic collapse. Finally, a country's

development is dependent upon adequate financial regulation.

Ecuador's response to the financial crisis was to dollarize the economy in March 2000. While such a scheme immediately restores fiscal discipline, it should not be seen as a development strategy. Rather, it is a short-term stabilization mechanism for economies in crisis. Therefore, Ecuador must design and execute a national long-term strategy with three phases: stabilization of the economy and poverty levels; nurturing of investment and recovery; and the creation of sustainable growth in reserves via trade and export activities. Only with such a strategy can Ecuador navigate its way out of the crisis, renew the servicing of its external debt and generate resources sufficient to safeguard the welfare of its people and resources.

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Perspectives on Socioeconomic Reform and Brazil's Internal Debt

Maximilian Martin

Overview

Socioeconomic reform projects require a strategic choice - should decision makers work for institutional convergence with the North-Atlantic model or pursue the route of experimentalist reform, creating new institutions adapted to local conditions? Taking the arguments of two advocates of convergence and experimentalism - Jeffrey Sachs and Roberto Unger - as placeholders, this short essay analyzes both approaches from a discourse analytic and a behavioral economics perspective. The analysis identifies tensions between some of the authors' assumptions and the ramifications of behavioral preferences and Foucauldian instrument effects. An application of the analytic to the restructuring of Brazil's internal debt suggests that experimentalist projects of reform are particularly constrained by existing institutional arrangements and agents' preferences.

Domestic Reform in the Age of Globalization

Socioeconomic reform is a historically and geographically bound phenomenon. The end of the Cold War has cleared the way for the international integration of markets for goods, services and capital. Unlike in the pre-World War I period, today's world economy is characterized by little mobility of labor, and fierce competition in similar products. Economies are vulnerable to phenomena of contagion and swings in market sentiments even in the absence of significant trade linkages. The need to manage capital flows determines fiscal and exchange rate policies, resulting in a "divorce between macroeconomic policy and the real economy" (Rodrik, 1999a:3-4).

International economic integration raises positive as well as normative questions regarding the development of the global economy and the place of developing nations in the global system. Experimentalists favor the creation of new institutional settings, whereas adherents of institutional convergence argue for the adoption of institutions from the industrialized world. Arguing that the market cannot create its own presuppositions, Unger advocates democratic experimentalism (Unger, 1998, 2000), whereas Sachs argues for institutional convergence (Sachs, 1994, 1998a, 1998b; Sachs & Warner, 1995, Radelet & Sachs, 1998).

Fostering trade and competition, economic integration pressures societies to alter traditional practices. Globalization exposes the fault line between the vanguard - groups who possess the skills and mobility to flourish in global markets - and those who do not, the rearguard (Rodrik, 1997; Unger, 1998). Openness results in more employment insecurity without a necessary increase in the level of employment (Rodrik, 1999a:9-12). As a result, the rearguard's demand for social insurance increases. However, the dictum of fiscal realism creates a "golden straitjacket," impairing the capacity of nation-states to provide insurance and to pursue non-convergent projects of domestic policy reform. This tension fuels resistance to change, and the rise of nationalist and protectionist sentiments that may jeopardize the project of globalization.

Political Philosophy and the Invisible Hand

Both experimentalists and advocates of convergence agree that sustained growth in a country like Brazil requires overcoming the lack of human capital, social inequality, and pork-barrel politics (Sachs, 1999; Unger, 2000). To deliver rising living standards, developing countries need to expand and modernize their capital stock. The range of policy choices for the financing of development initiatives is increasingly constrained. Countries need to appeal to global capital markets and must absorb the impact of their volatility.

Experimentalists and convergence theorists differ as to the context-dependency of institutional choices. Critical of neo-liberal reforms as advocated by the Washington Consensus, Unger emphasizes transcendence. He argues that representative democracy, free civil society, and the market economy can all take forms that are different from those they presently assume in the North Atlantic World (1998).

Less critical of the notion of diffusion of best practice, Sachs advocates working within existing relations and institutions. Proclaiming the universally beneficial impact of Adam Smith's invisible hand, except in cases where significant externalities are involved (e.g. education, basic research, public health), Sachs argues for the expansion of markets and the removal of distortions. To support markets, institutions and economies need to be shaped after the model of the successful North Atlantic economies. To level the playing field, developing countries should receive significant debt relief (e.g. 1998a, 1998b).

Experimentalist and convergence projects invite three sets of questions.

(i) What are the likely results in the short run? Is speed consequential for success? If a complex balance of market and non-market institutions is necessary for economic growth, cumulative reforms may entail prohibitive short run costs. An early and a later program and the piecemeal reforms that Unger proposes (1998, 2000) may not be viable in practice. On the other hand, rapid convergence as suggested by Sachs (1994, 1998a, 1998b) may encounter obstacles such as stable pockets of local knowledge and unforeseen idiosyncratic factors that end up undermining the convergence of institutions.

(ii) What are the consequences of convergence and experimentalism in the long run? To what extent is a country committed to a non-convergent project able to participate in the global economy? Conversely, how can a country committing to institutional convergence successfully implement blueprints of best practices if its system is characterized by differential local knowledge?

(iii) The difficulties inherent in successful social engineering may jeopardize both projects. Structural production in accordance with discursively elaborated plans requires agency, a potentially difficult endeavor given the constraints of interdependence magnified by globalization (cf. Ferguson, 1990; Martin, 1997, 1998).

The modernist character of Unger's project in a postmodern world introduces several tensions. Displacing familiar tradeoffs such as equity/efficiency, and emancipation/collective action, the project strikes an uneasy balance between micro- and macro-relations. Unger advocates a simultaneous creation of large-scale schemes invested with coercive powers such as an additional executive branch of government that sees to the fundamental rights of workers. If there is a micro-tradeoff between self-fulfillment and individual restraint in collective action, it will precipitate tensions on the macro-level. As long as there is a perfect alignment of individual preferences, coordination need not be coercive. However,

in a context characterized by the fragmentation of experience (cf. Harvey, 1989; Jameson, 1991; Lyotard, 1984) and differential local reinterpretation of hegemonic representations, transcendence of existing relations need not lead to a convergence of moral socioeconomic practices or preferences. It is reasonable to expect opposition to Unger's social endowment account (1998, 2000) by those who would suffer from an abolishment of individual property rights. This complication is likely to apply more generally to instances where perceived social and private net benefits differ.

Second, a central tenet of Unger's project is the transformation of the state from an agent of status quo maintenance into an agent of change (as part of the triangle state-civil society-market), aligned with the interests of the population. If the assumptions on convergence of practice due to human nature do not hold, strengthening the state may in fact be counterproductive. If one entertains the idea that there is a tradeoff between a state's control of society and its accountability, as well as the notion of differential preferences of agents, Unger's project may end up creating an alternative but equally (or more) predatory and totalizing vision of the state. Joel S. Hellman points to the case of transition economies, where stronger executives are associated with less reform (1997:73). A similar point is made by Rodrik whose cross-country analysis of 90 countries shows that less democracy is associated with greater volatility in growth, which is an inferior outcome for risk-averse agents (1999b:22-32).

A different set of tensions underlies the project of institutional convergence. According to Unger, Sachs reifies the Western market economies. First, while it is salutary to identify obstacles to development such as landlockedness, tropical diseases, and soil quality, an emphasis on the geographical determination of development prospects is not *per se* constructive. The logical conclusion of such an argument would endorse unconstrained flows of labor to permit an optimal allocation of labor subject to the constraints of climate, soil, and physical geography. Such an endeavor is hardly practical. Moreover, in dynamic environments, constraints are subject to change. The information revolution's separation of the economy of things from the economy of information is deconstructing traditional value chains and will alter the composition of transaction costs (Evans & Wurster, 1999). This may well alter the relation between current resource endowments and patterns of comparative advantage. Empirical research is necessary to forecast a plausible path of change, and its ramifications for development efforts.

Second, key elements of neoliberal globalization and free trade are elements of a cultural discourse rather than universally true representations. As a result, a "manual with the title 'how to build a market economy' [...] and the [...] directions to remove price distortions, privatize enterprises, harden budget constraints, enact legal codes" etc. is bound to fail, provided that the technology on how to operate a market economy is specific to local contexts (Rodrik, 1999b:15). Rodrik points to the importance of tacitness of knowledge, leaving blueprints incomplete. For example, when Hyundai started to build ships based on a design imported from Scotland, the firm found out that it could not fit the two halves of a hold together. The manuals did not contain the tacit knowledge vested in specific practices necessary to master the technology (Amsden, 1989:278-289; cited in Rodrik, 1999b:16, 16n8).

Implicitly, Sachs acknowledges this complication by advocating country-specific solutions, and arguing that economics has to become "less like theology, and more like medicine" (1999b:17-18). However, to reduce its contingency on Western thought,

economics may in fact have to become more like medical anthropology than like medicine, and begin to take seriously discourses other than the familiar Euro-American mode of imagining the economy. Experimentalists like Unger argue that marketization may not be the welfare-maximizing approach in all instances. Provided one had a true definition of welfare, and accounted for the complex tradeoff between free trade and ethnic or nationalist backlashes when devising development policies, this is a credible claim. Markets and economic practices experience local appropriations and interpretations that potentially displace most of their original meaning, leaving the label as an empty shell.

Experimentalism and convergence theory gravitate toward different corners regarding issues such as the degree of international economic integration and the role of the state. The emphasis on the state paired with a high-energy democracy in Unger's reform project may generate a path incompatible with the exigencies of globalization, and require a restriction of economic integration. This path may lead to less participation in international innovation and productivity gains than is desirable. Sachs' project gravitates toward the side of harmonization of domestic and external institutions and policies, leading to questions regarding the legitimacy of the rules of a system in which the most powerful countries enjoy more leverage. Even if there was agreement as to the shape of institutions that are desirable to foster economic growth and raise living standards, both experimentalists and convergence theorists are confronted with the same question. With or without a blueprint, how exactly do you create a functioning, fine-tuned system of mutually enabling institutions? The pervasiveness of crises and chaos in many parts of the world suggests that such systems are not automatically supplied by Adam Smith's invisible hand.

Perspectives on Brazil's Internal Debt

As the eighth-largest industrial nation (1997) and the country with the most uneven income distribution in the world, Brazil illustrates the difficulties that underlie development efforts. Despite a v-shape recovery from the devaluation of the Real in 1999, there is little reason to believe that Brazil is making much progress in addressing some of the underlying problems of its polity – inequality, the level and distribution of human capital, and a sociopolitical structure inhibiting effective governance.

Whatever the optimal strategy may be, its success will depend on the availability of resources. In his essay "A Segunda Via: Presente e Futuro do Brasil," Unger (2000) conceives of the forced restructuring of Brazil's internal debt to create a cash-rich state able to act as an agent of change as a prerequisite for the successful reorganization of the Brazilian economy and society. He suggests that Brazilian investors - a thriving part of Brazil's imagined community - should display solidarity. Since investors will not autonomously begin to act as patriots, Unger argues, the government must instate temporary selective capital controls (2000:35-37). To reduce the debt service burden on the budget, maturities have to be lengthened and interest rates de-linked from the overnight lending rate – a forced restructuring under the protective shield of capital controls. Through a subsequent mobilization of national resources via a high compulsory savings rate (2000:37), Brazil would be able to reduce its dependency on international capital flows, though probably not overnight.

In a comparative-static analysis, Unger's proposal to restructure Brazil's internal debt and the wise use of the funds that are freed up appears to be an effective means to

fund a process of reform. In a dynamic analysis, the balance is more pessimistic - the fourth forced restructuring of the debt in two decades might send signals to the investor community that could lead to dynamic losses that offset the potential gains. Assuming that the internal debt's term structure will be at least as unfavorable as the external debt's, the positive effects of restructuring are limited.

In addition, a premium is required since the debt is not hard currency denominated and carries a B- instead of a BB- rating. In other words, to reduce the internal debt burden in the way Unger suggests, the debt would have to be renegotiated in terms deemed unfavorable by the market. *Ceteris paribus*, Unger's policy proposal would have an adverse impact on investors' expectations, leading to a deterioration of the term structure of the external debt, and possibly capital flight, as suggested by voices from the international financial community. Unimpressed, Unger proposes to counteract capital flight by sanctioning citizens with the full force of the law (2000:37). If one assumes that expectations play a crucial role in maintaining inflows of foreign capital, the signaling effects of the policy would reduce foreign capital inflows. In December 1999, the internal debt was rated three notches below the external debt. Imagine a drop of the internal debt to CCC (well below investment grade securities), or DD (defaulted debt obligations - technically, promised payments are not being made in a scenario of forced restructuring). The rollover cost of the external debt, now downgraded as well, would rise significantly and undo parts of the gains from internal restructuring. The government's ability to issue new debt may be impaired, exacerbating fiscal imbalances if Brazil's notorious public sector deficits persist. Given its commitment to grand reform, containing negative expectations in the financial community may be difficult for Unger's program.

The short-term constraints sketched above need not be a problem if the internal savings rate is high enough, as Unger points out (2000:39-40). However, replacing foreign capital by internal savings commits the government to a very rapid course of reforms. Otherwise the short-term hardships are likely to become unbearable. The theory of expectations contradicts Unger's notion of a construction of a different model via piecemeal reforms, pointing to the short term as the Achilles heel of the project. If one perceives the long run as a sequence of short runs, short-term costs may prove prohibitive to the implementation of the grand project. At the very least, Unger's project would be distorted, not unlike the truncation of neoliberal reforms that tend to create an adverse social impact (cf. 1998:67-71).

Debt poses a problem for convergence theorists as well. Jeffrey Sachs has advocated the cancellation of highly indebted poor countries' official debt. If lenders have to bear part of the financial burden of debt relief, some turmoil in capital markets may be expected upon cancellation. Ultimately however, creditworthiness should go up as total indebtedness falls. However, official debt cancellation does not depend exclusively on the national government's determination, but also on the agenda of the international donor community. The immediate appeal of Unger's project is that it appears to put decision making back in the hand of a democratically legitimized national government. Notwithstanding, the signaling effects of Unger's project on the external front paired with practical constraints to implementing an alternative institutional regime within a short time span suggest that it carries important Foucauldian instrument effects. It may not accomplish what it intended to, but something else, and very effectively so (cf. Ferguson, 1990:255). At the end of the day, these instrument effects may be similar to

those recognized by deconstructionists in the analysis of development (cf. Escobar, 1995; Ferguson, 1990; Martin, 1997, 1998), undermining the project's humanist appeal. Given the practical constraints outlined above, the implementation of grand experimentalist reform as proposed by Unger seems to be compromised by the lack of discretion necessary for successful implementation. Convergence on the other hand may be an easier route to follow, but contribute little to addressing Brazil's underlying socioeconomic imbalances.

Behavioral Perspectives on Agency

Globalization creates opportunities as well as constraints. Hence, governments need to act strategically to maximize their degree of discretion. To inquire into options for strategic action, it is helpful to assume a messier model of human behavior than the Rousseauian type that Unger implicitly assumes or the rational actor. In this respect, it is instructive to analyze the prospects of experimentalist and convergent reform through the prism of behavioral economic preferences, biases, and heuristics.

Behavioral economics goes beyond the neoclassical model in two respects:

- (i) Prospect theory (Kahneman & Tversky, 1979) updates expected utility theory underlying the rational actor model by introducing more realistic behavioral preferences;
- (ii) behavioral scientists have identified a host of biases and heuristics (cf. Tversky & Kahneman, 1982) that lead individuals to an imperfect processing of available information. If these biases and heuristics are universal, there will be systematic deviations from the behavior predicted by the rational actor model. Unrecognized, these deviations undermine reform efforts. Taken into account, they provide a platform for strategic action, as a brief discussion in the context of Brazil's internal debt demonstrates.

The implications of prospect theory are compounded by other behavioral phenomena. First, behavioral economists such as David Laibson hold that agents' discounting functions of future payoffs are hyperbolic rather than exponential (cf. Laibson, Repetto & Tobacman, 1999:7-9). Behavioral hyperbolic instead of exponential discounting reinforces the necessity of rapid successes. The payoff of any success in period $n + 1$ is heavily discounted while the discounted payoff does not change much in future periods. Since losses are discounted as well, postponing losses and anticipating gains seems to be a dominant strategy to remain in the driver's seat of a reform process. Second, any social interaction is shaped by a number of heuristics and biases beyond loss aversion.

Ultimately, the crucial question is whether a sufficient number of individuals believe that the administration will be successful in the implementation of the program, pointing e.g. to the importance of leverage over the media to influence expectations. It is debatable whether the air time granted to Unger's advisee, presidential candidate Ciro Gomes, due to his liaison with a former soap opera actress is sufficient. Marketing Unger's project requires a deconstruction of Brazil's oligopoly ownership structure of mass media (cf. 2000:43-44).

Amos Tversky and Daniel Kahneman argue that an insensitivity to predictability and the resulting illusion of validity (1982:8-9) leads individuals to assess the likelihood of a future event based on the information they are given, regardless of its reliability. In addition, even if one forms an adequate expectation of the event of a failure to reform the economy, biases in the evaluation of conjunctive and disjunctive events (Tversky & Kahneman, 1982: 15-16) lead individuals to overestimate the probability of a conjunctive event. Likewise, agents tend to underestimate the probability of disjunctive events such

as “within the next four years, the administration will be replaced,” when the probability of the simple event in any given period is 5%. Tversky and Kahneman’s observation has two implications for Unger’s project.

(i) The *de facto* difficulty of controlling Brazilian communications media short of the implementation of a totalitarian system constitutes a practical problem, and

(ii) a limitation of the freedom of expression would undermine Unger’s goal of transcendence of existing structures for the sake of emancipation, a teleological problem. Another source of tension is introduced by the bias of imaginability. According to Tversky and Kahneman, the biases of imaginability (1982:13), that is, the ease of imagining the risks or benefits associated with a particular behavior lead to a gross misestimate of the probability of the associated outcomes. Failed reforms and phenomena such as hyperinflation and a depression inspire a more vivid imagination than successful reform.

Behavioral phenomena are equally pertinent in the implementation of convergent reforms as advocated by Jeffrey Sachs. While Unger’s project may be jeopardized due to resistance by the global financial community, Washington Consensus policies may trigger domestic resistance, as the Mahuad administration has experienced in Ecuador. Intuitively as well as analytically, it makes sense to assume that smaller adjustments are easier to implement than larger ones. On the other hand, behavioral economics suggests that agents should dribble good but not bad news (say, a tough adjustment). Whatever the case may be, framing seems to be a powerful device to secure the necessary level of support. Hugo Chavez has demonstrated that an abysmal economic performance need not be correlated with approval ratings in the short term, provided the government is able to draw on other mechanisms to create meaning.

Conclusion

A brief discussion of projects of socioeconomic reform based on the assumptions of behavioral economics hints at the difficulty of producing intended outcomes, and points to the importance of framing of issues. A deconstructionist reading of the complications associated with grand projects for positive change such as the project of development in general, and Unger’s reform of the Brazilian economy in particular, suggests that projects of grand reform and development are likely to end up creating outcomes other than the ones intended.

It is important to note that the success of big bang market reforms in transition economies is as constrained by behavioral phenomena such as the status quo bias as radical experimentalist reforms are in market economies. In addition, a deconstructionist perspective on reform suggests that the widespread lack of recognition of the embeddedness of objective interests in multilayered and polyvalent structures which are partially invisible to their inhabitants tends to foster outcomes that are “a baroque and unrecognizable transformation of the original intention” (Ferguson, 1990:275).

The relation between blueprints and outcomes is crucial for the apprehension of developmental projects of convergence and experimentalism. If international economic integration is to proceed, global society needs to set off a process leading to a restructuring and humanization of global bureaucracy, creating a global federalist system that corrects for the worst inequalities (re)produced by the world system, without stifling its capacity to innovate, raise productivity, and thus improve living standards.

Rather than a potentially nihilistic perspective, drawing attention to invisible facts and unreflected assumptions may broaden the scope for strategic action within existing relations. Behavioral economics provides pointers concerning the framing of development initiatives. To be able to appropriately define goals and to maximize the likelihood of success, agents should deploy strategies that capitalize on the insights generated by deconstruction theory and behavioral economics.

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Governance in the Information Age: Industrialized and Developing Economies and the African Challenge

Mouslime Kabbaj

Introduction

As information technologies increase their impact on economic growth and employment rates in the First World, the stakes are getting higher to setting up policies to generate, process and disseminate this asset not only nationally but also internationally. I believe that the Information Age is as important for Industrialized Countries (ICs) as for Developing Countries (DCs), and is at the crossroads of new challenges regarding globalization and governance. The cost for not being proactive in this global revolution, and for not endorsing appropriate policies, will be worse than that necessary to embark unprepared and improvise during the process. I also believe that the later the action is taken and supported by all actors, in the North and in the South, the more dramatic the situation will be for the large majority of the world's populations. Few countries and peoples will be spared by poverty and unemployment, lack of healthcare, and evolving regional conflicts and tensions, as some will be living in the information era and others in the era of the horse and cart.

In order to succeed at the national level, the approaches taken need to be holistic, integrating the government at all levels, the private market, and civil society, as well as requiring international cooperation and partnership, with strong leadership from top national officials. In DCs fundamental reforms should be considered, related to democracy and openness, decentralization and accountability, and economic rules of the game. All steps should be taken to support citizens' empowerment and to enable an innovative society, as well as to improve competitiveness and welfare. Information technologies represent a significant opportunity to strengthen DC's reform policies.

Realities of the Information Age-Information Technologies

It is worth noting that Montviloff (1990) and Blanc (1985) refer to information as only one step on an intelligence ladder, which grows from data, to information, knowledge and finally wisdom (GAI, 2000). Information can actually be defined as synthesis and interpretation of data that have been organized; processed and structured in order to make sense in the context of use and according to a purpose. Knowledge, which leads to the concept of knowledge worker, is founded on the use of information allowing a judgment.

Information networks are being constructed today using a variety of technologies, including microprocessors, memory, digital storage, broadband networks, video, broadcast and cable TV, the Internet, wireline and wireless communications. Presently, information and data are delivered on a routine basis all around the world on land and undersea via hybrid fiber coaxial cable and integrated digital networks, via radio spectrum, as well as telecommunications satellites.

As the world gains experience of information technologies, various considerations are elaborated to assess their impact on growth, governance and development. Winograd and Buffer (1996) stated that "information is more valuable

when it is shared that when it is hoarded, that it makes a premium not on size or mass, but on speed, and that information makes geographic distances less relevant by shrinking time and space." Keohane and Nye (1999) argued, "the real difference in the new information revolution lies in the reduced cost of communication, not only in the velocity of any individual communication." Moreover, "the institutional velocity reflects not only individual linkages but networks and interconnections among networks". It is clear that depending on the users' and institution's perspective, size, speed and costs are essential features. As far as globalization is concerned, costs and institutional velocity links are dominant factors, whereas shared and disseminated information is more related to governance.

The big picture involves continuing development, deployment, and adaptation of the technology and of all capacities that enable continuous innovation and learning. In that regard, I agree with the statement of the World Bank (WB, 2000) stating that:

"IT diffusion involves more than acquiring computerized equipment and micro-electronic-based product designs and related know-how, but also the development of technical change-generating capabilities, to adapt a given technology to a widening range of needs. Continuous improvement after acquisition is essential to sustain competitiveness."

The need for good management at the institutional level, good governance at the national level and education-related policy need to be addressed. Employment also is becoming a priority issue, as "sophisticated computers, telecommunications technology, robots and other intelligent machines are replacing traditional jobs" (Pfister, 1999). Countries with less skilled workers, less education, the poorest infrastructures, and the lowest investment in IT and in continuous training are then likely to pay a higher price in terms of development.

The information technology market is highly concentrated in the G7 countries, which accounts for about 88% of the world market for goods and services (Mansell and When, 1998). A number of indicators acknowledge the positive correlation between economic growth in ICs and investments in IT. Pahjola (1999) emphasizes the strong influence of information technology in the production of goods and services on economic growth in industrialized countries as well as newly industrialized countries. He notes that "computers and peripherals have accounted for 8% - 9% of the annual GDP growth in the United States, 16% in Finland, 19% in Singapore and 32% in the Republic of Korea, and that developing countries seem to have neither invested in IT nor benefited from such investments to the same extent than IC."

New corporations in ICs, the initiators of the process of managing successfully information technologies, reshaped their organizations and their objectives:

"success was depending on a quick non-bureaucratic response to the changing needs and desires of one's customer, ability to offer services and products that were better and cheaper, on becoming the best in your own domestic market and in the world" (Winograd and Buffer, 1996).

Moreover, as the success of the corporation and the accomplishment of common objectives were dependent on each individual, flat structures of employees linked together and exchanging data and information became the rule. Most corporations had to transform themselves and reengineer their organization or loose market share. Multinational companies had to reduce the importance of physical distance and transportation costs, linking their design, procurement, logistics, and marketing through Internet-based

technologies (Pahjola, 1999).

The information revolution impact and its benefits on the economic environment have prompted governments to participate and exploit the new advantages they bring. Along the way, it will probably change the governance principles and the balance of power, and as stated in GAI (2000), "accelerate the processes of value change as it exposes the people to new information and to new ways of dealing with that information."

Governance in the Information Age

The knowledge workers who emerge from private corporations and self-managed teams are serving as organizational models of the information age (Winograd and Buffa, 1996), particularly for governments. In addition, information technologies bring about new means for accountability and measurement of public service, as well as new demands from the community.

At the dawn of this new era a government is required to do the right thing in the right way. In other words, as Kamark (1999) has stated, the actual expected changes are less in the purpose of government and more in the form and organization of government. All states are focusing or should focus on "making a government smaller, more efficient and more responsive to the citizen." Three models seem to emerge since the beginning of the efforts to reform the government to tackle the changes at different levels of innovation, transparency and accountability (Kamark, 1999): entrepreneurial government, networked government, and market government. Peters (1996) has presented a slightly different analysis regarding the new types of government - market government, participative government, flexible government and deregulated government. Moving away from command and control methods, which are inapplicable in this new context, good government attempts, in all cases, to create a more efficient and effective public service, with a flat organizational structure that is close to its citizens. As such, I believe that all these models are properly suited to tackle the information age.

Isolated strategies in ICs do not lead to the same results as holistic approaches with regard to good governance at the information age. National officials that have set up a strategy to promote the use of information and communication technology respectively in the Republic of Korea and Singapore were considering it primarily as a tool for the economic development. Moreover the national strategy in Singapore consisted (Pohjola, 1999) of state intervention in information and communication technology, and manpower development, as well as of using the public sector as a lead user in deploying new IT. In the USA, IBM's Institute for Electronic Government is no more than a resource for government leaders to explore, understand and develop new insights for dealing with information age stakes (GAI, 2000).

While looking at New Zealand, Great Britain, or the Clinton administration's reinventing government programs, it can be noted that the reforms have been initiated from inside the country. In most of the DCs, it has been imposed by international or bilateral cooperation, and often set up with their support (Grindle, 1998). In my view, the question of good governance in DCs is objectively addressed as a global issue in addition to being a national issue. A new set of relations at the international level should in fact be organized vis-à-vis the practices of good governance in industrialized countries. I share the concern of the Commission on Global Governance (1995) that considers that global governance should imply a decentralized system built on a common set of values;

neighborhood values. These are to maintain peace and order, expand economic activity, tackle pollution, check greenhouse warming, combat endemic disease, curb the trade in weapons, prevent desert growing, preserve genetic diversity, deter terrorists, ward off famine, save species, defeat economic recession, share scarce resources, and beat drug traders. Because of the globalization process, good governance for ICs and particularly the leading actors means global good governance, which should encompass the DCs. Governments, intergovernmental institutions, multinational corporations and the global market, the global mass media, international NGO's are challenged by this need. Within the DCs boundaries, central and local governments, private sector and NGO's, citizens are also challenged.

Globalization Versus Decentralization in the Information Age

The promise of greater productivity and a higher standard of living comes with globalization, as it brings new opportunities, an expanded market, and a spread of technology, expertise and information. With decentralization comes a greater ability to participate, as it brings greater ability for citizens to shape their life, to respond more, and to be empowered in local government. As stated by the World Bank (WB, 2000), "both globalization and decentralization are driven by powerful underlying forces like the capabilities of information and communication technologies, and a rising sense among the people all over the world that they are entitled to participate openly in their government and their society." They will with no doubt increase in intensity. With the rise of a global information economy, geographical location is likely to matter less.

Indeed, cities like New York, London, Tokyo, Paris, are already acting as independent and international actors as well as providing high quality services to constituencies, based on strong capabilities in computing and telecommunications. The trend appears to be spreading. Heidelberg in Germany, Marseille in France, and Vienna in Austria have introduced IT into their administration for globalization and decentralization purposes. In the US, Boston, Seattle and others are on the same track (GAI, 2000).

In parallel, non-governmental actors have increased considerably in number and in influence in world politics and in international organizations. The attendance in the Davos forums or UN conferences by governments, corporations, and civil society precludes major changes in that regard. As the degree of interdependence is rising and decisions are transferred to an international level of governance, as suggest Rittberg and Bruhl (1999), the distance between policy makers and citizens should further decrease. They consider that civil society should be further involved in decision processes and that decentralization should be improved, so as to reflect the actual distribution of powers, the shape of global affairs and to contribute in making decisions collectively. I am convinced that information technologies, the spread of information and the easy access to these kinds of tools for individuals and NGO's will act as an accelerator in that regard.

We cannot skip the fact that globalization is viewed by many as bringing instability and unemployment because of fierce competition and flows of foreign capital. The information age is equally eliminating various levels of bureaucracy and management, and welcoming high-skilled knowledge workers, often in limited numbers. Bangalore, in the Southern State of Kamataka in India and actually considered the "Silicon Valley" of the region, has entered the information age. In this sister state of Massachusetts, Bangalore combines a sophisticated software industry and highly skilled labor pool,

which makes it (GAI, 2000) the "harbinger of a new global labor force that works in Cyberspace and that operates beyond the reach of governments." It appears that Bangalore faces the same problems that affect the large majority of cities in DCs, with dramatic tensions due to the presence of multinationals. While IT salaries are around \$10,000 annually, the average income in that city doesn't exceed \$400.

Africa's Position: Information, Information Technologies, and Development

The African continent has inherited a situation where roads and railways lines were built from the interior of the country to the harbors, and telegraph and telephone communications were constructed in order to stay in touch with colonial home capitals. Carved in different zones of influence, Africa was only subject to policies to further the development of the colonial countries and their peoples, thus leaving behind local people. The traditional small-scale local communities were preserved in some areas, whereas they were broken in others. The social and political systems sometimes tended to organize into networks with strong leadership for protection, problem solving and conflict resolution, not so in others.

Presently, the economic environment of the African continent is improving. The countries' annual growth has reached 4% on average; a few have reached 5% to 8%. The majority of African leaders and observers acknowledge that development needs reinforcement of macroeconomic stability, consolidation of financial sectors, review of judicial, legislative policies, efforts of regional integration, democratization process, and good management of public affairs (Camdessus, 2000). In other words, good governance is the only option if Africa is to reach 6% to 8% growth that is needed, as stated in 1995 at the Copenhagen Conference.

Most countries cannot have adequate and national use of IT unless the governments themselves are extensive users of the technology. Hanna, Guy and Arnold (1995) consider that the role of governments should be to promote diffusion of IT among lagging users such as SME's and social sectors and to expand private sector choices. Pahjola (1999) states clearly that DCs need not only to formulate national strategies to promote the use of IT, but also that the IT content of the investments should be high. Exporting firms must adopt the information age trend to remain competitive and to be linked to production networks, as well as to the global innovation network. To be able to maximize the benefits from investments in IT, DCs should build a mature national infrastructure, which amplifies the effects.

The experience of management that I had, as Director of the Royal Center for Remote Sensing in Morocco, proved to be a demonstration of successful government investment in IT. The national center was dealing with the distribution of satellite images, as well as adequate transfer of technology and appropriate training for the end-users. This high-technology tool was finally used in agricultural planning and statistics, prospecting of water research, desertification and vegetation stress monitoring. It allowed the expansion of the private sector in the field of geographical information systems and led to the setting up of a network of specialists. The movement was indeed amplified nationally, but also internationally as the national specialists developed specific expertise in different fields and was called for at regional and international levels. However, such experiences are still isolated and often not sustainable under local conditions.

These developments are often hindered in Africa by regional conflicts and

human security, authoritarian regimes and financial crisis. Several countries face a pressing need and prerequisite to preserve human security; which means "safety from the constant threats of hunger, disease, crime and repression; which also means protection from sudden and hurtful disruptions in the patterns of our daily lives, our homes, our jobs, our communities, our environment" (UNDP, 1994). Africa is the most challenged continent, a continent devastated by internal and evolving conflicts and their dramatic results.

Conflict Resolution Versus Decentralization Versus Globalization

Conflict management and governance are clearly related. The main goal of a country is to maintain peace within its borders. In that regard, Shaw and Schnabel's essay (1999) is consistent; sustainable peace and good governance are interrelated. In the African context, more than elsewhere, states must be held accountable to national, regional and international constituencies. There is room to be optimistic. The end of thirty years of conflict between Ethiopia and Eritrea, the state of non-declared war between Morocco and Algeria, despite the tension due to the Sahara crisis, efforts to rebuilt Angola, Guinea-Bissau and Mozambique, to make the transition from state socialism, economic reforms in Ghana, the transition in Nigeria to a civilian regime and in South Africa to a democratic system provides models of quite successful African governance (Deng, Kimaro, Lyons, Rotchild and Zartman, 1996).

To promote security and development, as in other regions of the world, good governance in Africa should involve increasingly government at central and local levels, the private sector and non-governmental organizations. Similarly, as in other continents, the World Development Report (1997) clearly encourages governments to downsize and reform the public service, as well as further empower the private sector and NGO's in order to deliver efficiently and effectively services and basic needs.

Africa in the Information Age: Remarks and Recommendations

African countries should strengthen good governance and all related organizations and institutions, particularly in setting up the necessary laws and regulations. As stated by the World Bank (2000), rule-based processes increase transparency policies designed to create desired outcomes and accountability of organizations to implement them. The legal system should offer equal treatment and protection to foreign and domestic investments, as well as human capital environment. The reduction of corruption and open markets for competition are essential prerequisites.

Lessons can be drawn from East-Asian countries where investments in education were significant, particularly in science and engineering. Creation of a learning economy is similarly a key to success in Africa. The system requires an economy that rapidly absorbs information and knowledge, diffuses it, and is adaptive to the changing environment. For the new information age to spread in Africa all barriers should be removed and innovation welcomed. Taxes, tariffs and other trade barriers on hardware and software should be eliminated or reduced appropriately. Competition in telecommunications should be encouraged.

All political constraints on IT development and diffusion are likely to impact negatively on economic growth. In addition, a fast growing software industry should be considered as presenting opportunities and a variety of niches for African countries. Initiatives such as the African Information Society Initiative (AISI, 2000), which

concentrates on focused and realistic objectives, are good models of adaptive projects. A stronger and dynamic involvement of all African countries at all levels of governance, supported by industrialized countries and international organizations will thus be likely to lead the continent into the information age and greater human security.

Conclusion

In this paper, I have identified the main trends of the new economy and its relation to information technology development. The industrial countries' socio-political environment is described, particularly the benefits of empowering people in active governance and democratic institutions. The virtue of decentralization in the globalization process is analyzed in that context. Hence, the global responsibility of industrialized countries needs to be based on neighborhood values, encompassing the whole community of nations.

The main issues at stake raised for the industrialized countries are used to review developing countries' position, particularly the African ones, vis-à-vis the information age. The major constraints in the continent are identified: regional conflicts, type of governance and leadership, non-competitive economies. Similarly, the global responsibility of the developing countries is considered a cardinal condition in order to converge toward a global information infrastructure distributing welfare, human security and shared values.

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Financial Globalization: Myths and Realities

Jerry Tardieu

Financial globalization reflects a host of forces, two of which are crucial: Foreign direct investment (FDI) and capital account liberalization. These two important dimensions of globalization are the subjects of heated debates. Yet, many of the main arguments raised on each side (by advocates and skeptics) should be tempered with a little common sense and realism in order to separate mythology from economic reality. Indeed, these two areas provide an excellent framework for analyzing some of the myths and realities often associated with contemporary aspects of financial globalization. The following paper will briefly address one of FDI's most common misconceptions before assessing in more details the dangers of premature capital account liberalization for small open economies without the adequate institutional and financial structures and the appropriate policies.

Foreign Direct Investment (FDI)

Some argue that foreign direct investment (FDI) has had an unprecedented impact on the developing world in the past ten years. This is only true in theory. Indeed, more than 80% of these funds are invested in five countries: Mexico, Argentina, Brazil, Russia and Poland. Therefore, accounting FDI as the primary source of external finance for 'developing countries' and a major characteristic the new global financial reality is simply false. Moreover, there is no correlation between need and investment. In Africa, where infrastructure of all kinds is cruelly lacking, foreign direct investment fell by 27% between 1994-95 and accounts for just \$2.1 billion, that is 3% of total world investment. The hope that capital can escape domestic low yield projects and travel internationally to less develop countries offering interesting investment opportunities is yet to materialize. Only when it does, can the developing world begin to build employment opportunities through the acquisition of technological and managerial capabilities leading to productivity growth.

The chances of developing countries attracting greater level of capital have now diminished. The decade has started with a boom in Wall Street where investors are taking advantage of the high rewards of I-stocks. Their appetites for emerging markets have, at least temporarily, abated. Very few developing countries are likely to gain from integrated international production in the near future. Nor are they likely to attain higher relative wages, access to improve management techniques, new technology, and marketing links. The vast majority struggle to attract investment despite the adoption of appropriate policies. These comprise restrictions on foreign ownership, a liberal trade and payments regime, open access to land and labor, low and uniform taxes and reduced limited public sector involvement in the economy.

Capital Account Liberalization

Skeptics of globalization have warned against capital account liberalization for small open economies claiming that short-term indebtedness causes economic downturn. Indeed, the past decade was a period of unprecedented international lending as the

outstanding stock of debt of emerging-market economies (mostly short term) went from \$ 1 trillion to \$ 2 trillion between 1988 and 1997. Most of the countries affected by the financial turmoil of the 90s had large ratios of short-term foreign debt (public or private) to international reserves. In each case the combination of large short-term liabilities and relatively scarce internationally liquid assets led to a confidence crisis, a collapse in exchange rates and a reversal of capital flows (Rodrik, 1999).

It is inaccurate to consider capital account liberalization as the sole cause of the financial crisis. The reality is that if individual nation states adopted right policies and implemented appropriate institutional and financial reforms in the first place, their economies would not to be suddenly wiped out by financial swings. Financial crises have more to do with inadequate policies and banking supervision, rather than open capital account policies. In order to meet the challenge of capital account liberalization, developing countries have to correct some major systemic weaknesses and their financial systems must respond to basic principles of transparency, sound banking, and private sector participation. The potential benefits resulting from capital movements are substantial only if supported by the appropriate economic policies, institutions, and financial sector stability.

Just as greater international capital flows can bring benefits to the developing economies by allocating savings and investments efficiently, the integration of financial markets has also proven to be dangerous and destabilizing. As this 'hot' capital travels the world in search of higher returns, nations can find themselves flooded with money from abroad one day, deprived of it the next, for these short-term funds can escape just as rapidly as they arrive. In some cases, events can happen so fast that the most advised analysts could get caught by surprise.

For example, before the East Asian financial crisis of 97, for the last three decades, East Asian countries' GDP per capita had consistently grown at an average of 5%. These gains had brought extended lifespans, increased educational opportunity, and a dramatic reduction in poverty. The macroeconomic policy stance was not a major contributing factor in precipitating the Asian crisis. The key trigger for the crisis was the buildup of excessive external liabilities largely in the form of short-term commercial bank credits to private borrowers in an increasingly integrated global financial system. In this context, not only domestic policies and institutions were unfit, but also the providers of external capital and their regulatory authorities failed to recognize the weaknesses of the East Asian borrowing countries and greatly overlooked the danger signals. By pursuing rapid domestic financial and capital account liberalization without developing complementary regulatory structures, the East Asian economies had put themselves in a vulnerable position.

The Mexican Case

As William Greider so vividly illustrated in his analysis (1998), the Mexican case remains a poignant example of the problems linked with massive and sudden capital outflows. In early 1994, President Clinton and his senior advisors promoted a newly modernized Mexico led by reform minded technocrats educated at Harvard and Stanford who believed that Mexico's liberalization policies were the key to prosperity. Two years later, Mexico was in ruins. Its economy had contracted by 7%, its financial and banking sector was in crisis, and millions of jobs were lost. Could it be that Clinton's advisors were

wrong about their Mexican counterparts? No, the answer does not lie in that.

In fact, David Gergen, then Senior Advisor to Clinton and now Public Service Professor at Harvard's Kennedy School of Government, met with Mexico's highest level officials on many occasions and found them to be 'top class' by any international standard. For Gergen, there was no doubt that Mexico's governance was in the finest hands. Yet even these brilliant minds seemed powerless against the ravages of unregulated 'impatient' capital. To really understand what went wrong in Mexico and figure out why the Mexican Government was defenseless, one first needs to understand what triggered the Mexican financial boom before the bust occurred.

Thanks to financial globalization and subsequent liberalization of capital flows, international investors took advantage of interest rate differentials between the US and foreign financial markets, that provided attractive arbitrage opportunity. Essentially, by borrowing in New York where interest rates were then comparatively low, an investor could use that money and purchase Mexican bond to capture important spread returns ranging from 5% to 8% annually, betting on the exchange rate remaining stable within an understood range. As more investors were motivated to do this, the price of Mexican bonds naturally soared and the market index quickly quadrupled. Smart and well-informed investors reaped enormous profits by borrowing in the United States and purchasing Mexican financial assets on the short term dollar denominated market. In 1994, the inevitable happened and the arbitrage game came to an end (Greider, 1998).

As Mexico's dwindling foreign reserves could not support the peso, the country had to devalue its currency. Both domestic and international investors panicked, taking \$25 billion out of Mexico in less than two weeks. The sudden crash spread around the world. Latin American markets fell by 38% in two months and Asian markets by 21%. Governments had to step in to save Mexico and rescue US investors. An embarrassed Clinton administration took the lead by assembling an international bail out of US \$50 billion to salvage the situation. Yet investors and technocrats alike quickly forgot the Mexican crisis. The US administration was no different. A smiling Bill Clinton posed in a colorful batik shirt at the 1994's Asia-Pacific Economic Forum (APEC) meeting and expressed his admiration for Indonesia's model of open economy. Indonesia was described as one of the ten "BEM" – big emerging markets – where per capita income was expected to triple. The country was enjoying its second decade of vigorous growth. However apparent rising prosperity was founded upon fraudulent private business, systemic government bribery and corruption. In 1996, amid political unrest and economic uncertainty, 'impatient' capital fled the country, within hours. The Indonesian economy was left in ruins.

Conclusion and Recommendations

Many lessons can be learned from the past financial crisis. The most obvious one is that excessive premature openness to foreign capital can be devastating for countries whose institutions, norms and rules are not appropriately structured. The alternative retreat to old fashion protectionism could result in economic stagnation. Few can now dispute the potential benefits resulting from capital movements if supported by the appropriate economic policies and financial institutions.

More specifically, countries can, for example, eliminate the tax, regulatory, and policy distortions that may, in the past, have stimulated excessive short-term capital

flows. For example, without risk-based capital requirements for banks, incentives for holding certain assets and liabilities will be altered. These measures may not go far enough, especially considering that corporate exposure may itself give rise to vulnerabilities. Therefore, countries could impose a reserve requirement on all short-term capital inflows to lengthen the maturity composition of these inflows without having adverse effects on valuable long-term capital.

Tax policy measures could also limit the extent of tax deductibility for interest in debt denominated or linked to foreign currencies. In this regard, a country like Chile has led by example. Its remarkable economic expansion and gains of the 1990s were solidified with major structural legal, economic, educational and social reforms. In the area of governance, Chile emphasized on transparency and efficiency in the public sector and regulated short-term capital inflows to be less vulnerable to hot money.

The orderly liberalization of capital flows and modernization of the international markets on the basis of universally accepted standards must be on the top of governments' agendas. Many countries deregulated their financial markets without the necessary accompanying laws and regulations, accounting and auditing procedures, transparency and disclosure, supervision and enforcement and settlement systems.

Instead of relying too heavily on foreign capital, governments through innovative appropriate economic and social reforms can create incentives for higher levels of local savings. The stock of local savings minimizes volatility of resources available (if appropriate real returns and risk level is provided). This way, through pension funds accumulating a base of funds, the next step would be to guarantee that those resources are channeled through productive investments and programs.

There are no simple answers to complex problems. With liberalization of capital, both wonderful opportunities and devastating setbacks are possible. To the extent that financial crises can be related to exposure in short-term foreign-denominated liabilities, countries should restrict those liabilities to reduce their vulnerability. But, most importantly, they must strike a balance.

This means adopting protective policies that do not jeopardize their attractiveness to foreign investors while strengthening their financial systems through bank assets restructuring, better risk assessment procedures, disclosure systems and accounting standards. Simultaneously, they should also promote ways to encourage long-term investments and institutions, norms and rules that are appropriately structured.

Because each country possesses unique circumstances, they need to prepare their own path to liberalization, under carefully tailored conditions with preliminary identification and assessment of steps to be taken individually to define a proper timetable. Failure to do so can only invite further instability. Far from being a myth, we know from experience that such outcomes can be reality.

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The Effect of Moral Hazard on the Valuation of Emerging Market Sovereign Debt

Steven Rahman and Jonathan C. Abshire

When valuing emerging market debt, investors may be influenced by moral hazard. This is especially likely during periods when the yield spread between US Treasuries and emerging market sovereign debt is compressed. Looking at twenty-five of these emerging markets, we found that pre-crisis yield spread compression could not be explained by changes in economic fundamentals alone. While moral hazard undoubtedly exists in debt capital markets, an attempt to quantify or to prioritize it offers little gain to the investor, in the absence of an understanding of how economic fundamentals affect yield spread.

This analysis required the development of an objective function derived from the literature surrounding the theory of moral hazard and the literature that describes the determinants of the yield spread. An econometric model was developed that attempted to understand the effect of a change in economic fundamentals, agency ratings and crisis atmospheres. The analysis determined that there was a strong likelihood that moral hazard existed during pre-crisis periods. Despite this, the analysis does not recommend that investors prioritize the understanding of or attempt to quantify the moral hazard effect. Rather, investors should develop a model which attempts to explain the effects of changes in economic fundamentals upon the yield spread.

Statement of the Problem

Following the international economic crises of 1994, 1997 and 1998, some of the debate centered on the problem of moral hazard. Moral hazard results when an insured party has an incentive to alter its utility maximizing behavior in order to capture a larger payoff from an insurer. Much analysis centered on the policies of the World Bank, the International Monetary Fund, and in some cases the United States Treasury. Within the context of moral hazard, these institutions are referred to as *lenders of last resort*. In the context of the moral hazard question, they act as insurers. This paper examines how *lenders of last resort* may alter the behavior of debtor nations and investors. The authors hope to address the following questions:

- What role if any does moral hazard play upon the determination of the yield spreads between emerging market sovereign debt securities and U.S. Treasuries?
- How should investors consider when valuing these bonds?
- Is it a priority of an investor to understand how moral hazard affects the yield spread? Can an investor develop a system or framework that can help to understand moral hazard in the context of its investment decisions?

An Example of the Moral Hazard Effect

Suppose that an emerging market sovereign is attempting to raise capital to fund an infrastructure project and discovers that the cost of borrowing the funds is less than originally anticipated. The sovereign begins to issue more dollar-denominated debt because of the low cost and also begins to allocate funds to projects unrelated to the original infrastructure project. This allocation creates the illusion that the sovereign is more sound than economic fundamentals would indicate, which in turn results in an appreciation of the sovereign's currency and allows it to issue even more debt. The process continues until a neighboring sovereign defaults on a loan or a bond.

At this point, investment analysts begin to review the economic fundamentals of all of the sovereigns within their emerging market debt portfolios and discover that the yield spread cannot be justified. Investors begin selling the debt, depreciating the currency and perhaps, causing the sovereign to default also on its debt. Alternatively, investors do not sell and the sovereign does not change its behavior immediately, since both parties assume that the International Monetary Fund or another *lender of last resort* will intervene to ensure that the sovereign will not default. Anticipating this intervention compresses the yield spread prior to the crisis. Many attribute this pre-crisis spread compression to a moral hazard effect.

What is Emerging Market Debt?

In almost every case, emerging market debt may be grouped into one of four categories: Brady bonds, bank loans, Eurobonds, and local issues. Brady bonds are defaulted sovereign bank loans that have been converted into long-term, dollar-denominated bonds using zero-coupon U.S. Treasury securities as collateral for principal payments, and which frequently use money market securities as collateral for some interest payments.

In 1989, Mexico became the first country to enter a Brady agreement. Soon thereafter, many other large debtor nations signed their own agreements. This created a market in which a majority of Brady bonds were from the largest debtor nations. And since much of the international commercial bank lending to developing nations during the 1970s and 1980s was to Latin America countries, Brady bonds were largely issued from this region.

In this analysis, the authors consider how the stripped yield spread is affected by changes in economic fundamentals for the countries within the EMBIG, the Emerging Market Bond Index Global that is produced and managed by J.P. Morgan. In developing this index, J.P. Morgan "defined an emerging country as one that has per capita income of less than US\$7,000 or has defaulted on or restructured its external debt within the last ten years" (*Emerging Market Debt*, Cambridge Associates, 1999).

The Theory of Moral Hazard and Unobservable Behaviour

The authors' methodology is grounded in two groups of literature. The first has provided insight into the factors that determine the yield spread. The second described moral hazard.

By understanding the determinants of yield spreads, it can be determined whether or not investors (buyers of emerging market sovereign debt) and the market for sovereign debt are making their decisions based on the available economic fundamental information.

If economic fundamentals can explain changes in the yield spread completely, then one may assume that the market is pricing sovereign debt efficiently. However, it is possible that economic fundamentals cannot explain all of the change in yield spreads over time. Specifically, pre-crisis yield spread compression is not likely explained or predicted by fundamentals and could be the manifestation of moral hazard.

'Moral hazard' describes a behavior that surrounds the principal-agent problem. The Principle- Agent Problem is illustrated as follows:

"Consider two individuals who operate in an uncertain environment and for whom risk sharing is desirable. Suppose that one of the individuals (known as the *agent*) is to take an action which the other individual (known as the *principal*) cannot observe. Assume that this action affects the total amount of consumption or money which is available to be divided between the two individuals. In general, the action which is optimal for the agent will depend on the extent of risk sharing between the principal and the agent" (Grossman and Hart, 1983).

In a principal-agent problem, if the outcomes that are conditional upon the actions of the agent are unknown or uncertain, then the behavior of the agent is unobservable. Where the agent's utility is bounded, an optimal equilibrium may be approximated through the use of contracts. Within general models, solutions may not always be found through the agent's first order conditions.

J.A. Mirrlees attributes the interest in unobservable behavior by agents to the work of Mark Pauly in 1968 and to the work of Kenneth Arrow in 1970. These authors did not suggest or describe a model for these situations. Instead, they argued that "insured persons who fully exploit their contracts, expressed in terms of observable behavior, thereby reduce the efficiency of the economy" (Mirrlees, 1975). Mirrlees disagrees and argues that there are many cases in which self-interested unobservable behavior does not lead to significant losses of efficiency. Rather, he argues that if every participant were to act fully in their own self-interest, and if these interests are known, then the unobservable behavior can be 'observed' and contracts can be written accordingly.

In 1970, Richard Zeckhauser built upon the work of Pauly and Arrow. Zeckhauser's paper was described by Mirrlees as "the first formal model of moral hazard" (Mirrlees, 1975). Zeckhauser discussed the behavior of patients that chose insurance policies where payments were proportional to medical expenditures. If an insurer can fully monitor the actions of the insured and the actions of nature, then it is less likely that adverse incentives will exist. However, when an insurance payoff is dependent entirely upon the insured's actions, then "the insured will be induced to alter his natural maximizing action somewhat" in order to increase the payoff from the insurer (Zeckhauser, 1971).

Within the context of the yield spread question, the moral hazard effect suggests that yield spreads, at times, may decline to levels that do not compensate the investor for the appropriate level of risk. This may occur due to the existence of *lenders of last resort*. That is, the behavior of the insured or the agent (the country, the sovereign and investors) may be altered by the existence of insurance provided by the International Monetary Fund or other *lenders of last resort* such as the United States Treasury in the case of 1994 Mexican Peso crisis.

Insurance companies limit the moral hazard problem through the use of deductibles. For less creditworthy customers, or for customers who demonstrate costly behavior, the deductibles are likely to rise. An example of the use of "deductibles" within the context of international lending was recently reported in *The Financial Times*. The article described "the Japanese policy of refusing new bilateral aid to countries that default on debt", which is significant in that Japan is the largest source of foreign aid in the world. The logic is clear: Japan hopes to instill financial responsibility in debtor nations with the threat that they will be ineligible to access large and available pools of aid monies should they lack discipline (Fidler, 2000).

Methodology

A great number of potentially important variables were identified in the course of our literature review. Economics is rich with explanations for the relationship between investment performance and economic performance. While we would rather take more of these variables into account than less, reducing the magnitude of omitted variable bias' distortion of our estimates, we faced great constraints in terms of data availability. Data on yield spreads was made available in the form of a short time series for a composite of sovereign issues by country. Economic data from the International Monetary Fund's International Financial Statistics database were available at quarterly frequency sporadically. Twenty-five countries were selected from J.P. Morgan's Emerging Market Bond Index, Global.

For the selected countries, the authors chose a selection of regressors that adequately captured national liquidity conditions, economic stability and the quality of national economic management, source of exogenous shocks to emerging economies and market sentiment. While a great number of potential variables were of interest, there was a trade-off to be made between the marginal explanatory power of individual variables and the loss of degrees of freedom resulting from the addition of such variables. The final set of regressors included: 1) Total Foreign Reserves less Gold, 2) Crude Oil Production, 3) Consumer Price Index, 4) Debt Service Coverage Ratio, 5) Ratio of Tax Revenues to GDP, 6) S&P Rating, 7) Moody's Rating, 8) Total external debt, 9) a 1994 dummy and, 10) a 1997 dummy.

Cantor & Packer (1996) verified that sovereign credit ratings implicitly contain a great deal of economic information. Each set of regressions began using only the reported ratings from Moody's and Standard & Poor's. These were then removed from the model and other variables were added in a staged manner.

The first of these staged additions was non-gold reserves, a measure of liquidity. Based on the consensus that the Asian financial crisis was in large part a liquidity crisis, this seemed very reasonable. That liquidity is a significant variable was borne out as the authors observed very high t-statistics for reserves in country after country. Next, total debt outstanding was added to the model based on the assumption that absolute levels of debt are a major component of risk to investors. Third, variables were added which are proxies for the effect of exogenous shocks on emerging economies: crude oil production. Thus three major sources of yield spread risk were built into the estimates: liquidity, debt burden and exogenous shocks.

The next stage required the addition of the following variables: ratio of tax revenues to GDP, inflation, and the debt service coverage ratio. Only then were the

sovereign ratings re-introduced to test whether or not they added any unique explanatory power to the model. In each case, F-tests indicated that they do indeed deserve consideration. Finally, to measure the effect of free-floating market anxiety towards developing countries during crises, dummy variables for the years 1994 and 1997 were included. When one of the variables was not available from the IMF or the World Bank for a country, estimates were allowed to suffer and there was not attempt to fit the data through the addition of new variables. The accuracy of the estimates deteriorates when time series for critical variables ends.

After designing this sequence and testing its feasibility using the entire global data set, the model also used both regional and national data sets. Thus for each country, there are three sets of model predictions that can be compared to observed spreads: an estimates using the coefficients from the global model, another using coefficients from regional data, and another which represents the best possible test using only data from each individual country. In sum, this report includes the results of over 130 regressions, the end result of over 1000 multivariate regressions.

The strength of this approach stems from the fact that investors will have different data available to them at different times, coloring the way that they approach forecasting yield spreads. In addition, it may be the case that some nations tend to be swept up in regional economic and financial trends, while others tend to go their own way. Finally, there may be times when emerging market nations become fungible in the eyes of investors, in which case estimates using a global data set may be most informative.

What role, if any, does moral hazard play in determining the yield spreads of emerging market sovereign bonds over U.S. Treasury bonds of similar maturity? The stripped spreads of emerging market sovereign bonds can be explained largely through reference to economic fundamentals. Historic data on these fundamentals is freely available from public sources. Within the study, it was revealed that the market frequently disregards economic fundamentals as it assesses the risk of sovereign debt. If driven by the expectation of a bail-out by a third party, this would present an example of moral hazard. Expectations of this sort are acknowledged to have been present in the decision-making processes of some investors during each of the recent financial crises.

This moral hazard effect appears to vary over time, increasing in likelihood during the periods leading up to a crisis and waning at other times. Estimating the "amount" of moral hazard at play at any given point in time would require special knowledge of where one was in the cycle of prosperity and panic that seems to plague these countries. Instead of focusing on this question, we would instead encourage an investor to consider in a more systematic manner, the primary drivers of risk (both real and perceived) associated with investing in the sovereign debt of emerging markets. By doing so, the investor will have a clearer sense as to how yield spreads ought to behave according to observable factors, and will be able to better decide whether the market's view of the unexplained portion of the spreads is warranted or not. The author's model is a good first step towards such a framework of analysis.

How should investors think about the problem when valuing these bonds? An investor should not think about moral hazard until he has developed a model that attempts to quantify the effects of changes in economic fundamentals upon the yield spread. The

analysis has revealed that moral hazard does exist but its effects are relatively small when compared to the many other elements that determine the size of the yield spread. However, an investor should remain inquisitive regarding trends in economic fundamentals and alert to the fact that moral hazard may be one force in motion at times when yield spreads become unduly compressed relative to the level explained by fundamentals.

In these cases, the investor will have available to it any number of options that will help it to limit the effects of the information asymmetries that allow the moral hazard effect. These might include increased monitoring of the situation by country, the dispatch of seasoned analysts to the country in question to interview government officials and other knowledgeable parties, or by calling public attention to the circumstances. The last of these is the least expensive option and is likely to be very efficient, as a great number of interested parties react to their individual incentives to uncover hidden information.

Is it a priority of an investor to understand how moral hazard affects the yield spread? Can the an investor develop a system or framework that can help it understand moral hazard in the context of its investment decisions? As mentioned earlier, the analysis does not recommend the continuous monitoring of moral hazard *per se*. However, the authors do believe that an increased sensitivity to its likelihood will be one benefit of a more systematic approach to the incorporation of economic information into decisions regarding the purchase and sale of sovereign debt from emerging markets. Overall, the moral hazard effect on sovereign bond yields may be dominated by the linked effects of faulty analysis and information asymmetries.

To elaborate, it is cause for concern that most banking institutions failed to even acknowledge the possibility of a devaluation of the Thai bhat until it collapsed in 1997. It is even more worrisome that some analysts have complained about the amount of political pressure focused on preventing them from releasing negative analyses of countries prior to crisis periods.

In short, we believe and have demonstrated that there is merit to approaching the analysis of the sovereign debt markets in a systematic, rigorous fashion. However, collecting and analyzing the enormous amounts of data that a fully-implemented version of our model would require is something of which only a few investors and institutions are truly capable.

Beyond the fact these models should be natural sources of forecast values for critical variables, they may shed additional light on the relationship between yield spreads and economic fundamentals. As greater proportions of yield spreads can be explained with accuracy and efficiency, the scope of possible moral hazard will be reduced. There will simply be less room from within which agents may take advantage of information asymmetries. The overall efficiency of capital markets at the valuation of sovereign debt will be improved. An investor's risk will be reduced, and it will be better able to discern the difference between danger and opportunity. Most importantly, emerging market sovereigns will be able to determine with greater accuracy the cost of their funds. This will lead to better capital budgeting and more responsible fiscal management.

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- | | | | |
|----------------------|-----|--------------------------|----------|
| Afghanistan | 39 | election | 68 |
| Africa | 82 | embargo | 62 |
| arbitration | 172 | EMBIG | 206 |
| ASEAN | 171 | engagement | 149 |
| auditing | 202 | ethnicity | 23 |
| Australia | 130 | experimentalism | 187 |
| behavioral economics | 187 | faith-based org | 149 |
| Bosnia Herzegovina | 54 | feminist majority | 39 |
| Boston | 123 | financial crisis | 171 |
| Bradley, Bill | 68 | financial liberalization | 202 |
| Brady bond | 206 | financial regulation | 202 |
| Brazil | 187 | - sustainability | 171 |
| Camisea | 130 | fluctuation reserve | 47 |
| capacity building | 32 | gender | 23, 39 |
| capital flows | 202 | gender apartheid | 39 |
| Catholic | 149 | geostasis | 206 |
| CEDAW | 39 | globalization | 187 |
| Charitable Choice | 149 | government | 149 |
| charity | 149 | - programs | 119 |
| Civil society | 32 | grassroots | 68, 104 |
| commercialization | 104 | health | 62, 172 |
| comm development | 104 | health rights hotline | 172 |
| conflict management | 172 | HMO | 172 |
| conflict resolution | 23 | Holbrooke, Richard | 54 |
| congregation | 149 | hot money | 171, 202 |
| consent | 130 | housing technology | 104 |
| contributions | 47 | human rights | 23, 39 |
| Corruption | 141 | illiteracy | 62 |
| cost-effectiveness | 104 | IMF | 171, 206 |
| Countryside Crafters | 18 | impact assessment | 89 |
| credit | 82 | India | 104 |
| credit organization | 82 | indigenous peoples | 130 |
| Cuba | 62 | infant mortality | 62 |
| cultural economics | 187 | informal finance | 82 |
| Dayton peace accords | 54 | Informed | |
| debt-service ratio | 206 | - consensus | 130 |
| defined-benefit | 47 | - consent | 130 |
| democratization | 54 | Inner-city | 119 |
| denomination | 149 | Innovation marketing | 104 |
| deregulation | 202 | investment | 47 |
| dev. country debt | 187 | Jabiluka | 130 |
| developing economies | 202 | Japanese bilateral aid | 206 |
| development | 187 | JP Morgan | 206 |
| disclosure | 202 | justice | 149 |
| discourse analysis | 187 | Kenya | 82 |
| economic | | Latin America | 47, 187 |
| - anthropology | 187 | leadership | 54 |
| - development | 119 | LEAP | 18 |
| Ecuador | 186 | Legislature | 141 |
| empowerment | 89 | lender of last resort | 206 |
| education | 62 | life expectancy | 62 |

litigation	172	retirement	47
mall business	119	Rose, General M	54
managed care	172	rotating savings	82
media	54	rural banking	82, 89
mediation	172	rural finance	82,89
Mexico	72, 202	sanctions	39
MFI	72	savings	82
microfinance	82, 89	savings and credit	89
moral discourse	149	secondary education	62
moral hazard	171, 206	self-help group	89
negotiation	172	SEWA	89
neutral	172	social capital	82
New Hampshire	68	social justice	149
NGO	104	social sector	62
- marketing	104	social security	47
Nigeria	141	speculative attack	171
ombudsman	172	strategic alliances	123
Owen, David	54	Sudan	23
parallel growth	119	taliban	39
parish	149	technology transfer	104
partnership	32	tertiary education	62
- city	123	third party review	172
- university	123	time-inconsistency	82
patients' rights bill	172	tobacco	18
pay-as-you-go	47	transparency	202
peace	23	Transparency	141
peace-building	54	United Kingdom	32
peace-making	54	United Nations	39
pension	47	United States	23, 32
- reform	47	University	123
Peru	130	urban deprivation	32
Peso crisis	206	urban policy	32
Philippines	130	USIA	54
policy reform	187	utility function	82
politics	68	veto power	130
- freedom	141	volunteers	68
- stability	202	voters	68
poverty alleviation	82	war	23
Presidential campaign	68	welfare reform	149
Press	68	women	23, 39, 82
principal-agent prob	206	World Bank	206
profitability	47	yield spread	206
project impact	130	Yugoslavia	54
public diplomacy	54	Zeckhauser	206
pub-priv partnerships	123		
recognition-bond	47		
refugees	23		
regional cooperation	171		
regulation	47		
religion	23		
reserves	47		

Notes

Notes

Year 2000 KSG student perspectives
on community development,
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faith, ethics and reform.

