# Cornell International Affairs Review




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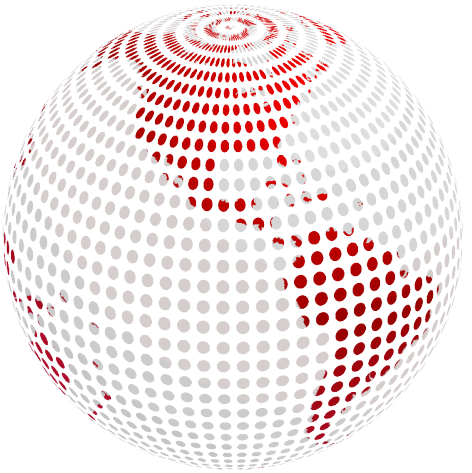
# Cornell International Affairs Review



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# President's Letter

Now in its third full year of operations, the Cornell International Affairs Review (CIAR) continues to provide a forum for discourse and debate of pertinent international affairs issues on Cornell's campus. By adhering to our three pillared approach of an international, interdisciplinary and intergenerational approach to world affairs, we effectively engage all aspects of our community. It is a strong testament to the dedication and hard work of our executive board members, associate staff and board of advisers that CIAR has risen from simply an idea to a prominent medium for expressing new ideas about international affairs. The variety of authors published in this issue and the guests of the forums we host reflects our principles and represents an iconic image of CIAR.

November 9, 2009, the week of this publication, carries a special significance for students of international relations. Exactly twenty years ago the Cold War symbolically ended with the fall of the Berlin Wall. Though this theme highlights our annual Gala Dinner, all of us who worked on this publication were no more than a year or two old. Our parents may remember, but this generation certainly does not. Now, two decades later, as we have failed to witness the "End of History," the world of international affairs has shifted from a bipolar structure to one synthesizing regions, governments, transnational actors, and non-state actors. The neo-conservative foreign policy movement of the last decade gave way to Secretary Clinton's deployment of "smart power" to confront international crises. With a plethora of issues on hand, CIAR attempts to remain at the forefront of analysis on pertinent topics through a series of working breakfasts or lunches with faculty and visiting policymakers, our gala dinners, and our forums and panel discussions,

This semester we hosted forums relating to the protests in Iran, Mexican drug cartels, and the Obama Administration's new approach to the Sudanese Crisis. The strong student showing at each event, and the multitude of questions for our panelists, reinforces the notion that students are very much engaged in world affairs. Furthermore, CIAR co-sponsored over a dozen other international affairs events at Cornell. These endeavors illustrate our objective of mobilizing resources across colleges and disciplines to help us understand the multiple dimensions of a topic.

I would be remiss if I did not specifically thank our entire staff for their hard work in ensuring this publication was produced in a timely and professional manner. This journal would not be possible without your efforts and I thank you once more for overcoming adversity. It is all of our hope that the work we have done in perfecting this publication has raised the intellectual vibrancy of our campus and proven that students are capable of addressing complex foreign policy issues. We students remain engaged with the world and are eager to debate and interact with professors. As we look ahead to next semester, I am confident that CIAR will continue to be a center of reflection on campus. Thank you to everyone who helped make this endeavor possible.

**Mitchell Alva**
**Cornell University,**
**Industrial and Labor Relations, 2010**
**President, Cornell International Affairs Review**
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# Editorial Letter

It is undeniable that the focus of international attention over the past year has been in the field of economics. As the consequences of the international financial crisis are increasingly felt, it is natural that its effects on international affairs need to be examined. With this in mind, the articles of volume III, issue 1 of the Cornell International Affairs Review (CIAR) explore both the problems and prospects of international economic bodies and regulation in the wake of the crisis, including the new Group of 20 (commonly known as the G-20), its parent organization the Group of 8 (G-8), and transnational financial conglomerates.

Looking backward, Andrew Wilmarth of George Washington University historicizes the financial crisis in terms of the immense power of conglomerates in global markets, showing how the actions of governments, regulators, and banks shaped the economic conditions for the crisis. Looking forward, Shalendra Sharma of the University of San Francisco investigates what the new G-20, with a wider set of voices than its predecessor, the G-8 can accomplish in molding the direction of the world's economy. Sharma also enjoins us to remember the critiques of this new level of centralization.

Former CIAR President Luis-F. de Lencquesaing looks more specifically into the disjunctures between American and European financial regulatory systems, suggesting that a certain degree of regulation is essential in the prevention of future crises, both internationally and in more localized contexts. This article begins a focus on individual nation-states, which proceeds through the rest of the articles.

Broadening out from the financial sphere, two Russian professors explain contemporary Russian foreign policy, while Cornell undergraduates consider how economic power plays into the foreign affairs of states in varying ways. For William Gerding and Zachary Montague, Japan represents a source of potential power as it reasserts itself in East Asia as an economic, and in the future, military strength. For Gabriel Rodrigues, Brazil should be attended to in a different way, as its new economic strength may be comparable to Japan's, but cannot be disassociated from notions often ignored in certain theories of international politics, including soft power.

Bringing us back to the international context, Sebastien Malo's exploration of dilemmas concerning peace, justice, and international jurisdiction in Uganda reminds us of what is at stake in questions of international regulation. Indeed, the abstractions of economics can lead us away from the ways in which internationalism is inseparable from trickier matters of ethics. The international regulation of finance, we think, should be situated in this broader scope.

Through editing meetings, group discussions, and presentations by members, the ideas presented in this journal were the product of many collaborative efforts of both officers and members of CIAR. It is worth noting that the world of international affairs, though tangentially related, is not the main focus of our studies, and as such we were consistently engaged by the interdisciplinary approaches of many of the authors and their interlocutors, many of whom came from such fields as Classics, Industrial and Labor Relations, and Linguistics. This made for a challenging and exciting process, which we look forward to repeating in the Spring.

**Cecilia de Lencquesaing**
**Vice President, CIAR**
**Arts and Sciences, 2011**
**College Scholar,**
**Comparative Literature**

**Maurice Chammah**
**Managing Editor, CIAR**
**Arts and Sciences, 2010**
**College Scholar,**
**Near Eastern Studies, Anthropology**

# Contents

# Why Financial Conglomerates Are at the Center of the Financial Crisis[1]

**Arthur E. Wilmarth, Jr.**
**Professor of Law, George Washington University Law School**

*Professor Arthur Wilmarth is the author of numerous articles in the fields of banking law and American constitutional history. After 11 years in private law practice, he joined the faculty of George Washington University in 1986. Professor Wilmarth has testified before committees of the U.S. Congress, the California legislature, and the D.C. Council on bank regulatory issues. He is a member of the editorial board of the Journal of Banking Regulation, published by Palgrave Macmillan Ltd. This essay is adapted from portions of the following article: Arthur E. Wilmarth, Jr., The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis, 41 Conn. L. Rev. 963 (2009)*

The global economy is currently experiencing the "most severe financial crisis since the Great Depression." The ongoing crisis has battered global financial markets and has triggered a world-wide recession. Global stock market values declined by $35 trillion during 2008 and early 2009, and global economic output is expected to fall in 2009 for the first time since World War II.[3]

In the United States, where the crisis began, markets for stocks and homes have suffered their steepest downturns since the 1930s and have driven the domestic economy into a steep and prolonged recession. The total market value of publicly-traded U.S. stocks slumped by more than $10 trillion between October 2007 and February 2009. In addition, the value of U.S. homes fell by an estimated $6 trillion between July 2006 and the end of 2008. U.S. gross domestic product declined sharply during 2008 and the first quarter of 2009, and five million jobs were lost during the same period. Many sectors of the credit markets essentially ceased to function.[4]

The turmoil in global and domestic financial markets reflected deep concerns among investors about the viability of major financial institutions. Commercial and investment banks and insurance companies around the world reported more than $1.1 trillion of losses between August 2007 and March 2009. To prevent the collapse of the global financial system, central banks and governments in the United States (U.S.), United Kingdom (U.K.) and Europe provided almost $9 trillion of financial support in the form of emergency liquidity assistance, capital infusions, asset purchase programs, and guarantees. U.S. federal agencies extended about half of that support. Nevertheless, the ability of global financial markets to recover from the crisis remained in serious doubt in May 2009.[5]

As discussed below, seventeen major financial conglomerates account for a majority of the losses reported by global banks and insurers since the crisis began. In view of the huge losses suffered by these giant institutions, and the extraordinary governmental assistance they have received, they are clearly the epicenter of the crisis. They were also the primary private-sector catalysts for the credit boom that led to the crisis.

During the past two decades, governmental policies in the U.S., U.K. and Europe encouraged massive consolidation and conglomeration within the financial services industry. The Gramm-Leach-Bliley Act of 1999 (GLBA), which authorized U.S. banks to affiliate with securities firms and insurance companies,

was part of a strong international regulatory trend in favor of universal banks.[6] Domestic and international mergers among commercial and investment banks and insurers produced a dominant group of large complex financial institutions (LCFIs). By 2007, seventeen LCFIs effectively controlled domestic and global markets for debt and equity underwriting, syndicated lending, asset-backed securities (ABS), over-the-counter (OTC) derivatives, and collateralized debt obligations (CDOs).[7]

Universal banks exploited their dominance of global financial markets by pursuing an "originate-to-distribute" (OTD) strategy. The OTD strategy included (i) originating and servicing consumer and corporate loans, (ii) packaging those loans into ABS and CDOs, (iii) creating additional financial instruments, including credit default swaps (CDS) and synthetic CDOs, whose values were derived in complex ways from the underlying loans, and (iv) distributing the resulting securities and financial instruments to investors. LCFIs used the OTD strategy to maximize their fee income, reduce their capital charges, and transfer to investors (at least ostensibly) the risks associated with securitized loans and other structured-finance products. However, because many financial conglomerates followed similar OTD strategies, their common exposures to a variety of financial risks – including credit risk, market risk and liquidity risk – produced a significant rise in systemic risk in global financial markets.[8]

Even before the subprime lending boom began in 2003, some observers raised questions about the risks and conflicts of interest created by the new universal banks. For example, LCFIs played key roles in promoting the dotcom-telecom boom in the U.S. stock market between 1994 and 2000, which was followed by a devastating bust from 2000 to 2002. Many leading universal banks were also involved in a series of scandals involving Enron, WorldCom, investment analysts, initial public offerings, and mutual funds during the same period. However, Congress did not seriously consider whether financial conglomerates posed a serious threat to the stability of financial markets and the general economy. Instead, political leaders assumed that federal regulators and market participants would exercise sufficient control over universal banks.[9]

***"Seventeen major financial conglomerates account for the majority of losses reported by global banks and insurers." since the crisis began."***

The U.S. experienced an enormous credit boom between 1991 and 2007. Household debt rose by $10 trillion (to $13.8 trillion), nonfinancial business debt grew by $6.4 trillion (to $10.1 trillion), and financial sector debt increased by $13 trillion (to $15.8 trillion). As a result of this credit boom, the financial services industry captured an unprecedented share of corporate profits and gross domestic profit. Governmental policies (including the Federal Reserve's overly expansive monetary policy, as well as currency exchange rate policies pursued by foreign governments) were important factors that encouraged credit growth within the U.S. At the same time, universal banks were the leading private-sector catalysts for the credit boom.[10]

During the boom, LCFIs used nationwide mass marketing, automated loan processing, and securitization to provide huge volumes of high-risk home mortgage loans and credit card loans to nonprime borrowers. The federal government facilitated the creation of nationwide consumer lending programs by LCFIs, because federal laws preempted state usury laws and other state laws that had traditionally shielded consumers from predatory lending. Unfortunately, Congress and federal regulators failed to establish adequate safeguards to protect consumers against abusive lending practices by federally

chartered depository institutions and their subsidiaries and agents.[11]

Originations of nonprime mortgages rose from $250 billion in 2001 to $1 trillion in 2006. Nearly 10 million nonprime mortgages were originated between 2003 and mid-2007. LCFIs used securitization to spur this dramatic growth in nonprime lending. By 2006, more than four-fifths of nonprime mortgages were packaged by LCFIs into residential mortgage-backed securities (RMBS). As the securitized share of nonprime lending increased, lending standards deteriorated. For example, lenders increasingly offered subprime mortgages with low "teaser rate" payments for two or three years, followed by a rapid escalation of interest rates and payments. As a practical matter, subprime borrowers were forced to refinance their loans before the "teaser rate" period expired, and refinancing was possible only as long as home prices kept rising. LCFIs effectively created a system of "Ponzi finance," in which nonprime borrowers had to keep taking out new loans to pay off their old ones. When home prices stopped rising in 2006 and collapsed in 2007, nonprime borrowers were no longer able to refinance their debts. Mortgage defaults skyrocketed, and the subprime financial crisis began.[12]

Financial conglomerates aggravated the risks of nonprime mortgages by creating additional financial bets based on those mortgages. LCFIs re-securitized lower-rated tranches of RMBS to create CDOs, and then re-securitized lower-rated tranches of CDOs to create CDOs-squared. LCFIs also wrote CDS and synthetic CDOs to create additional financial bets based on nonprime mortgages. By 2007, the total volume of financial instruments derived from nonprime mortgages was more than twice as large as the $2 trillion in outstanding nonprime mortgages. LCFIs persuaded regulators and credit rating agencies that the securitization process transferred the risks of nonprime lending to far-flung investors. In fact, however, LCFIs retained significant exposures to nonprime mortgages because (i) LCFIs kept RMBS and CDOs in their "warehouses," and (ii) LCFIs transferred RMBS and CDOs to off-balance-sheet conduits that relied on the sponsoring LCFIs for explicit or implicit financial support. Thus, many LCFIs pursued an "originate to *not really* distribute" strategy, because they retained significant residual risks in order to complete more transactions and earn more fees.[13]

Universal banks created similar risks


with their credit card operations. While the housing boom lasted, universal banks aggressively expanded credit card lending to nonprime borrowers and encouraged borrowers to use home equity loans to pay off their credit card balances. As in the case of nonprime home mortgages, LCFIs discounted the risks of nonprime credit card loans as long as they could securitize most of the loans. The securitization market for credit card loans shut down in 2008, just as it had done for subprime mortgages in 2007, leaving LCFIs with large exposures to nonprime loans.[14]

Universal banks also pursued reckless lending policies in the commercial real estate and corporate sectors. LCFIs used securitization techniques to promote a dramatic increase in commercial mortgage lending and leveraged corporate lending between 2003 and mid-2007. LCFIs used many of the same risky loan terms (including interest-only provisions and high loan-to-value ratios) for commercial mortgages and leveraged corporate loans

that they used for nonprime home mortgages. In all three markets, securitization created perverse incentives for universal banks. LCFIs believed that they could (i) originate risky loans without properly screening borrowers and (ii) avoid costly post-loan monitoring of the borrowers' behavior, as long as the loans were securitized and transferred to investors. However, LCFIs often retained exposures to residual risks. This was particularly true in the market for leveraged corporate buyouts (LBOs), because LCFIs frequently agreed to provide "bridge" financing if they could not locate enough investors to fund the deals. Once again, the ability of LCFIs to control their risks was undercut by their emphasis on maximizing transactions and fees. When the securitization markets for commercial mortgages and leveraged corporate loans collapsed in mid-2007, universal banks were exposed to significant losses in addition to their problems with nonprime consumer credit.[15]

The huge losses reported by financial conglomerates since the outbreak of the financial crisis demonstrate that (i) LCFIs were leading catalysts for the credit boom that led to the crisis, and (ii) LCFIs are the epicenter of the crisis. Between August 2007 and April 2009, commercial and investment banks incurred more than $910 billion of losses, and insurance companies suffered an additional $220 billion of losses.[16] More than half of those losses were reported by seventeen of the world's leading financial conglomerates.[17]

Thirteen of those seventeen conglomerates suffered severe damage. Of those thirteen LCFIs, (ii) six institutions (AIG, Bear Stearns, Lehman Brothers, Merrill Lynch, RBS and Wachovia) either failed or disappeared in government-assisted mergers or were nationalized; (iii) three institutions (BofA, Citigroup and UBS) continue to operate under private management but with government-funded life support and close supervision; and (iii) four other institutions (Barclays, Goldman Sachs, HSBC and Morgan Stanley) reported serious losses and were forced to make major changes to their operations.

Governments and financial regulators took extraordinary steps to prop up their leading financial institutions. In April 2009, the International Monetary Fund (IMF) reported that U.S., U.K. and European central banks and governments had provided nearly $9 trillion of support to financial institutions, including $2 trillion of emergency central bank liquidity assistance, $2.5 trillion of government asset purchase commitments, and almost $4.5 trillion of financial guarantees. U.S. authorities extended about half of that support.[18]

The current crisis has revealed a stunning failure of financial regulation. During the past two decades, regulators in developed nations (particularly the U.S. and U.K.) generally implemented the following policies:

- To rely primarily on market mechanisms and "soft" supervisory guidance as methods for directing and restraining the conduct of LCFIs, while reducing the use of binding regulations (including consumer protection laws);
- To promote the use of quantitative risk models as substitutes for traditional methods of evaluating the risks of customers and financial institutions;
- To encourage LCFIs to replace traditional methods of credit intermediation – in which banks screen and monitor borrowers and hold loans on their balance sheets – with an OTD strategy that transferred loans to widely dispersed investors who had little opportunity to evaluate the creditworthiness of borrowers;
- To encourage LCFIs to pursue additional fee-based business lines tied to the capital markets; and
- To promote continued consolidation within the financial services industry, based on the belief that larger and more diversified financial conglomerates offered greater safety and profitability.

Critics have alleged that the foregoing regulatory policies actually impaired the safety of financial institutions and undermined the

stability of financial markets, because such policies encouraged:

> An excessive reliance on quantitative, market-sensitive measures of risk and capital, which accentuated booms and aggravated busts in the business cycle;
>
> An overuse of structured-finance securitizations and OTC derivatives, which created complex and opaque risk exposures and a fragile web of interconnections among LCFIs and various sectors of the financial markets;
>
> A greater dependence by LCFIs on funding from the capital markets, which increased the vulnerability of the financial system to liquidity shortages and panics;
>
> A failure to restrain the growth of systemic risk within LCFIs; and
>
> A misplaced confidence in market discipline as an effective restraint on excessive risk-taking and abusive practices by LCFIs.[xix]

With respect to the last criticism, observers have pointed out that market discipline is inherently procyclical and is too lax during euphoric "bubbles" and too extreme during panic-induced "busts." The effectiveness of market discipline is also undermined by self-reinforcing herd and momentum effects, which cause market participants to follow the herd even when they have doubts about the wisdom of the course the herd is pursuing.

Two striking examples of the power of herd mentality appeared in statements made by the chief executive officers of BofA and Citigroup shortly before the financing boom for LBOs collapsed in the late summer of 2007. In May 2007, Kenneth Lewis boasted during a speech that BofA had participated in seven of the 15 largest LBOs during that year. However, during the question-and-answer period following his speech, Mr. Lewis acknowledged that "[w]e are close to a time when we'll look back and say we did some stupid things. . . . We need a little more sanity in a period in which everyone feels invincible."[21] Two months later, Chuck Prince of Citigroup famously declared during an interview with the *Financial Times* that "[w]hen the music stops, in terms of liquidity, things will be complicated. But, as long as the music is playing, you have got to get up and dance. We are still dancing."[22] Thus, even the top executives of the largest banks in the world felt compelled to follow the herd.

The past two years have witnessed an unprecedented expansion of governmental support for LCFIs. In an article published in 2002, I maintained that the "too big to fail" (TBTF) policy was "the great unresolved problem of bank supervision."[23] I argued that the passage of GLBA made the TBTF problem much worse, because GLBA's authorization of financial holding companies increased the likelihood that "major segments of the securities and life insurance industries will be brought within the scope of the TBTF doctrine, thereby expanding the scope and cost of federal 'safety net' guarantees."[24] I also warned that the risk control measures relied upon by GLBA's supporters – including market discipline – were plainly inadequate.[25] I predicted that the new financial holding companies would successfully exploit TBTF subsidies because "the unmistakable


*Four months after the interview, Chuck Prince was no longer "dancing" as the CEO and Chairman of Citigroup.*

lessons of the past quarter century are that (i) regulators will protect major financial firms against failure whenever such action is deemed necessary to preserve the stability of financial markets; and (ii) financial institutions will therefore pursue riskier and opaque activities and will increase their leverage, through capital arbitrage, if necessary, as they grow in size and complexity."[26]

The current financial crisis has confirmed all of the foregoing predictions. During the past decade, regulators in developed nations encouraged the expansion of large financial conglomerates and failed to restrain their pursuit of short-term profits through increased leverage and high-risk activities. LCFIs were allowed to promote an enormous credit boom that led to a worldwide financial crisis. In order to prevent a complete collapse of global financial markets, governments adopted extraordinary measures to support major banks, securities firms and insurance companies. Those support measures, which are far from over, establish beyond any doubt that the TBTF policy now covers the entire financial services industry.[27] Consequently, one of the most pressing policy imperatives is to reform the regulation of financial institutions and financial markets with the goal of (i) eliminating TBTF subsidies and their moral hazard effects, and (ii) establishing effective restraints on risk-taking by LCFIs.

## Endnotes

1 This essay is adapted from portions of the following article: Arthur E. Wilmarth, Jr., The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis, 41 Conn. L. Rev. 963 (2009), available at http://ssrn.com/abstract=1403973.
2 Markus K. Brunnermeier, Deciphering the Liquidity and Credit Crunch, 2007–08, 23 J. Econ. Perspectives No. 1, at 77, 77 (Winter 2009).
3 Wilmarth, supra note 1, at 966-67.
4 Id. at 967-68; James C. Cooper, The Great Adjustment Is Well Under Way, Bus. Wk., April 13, 2009, at 6.
5 Wilmarth, supra note 1, at 968, 1043-46.
6 Id. at 972-80. As used in this essay, the term "universal bank" refers to an organization that has authority to engage, either directly or through affiliates, in the banking, securities and insurance businesses. See Arthur E. Wilmarth, Jr., The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks, 2002 U. Ill. L. Rev. 215, 223 n.23, available at http://ssrn.com/abstract=315345. In addition, the terms "universal bank," "financial conglomerate" and "large complex financial institution" are used interchangeably.
7 Wilmarth, supra note 1, at 980-95.
8 Id. at 994-97, 1020-37.
9 Id. at 996-1002.
10 Id. at 1002-12.
11 Id. at 1011-15, 1035-36.
12 Id. at 1015-27.
13 Id. at 1027-35.
14 Id. at 1035-37.
15 Id. at 1037-43.
16 Id. at 1043-44.
17 See id. at 994-95 (explaining that, in 2007, the world's leading financial conglomerates included (i) the four largest U.S. banks – Bank of America (BofA), JP Morgan Chase, Citigroup and Wachovia; (ii) the five largest U.S. securities firms – Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley; (iii) seven major foreign universal banks – Barclays, BNP Paribas, Credit Suisse, Deutsche Bank, HSBC, Royal Bank of Scotland (RBS), Societe Generale and UBS; and (iv) American International Group (AIG), the largest U.S. life insurer and second largest U.S. property and casualty insurer). By April 2009, AIG had recorded $87.3 of losses resulting from the financial crisis, compared to $544 billion of losses for the remaining 16 institutions. Id. at 1044 n.423.
18 Id. at 1044-46.
19 Id. at 1047-48; see also Daniel K. Tarullo, Banking on Basel: The Future of International Financial Regulation 98-108, 120-21, 131-35, 139-41, 149-90 (2008) (criticizing the Basel II capital accord, particularly the accord's heavy reliance on quantitative risk-based models developed by LCFIs).
20 Arthur E. Wilmarth, Jr., How Should We Respond to the Growing Risks of Financial Conglomerates?, in Financial Modernization After Gramm-Leach-Bliley 65, 110-13 (Patricia A. McCoy ed. 2002); see also Robert J. Shiller, Irrational Exuberance (2d ed. 2005), esp. at 157-72..
21 Greg Ip, Fed, Other Regulators Turn Attention to Risk in Banks' LBO Lending, Wall St. J., May 18, 2007, at C1 (quoting Mr. Lewis' remarks as reported by Bloomberg News).
22 Counting the reasons not to be cheerful, Investment Adviser (FT Business), July 23, 2007 (quoting from Mr. Prince's interview).
23 Wilmarth, supra note 6, at 475.
24 Id. at 446-47.
25 Id. at 454-75.
26 Id. at 476.
27 Wilmarth, supra note 1, at 1049-50. The comprehensive reach of the TBTF policy is confirmed by the federal government's recently-completed "stress test" for the 19 largest U.S. banking organizations (each with more than $100 billion of assets). In announcing the "stress test," regulators emphasized that none of the banks would be allowed to fail the test, because the federal government would provide any capital that was needed to ensure the survival of all 19 banks. Id. at 1050 n.449.

Photos Courtesy of:
"Foreclosure." Flickr. 29 Oct. 2009. http://www.flickr.com/photos/respres/2539334956/sizes/l/
"Chuck Prince, ex-CEO of Citigroup." Wikimedia.. 29 Oct 2009. http://upload.wikimedia.org/wikipedia/commons/e/e2/Prince25012007.jpg

# The G-20 Preempts the G-8:
## *What Kind of World Economic Order?*

**Shalendra D. Sharma**
**Professor, University of San Francisco**

*Shalendra D. Sharma (Ph.D., University of Toronto, 1993) is Professor in the Department of Politics and teaches in the MA program in the Department of Economics. Sharma is the author of Democracy and Development in India (Lynne Rienner Publishers, 1999), which won the Choice Outstanding Academic Title for 1999; The Asian Financial Crisis: Meltdown, Reform and Recovery (Manchester University Press, 2003); and editor of Asia in the New Millennium: Geopolitics, Security and Foreign Policy (Institute of East Asian Studies, UC Berkeley, 2000); From Vision to Action: Strategies to Achieve the Millennium Development Goals. Sharma has published more than four dozenarticles in leading academic journals.*

*Sharma is also a consultant for the World Bank and the IMF. He received USF's University-wide Distinguished Teaching Award for 1996/1997 and the University-wide Distinguished Research Award for 2002/2003.*

Few would disagree that the most significant development at the G-20 meeting in Pittsburgh during September 24-25, 2009 was the formal acknowledgement of the changing of the guards. In the draft communiqué, President Barack Obama declared that from now on, the Group of 20 (G-20) will be the primary organization responsible for coordinating global economic policy. The British Prime Minister Gordon Brown was more explicit, noting that "the old system of international economic cooperation is over. The new system, as of today, has begun...The G-20 is now the premier economic organization for dealing with economic management around the world."

The G-20 now takes over the responsibilities and challenges that had been for decades the purview of an elite club made up of the world's wealthiest countries–the G-7, and more recently, the G-8. It has been a meteoric rise for an organization hastily put together only in 1998 and formally established in 1999 to ostensibly break the glass ceiling at the exclusive G-7– or, according to the official line, to bring together "systemically important industrialized and developing economies" to discuss key issues in the global economy. Ironically, it was the financial crises of the late 1990s (in Asia, Argentina, and Russia, among others) that led to the creation of the G-20. These crises, in particular, the dysfunctional, often half-hearted response by the powerful G-7 economies and financial institutions like the International Monetary Fund (IMF) and the World Bank, led emerging economies like China, India, Russia, Brazil (the so-called BRIC countries), among others, to demand a more fair and balanced representation in global organizations. It was the perfect storm unleashed by the financial crisis of 2008 that finally shattered the glass ceiling. For the secretive, yet increasingly weary and flabby G-8, economic reality and prudence dictated that it was time to acquiesce and make space at the table for the new and emerging titans and players of consequence in the world economy –the Chinas, the Indias and the Brazils. At the G-20's inaugural meeting, this expedient group of old and new, including Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom

and the United States, with simultaneously clashing and converging interests, pledged to work together to resolve common challenges.

No doubt, the G-20, which includes countries from all regions of the world and together constitutes some 90 percent of global gross national product, 80 percent of world trade, and over two-thirds of the world's population, is a far more representative body. Yet, before Pittsburgh, the conventional view was that the G-20's broad membership was a mere front ("G-8 plus 12" was what the G-20 was disparagingly called), designed to give the organization greater legitimacy, while real power and influence still resided with the "old boys" in the G-8. However, the unprecedented subprime-induced financial crisis, which was triggered in the United States and has wrecked havoc in the G-8 countries, seems to have finally forced the recognition of a new global reality: that the G-20 countries, especially economic behemoths like China and fast growing economies like India, now have the wherewithal to play an important role in mitigating the global financial crisis. In fact, the important contributions made by China and other emerging economies in averting a global economic disaster by implementing aggressive stimulus programs in concert with the United States and Western Europe were hardly lost to the old boys. Arguably, as this reality began to sink in, the United States and the other G-8 members reluctantly agreed to make the G-20 the new global economic coordinator and chief architect in creating the so-called "new global financial architecture." At its April 2008 meeting, the G-20 was upgraded from a ministerial to a more powerful leaders-level forum. The G-20 had finally arrived.

Although history may very well remember that the main achievement of the Pittsburgh gathering was the institutionalization of the G-20 as the world's premier economic body, President Obama, breaking subtly with protocol, declared the Pittsburgh summit a success on the first day after another dramatic breakthrough. In an unexpected move, the G-20 agreed to make the IMF more representative by increasing the voting power of countries which have long been under-represented in this premier financial organization during the IMF's next quota review due in January 2011, with similar reforms endorsed for the World Bank.

***"The G-20 is now the premier economic organization for dealing with economic management around the world."***

Specifically, the advanced economies led by the United States agreed to shift the IMF's voting power by at least 5 percent. Although this is a modest reweighting, it nevertheless means that the current split in voting power (which is 57 percent for industrialized countries and 43 percent for developing countries), will now become more balanced – albeit, not entirely equal. The fact that Britain and France (who will see the biggest dilution in their voting power), and who have long resisted this reform, agreed to the voting shift without delay and with unanimity underscored their recognition of the new global economic reality, and the fact that China, India, Brazil and Russia, among the other G-20 members, had made clear that their cooperation on pressing global economic issues was contingent on meaningful reforms in the IMF (especially changes to the skewed voting system) and other global bodies. Indeed, the Brazilian Finance Minister Guido Mantega had drawn a line in the sand by demanding in April 2009 that the IMF's "democratic deficit" had to be corrected quickly. Although the BRIC countries had demanded a 7 percent shift in voting power, they apparently settled for 5 percent.

This does not mean that all the emerging economies will receive a quota increase. Rather, China, which is most underrepresented (with only a 3.7 percent voting share on IMF executive board decisions) will see its share rise sharply, while Britain

and France, including Saudi Arabia, the most overrepresented country (with a 3.2 percent voting share) will see their shares decline. Since this change will come at the expense of the Europeans without affecting the United States (which will continue to maintain its voting and veto powers ), and given the IMF's opaque voting formula and machinations within the executive board, implementing this change will neither be easy nor pleasant. It is important to note that earlier proposals regarding changes in the voting formula at the IMF (and the World Bank) have gone nowhere and there is no guarantee that the G-20 members will be able to bridge the long-standing disagreements over how much power the wealthy nations should cede to major developing countries. Compounding this challenge is the fact that some of these proposed changes are subject to approval by the legislatures of some member countries – meaning that legislatures may not approve what their executives agreed to in Pittsburgh. For example, the United States has a 17 percent voting share in an organization that requires 85 percent majority for all major decisions,

*Susilo Bambang Yudhoyono, the President of Indonesia, takes his seat at the conference table.*

which means that the U.S. Congress can veto any changes it does not like – and it does not like many. Nevertheless, the IMF's new voting order proposal, which more fairly reflects the relative weights of its 186 member countries in the world economy, is long overdue, not only for the sake of fairness, but that a more representative and accountable governance structure is essential to strengthening the IMF as a global organization. For example, recognizing China's new economic clout and giving it greater say within the IMF has the potential to make China a less adversarial and more responsible stakeholder, besides providing further momentum to the 2011 deadline for overhauling IMF governance. Since the G-20 also agreed in principle that the head of the IMF should be selected based on "qualifications and not nationality," it means that the traditional practice under which the head of the IMF was a European and the president of the World Bank an American, may soon become another quintessential relic of an earlier economic order.

After such a momentous development, the remainder of the meeting tackled boilerplate issues that all stakeholders could agree with – at least on paper. For example, all the G-20 member countries agreed to subject their domestic economic policies to the scrutiny of a peer review process in order to determine whether they were "collectively consistent" with internationally agreed regulations by 2010. Although the IMF has been designated as supervising this process, the reality is that the plan lacks an enforcement mechanism to enable the IMF do perform its duties, including the basic task of correcting global imbalances. More specifically, although the G-20 stressed the importance of balanced growth by emphasizing the need to avoid the "reemergence of unsustainable global financial flows," how this was to be achieved was not spelled out. In other words, how can a balance be achieved between countries like the United States and Britain which chronically run large dollar current-account deficits and others, most notably, China, Japan and Germany, which persistently run-up large surpluses? It is now widely acknowledged that these large dollar surpluses were not only partly responsible for the asset bubbles that underlie the current financial crisis; these imbalances have also left the deficit countries globally uncompetitive, especially in manufacturing

industries. Unfortunately, the G-20 could only agree on the principle that both too much saving and too much spending were equally destabilizing. Clearly, coordinated action by the G-20 on this critical issue is unlikely. Similarly, while each member country also committed to a more coordinated financial regulation and to expeditiously clamp-down on bankers pay schemes by linking pay to "long-term value creation, not excessive risk-taking," again, the details regarding implementation were missing. The suggestion that supervision of salary and bonuses would be carried out by each country, while the Financial Stability Board (a group made-up of finance ministers and central bankers) will only broadly monitor implementation, raised more questions about the G-20 seriousness on this critical matter. Equally troubling, details regarding how derivatives such as credit default swaps (responsible for the credit crisis) were to be regulated were missing.

At the insistence of the United States, the G-20 members agreed to require their banks and other financial institutions to have "higher levels of capital reserves" as a buffer against unexpected losses or disruptions in credit markets – albeit how "high" these capital reserve levels were to be was not specified. Instead, the levels were to be developed by each country by the end of 2010 --with the aim of putting them in place by the end of 2012. The EU, which has long claimed that increasing capital requirements would put their banks and financial institutions at a competitive disadvantage because they have traditionally maintained smaller reserves, clearly got its way on this issue. Regarding trade, the G-20 members made a commitment to "reject protectionism in all its forms" and pledged to work diligently to conclude the never-ending Doha Round of trade talks. However, missing were the details as to how they planned to avoid protectionism – especially, the "creeping protectionism" in the United States and the EU. Clearly, for highly export-dependent economies like China this is a major concern. In fact, in an apparent reference to a recent trade dispute in which the United States imposed punitive tariffs on Chinese tire imports, President Hu Jintao politely rebuked the G-20 leaders to "resolutely oppose and reject protectionism in all forms." For its part, apparently glowing in its newfound status as a global economic trendsetter, Beijing reiterated its commitment to rebalancing the world economy by "strengthening domestic sources of growth" – or more bluntly, by consuming and importing more. The fact that China promised to further boost domestic demand (in addition to the $600 billion it has already spent to stimulate its economy and make it less dependent on exports), signals the arrival of China as the new global economic powerhouse. Yet, the G-20 could have done more. In particular, it should have impressed upon China, which is quite understandably concerned about a "collapse" of the U.S. dollar and the losses this would entail on its massive $2 trillion of foreign-exchange reserves, to fix its irredentist exchange-rate system if it is to solve its currency problems. Although China reiterated its commitment at the G-20 to move to a more flexible exchange rate (because an appreciation of the yuan in effective terms would help promote more balanced growth in China and in the world economy), the fact is that China has kept its currency essentially flat against the dollar since the global financial crisis erupted in mid-2008.

In addition, a number of other contentious issues remain on the table.

*The cast and characters of the G-20 summit take their final bow.*

For example, although the G-20 leaders unanimously endorsed an agreement regarding the phasing out of subsidies for fossil fuels and coal to help combat global warming by reducing greenhouse gas emissions, they did not provide any details as to the permissible levels or set a fixed timetable when the reductions were to take effect. Countries such as China, India and Russia, which provide generous tax breaks and direct payments and subsidies to their energy companies (both government owned and private), have long argued against the equivalence between them and the advanced economies, including that they undertake binding mitigation commitments. This is because, although the United States, China and India are among the world's three largest carbon emitters in absolute terms, when population and per-capita income are factored in, the latter two rank quite low. Based on this, China and India claim that if they were to agree to cap their emissions at current levels, their growth would be gravely undermined. Moreover, both countries have long demanded that the developed countries first commit to reducing their greenhouse gas emissions by at least 40 percent from 1990 levels by 2020, before they will consider any emissions caps. This demand is a non-starter as none of the rich countries will even come close to agreeing to such ambitious reductions. For example, even the ambitious American Clean Energy and Security Act of 2009 (or the Waxman-Markey Bill), passed by the U.S. House of Representatives on 28 June 2009, seeks to reduce greenhouse gas emissions over time to only 17 percent of 2005 levels by 2050.

To compound the challenges further, both China and India preemptively have declared illegal under World Trade Organization (WTO) rules any attempt by the United States and other advanced economies to levy a carbon tariff on their exports. No doubt, both China and India, among others, will find it difficult to make their paper promises a reality. Similarly, G-20 members such as Brazil and Indonesia also have their own concerns. Since the emissions problem in both these countries stem from deforestation, Brazil has offered "in principle" to reduce its deforestation rate by 70 percent over the next ten years, provided it receives sufficient compensation. Indonesia has made similar demands. Yet, President Obama has set the bar high in making it abundantly clear that he expects the G-20 countries to set an example by reaching a bold agreement on global warming later this year (December 2009) at Copenhagen where the international community will try to forge an agreement to replace the Kyoto Protocol which expires in 2012. However, with the U.S. Congress deeply divided on this issue it remains to be seen if even the United States can deliver – that is, negotiate and ratify – its part of the bargain.

Pittsburgh was the third summit this year for the G-20. Undoubtedly, regular summitry has paid off its share of dividends. The G-20 countries surely deserve high marks for the estimated $5 trillion in stimulus they has collectively orchestrated into their economies to revive growth. Regular meetings and coordination among the various central banks have helped to ease the credit crunch and restore the flow of credit to consumers and businesses. Thus, President Obama's oft-mentioned statement that the actions taken by the G-20, "brought the global economy back from the brink," has much validity. Yet, as noted earlier, much of the more difficult and important regulatory reform measures need to be put in place to revive growth and prevent a repeat of the crisis. Moreover, the sad reality is that many of the commitments the G-20 members made earlier (such as not resorting to protectionism) remain unfulfilled. According to the World Bank, over the period spanning a few months (between the G-20 summit in Washington in November 2008 and the London summit in April 2009), seventeen of the G-20 countries had adopted measures that either imposed restrictions on imports or favored domestic products over imports. The

great irony has been that it is the advanced economies like the United States and the EU (once the staunchest supporters of global economic integration) that have become more protectionist. Indeed, the Obama administration has shown little enthusiasm for free trade – turning a blind eye to the NAFTA agreement by refusing to reject the Congress decision to close the border to Mexican trucks; failed to advance the three free-trade packages that are pending in Congress with Colombia, Panama and South Korea; the September 18 decision to slap punitive tariffs on Chinese made tires; and perhaps most egregious, failure to help revive the moribund Doha round of trade talks – all seem to confirm the view that many Democratic law-makers are more interested in wooing their key labor constituencies than support open global trade. Seen in this light, the G-20's announcement to conclude a new global trade agreement by the end of 2010 seems overly optimistic. To the contrary, given recent experience, the best one can hope for is that the G-20 resists trade barriers and avoids the disastrous spiral of tit-for-tat retaliation when countries erect protectionist barriers.

Finally, will the world's newest and the most exclusive of clubs behave like its predecessor? That is, despite its noble intentions, it may have trouble delivering on its promises. To long-time observers of economic summits, the Pittsburgh gathering seemed jarringly similar to the recent past, producing what used to come from the G-8: lofty goals, but few specifics. Indeed, since the agreements endorsed by the G-20 are mostly pledges rather than binding commitments (thus, there are no penalties if countries fail to comply), it remains to be seen when and if they are implemented. Yet, the G-20, given its heterodox representation and broad legitimacy, has the opportunity to decisively break from its predecessor's vain and hegemonic past. For starters, it can do this by meaningfully helping the world's excluded (the G-172), especially the most forgotten and excluded amongst them – the poorest of the poor, the so-called "least developed countries." It is important to reiterate that the G-172 countries had no role in starting the crisis, but have been disproportionately impacted by the virulent contagion. Unlike the G-20 and other developing countries, the low-income countries lack the resources to mount an effective fiscal response to the crisis. Not only have their revenues sharply declined, their ability to tap international capital markets has become exceedingly constrained. Without additional support many of these countries face the risk of reversing much of their recent hard-won gains in combating poverty and progress towards meeting the Millennium Development Goals (MDG). Stated more bluntly, without immediate assistance, millions of people face the risk of being forced back into extreme poverty.

Yet, despite the commitments made by the G-20 in their previous two summits, including the allocation of $250 billion worth of Special Drawing Rights (SDR) as part of an overall global stimulus plan, the sad reality is that not much assistance has been disbursed to alleviate the massive human and social costs of the crisis in these beleaguered countries. For starters, the G-20 can increase the low level of concessionary aid to the low-income countries. It can do this relatively quickly by expanding resources in order to enable countries eligible for International Development Association loans to meet the MDG. More broadly, even if the G-20 implements only modest measures to help these low-income countries, such as giving market access for their products and funds for a stimulus package designed to provide basic safety nets for their vulnerable populations, it will go a long way to underscore that real change has finally come to the world's premier economic body – that will be change everyone can believe in.

## Endnotes

1 "Leaders' Statement: The Pittsburgh Summit," September 24 – 25, 2009 http://www.pittsburghsummit.gov/mediacenter/129639.htm (accessed September 25, 2009).

2 The G-7 was formed in 1976, when Canada became a member of the then Group of Six countries which included France, Germany, Italy, Japan, United Kingdom, and the United States. The G-7 provides a venue for each country to get together, sometimes several times a year to discuss and formulate macroeconomic policies. The G-8 is different in the sense it was created to allow the heads of governments of the G-7 plus Russia to meet annually and discuss pressing issues of the day.

3 The European Union is represented by the rotating Council presidency and the European Central Bank. In addition, the Managing Director of the IMF and the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in G-20 meetings on an ex-officio basis.

4 The review was actually due in 2013, but brought forward to 2011.

5 The vote share of IMF member countries is reviewed every five years. Currently, the U.S. vote share is 16.77 percent, followed by Japan with 6.02 percent Amongst emerging economies, China's is the biggest with 3.66 percent, followed by Saudi Arabia with 3.16 percent, Russia with 2.69 percent, India with 1.89 percent, Brazil with 1.38 percent, and South Korea with 1.33 percent. The IMF requires an 85 percent majority to approve all key decisions, including amending its Articles of Agreement.

6 Guido Mantega, 2009. International Monetary and Financial Committee, International Monetary Fund (statement by the minister of finance of Brazil, April 25, 2009), p. 5. http://204.180.229.21/External/spring/2009/imfc/statement/eng/bra.pdf 7
The United States, with its 16.77 percent of cotes share enjoys an effective veto in the IMF. However, if the United States share falls below the 15-percent threshold, it will mark the end of its veto.

8 The IMF has 186 members, represented by 24 executive board members

9 Both before and during the meeting, there was a very public disagreement between the United States and France regarding on how best to clamp down on executive pay. Although, both agreed that executive bonuses contributed to the financial crisis by rewarding short-term performance without due regard to long-term risks, France preferred the imposition of specific caps on executive bonuses. On the other hand, the United States and Great Britain argued that placing specific caps were too punitive and suggested that bonuses should be deferred for several years to reduce market participants engaging in risky gambles. The American view prevailed.

10 Although Chinese President Hu Jintao, for the first time pledged to reduce "by a notable margin" its carbon pollution growth rate as measured against economic growth, he did not provide specific targets.

11 It is important to note that over the objections of President Obama, the U.S. Congress (both the House and especially the Senate) has great reservations on his plans to combat global warming. The United States rejected the Kyoto Protocol because it exempted countries like India and China from certain obligations.

*Photos Courtesey of:*

*"SBY in Pittsburgh, 26Sept09." Wikimedia. 29 Oct 2009. http://upload.wikimedia.org/wikipedia/commons/4/44/SBY_inPittsburgh%2C_26Sept09.jpg*

*"Pittsburgh Summit 2009." Wikimedia. 29 Oct 2009. http://upload.wikimedia.org/wikipedia/commons/0/0d/2009_G-20_Pittsburgh_summit.jpg*

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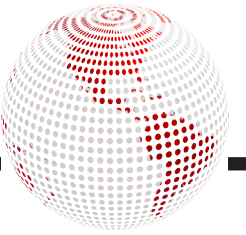
# A World of Financial Models: The French Touch in Deregulation, 1980-2009



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September 15th, 2008. Lehman Brothers files for bankruptcy. The Anglo-American model of finance collapses. This is a "Big Bang" for the global financial markets. The months following saw a rush to rebuild the premises of the financial markets and set the stage for a regulatory revolution. The G-20 meetings have offered some first steps towards a global compromise.

Change. This word, perhaps overused in other contexts, is insufficient to describe the revolution that is taking place in the organization of American finance. But, apart from the media buzz and the populist rhetoric of politicians, can we expect the Anglo-American organization of finance to change that dramatically? Will the G-20 lead to global convergence on new terms? Warren Buffet, referring to the current financial crisis, has famously said: "when the tide goes out, you see who has been swimming naked." The American and British banks in general seemed to have left their swimsuits on the beach and to have dived into the ocean of risk-taking, and of complex financial products. Current estimates place the assets of banks at around $1.2 trillion, and the liabilities at $2.5 to 4.9 trillion. This gap illustrates the magnitude of the risks taken by banks. The French banks, operating in a transformed French deregulated and market-based political economy, seem to have remained dressed while swimming in the waves.

Understanding how the French model of finance has evolved and how far it has changed in reaction to external factors will allow us to understand the dynamics of change in financial systems. This article will argue that financial systems do change, and sometimes radically, but they do not abandon their national or regional specificities. The result of external pressures leads to transformed systems, which is not always an alignment on dominant market practices. Behind the convergence of "best practices," different sets of values and institutions will produce different models. Underlying cultural and institutional frameworks mediate the changes, and distinct settings produce distinct outcomes.

Looking at the French case, I will show how global pressures and the competition with the US and Great Britain have radically transformed French finance. I will also examine the nature of the pressures of European harmonization. They have influenced the evolution of the French model by integrating it in the Single Market. But the deregulation of France had its limits. Specific features mediated the external pressures and produced a transformed yet distinct French model, which kept a flexible but robust approach to financial regulation. The excesses of the Anglo-Saxon model were avoided. The tides change, but what people wear or do not wear in the

water does not change that quickly. They need time to remake themselves, and they remake themselves differently.

This article will argue that the limits to French convergence towards the Anglo-American model of finance are the result of two key features: a specific culture of French elites and their relationship with the state, and the universal bank structure of the French financial system.

Why should we look at France for guidance in understanding change in financial models? The French case is enlightening because it is a particularly hard case for convergence, as it was historically very regulated. The French financial system started in the 1980s as what Zysman calls a "credit-based price administered" system (1983). Today, it is a market-based system. This dramatic transformation illustrates the power of the markets in forcing change. But when we look at the details of the new system, France did not converge entirely towards an Anglo-American financial system. It created its own system, with a balanced approach to markets.


*Lehman Brothers Collapse, Bankers face a bleak future.*

The culture and the institutions of France constrained the global and regional pressures to reinvent a different model.

## The Transformation of French Finance: Deregulation from the 1980s to the 2000s

French finance was transformed and deregulated from the mid-1980s to the 2000s. It has adapted to globalization. The financing of the French economy evolved from being credit-based to market-based. The regulatory framework is more flexible and allows financial institutions to take more risks. This seeming convergence towards a liberal model was a "little big bang" (Cerny 1989), and as Schmidt reminds us, the French system, compared to Great Britain and the US, is the country that has changed the most (1996). However, France remains distinct in the regulation of its transformed model, and the convergence towards the Anglo-Saxon model remains partial. The underlying values and approach to regulation remain distinct. This contradiction between the power of external factors in changing France and the survival of a distinct model is puzzling. In this section, the transformation of France and its distinct outcome are briefly exposed.

### *Changes in French Finance (1980s-2009)*

France in 1980 was a credit-based system with government-administered prices, in contrast to the British and American models, which were market-based and allocated resources by competitively establishing prices (Zysman 1983, 18). The financing of the economy was based on credit, and financial markets were secondary and accessible only for a particular set of large companies for operations controlled by the state (Zysman 1983, 123). France was an "overdraft economy," a "political economy that has become dependent on the allocation of credit by institutional lenders (Loriaux 1991, 9). This system was based commercial banks that accompanied firms with long-term financing.

France in 2007 was very different. The financial system was transformed. Michel Barnier, in the Cornell International Affairs Review, explained that France "has passed from one era to another, from a closed-in and regulated world to a world open to exchange and to competition" (2007, 6). The financing of the economy is based on the financial markets and the issuance of bonds and stock, rather than by bank loans. The French firms finance themselves essentially on the financial markets, and this behavior is similar to the actors on the American liberal market (Culpepper 2006, 50). The capital raised on the stock exchanges in France went from being negligible in France in the early 1980s to being the main source of financing of French firms.

***"The French have reacted to the global challenges of regulation by retaining a strong but flexible role for regulation."***

The French banks are now freed from the full control of the state. They are able to engage in many risky operations. French banks propose complex financial products. They are global actors that compete with American financial institutions (Padoa-Schioppa 2004, 55). The French financial players are important and competitive in an increasingly integrated world (Larosière 2007, 13). French banks are strongly involved in the securities markets and organize many deals. In 2006, BNP Paribas organized 63 operations, accounting for 108 billion euros. The financial sector in 2007 represented five percent of the GNP (Lagarde 2008).

The French market is also very open to international banks. The American banks have been advisors on more than 60 percent of the investment banking deals originated in France in 2006, and four of the five largest deal winners in France were American: Goldman Sachs, Merrill Lynch, Morgan Stanley, Citigroup (Larosière 2007, 21). This French evolution is recognition that in a world where the financial assets have been "soaring," to reach 3.5 times the world GDP in 2006, to enhance efficiency, you have to take advantage of these assets rather than use only the capital-consuming national credit-based financing (SIFMA 2008, 5).

Similarly to the US, the over-the-counter (OTC) market has expanded significantly. Michel Prada, former chairman of the French securities regulator, underlined the importance of the unregulated OTC market in France. Many new complex financial products are traded on this market on which no regulator has jurisdiction.[1] The French credit default swap (CDS) market is very important, as well as the market for securitized products, such as collateralized debt obligations (CDO) and other similar products (FBF 2009, 9). There is an externalization of risks from the banks balance sheets, and we have dissemination of risk in the hands of many actors on the markets.[2]

The French financial markets follow the international rules established by the Basel Committee on Banking Supervision (Kapstein 1994, 103). The recent Basel II framework and its refinement of the capital adequacy requirements and improved risk management is an illustration of how the French financial supervision has converged (Larosière 2007, 23; Artus and Virard 2008, 81). The Basel Committee is a work in constant progress, and different sub-committees meet constantly, leading the French model to evolve and converge with the other financial centers.[3] The international accounting standards are slowly harmonizing thanks to the international financial reporting standards (IFRS). The cooperation of the national securities regulators in the framework of the International Organization of Securities Commissions (IOSCO) leads to an increase in convergence of the international regulations (Schmidt 2002, 37). The IOSCO Technical Committee, chaired by the Frenchman Michel Prada (who explains this in his article in the Cornell International Affairs Review), led to the establishment of a set of international

standards for securities transactions.[4] French markets seem to have converged significantly. This contrast between the 1980s and the 2007 is the result of a series of deregulatory reforms enacted by successive governments that for reasons of space we cannot go over here (See Loriaux, Abdelal, Hancké, La Serre and others).

***The Distinctiveness of French Finance in a Globalizing world***

France, although it has changed and converged towards a liberal model, remains distinct (Culpepper, Hall and Palier 2006, 16). What characterizes this distinctiveness? France is not quite a liberal market economy (LME) as underlined by Culpepper (2006, 63). Indeed, Hancké reminds us that "the French political economy retains, even after capital markets have become more flexible, specifically French characteristics" (2001, 334). The underlying values of French finance and of French regulation remain distinct and maintain a robust regulation in a new framework.

The French regulators remain *tâtillon* and look at details. Indeed, they keep a culture of control and inspection that is very detailed, and looks not only at the processes that the bankers follow when they do a market operation, but they pay special attention to the products themselves and the evaluation of the risk of the product. Prada emphasizes this aspect of French regulators, and underlines the common sense approach that is taken by the regulators, which, he implied, contrasted with a more ideological approach in other countries that believed that the market actors were inherently right and that detailed controls were not required.[5] A member of the Commission Bancaire, the French banking supervisor, emphasized this French characteristic with respect to the approach to the supervision of the prudential ratios of French banks.[6] The French have reacted to the global challenges of regulation by retaining a strong but flexible role for regulation.

Perhaps the strongest illustration that France remained distinctive in its regulation of the financial markets is that the financial crisis hit French banks as a consequence of American excesses, rather than as a consequence of French excesses. Although it did uncover some excessive risk-taking and some failures in risk management, most of the losses came from products that were originated outside of France and that were brought in by banks that were diversifying their portfolios.[7]

Although France changed from its early 1980s political economy, it did not abandon its specificities, and still has robust regulations of its financial markets. This is a puzzling outcome. Given the power that external forces have had in changing the French political economy in general and in particular the organization of its financial markets, it is puzzling that France kept a distinct approach to the regulation of its new model. The new system is a deregulated market-financed system, with the government out of the markets, and fairly light regulations that give an important level of freedom and flexibility to financial actors to innovate. The composition of the French financial markets and their regulation is in general similar to the American or British markets. However, this is not a blind convergence towards the American or the British approach to the regulation of the financial markets. The notion of self-regulation has not permeated the French system. So there is a limit to convergence theories and to the victory of markets.

## Global Changes and Their Impact on Financial Systems

In the last few decades, at the global level, technological changes and innovations have strongly impacted the organization of the financial industry. This led to a series of changes towards the deregulation of the financial sector and a new approach to finance. These global changes also led to a heightened competition both between financial institutions and between financial centers, leading to interjurisdictional competition (Vaillancourt 2007). These global factors influenced all countries. They

influenced France in particular and made a reform of its financial system necessary. France liberalized starting in the 1980s (Loriaux 1991). The deregulation of the financial markets continued in the 1990s and 2000s, and the role of the state in the financial system was redefined (Culpepper 2006). As a result of these global pressures, France partially converged towards a deregulated model and took the state out of the markets.

***Technological Innovations***

Technological changes have been quite important in the last decades, and they have promoted competition. Technology has been seen as a factor that would force convergence between national political economies towards a set of 'best practices' required by the new technologies.

The most important technological changes have been the information, communication and technological innovations (OECD 2008, 14). These technological changes were dramatic (Comte-Sponville 2004, 199). These technological changes are primarily developments in electronic communication, telecommunication, transportation and data processing.

*Competition technology has promoted vicious competition in financial markets*

New information and communications technologies also led to "dematerialization." This term characterizes the process by which securities ownership, which used to be in the form of physical certificates, was converted into electronic records.

These technological innovations allowed financial institutions to get around a lot of regulations. Regulations that separated different activities in the financial markets quickly became obsolete. Non-bank financial institutions became competitors of banks for certain products. Banks needed deregulation to have a level playing field in which they could compete fairly. As a result, new technologies and innovations led to the process of conglomeration (Padoa-Schioppa 2004, 57). This led to the creation of bigger financial institutions that had the ability to give all sorts of financial products.

The financial actors took advantage of these technological changes and innovated, creating new financial products and new ways of dealing with risk. In turn, these innovations impacted the financial system and increased deregulation.

***Innovations in Financial Products***

There have been many innovations in the financial markets. New financial products were produced by the "Quants" and sold on the markets. The "Quant era" started in the mid-1980s, when these math and physics PhDs created and priced new investment structures (Salmon 2009). These innovations offered higher remunerations, and what was believed to be lower risk. They changed the composition of the markets, in particular by increasing the size of the global unregulated over-the-counter (OTC) market, on which complex financial products were exchanged between financial institutions.

The process of securitization is perhaps the most important of these innovations. Securitization has two meanings: the increased reliance on securities to finance an economy or a process by which complex financial products are created by packaging different vanilla products together. It is the second meaning which is referred to here. Guy Moszkowski underlines the importance of the securitization process, which consists of "putting together a pool of assets that provide

a regular cash flow, tranching it, and selling different layers of risk to different investors."[8] Other innovations such as the CDS, CDO and others also were developed.

The outcome of the combination of innovations and of this set of incentives was a global environment in which regulations were more relaxed and financial institutions were more daring. France did not escape this general trend.[9] The impact of technological evolution and innovation on the financial services industry is not new. Already in the Middle-Ages, the invention of letters of credit between Flemish and Italian markets was a little revolution in finance. The difference today is the suddenness and amplitude of these technological changes and innovations, which are transforming the value scales, distances, time and production processes (Lencquesaing 2007, 7). Since the 1970s, the flows of investments have changed radically and changed the relationship between the state and the markets to the advantage of the markets (Ohmae 1991, 161). These technological changes and innovations in financial products cannot be tamed by the regulators, and this led to a global environment in which deregulation was seen as the desired outcome (Calomiris 2000, 247; Stiglitz 2003, 255).

Competition has also been a crucial factor in deregulation, but again, for reasons of space, these elements developed elsewhere will be left out of this article.

## Regional Market Pressures: Globalization with a Political Face

The French financial markets deregulation is also a European story. This section shows how the European Commission, as a consequence of its political strategies to achieve European harmonization, played a role in accelerating and coordinating the deregulation movement that member states initiated. It was difficult for the European Commission to impose a common regulatory framework that would have forced member states to abandon their national specificities. Given its structural weakness, it had to rely on political strategies to harmonize the markets. These strategies reinforced the global pressures for deregulation. The Commission forged winning coalitions by using the differences in objectives between those who wanted liberalization as an end in itself and those who saw it as a necessary intermediate goal for long term political integration. The Commission unified them around the shared objective of harmonization and was able to pass its directives. Because of this strategy, the directives came down on the side of global markets. The Commission also used competition between national regulatory systems to promote harmonization outside of the legislative process. This strategy of promoting interjurisdictional competition and using market forces as a tool to harmonize reinforced the deregulatory pressures on France.

### *The European Union as an Actor for Harmonization and Deregulation*

The European Union is an important actor in the regulatory arena. Through the policies of the European Commission, it has had a role in furthering harmonization and deregulation of the national regulatory frameworks. Schmidt goes even farther and argues that "Europeanization has represented a strong force for change, stronger than globalization" (2002, 14). Although this process was already started at the national levels in most member states by the time harmonization and deregulation of the financial services industry became a European Union policy, the actions of the European Union have had a significant role in accelerating and coordinating the national reforms. It served as a "locus of coordination of market reforms" (Jabko 2006, 58).

To respond to the new challenges in financial supervision, in particular the internationalization of the financial groups who increasingly operate on a cross-border

basis, the European Union has furthered cooperation and coordination between national regulators. There are three supervisory committees, which are part of the level 3 of the Lamfalussy process, and have the objective to promote supervisory convergence. They are the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR), and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). These committees play a very important role in harmonizing the rules of supervision of the member states (SIFMA 2008, 28). They are a place of cooperation and coordination between national supervisors, who keep different approaches.[10] This evolution in the Commission's approach to legislating on financial regulation and the development of these committees added more pressures on France to converge towards a deregulated model.

***Harmonization on Market Terms and the Weakness of the Commission***

The European Commission has improved the harmonization of the frameworks for financial regulation in the member states. This was a difficult task given the structure of the European Union and the ambition of the objectives. Indeed, the ability of the Commission to force member states to agree to its policies was limited and harmonization is inherently difficult as states have to change their systems and sometimes lose their specific competitive advantages. As a consequence of the tension between the ambitious objectives and the limited means to achieve them, the Commission could not simply craft a framework for financial regulation and impose it to the member states. Competition and deregulation seemed like the only options to achieve harmonization.

It is difficult to impose reforms that create losers, as the losers face clear costs and mobilize in a stronger form than the winners. Indeed, the gains for the winners would be on a longer time horizon and more diffuse. If there is a central authority that can easily coerce the losers to accept their faith, then the collective good can be attained. But when there is no central coercive authority, as at the EC level, then implementing the common interest becomes harder. The problem becomes more difficult when the winners and the losers are not only sub-sectors of the financial services industry or specific firms, but member states themselves, as may be the case in the transformation of the financial system as a whole.

As a consequence of the difficulty of harmonization, the Commission cannot provide its own framework and impose it. It has to rely on compromise, and the easiest compromise is to deregulate, rather than change the regulation models of all member states to one tightly regulated model.

***Deregulation as a Result of a Coalition-Making Strategy for Harmonization***

In this context of difficult harmonization, the European Commission has elaborated a political strategy to build a winning coalition of actors capable of bringing reforms and passing directives. This strategy was based on bringing together groups that did not share the same vision on liberalization. It managed to bring together these "strange bed fellows" by playing on the ambiguity of the final objectives these groups pursued. The neo-liberal Anglo-Saxons wanted to have the European Union as a free-market zone with no barriers, and with a deregulated financial system. The continental groups saw financial market integration on deregulated terms as an intermediate objective which would enable the emergence of a political Europe. These different groups formed a coalition that allowed the European Commission success in harmonization and deregulation. This strategy increased the pressures on France to deregulate.

To achieve a winning coalition to liberalize finance was not a given, and this

strategy was a tool to succeed in a difficult mission. The promoters of Europe managed to bring different actors with different interest together. Harmonization meant deregulation to a certain extent, and the loss of many powers of the state over the financial markets. The natural coalition that supported this objective was formed by the neoliberal actors, the international business groups, and the states that would benefit from more deregulation. But this coalition was a minority, even within the Commission's bureaucracy. The promoters of Europe used the long-term objectives of European integration shared by many actors in order to bring them to compromise on liberalization as a necessary moment to further integration. They argued that the deregulation and liberalization was only an "intermediate" goal that was necessary to make the ideal of a united Europe a reality. Liberalization, then, became a difficult but necessary medicine to swallow.

*Meeting of the European Commission in Brussels, Belgium*

This strategy did indeed succeed in bringing together "strange bedfellows" that did not share common long term objectives. The winning coalitions that were forged allowed the European Union to coordinate deregulation of member states and to harmonize through a series of directives. These directives, because of the composition of the coalition, liberalized the markets and have put an additional pressure on France to deregulate.

***A Strategy of Interjurisdictional Competition and Deregulation***

Harmonization of the financial sector, past a certain level of relatively consensual convergence, becomes harder when the resilient aspects of the national models are concerned. The European general interest was in stronger contradiction with the national interests of certain member states. The capacity of the European Union to broker compromises and to forge winning coalitions to produce legislation was further constrained when the regulations they tried to harmonize the resilient regulations. As the harmonization process reached some core aspects of national models and the implications for the competitiveness of financial centers get bigger, the Commission turned to the promotion of interjurisdictional competition as the central tool for harmonization. This strategy of competition, in context of mutual recognition of financial regulations across the European Union put in place by the 1992 plan, led to important pressures on national financial centers to deregulate in order to stay competitive. Theses pressures did not come specifically from directives that legally required deregulation, but rather from market forces. This also increased the pressures on France to deregulate.

This strategy of promoting competition played by the European Commission is the product of the constraints of its weakness, but also of the ideas that came to dominate the Commission in charge of these policies. This strategy has increased the reliance on market pressures to force convergence of national regulatory frameworks for financial services and have let competition define the general interest. This competition leads to deregulation, and harmonization around minimum regulatory requirements. Therefore, politics at the European Union level play a crucial role in French deregulation. Global European Union factors have put strong pressures on France to deregulate its financial system.

## A Distinct French Outcome: Elite Culture and Universal Banks

The French model remains distinct. It kept a robust regulatory system, with regulatory agencies that had a *tâtillon* approach to controlling the market operations of financial institutions. The regulatory agencies did not become captured by the markets, as they did in other countries. French banks did not engage in as much risk-taking as their Anglo-Saxon counterpart. Although France has evolved towards a market-based financial system, its approach to regulation was not identical to the neo-liberal approach that dominated other financial centers subject to similar external pressures, in particular London and New York. Given the global pressures from technological and financial innovations, given the regional political pressures that accompanied and reinforced convergence, why is the French outcome distinct? This puzzle can be explained by the specific culture shared by the cohesive French elite. It has strong ties with the state and some sense of the general interest, or at least of the interest of the state, which they equate with the general interest. The organization of the French elite constrained the market pressures and led to this distinct outcome. The specific institutional setup of the main actors on the financial markets, the French universal banks, also played a role in constraining the external pressures. The universal banks produced a specific culture of risk-taking, and its business model, based on long term relationships with its clients, did not require as much deregulation. These factors shaped the way these external pressures impacted the French model. The convergence towards one global model of finance is not the necessary outcome of these external pressures.[11]

### *A Cohesive French Elite and Its Approach to the State and Regulation*

The distinct French outcome is the product of the relations between the elite and the state.[12] The elite are cohesive and go back and forth between civil service, politics, finance, regulation and the industry. They are socialized by similar educations and career paths. This produced a distinct world view which constrained the external deregulatory pressures. French elite culture and cohesiveness is an important factor to explain why France has a distinct regulatory model. "Deregulation does not mean no rules, just different rules," as Schmidt (2002, 20) reminds us. And the characteristics of these different rules are partly determined by features of the nation, such as the organization of the elite.

The cultural setting of France shapes the elite, which are predisposed to leave power in the hands of the state and to give it a strong role in the regulation of finance. This produces a suspicion towards the ideas according to which markets can self regulate and banks will control their risks.

The fact that the leaders of the banks, of the state, and of the regulators all went to the same schools and were socialized in a world view that emphasizes the service of the state, explains this particular approach to finance in France. Furthermore, because these networks between bankers and regulators are so strong, there is a special relation between them. They have access to each other and as a result, regulation is not viewed with as much suspicion as in other countries. These networks also allow the state to influence at the margins the policies of the banks. Indeed, the public officials have a direct access to the CEOs of the banks on a personal basis (Zysman 1983, 115). This passage in the civil service helps define the world view of the elites and this can explain the distance with the Anglo-Saxon doctrines by which the markets are capable of self-regulation, and that the state should completely exit the markets and let the financial actors forge their own tools of regulation. The approach to risk and regulation of the leadership of the banks is then defined in part by this particular career path. Firms tend to behave in accordance to a management culture, practices, and political

ties that are maintained (Schmidt 2002, 35). Schmidt summarizes the particularity of the French elite in the following way: "" (2002, 30). The shared suspicion of the French elite towards the markets and their relationship with the state explain the resilience of a French model of financial regulation in a context of deregulatory pressures usually understood as ineluctably forcing full convergence.

***Universal Banks***

The French financial system is based on the universal banking model. Universal banks are the main actors on the French markets. Specialized financial institutions are secondary. The universal banking model is based on having different financial services grouped together in one bank. Banks have a portfolio of activities split between retail banking, investment banking and asset management. Some universal banks give more importance to one line of business or to another, so certain universal banks are more present in retail banking or in market activities. But overall, this model, with a balance between its two main activities of retail and markets, offers a particular risk management culture and give priority to long term relationships with customers and this leads to a robust financial system (Paris Europlace 2009, 12).

Investment banking and corporate finance activities were mainly developed inside the universal banking framework. These activities were therefore regulated by the same regulators as commercial banks. As a result, the French BFIs were regulated by the AMF for their securities activities, and by the Commission Bancaire for the respect of prudential ratios by the bank as a whole.[13] Therefore the operations on markets were structurally regulated. During the 1990s and 2000s, when the importance of markets increased in the financing of the economy relative to credit, the importance of the investment banking departments grew, but they grew inside the framework of the universal banks.[14] Therefore, these activities remained regulated, even if the regulations were flexible.

In contrast, the evolution of finance in the US was marked by the Glass-Steagall Act of 1933 (Calomiris 2000, 334). Commercial banks and investment banks were separated. The commercial banks were very highly regulated. The investment banks were not strongly regulated. The logic for this was that their market operations were mainly between institutional investors or firms, who understood the risks they were taking. It was not deemed necessary for the state to be involved in the protection of these actors. They were not the "widow and the orphan," and the state was not going to protect them. As a result, the investment banks were not regulated by the Fed, which controls prudential ratios. When the investment banks became more central to the economy, the regulations remained light. The regulatory distinction between the SEC and the Fed and the inability of the Fed to control the risk levels of investment banks did not enable the regulators to understand the systemic risks involved with the increase in proprietary trading of the investment banks. This problem was already evoked in a report led by Glen Hubbard, John Thornton and Hal Scott (2006).

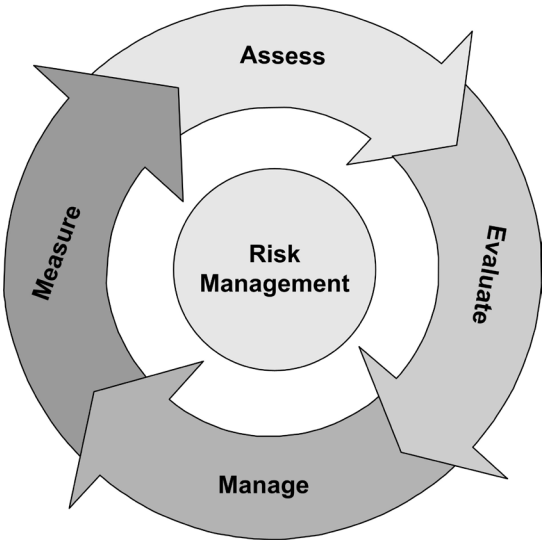
***Consequences of the Universal Banks on French Financial Regulation***

*The economic crisis of 2009 has not dampened France's national pride.*

Institutions shape the policy and institutional preferences of economic actors. Market pressures on firms are very different from one country to another (Schmidt 2002, 31). The universal bank characteristic of the French financial system is important to consider as an institution shaping the preferences of financial actors for the regulatory framework. Indeed, the French universal banks prioritize the long-term relationships with their clients (Paris Europlace 2009, 12). They can adopt this strategy because they are relatively less dependent on the short-term market pressures and are not required to do deals all the time to survive. This is allowed by the "cushion" provided by the recurrent profits from the commercial banking activities which can mitigate losses.[15] The long term horizon constrains the BFI from selling to clients products that are too complex and with hidden risks, at high prices. Indeed, if its services are not appropriate (for example if the products are oversold or if their risk levels are misevaluated), the long term relationship is compromised. They take a particular responsibility in the products they offer to their clients. They are not solely in the deal-making perspective. This means that they offer less original solutions. This long term relationship enables the universal bank to be less aggressive and less risk-taking (McCoy, Frieder and Hedges 1994, 18).[16] Furthermore, the shareholders are not as focused on short-term profit. This is a characteristic of the French model (Fioretos 2001, 221; Culpepper, Hall and Palier 2006, 16).

As a result, the policy preferences of the French banks are not necessarily full deregulation and freedom to engage in excessively risky operations, as excessive risk is not required for survival. The competition, although intense, remains at a reasonable level, as banks have a set of loyal clients, and a recurrent source of profits from commercial banking. This produces a stable system.[17]

There is a specific culture of risk management that comes from the universal




bank model. Indeed, the top management of a French bank is comprised of bankers that are commercial bankers first. As we have seen, they often spend time in the public service, which participates in shaping their world view and their understanding of risk. But in their career paths they also are often commercial bankers first, and have an approach of bankers, not investment bankers, towards risk. And the commercial banking culture is more risk-averse and less regulation-averse. The top management moves back and forth between commercial banking and investment banking. Therefore even the heads of investment banking activities of the bank share to some extent this common culture.

The institutional organization of the French universal banks also constrained the possibility for the interests of the investment bankers to reach the level of policymakers. Indeed, when the bank is lobbying the state, it represents the interests of the bank in general, not just the interest of the investment bank department. And the final position of the banks is set by the President of the bank who, as shown earlier has an approach to risk defined by his experience as a banker. Therefore, banks are not likely to ask for significantly more deregulation.

## Conclusion

In finance, the global changes brought by technological and financial innovations and competitive pressures are real. They are necessary. They are driven by the search for efficiency and by globalization. It is a necessity to optimize the usage of savings and capital to finance growth, to finance emerging countries, to finance the new economy under the pressure of new constraints, such as the environment or longer life expectancies. These changes impact the world; they lead to partial convergence of different national financial systems and regulatory frameworks, and are ineluctable. France has experienced these pressures and deregulated its financial system.

Yet other external forces also played a key role in French deregulation. The European Union has accompanied, accelerated, and coordinated the convergence of European regulations. The legislation pushed by the European Commission was clearly on the side of the markets, and reinforced the pressures on member states to abandon their control of finance. The political strategy of forging winning coalitions to pass legislation reinforced the deregulatory characteristics of the European directives. The political strategy of relying on market forces to further harmonize through competition between national regulatory systems also reinforced the deregulation pressures. Change is not just the result of the impersonal forces of globalization. Politics, in this case politics of the European Union, also play a role in deregulation.

Given these pressures, France changed. But it also remains distinct. It keeps its own values and approach to regulation. Its modern, market-centered, flexible, deregulated financial system has not fully converged towards the Anglo-Saxon, self-regulation approach. French regulation remains balanced and robust. It combines protection of the investor against systemic risk and market efficiency. It is an example of "smart regulation."

Why has it kept its specific approach to regulation in its transformed market-based system? Why has it not fully converged towards the dominant liberal system? This article has argued that domestic factors constrained the power of the markets. The culture of the French elite is permeated by the state. The elite are socialized in a specific world view which emphasizes the general interest and the need for state sovereignty, and views the markets with suspicion. The way the elite thinks of the market and the state refined the policies chosen to modify the French financial system. The organization of the French universal banks, with their diverse portfolio of activities balanced between market operations and commercial banking, has also shaped these external pressures, through a specific culture of risk and a business model which relies on long term relations with the corporate clients.

The French model survives, transformed. It has experienced an *Aufhebung*, a sublation, rather than a negation. The French model is both *preserved* and *changed* and has evolved to take advantage of new opportunities in a globalized world. How much will this model, and its nuanced approach to markets and regulation, influence the post-financial crisis global framework? This French case based on its traditions and values demonstrated its ability to adapt to the market needs and to the pressures of European and global convergences. The current financial crisis triggered a process by which the assumptions behind the current dominant framework will be revisited. A new framework will have to be more globally accepted and based on values that maintain confidence on markets, responsibilities, transparency, balance between innovation and investor protection, and balance between organized market and OTC market. In this perspective the French case demonstrated an interesting compromise, which may be a valuable input for the creation of a new global framework launched by the G-20 in April and September 2009.

## Endnotes

1 Interview with Michel Prada (AMF), Paris, January 7th 2009.
2 Interview with René de La Serre (CCF), Paris, January 8th 2009.
3 Interview with Stephan Boivin (Commission Bancaire), Paris, January 15th 2009.
4 Interview with Michel Prada (AMF), Paris, January 7th 2009.
5 Interview with Michel Prada (AMF), Paris, January 7th 2009.
6 Interview with Stephane Boivin (Commission Bancaire), Paris, January 15th 2009.
7 Interview with Anne Marion-Bouchacourt (Société Générale), Paris, January 15th 2009
8 Interview with Guy Moszkowski (Merrill Lynch), New York, February 7th 2009.
9 Interview with Michel Prada (AMF), Paris, January 7th 2009.
10 Interview with Michel Prada (AMF), Paris, January 7th 2009.
11 For more writings on the resilient aspects of national models, see Berger and Dore (1996), Boyer (1996), Garrett (1998), Culpepper, Hall and Palier (2006), Hall and Soskice (2001), Moran (1991), Pierson (1996), Pontusson (2005), Schmidt (2002), Streeck (1997), Trachtman (1993), Vitols (1997), S. Vogel (1996), Wade (1996).
12 For writings on the French elite system, see Armstrong (1973), Bauer and Bertin-Mourot (1997), Bourdieu (1989), Crozier (1964), Hancké (2001), Mandras and Suleiman (1995), Rouban (2002), Schmidt (1996), Suleiman (1978), Ziegler (1997).
13 Interview with Stephane Boivin (Commission Bancaire), Paris, January 15th 2009.
14 Interview with Arnaud de Bresson (Paris Europlace), Paris, January 14th 2009.
15 Interview with Philippe Morel (BCG), Paris, January 8th 2009.
16 For more writings on universal banking, see Calomiris and Hubbard (1990), Calomiris and Pornrojnangkool (2006), Kashyap and Stein (1995), Rajan (1992).
17 Interview with Rene de La Serre, Paris, January 8th 2009

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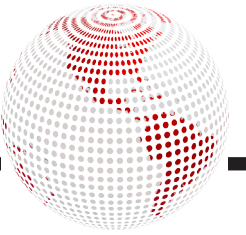
# The Modern Foreign Policy of Russia



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*Over the two decades of post-Soviet history of modern Russia, its foreign policy has gone through several distinct periods and long-term trends.*

*The periodization of the new Russia's foreign policy includes a "romantic" or "Kozyrev's" period, during which the leaders of a democratic Russia tried to integrate the country into a system of institutions and partnerships with the leading Western states. Kozyrev's departure from his post as foreign minister in January 1996 and the arrival of a new foreign minister, who would later become the Prime Minister, a "political heavyweight" of modern Russia Yevgeny Primakov, marked a change in the strategic direction of the country's foreign policy. The key definition of this period was "multipolarity."*

*The arrival of Vladimir Putin to the Kremlin in early 2000, marked a new stage in the development of Russia's diplomacy. At first it was characterized by attempts to build relations of partnership on an equal footing with Washington and NATO countries in the anti-terrorist coalition, and then, from about 2003, by a gradual build up of contradictions between Russia and the United States. During this period (2000-2008) a special feature of Russia's foreign policy was its increased assertiveness in relation to the neighboring CIS countries. After the election of Dmitry Medvedev as president in March 2008 Russia has been busy searching for a new strategy for its foreign policy, which would retain some of the achievements of previous periods, but would also be more cooperative toward the leading nations of the world. Such policy should create a favorable external climate for the modernization of Russia's political system and its national economy.*

## Russia's Foreign Policy – Basic Features

Despite some differences between these periods, two trends are constantly present in the foreign policy of the post-Soviet Russia.

The first is the desire to get integrated into the transatlantic community by joining Western institutions and taking a place worthy of Russia's status of a great power.

The second is the striving for a multipolar world where Russia would be one of the poles, negotiating on an equal footing with other centers of power in a traditional Realpolitik style. It is in trying to establish itself as one of the poles of world politics that Russia attaches importance to developing relations with countries in the post-Soviet space. Moscow has sought to retain the Commonwealth of Independent States (CIS), as well as to create in the framework of its "specialized" international associations the potential for cooperation and ability to copy over time the integration strategy of the European Union. Thus, Russia is seeking to strengthen the authority of the CIS and its structures, thus monopolizing the right to represent its interests on the international scene.

The trend towards integration and multilateralism in Russia's foreign policy has almost always operated in parallel, but the balance of power between them is constantly shifting. In the first half of 1990s and at the beginning of the 21st century the first trend was predominant, while in the second half of 1990s and in recent years – the second trend took over. However, the predominance of one of the trends has neither ever been nor

is absolute now. Both trends are permanent, at times louder, at times fainter, but almost always closely intertwined. It should be noted that some modern Russian politicians do strive for multipolarity, considering it to be the most advantageous architecture of international security for Russia. Some other politicians, however, use this slogan as a means to wrestle from the West more favorable conditions for inclusion in the transatlantic community.

Such inconsistency in conducting the strategic line of Russia's foreign policy by the state leaders can be explained by three factors. First of all, Russia is undergoing a period of transition that is very difficult and painful, while at the same time it is currently still in the very initial stages of the long road to a free market economy and democracy.

Secondly, the fluctuations in the foreign policy of Russia are related not only to the fact that Russia's elite are fragmented and there are groupings with different economic interests, different political and ideological orientations, but also to the fact that the ruling group is convinced that Russia's advantage is in her ability to keep her hands free, maneuvering between the great nations and their blocks.

Thirdly, a significant impact on Russia is being made by a policy of ambiguity of other centers of power in contemporary international relations – the United States, the European Union, and the People's Republic of China. At times, the West exhibited a lack of attention to Russia, ignoring her views on some major international issues. Under these circumstances Russia is trying to respond to the challenges of her own safety on an ad hoc basis, especially when convinced that her legitimate interests are being disregarded by other states.

## World economic crisis and Russia's diplomacy

The current global economic crisis has had an enormous impact on Russia and its politico-economic system. At the early stage of crisis of 2008-09 Russia's elite was optimistic about the future of national economy. As Chairman of the State, Duma Boris Gryzlov stated, Russia will come out of the crisis stronger, while the United States and most European Union countries would be weakened. More cautious assessments were basically ignored. However, as the crisis unfolded, the mood in the ruling circles began to change. The speeches of President D. Medvedev stated quite clearly the thesis that the economy was at an impasse, that the crisis was systemic in nature and that immediate measures were required for a transition from a raw materials economy to a more innovative model of development. Therefore, the objective of foreign policy became the creation of favorable conditions for the modernization of the country.

It should be noted that none of the political elite or big business members has spoken openly against the appeal of the Russian President to modernize the state and the economy. However, much of Russia's upper stratum of society is quite happy with the status quo of Russia supplying raw materials to markets in developed countries. They are more in tune with the slogans of stability, which partially conceals nostalgia for the Soviet times, than with the call for modernization where their ability to compete should be constantly challenged. It is likely that this conflict will soon spread from the domestic sphere to the field of international relations. That is why a significant element of uncertainty will remain in the foreign policy of Russia for 2010.

An important indicator of Russia's readiness to introduce a qualitative change in the foreign policy will be her course of action toward the leading international organizations. In the nearest future Russia will be unlikely to vote for radical changes to the existing system of global intergovernmental organizations. Most domestic politicians and experts believe that Russia has more to lose than gain from such changes. First of

all it refers to the UN, which is still regarded in Russia as the leading international organization, the axial structure of the entire system of international relations and international law. Officially Russia supports the UN reform, but in practice, it seeks to delay the process, as any change in the composition and authority of UN institutions, including the Security Council, would reduce Russia's role in international affairs.

On the other hand, Russia will promote the role of the G-20 where she feels more at ease than in other similar clubs for sovereign states devoid of rigid rules of intergovernmental organizations and enforceable decisions. The G-20 has now become the most representative forum where the leading nations of the world discuss critical and pressing issues. That is what motivates Russia to actively participate in its work, and to advance her own initiatives or support the ideas, broached by others, that match the current stage of reforming the national politico-economic system. Russia's interest in the G-8, from our point of view, will be decreasing in the coming years. This will be happening primarily due to a significant difference in the status of the seven older members of the Group and Russia. All member-countries of the former G-7 are also parties to the leading Western institutions. They all enjoy a higher standard of living, a well-functioning system of democratic institutions, and their economies, unlike Russia's, do not heavily depend on the fluctuations in commodity prices. The Russian ruling elites are chafing under the regular threats of exclusion from the G-8 and the miniscule impact that Russia exerts on the Group's activity and the process of taking key decisions. As the frustration with the G-8 rises, Russia's interest in other forums grows stronger, particularly in the BRIC. Surges of Russia's interest in this group almost always follow the appeals of political figures in the United States and the EU to exclude Russia from the G-8 as a form of punishment for her actions, both in domestic and foreign policy fields. However, the best of times within the BRIC are over for the Kremlin in 2010 – Russia's economy is in a much worse state than that in China, India, or Brazil. The gap between Russia and Brazil in terms of economic parameters of the GDP for 2009 is rapidly declining due to the incremental growth in Brazil and a steep fall of Russia's GDP by about 7.5 percent. At the same time there is a fast growing gap between the continuing rapid expansion of Chinese and Indian economies and recessionary socio-economic indicators in Russia.

*Russian-Ukrainian relations have been strained as a result of Ukraine's Western ambitions*

The outflow of capital from its domestic market and a significant devaluation of the Ruble in the late 2008-early 2009 dealt significant blows to Russia's international prestige. The crisis has clearly demonstrated that Russia's economy is one-sided and depends on the export volume of oil and gas, and their prices in the world markets. The potential for sustainable economic growth driven by domestic demand remains extremely low in Russia.

Nonetheless, the crisis has not brought about a curtailing of Russia's presence in some regions of the world. On the contrary, Russia acted as a creditor and provider of financial assistance to some CIS States (Belarus, Kyrgyzstan, and Tajikistan) and intensified cooperation within the EurAsEC, Customs Union and the CSTO.

In 2010 Russia will continue negotiations to join the WTO that have unsuccessfully dragged on for over 15 years. The initiative proclaimed by Vladimir Putin on

June 10, 2009 for Russia to accede to the WTO as part of the Customs Union with Kazakhstan and Belarus, instead of each country joining the WTO separately, in our view, has no chance to be successfully implemented. In times of crisis Russia's ability to provide extensive assistance to Belarus and the desire to open its national market for industrial products from Kazakhstan is limited, as it would imply adverse consequences for Russian business. Thus, in the years to come Russia will have to continue negotiating individually on its accession to the WTO. However, until the end of the current global economic crisis and the return of Russia's economy on the path to sustainable growth, Russia will not make the decisive move to a full WTO membership, remaining the largest economy outside the world's liberal trade system.

**U.S.-Russia Relations**

So far, cooperation between Russia and the United States – the widely publicized "reset of relations" – has not moved beyond the strategic security issues: nuclear arms reductions and the establishment of regional or global missile defense systems. However, apart from issues of military security, there are many issues of bilateral relations which are still awaiting solutions.

In the early 2000s, a view that the bilateral agreements on nuclear arms reductions should be done away had become dominant in the United States. During the George W. Bush presidency, U.S. leaders seemed to believe that the non-proliferation of nuclear weapons could be ensured solely by U.S. efforts, without recourse to the mechanisms of multilateral diplomacy. Regime change in the so called "rogue states" became the main focus of attention, as well as the establishment of a new generation missile defense system able to neutralize the threat of nuclear attack.

It was thought that arms control could prevent the U.S. from opting to use military force when and where a threat to American interests or the interests of its closest allies emerged. In addition, many pundits predicted the collapse of Russia's economy, the obsolescence of armaments and the gradual decline of Russia into a power of the third world. Russia's leaders had to go to great lengths to prove that the U.S. leaders were wrong in their views. Putin's Munich speech at the conference on European security in February 2007 became the most vivid example of such efforts. Over the past decade, Russia's armed forces were able to carry out successful flight tests of maneuverable strategic warheads, develop a new type of intercontinental ballistic missiles (R-24), etc.

Already back in 2008 it became clear that the G.W. Bush Administration's plans to push for regime changes or building a new generation of missile defense could not be implemented as scheduled. Thus, the new team in the White House has had to acknowledge the right of other states to develop their own models of democratic institutions and governance; at the same time, Russia has once again become an attractive partner for negotiations on nuclear arms reductions.

A series of events such as the March 2008 election of Dmitry Medvedev, a supporter of further liberalization of the politico-economic system, and the departure from U.S. public office of "hawks" such as Dick Cheney and Condoleezza Rice helped turn a new page in the bilateral relations. So far the U.S. and Russia have not been able to overcome the structural problem that has been hampering their relations during the entire period following the end of the Cold War. It lies in the fact that, despite good personal relations between the leaders of the two countries, the mutual understanding and willingness to cooperate inherent in the relationships between Boris Yeltsin and Bill Clinton and Vladimir Putin and George W. Bush, Dmitry Medvedev and Barack Obama do not always cross to other levels of government. The track record of relations and negotiations

between the ministers, parliamentarians, regional leaders, representative of business circles and civil society is replete with conflicts and mutual distrust. The presence of mutual understanding and sympathy at the highest levels of state power not only made relations between Washington and Moscow predictable, and guaranteed the impossibility of a global conflict, but also entailed the possibility to keep up the tension even in those matters that could be relatively easily resolved.

Therefore, in 2010, the relations between Russia and the United States, in our opinion, will improve. Pushing the "Reset" button, promised by the administration of Barack Obama, will have a positive effect, although to a limited extent. Most likely, a mechanism of consultations and negotiations, agreed upon during the July 2009 Summit ,will be created and will produce first results in 2010. However, most pressing challenges will linger on. The U.S.-Russia relations remain largely strategic and, to a great extent, depend on whether a new START agreement will be signed this year. Some controversy over the situation in the post-Soviet space appears to be abating; there are also prospects for converging views on the Iranian and North Korean nuclear programs. Nevertheless, Russia's ruling elite will continue to react negatively to the fact that the U.S. cares less about its relations with Russia than Russia does about the relations with the United States. For the Russian political figures the relations with the United States remain the main concern just as during the Cold War, whereas for the United States these relations are no longer a priority. Thus, one should not expect a qualitative shift in Russo-American relations.

Russia will seek to consolidate its influence in the post-Soviet space. However, the main emphasis will not be placed on the CIS (the latter will increasingly become a club), but on such organizations as the CSTO, EurAsEC, and the Customs Union. Attempts to dislodge the US dollar from the foreign trade transactions will continue, but the desire to prop up the Ruble will be sluggish due to Russia's own economic difficulties.

Great attention will be paid to the presidential campaign in Ukraine in 2010. This time Russia's tactic is likely to differ from that in 2004. Russia will not bet on any particular candidate, but will try to hamper the most unacceptable team (Viktor Yushchenko and his supporters) and negotiate with whoever wins the race.

## Georgian-Ossetian conflict and its implications for Russia

As for the conflict between Georgia and its two breakaway regions, Russia took the position that only the Russian army could ensure the preservation of peace. Undoubtedly, for several years, from the time of attempts by leaders of the "Rose Revolution" of Georgia to solve the Ossetian and Abkhazian problems by military means back in 2004, the leadership of Russia had viewed the scenario of renewed hostilities in the region as quite probable. At the same time the status quo that existed before the August 2008 war, in general, suited Russia, since over time the political and economic position of Russia in the two regions had grown stronger. At the same time, the stalemate in the position of the parties over the years implied the decreasing of the already small chances of Georgia to restore its territorial integrity by gaining control over the territories of the two breakaway regions.

Thus, Russia's current policy toward Georgia and the conflict between Georgia and the two now independent countries (South Ossetia and Abkhazia) is based on several principles.

Firstly, the recognition of sovereignty of these states is final. Any review of it would be impossible for as long as the reason that prompted Russia to recognize their sovereignty is not removed. This reason is the precedent set by the United States in its recognition of Kosovo in February 2008.

Secondly, Russia's leaders will never

agree to a dialogue with Saakashvili and his closest associates. Having ordered the use of weapons against Russian peacekeepers, the Georgian President became a "political corpse" for Russia. This means that until 2013, as long as M. Saakashvili stays in office, there will be no diplomatic relations between Moscow and Tbilisi; some economic sanctions will also remain in place.

Thirdly, the conflict over the breakaway regions of Georgia significantly changed the balance of power in the Caucasus. It led to a noticeable decrease of the U.S. influence in the region, and forced Armenia and Azerbaijan to conduct a multi-vector policy, which includes expansion of energy cooperation between Russia and Azerbaijan and the rapprochement between Turkey and Armenia.

The events of August 2008 can be regarded as a moment of birth of Russia's peculiar "Sinatra Doctrine." Under this "doctrine" Russia attempts to indicate the zone around its borders, toward which it will conduct its foreign policy without regard to the U.S., and where it is ready to use all means at its disposal preventing any further possibility that this territory could become a source of threat to its security.

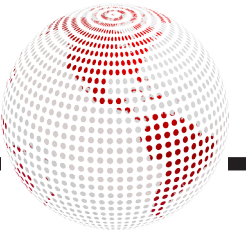
Indeed, Russia among the great powers is "a hard case" for Washington. The United States and the European Union are tied together by an alliance and a common strategy in the international arena. The U. S. and China enjoy enormous trade relations that are reinforced in times of crisis by a shared interest in the global monetary stability. The U.S. and India are brought together by common values of democracy, which allows resolving many issues of bilateral relations without undue politicization. By doing it "my way," as the "Sinatra Doctrine" assumes, Russia displays its status of a regional power in Eurasia and tries to maintain an equal dialogue with the USA.

## Conclusion

In the coming year Russia will preserve the main traits of its current foreign policy – the desire to maintain the status quo, both globally and in bilateral relations with Washington. Internationally, Russia's primary mission, something that the current leadership pays great attention to, is to uphold the existing system of international law with a strong emphasis on respecting sovereignty and non-interference by states in the internal affairs of other states. At the same time, Russia will endeavor to give impetus to integration processes in the CIS. Its main objective is to achieve the status of the leader in the post-Soviet space and to attain a mandate to represent the interests of states within this space internationally. The resources of Russia's diplomacy in 2010 will largely depend on the shape of its national economy. However, the implementation of the aforementioned two goals (maintaining the status quo and leadership in the post-Soviet space) will be a priority for Russia regardless of the state of its economy.

*Photo Courtesy of:*
*"Medvedev, Putin and Tymoshenko." Wikimedia. 31 Oct 2009. http://commons.wikimedia.org/wiki/File:Medvedev,_Putin_and_Tymoshenko.jpg*

# For Japan, Better Late Than Never



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*The Japanese general election on August 30, 2009 ousted the Liberal Democratic Party (LDP), which had governed almost uninterrupted for 54 years. In its place rose the Democratic Party of Japan (DPJ) and its leading man Yukio Hatoyama. What follows is a brief profile of the DPJ's main economic challenges and policies, succeeded by the chief points of contention in the DPJ's interpretation of Japan's alliance with the US, the invariable focus of which is military. Now, Japan finds itself at a crucial junction to reassert itself as a regional leader in Asia, whether military or civilian, and it can only do this gracefully by maintaining a relatively undisturbed rapport with the US in economic and military matters. Japan also needs to increase its presence in the Asian economies and, possibly, Asian military affairs, a policy that the US would condone.*

## New Government and Domestic Challenges

The road to success for the DPJ in this year's elections was not unlike that of the Democratic Party in the US. In the wake of the global financial crisis, both parties emerged riding the wave of popular discontent with the party in power. In their leadership, the young and smooth-talking Barack Obama greatly resembled the quirky and unorthodox Hatoyama, both in persona and rhetoric. It was clear from campaigning and advertising that both men aggressively promoted the public perception that their party represented great ideological shifts in their respective states' domestic and foreign policy. However, with both parties now in power, and in control of the world's two largest economies, it is becoming clear that the DPJ has stepped into a domestic situation completely unlike that of the US, or indeed the rest of the developed world.

Having unseated the rival LDP, which dominated Japanese politics since 1955, the word "change" as used by the DPJ has connotations far deeper than the word embraced by the Obama Administration during the presidential campaign. For many Japanese, the last three decades can be characterized by growing income disparity, unconceivable government spending, and a national debt of over $10 trillion that some theorists now think capable of breaking the economy. With a debt-to-GDP ratio approaching 2:1 left over from the previous administration, the public call for change to Hatoyama has been to somehow stabilize the domestic economic situation while maintaining a high standard of living and social welfare system.

So far, the government's answer has been to make widespread cuts in the extensive public works projects embraced by the previous party, such as the 48 government-financed hydroelectric dam projects the DPJ has announced plans to abandon.[1] These expensive civil engineering projects that proliferated in the postwar era have been accused of allowing pork barrel spending, and blamed for funding "road to nowhere" construction that yields little social benefit. Analysts have argued that the broad social welfare system modeled after the European one, which the DPJ hopes to create with the funds cut from construction projects, will ultimately turn out to be far more costly than the public works it will replace. Thus, the borrowing will have to continue in quantities something to the tune of $550

billion as stipulated by the Japanese finance minister on October 20th.[2] With tax revenue as low as it is, this dependence on the sale of government bonds as the primary means of income is worrisome at best. Implications of this alarming trend in the national debt boiled to the surface last year, when the interest payments consumed over a fifth of the government budget.[3]

Considering that the sectors of the population the DPJ has relied on for support include the unemployed, and the socio-economic underclass, to whom the party has promised many benefits, stabilizing government spending should be a priority for the fledgling DPJ. Among these promises were pledges of increased spending on healthcare, child support, public secondary education, and guaranteed minimum pensions.[4,5] There is no indication that Japan will be able to regain any semblance of control over its national debt, much less institute any meaningful welfare advances, until it manages its spending more deftly. As of now, it seems that the steps Japan's leadership must take to rein in the economy are unlikely to be as comfortable as much of the population would like. The reality Japan now faces is that increased spending may not be the key to economic recovery, or at least in the same way it has been employed in countries like the US. It is entirely possible that steps to economic recovery will resemble something closer to the period of toil predicted by former Prime Minister Junichiro Koizumi, which may have to focus less on moderate policy transition, and more radical reform.


*Papers announce the victory of Yukio Hatoyama, the current Prime Minister of Japan*

## Economic Interests Abroad

Despite the panic and uncertainty the Japanese economic situation has caused at home, it is a prime opportunity for the young DPJ to step up to the plate on financial foreign policy. Neither the lingering effects of the global financial crisis, nor its inherited economic problems have limited the new party so far from playing its traditional role as a key world power, and may ultimately be a chance for it to forge stronger ties in the future.

We have not yet seen enough from this government to analyze its foreign economic policy, but it has identified several goals that will prove essential to its success in the future if realized. They are effectively summarized by the DPJ's slogan for foreign and economic policy: *nyua nyuou* (enter Asia, enter the West).[6] The first is to maintain amicable economic relations with the US, which it hopes will continue to be a close trading partner throughout hard economic times. The second is to strengthen cooperation within Asia, more specifically between Japan, China, and South Korea, in an attempt to draw these countries' economies closer. How Japan conducts its foreign relations in the years to come will be closely tied to its economic situation, and may be crucial in facilitating its recovery.

Especially in light of US-Japanese tensions over Japanese military policy, the DPJ has strived to improve relations between the two, encouraging increased bilateral trade. Most immediately, party officials have promised prompt negotiations on a new free-trade agreement between the two states,[7] and have declared long-term plans to improve Japanese economic institutions still to be planned out. Obviously, the support

from the US will continue to be intrinsic to Japan's overall economic health, and losing economic cooperation because of political disputes would be a staggering blunder for the new administration. However, good relations between the Obama administration and the DPJ could translate into more than just economic recovery. Experts on Japanese foreign policy such as Sheila Smith have observed that domestic turmoil over the last few decades has caused declining interest in global affairs.[8] She, along with others, have predicted that the strategy to strengthen Japan's bilateral agreements with the US may effectively push Japan into a role of greater participation in international affairs.[9]

The bigger prospect for Japanese long-term gain lies in relations between Japan and China. Secretary General Katsuya Okada of the DPJ has stated publically that his party believes the two states must strengthen economic cooperation and maintain closer communication in order to wield greater collective influence in world affairs.[10] However, the party has declared much larger ambitions than simply stronger relations between Japan and China. In its party platform, the DPJ calls for "proactive diplomacy," or more specifically, to "establish intra-regional cooperative mechanisms in the Asia-Pacific region with the aim of building an East Asian Community."[11] The so-called "East Asian Community" as described by Hatoyama would potentially involve a future regional currency union, and a system possibly resembling something close the European Union.[12] Many of the region's governments are not opposed to this movement: on October 25, 2009 at the 4th summit of the Association of Southest Asian Nations (ASEAN) the chairman included in his closing statement that the ASEAN nations "acknowledged the importance of regional discussions to examine ways to advance the stability and prosperity of the Asia Pacific region. In this connection, we [the members] noted with appreciation… Japan's new proposal to reinvigorate the discussion towards building, in the long run, an East Asian community based on the principle of openness, transparency and inclusiveness and functional cooperation."[13] A close interpersonal connection between South Korean President Lee Myung-bak and Hatoyama has led to a fruitful relationship between the two nations,

***"Support from the US will continue to be intrinsic to Japan's overall economic health, and losing economic cooperation because of political disputes would be a staggering blunder for the new administration."***

and secures the prospect for tightening relations, both politically and economically in years to come.[14] Clearly, the ability to persevere throughout this bleak economic period will designate Japan and its new government as a leader among the Asian states, and push it closer to this goal of greater regional cooperation in the future. While this goal may be distant for the time being, it nonetheless offers great insight into the intentions of the DPJ with regard to its foreign policy.

There are two main ways that Japan can reclaim its status as an economic leader in Asia. The first is through maintaining its high export levels. Its constant dependence on exports may have contributed to Japan's quick reemergence from the global recession, as it was in the case of Germany. Yet both the DPJ and the Japanese populace understand that its current-account surplus is unsustainable due to the yen's buoyancy – Japan is the only Asian state that doesn't artificially undervalue its currency[15] – and unhealthy for the Japanese economy. By encouraging low production costs and labor-wages and allowing the owners of businesses to horde profits, Japan reinforced the income inequality ushered in by the lost decades of the 1980s and 1990s, when an asset price bubble cratered and plunged the entire economy into a complete

standstill. It also deepened the rift that began in the lost decades between large, extremely profitable firms and small, floundering business, a further agent of unequal income distribution.[16] Hatoyama sees the account surplus, along with the nation's new income inequality, unemployment, and homelessness, as remnants of Junichiro Koizumi's policy of "unrestrained market fundamentalism and financial capitalism,"[17] words which he pronounces in a disapproving tenor.

The second approach is to reassert itself as a financial investing power in Asia. Three economic policies are required for this to happen effectively. The first policy is to encourage the appreciation of the yen. The DPJ seems to favor this, if with some hesitation. Any reticence they feel is on behalf of the exporting farmers, carmakers, and electronics firms who benefit from the weak yen in so far as it gives them a competitive price-advantage.[18] Yet only when the yen has a stronger purchasing-power will Japan be able to invest in neighboring Asian markets, and, in this competitive arena of investment, it will be able to trump China, whose export-dependence demands Beijing to artificially undervalue and peg the yuan to the dollar. This would establish a robust Japanese investment-driven economy as a foil to the Chinese export-driven economy and would grant Japan all the political sway that attends an investor-nation whose economic presence in neighboring markets has become essential to those nations. This investment is the second policy to reclaim its former economic position in Asia. Once Japan has invested abroad, it will be able to maintain more stable growth. Moreover, once it has secure investments, Japan will definitely be within reach of accomplishing its third economic policy: balancing its current-account surplus, an effort that would require a large increase in domestic consumption and import as well as a strong curtailment of Japanese exports. The appreciation of the yen that will follow investment will also boost domestic consumption and import, through the currency's new purchasing power. To speed this process, Hatoyama has already taken a step towards improving consumption by proposing to lower business taxes and rates (though this has caused some logical unease in economists who cannot reconcile this picture with the country's huge amount of debt).[19] Investment alone will not balance the current-account surplus – in fact, it may exacerbate it. The reason why an investment-driven economy would lead to a more even current account is that, unlike an export-driven economy, the appreciation of the yen that would follow investment would be sustainable. Since Japan is currently a major exporter, the appreciation of the yen that results from a strong export-economy is disrupting the continued sale of goods abroad. There is tension in Japanese business between the strength of the yen and the economy's dependence on exports. The major shift towards investment would dissolve this tension.

Now is the time for Japan to capitalize on this opportunity. Because the yen is on the rise[20] and other countries' economies are struggling, there is an investment vacuum in many of the Asian nations. This window will not last for long, as Forbes already predicts that by early 2010 a new wave of Asian foreign direct investment will begin.[21] This is the optimal chance for Japan for buy into Asian markets abroad and reestablish itself as an economic power and stabilizer in that region of the world.

It is important to note that this issue of Japanese leadership and greater regional cooperation could be one of mild tension. This is particularly due to the commonly antagonistic competition in the international economic atmosphere and the lingering anxiety across all countries about the implications of global recession. Due to Japan's great historical importance as a major exporter, the leaders of the DPJ must be cognizant of the weight they throw around in international relations. With China and the US not always completely at

ease with one another's role in their economic relationship, Hatoyama and his administration must be certain not to alienate either state with any behavior that could resemble preferential treatment. To illustrate the sensitivity of the situation, the Obama Administration has already expressed its concern that it be included fully in whatever movement towards increased economic integration in Asia might come of Japanese diplomacy with China and South Korea, proposing a summit meeting with the leadership of all the nations involved.[22] The US has recently been on the defensive, scrambling to increase diplomatic relations between the itself and Japan amidst remarks by Hatoyama emphasizing less reliance on the US and more cooperation within Asia. Representing such a large economic force, it would be unwise for Japan to act impulsively with regard to its foreign economic policy, as both the US and China look to Japan as a financial powerhouse and much-desired ally.

***Clearly, the ability to persevere throughout this bleak economic period will designate Japan and its new government as a leader among the Asian states***

Since China has responded less than enthusiastically to Japan's visions for economic union within Asia, it would be in Japan's best interest to think more individually and do some inward reflection before seeking demanding commitments abroad. Still slightly unsure of its role in the global economic playing field both now and in years to come, and saddled with domestic economic problems, Japan is undeniably at a critical crossroads. For its new leadership, this is an opportunity to remake Japan to the same extent as after WWII, and should be viewed and handled as such. However despite this great potential, the DPJ is playing a high-stakes game and may indeed face financial disaster should it mismanage its domestic or foreign policy.

## The Two States

Change has come to Japan, and this invariably involves military reform. This is because the real guarantor of Japanese security is not the Japanese military, the framework for which was outlined by the US after WWII and which is unambiguously defined as a self-defense force. Japanese security explicitly lies in the US' nuclear umbrella and the presence of nearly 50,000 American troops in Japan, the result of a post-WWII status-of-forces agreement between the two powers; this explains the US' interest in the matter. That the DPJ would want to promise a decreased dependence on the US for Japan's defense only stirs anxieties in Washington. Yet Hatoyama's cabinet has not failed to express that the main focus of their new military agenda easily fits under their desire for an "equal" relationship with the US. In fact, this insistence on "equality" has only arisen in topics concerning American military presence. The Japanese do not want all of America's troops to clear the archipelago. They do not want to be left by the force through which they have been able to limit their defense spending to 1% of GDP.[23] And though the specifics of what Hatoyama's administration will be proposing on this subject are vague, it is clear that the DPJ do not want to evict all of the US troops stationed in Japan.

Though the detailed opinions held by the cabinet are unknown, it is evident which areas of reform the DPJ members have been discussing. Most do not want to fulfill the troop realignment pact as agreed. The pact that Japan and the US wrote up under the LDP in 2006 records the planned relocation of a helicopter base and Marine Corp troops from Futenma in one area of Japan's southern island prefecture of Okinawa to Nago, another location on the same island.[24] Hatoyama has stated clearly his wishes that the troops be located somewhere off the island. It took over a decade of retooling for this pact to be accepted by both the US and Japan; needless to say, the lost progress is disheartening to the

US. The process of revising this clause of the "Roadmap for Realignment Implementation"[25] would be immensely time-consuming, a quality of international policy that the U.S. – because it has so many interests in regions such as East Asia – hopes to evade as much as possible. Furthermore, because of the absolutism of the issue, it will be very hard to define a compromise; the base, after all, is either on or off the island. Such prospects notwithstanding, Hatoyama unswervingly asserts his confidence in the American military presence in Japan; on October 21, 2009 he told US Defense Secretary Robert Gates that "under the circumstances in which uncertainties remain in this Northeast Asia region [referring to North Korea and China], I think it is imperative to maintain and develop our alliance even further."[26] As far as the US is concerned, it seems that Gates will not allow any change of plans: the displeasure of local residents with the noise, pollution, and other disruptions which they attribute to the base that constitute the grounds for Japanese resistance to continued presence in these districts of Okinawa falls far lower on America's list of priorities than does the proximity of having a base so near mainland China.

A second competition of wills between Japan and the US concerning military power has emerged from another clause in the same "Roadmap of Realignment Implementation" signed in 2006. This clause, immediately following the statement of the relocation of the helicopter base in Okinawa, maintains that of the costs generated by the relocation of 8,000 Marines and their 9,000 dependents from Okinawa to Guam by 2014, Japan will foot $6.09 billion of the expense. Tokyo feels that Japan should not be made to shoulder such a heavy price. The movement of troops was arranged with a look towards China's growing military strength. That Japan and the US share the desire for an American check to China's power is undeniable. However, though Hatoyama does want troop retrenchments in Japan, it is not unimaginable that he would feel indignant that the Japanese should have to pay the lion's share for a relocation of troops from their country. This becomes even clearer if one notes that this removal of armed forces would situate troops over 1,500 miles away from mainland Japan. At present the troops are on the islands, ready to be at hand in the second after the alert for the defense of Japan. Hatoyama is not upset that the troops are relocating; he's simply galled that this clause of the "Roadmap of Realignment Implementation" forces the Japanese to pay for a decrease in their immediate defense.

The third point of contention between the US and Japan is also largest and potentially the thorniest. Hatoyama has expressed loudly that he feels the Japanese constitution should be amended, including Article 9, which bars the Japanese from warfighting and relegates its small armed force to its current position of Maritime Self-Defense Force.[27] To what degree he would currently like to temper Article 9 is unclear, and to what degree the Japanese Diet (their parliament) would approve is essentially unknown. Though this has caused much understandable anxiety in Washington, one might call its true rationality under question: Hatoyama has not called for the dissolution of Article 9 or the Maritime Self-Defense Force, after all. Furthermore, nowhere does Hatoyama suggest that any newly militarized force would be offensive or that, if Japan were allowed to build its own forces, it would proportionately expel American troops. This may in fact be the right time for Japan to ratchet up its armed forces if ever there will be one: it will certainly send a strong, deterrent message to North Korea if Pyongyang sees both US and Japanese troops manning bases along the archipelago, if not only because of the growth in numbers, also because expanded Japanese forces would guarantee the permanence of the military check from Japan on North Korea. Permission for the Japanese to grow their defensive forces would also finally capitalize on the window of opportunity which the U.S. has forced Japan to waste since the late 1970s,

when China's army first began modernizing and multiplying. If Japan could decrease the relative military power of China by any degree, it would be in America's interests; though Washington itself prefers to tower above all other military powers, it should sooner encourage Japan to help check China then have itself suffer an additional loss of relative military strength through inaction.

It is not unreasonable that the Japanese should want to expand their defensive military forces as regards their own security. Washington does not need to misapprehend this as a threat. More than an attempt on Japan's part to build any military capability against the US, this indicates a fear the Japanese have concerning the US priorities. As the image of American power and influence begins to dissolve in an international scene of rising multipolarity, Japan is beginning to feel anxious about the difference between the US' immediate desire for demilitarization in East Asia and Japan's desire for its own long-term security and the persistence of a Japanese defense capability if, on some distant day, America should no longer be a power-player in Asia. In an op-ed in the New York Times, Yukio Hatoyama himself voiced this conviction of America's gradual decline, writing that "I [Hatoyama] also feel that as a result of the failure of the Iraq war and the financial crisis, the era of U.S.-led globalism is coming to an end and that we are moving toward an era of multipolarity"[28]. Japan seems also to be concerned about Washington's current priorities: with redoubled efforts in Afghanistan and talks of a troop increase, Tokyo wonders where it ranks in the U.S.'s list of military resource allotments. And how quick would the response be to an alert raised in North Korea? Though Washington would undoubtedly reassure Japan on all these measures, it is entirely possible that Japan, in accordance with the international institution of states to grasp after self-help, should be worried.

It is also noteworthy in this vein that the DPJ holds unanimously that Japan does not want to develop nuclear weapons. Hatoyama advocates loudly for global non-proliferation. He has rebuked several overtures from North Korea for sanction-lifts and economic cooperation and has confirmed that he will neither normalize relations with Pyongyang nor deviate from the last administrations hard line towards North Korea's nuclear and missile aspirations[29]. This repudiation of nuclear weapons – a sentiment deeply rooted in Japan's history, being the only state to have undergone nuclear attack – has even reached such a pitch that the DPJ members are still debating among themselves about the procedure for the storage, transshipment, and operation of the US' nuclear weapons in Japan[30] [31]. If any of these policies of the DPJ ought to be unsettling to Obama's administration, it should be that the new administration feels ambivalent about housing America's nuclear arms.

*Currently, Japan's military forces serve strictly in a defensive role, working with the United States to protect its territory.*

Two more positions the DPJ has held – but has also abandoned – are worth noting, if only for understanding the party's lineage. It has since abandoned both. First, this is not the first time the DPJ has questioned the LDP's approach to Article 9. Throughout its political career the DPJ's leaders, especially Ichiro Ozawa, strongly criticized the use of the Japanese Maritime Self-Defense Force in UN-authorized operations. Ozawa declared this a direct violation of the nation's everlasting relinquishment of war as stated in the article.

The rest of the DPJ, though not so outspoken as Ozawa on the controversial issue above, have taken issue with the use of the Maritime Self-Defense Forces in antipiracy operations in the Gulf of Aden and the Indian Ocean surrounding Somalia.[32] In the 2009 election manifesto of the DPJ, however, it reads that the DPJ will "play a proactive role in UN peacekeeping operations"[33].

The second renounced point was the Japanese participation in refueling missions for the US-led forces in Afghanistan. These operations used the Maritime Self-Defense Force as a fleet of fuel-taxis that refilled the coalition in the Indian Ocean. It is essential to the efficiency of the war effort that the Japanese continue this cooperation, though it did cause some concern amongst DPJ members as to the legitimacy of these actions as wise foreign involvements and under Article 9. Though it has opposed such missions, it has accepted them for now. More might be said on this issue, however, in January, when the law allowing this assistance is set to expire[34].

Though the DPJ has stated these areas of reform, as a nascent administration only recently assuming power they have not intimated what degree of reform they hope to undertake. Furthermore, it can be confirmed that they will make no dramatic change without including the US and, in all likelihood, without proposing it first to Obama's administration before Tokyo's own Diet. Hatoyama has never softened in his dedication to "building constructive, future-oriented relations with the Japan-US alliance as the cornerstone"[35], nor does Washington have any reason to expect such wavering.

In light of these concerns of the DPJ, it should be mentioned that, if Japan is going to reassert itself as a leading power in Asia, it needs to do so under this administration and in tight step with the US. Any breakdown in communication or cooperation between the two states would be detrimental to both, though obviously more so to Japan. Accordingly and in absolute terms, Japan should sooner accept American terms than sever itself from the U.S. alliance, though there are very few issues in which the US should be entirely inflexible. Japan will not have much more time to act and reassert itself as a leading power in Asia. China has long surpassed it as the military power of the East, as *per* America's interference. (Whether this interference was in America's long-term interest is not nearly as important as addressing how America will continue to promote stability in Asia through its influence with Japan and other nations.) China will soon outstrip Japan as the world's second largest economy[36]. The emergence of China has detracted from Japan in these two spheres that historically Japan has dominated. It is in both the US' and Japan's shared interest that Japan rise to its previous position of regional leader and stabilizer. Japan needs to remind America that, as far as Washington is concerned, better Tokyo than Beijing in all foreign policy matters. This preference should be seen as a path-dependent result of Japan's history as the US's prominent eastern Cold War ally and of the transparency that has prevailed in all rapport between Japan and the US since the Allied occupation after WWII. Japan needs to stabilize its economic growth and raise itself up as an Asian economic leader by balancing its account surplus, strengthening the yen, and investing in neighboring markets. Japan needs to reassure the US that its policy of "enter Asia, enter the West" reaffirms and secures America's influence in Asia. It should be a self-reinforcing alliance that is forged between the Tokyo and Washington: Washington should promote Japanese regional influence and grant it limited military independence, and Tokyo, through its privileged status as America's liaison in Asia, should uphold America's interests for stability, security, and the continued presence and role of the US in Asian military and economic decisions[37].

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"Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes.
In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized."
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Photos Courtesy of:

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# Putting the B in the BRIC:

## *Brazil's rise as a major emerging power*

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*The world is rapidly changing and the new international order includes developing nations as powerful actors. Among them, Brazil stands out as one of the most influential and promising players. This article examines Brazil's case as an emerging major power in the international system. Despite several challenges it has yet to overcome, Brazil presents itself as a stable nation capable of being an economically and politically influential. This paper analyzes how Brazil is much more than just soccer, the Amazon, and Carnaval; in reality, it is becoming a powerful actor in the international system that does has a lot to offer.*

*Brazilians always had the hope that some day their country would launch off into an age of economic growth and stability. The promise of living in the "nation of future" has been present in Brazil even in the early 20th century, when thousands of people immigrated dreaming of a better life. Unfortunately, the situation did not play out as nicely as they had hoped. Whether it was due to the fragility of the domestic political regime or its economic failures, Brazil was never able to reach this dream. In fact, Brazil has a long history of ups and downs. All of its booms were short-lived – the milagre economico (economic miracle) of the 1970s, for instance, was quickly followed by a ride with hyperinflation and increasing public debt in the 1980s. Brazil re-established a democratic regime in 1985 with the hopes of beginning a new era of progress and stability. Twenty-five years later this goal is, for the first time, tangible.*

*Brazil now enters the 21st century as one of the main emerging powers in the world. Brazil's influence abroad increased tremendously in the last decade. Whether it is in speeches over global issues at the United Nations or at meetings of the world's biggest firms, it seems clear that Brazil is no longer overlooked. This only happened after Brazil finally reached political and economic stability, positioned itself as an international leader, and demonstrated the virtues of several of its unique characteristics. After years of struggle and little self-esteem, Brazil now emerges out of the biggest crisis in 80 years as the prominent leader for Latin America.*

### Lingering Challenges

Before Brazil can claim its status as a major power, it must first respond to the calls to improve the standard of living for its citizens. First of all, most of the population still experiences extremely low levels of socio-economic development. Brazil's universal healthcare system does have certain strengths (such as its renowned free AIDS treatment program), yet in general it is highly underequipped given the population's increasing needs. Similarly, the public education system is flawed; primary and secondary schools are falling to pieces, professors are unprepared, and many Brazilians barely know how to read and write. Except for a handful of top-tier institutions, most universities are either public and badly funded or private and greedy. On top of all of that, the government still has to deal with increasing levels of urban violence and the ineffectiveness of its law-enforcement institutions. Despite its economic progress, millions of Brazilians still live with these issues and are unable to fully reap the benefits of the country's growth.

Brazil also has problems with certain governmental actions in political and

economic affairs. One of the biggest setbacks is a lack of fiscal austerity. Recent data shows that taxes amount to about 36% of the GDP, a level similar to those of Scandinavian states, where people can better afford to pay that much. This money fuels the government's excessive spending, which actually rose from 7% to 32.5% of the GDP in the last 14 years.[1] The state, however, only directs a fraction of that to efforts to ameliorate the problems of poor Brazilians. Such inefficiency by the government generates inflation and forces cuts in areas such as education and healthcare. Not only do these levies inhibit investment and innovation, their complexity also adds the bureaucratic inefficiency known as the *Custo Brasil* ("Brazil Cost").[2] Many taxes overlap and the rifts between federal, state and municipal governments over how much each of them should get leaves space for corruption and mismanagement. Moreover, the lack of adequate fiscal reform can threaten long-term economic stability, curb social welfare, and crowd-out investment. In spite of so many difficulties, Brazil now has many reasons to consider itself as a major power on the rise.

## Economic and Political Stability

After years of many ups and downs, Brazil's accomplishments in the last couple decades grant it a new level of political and economic stability. From 1985 to 1994, Brazil underwent a series of failed economic plans that seriously jeopardized its stability. In the first five years after re-democratization, the government implemented artificial methods – such as forcefully "freezing" prices and removing zeros from the currency – to control the rampant stagflation, all of which failed. The initial political turmoil instigated fears of what would happen, but Brazilians once again had the hope that things would improve for them. Unfortunately, the country spent nearly a decade fighting hyperinflation, rising unemployment rates, increasing budget deficits, and suffocating pressure from its foreign lenders, namely the International Monetary Fund (IMF).

In 1994, however, President Fernando Henrique Cardoso came to light with a different strategy. Cardoso, a knowledgeable sociologist and former finance minister, had helped develop a viable solution to Brazil's

***"After years of struggle and little self-esteem, Brazil now emerges out of the biggest crisis in 80 years as the prominent leader for Latin America."***

economic problems. Under Cardoso's regime, the government developed the *Plano Real*, a new economic package that had as its core the mission of curtailing inflation, stabilizing the economy, and creating a new, solid currency. Cardoso's presidential campaign was largely successful because, as poor citizens, Brazilians feared the "monster" of inflation more than anything else. From 1993 to 1997, his actions curtailed the official inflation rate from 2,477.15% a year to just 5.22%.[3] The new *real* established parity with the American dollar, which in turn triggered new investments. Cardoso also privatized some sluggish public companies that operated as quasi-monopolies in vital sectors (such as mining, energy and telecommunications). In spite of certain successes, Brazil was still very frail and it quickly succumbed to a series of international economic tribulations. The crises of Russia and the Asian "Tigers" posed serious threats to the domestic economy and demanded strenuous efforts from both the public and private sectors. By 2002 the Brazilian economy still lingered and all branches of government suffered from corruption. Cardoso was still able to lawfully add a second term to his presidency, but after a challenging but meaningful administration, he handed over the power to the leftist union leader and his political archrival, Luis Inácio "Lula" da Silva.

Lula, as he is commonly known in Brazil, co-founded the *Partido dos Trabalhadores* (PT, or Worker's Party) and had

already run for presidency three times. His victory in 2002 generated mixed feelings at the time. His supporters saw him as a genuine Brazilian that grew up in a poor family, did not attend high school, and moved up in life starting as a low-class, blue-collar worker. His dissenters, on the other hand, viewed him as an extreme socialist that was willing to reverse Cardoso's policy in favor of an "anti-Western" Brazil. This abrupt change from a right-wing to a left-wing regime generated fear, especially abroad. Many economic and political analysts instantly questioned whether Brazil really deserved to be in the select group of the BRIC (Brazil, Russia, India and China). Brazil was overwhelmingly discredited and it looked like everything would go wrong again, but Lula, in the end, proved to be a moderate and skillful leader.

On the economic front, Lula continued Cardoso's successful policies, and he kept all of the promises the past administration had made. Despite objections from within his own party, he maintained the regime of fluctuating, market-ruled exchange rate, and prioritized primary surplus – committing an established percentage of the GDP to pay off debt. With this, Brazilian public debt fell from nearly 60% of the GDP in 2002 to around 40% in the first months of 2009.[4] Another measure he preserved was inflation-targeting, which preserved the government's commitment to containing any abnormal price level spikes. Lula also nominated former BankBoston CEO Henrique Meirelles to the presidency of the Brazilian central bank; Meirelles gave the leftist administration more credibility with international investors, and his autonomy to stipulate interest rates and monitor exchange rate policy[5] proved that the extremist political rhetoric of Lula's leftist peers was not all-powerful. Furthermore, Lula reaped the benefits of this decade's economic boom to surf the "commodity wave." With the increasing demand of raw materials from powerhouses like China and India, Brazil took advantage of rising exports and global commodity prices to exponentially increase its net trade surplus. Consequently, the government was able to accumulate, as of October 16, US$ 232 billion in international reserves[6] and repay longtime lenders.

On the political front, Lula's success has been more limited. Despite its recent improvements, Brazil still suffers from much corruption. In the seven years he has been in power, Lula has seen at least two of his main ministers step down due to corruption charges, and Congress has become a center of national discontent. By the time of his re- election in 2006, Lula had already seen many key political figures of his party being prosecuted. Nonetheless, this does not seem to hinder the president's political strength. Boasting an approval rate of over 76% even after the crisis, Lula is the most popular leader in Brazil's recent memory.[7] His economic success and his social policies, especially with the extremely poor citizens, are the reasons. His *Bolsa Familia*, a welfare program that transfers money to poor families, unified and expanded the policies previously implemented by Cardoso. It offers the extremely poor citizens a means to earn money as long as their children attend school and take all vaccines they need. In the last six years, the *Bolsa Familia*, coupled with the country's economic growth, made 31 million Brazilians move up in social class. In fact, from 2003 to 2008, the percentage of Brazilians that earn less than US$ 450 a month decreased 43%.[8] Brazil's democratic regime and Lula's choice not to change the constitution and run for a third mandate offer a completely different picture than what one usually encounters in Latin American politics. Brazil is now committed to stability and socio-economic development, not to populist ideologies or coup d'états.

## International Leadership

Due to this recently achieved economic and political stability, Brazil is now Latin America's main leader and a prominent global player. In the domain of international relations Brazil

has a rising influence.

Brazil's international leadership is first evidenced in its ties with its Latin American counterparts. Its relationships with certain countries, like Chile and Peru, have always been amicable, but other nations are more problematic. Hugo Chavez, for example, uses his "Bolivarian revolution" as a means to criticize the Western powers and gain support from Venezuela's underprivileged classes. In spite of his inflammatory comments, Brazil doesn't adhere to Chavez's rhetoric and tries to establish a cooperative relationship. An example is the attempt for a multi-billion dollar joint venture between Brazilian oil mogul Petrobras and its Venezuelan counterpart PDVSA to build a refinery.[9] Brazil also tries to appease the complaints of underdeveloped nations like Bolivia and Paraguay. In many instances, Brazil gave in to several of their demands, alleging that it had no interest in taking advantage of its poorer neighbors and that the welfare of South America as a whole was in Brazil's best interest. This is the reason why President Lula has worked hard recently to promote regional cooperation and pragmatism through the Union of South American Nations (UNASUL).[10] Although Brazil


*The "pré-sall" oil reserve, discovered off Brazil's coast, holds 5 to 8 billion barrels of oil*

should be careful not to appear too passive, such attitude demonstrates the country's willingness to cooperate.

In an attempt to show its concern with human rights and security, Brazil also decided to lead the current UN peacekeeping operation in Haiti. After the local government collapsed in 2004, Brazil promised to help the poorest nations in the Americas overcome widespread violence. The mission has had its low points, but one of its greatest achievements yet was the friendly soccer match between the Brazilian squad and Haiti. Soccer stars like Ronaldo, Ronaldinho and Kaká showed how Brazil's "friendliness" was more profitable than any sort of military action. Regardless of the result of the match, millions of Haitians forgot all of their problems for an entire day to cheer and parade with their idols through the streets of Port-au-Prince.

In a broader context, Brazil views alliances between developing nations, or so-called South-South cooperation, as a vital part of its international agenda. In the past, developing nations could hardly interact with one another unless a developed nation worked as a liaison. What Brazil currently envisions is a new global order, where the global South can interact independently of the North. This process involves other major rising powers as well, but President Lula has made South-South cooperation one of the biggest issues of his foreign policy. As a consequence, Brazil is turning into a meaningful player in different regions of Africa and Asia. Leading Brazilian companies have installed offices all over, from Mozambique to China. Likewise, the Brazilian government has made some attempts to show its benevolence to its Southern peers. The Brazilian Agricultural Research Corporation (Embrapa), a leading institute in agricultural research and technology, recently built their first African office in Ghana. The technology Embrapa studies can help local farmers produce better crops as well as develop biofuels.[11] All of this effort has proven to be very successful, especially because

most underdeveloped nations tend to trust developing powers like Brazil, China and India more than Western powers.

Considering its recurrent presence in global debates, Brazil now asserts its role as a prominent player in international politics. First of all, Brasilia's influence in economic bodies like the World Trade Organization (WTO) and the IMF is growing exponentially. As an exporter nation and advocate of free and fair trade, Brazil has successfully used the WTO to solve its disputes (such as its complaints against American subsidies on cotton.) Moreover, in the current debates about the financial crisis, Brazil became, for the first time in its history, a lender nation to the IMF. This is unprecedented for a country that, only a decade ago, depended on IMF loans and suggestions to run its economy. In the United Nations, Brazil holds a stronger presence and aspires to hold a permanent seat on the UN Security Council as a Latin American representative. The creation of G20 also indicates a global recognition of Brazilian influence in politics and economics. In the last summits in London and Pittsburgh, President Lula and the central bank's Meirelles urged nations worldwide to cooperate, signaling that the new global order resides beyond the archaic G8.

## The Future is Not Just Soccer and Carnaval

Brazil's recent stability and accomplishments in foreign policy do grant it the title of Latin America's most powerful nation. Nonetheless, there are six other factors that can now (and in the near future) make its status as a rising major power even stronger.

First, Brazil has, as one of its greatest assets, its natural resources. Brazilian soil is extremely fertile, the land is relatively flat, and fresh water is abundant. It comes to no surprise then that Brazil is currently the world's largest produce of beef, poultry, coffee, sugar and ethanol. The Amazon forest, although mismanaged, is still the world's largest ecosystem; opportunities for sustainable development and carbon trade are privileges Brazil can profit on at anytime. It is also worthwhile to mention that Brazil is immune to natural disasters like earthquakes, volcanoes and hurricanes. All of these factors allow the country to become a great player in the commodity market. Brazilian Vale S/A, for instance, now uses its status as the world's second largest mining company to stipulate prices that clients (like China) have to pay for iron ores. [12] In addition, Brazil recently discovered a humongous oil reserve right off of its coast. Labeled as pré-sal (pre-salt), this reserve sits under a layer of salt that is several kilometers thick, and it holds about 5 to 8 billion barrels of oil. [13] With the prospects of oil revenue, Brazil already created its own sovereign fund, and private investments in infrastructure and technology are booming. As developing countries grow and consume more, Brazil will profit from being one of the world's main suppliers of raw materials.

Secondly, Brazil's cultural and historical background makes it a cohesive and relatively peaceful nation. Unfortunately, violence is still very present in day-to-day life. Cities like Rio de Janeiro do have drug warlords dominating the slums, and authorities are still very unprepared to deal with the situation. Nevertheless, this violence arises due to socio-economic factors. A thief will rob or kill because he is poor, uneducated, and unemployed; if they have no hope of moving up in life, crime would most likely be their last resort. The situation may at times be dire, but economic development and proper education could reduce these crime rates. This is not the case with some other nations. The Russians cannot apply the same rationale to resolve their issue with the Chechens, nor can China with the Tibetans. Brazil has no Georgia, no Taiwan and no Kashmir. It has no nuclear weapons, and no historical tension with any other nation abroad. In fact, the closest Brazil gets to an international conflict is when it plays soccer with its longtime archrival Argentina.

Third, Brazil's current democratic regime is considered legitimate. Historically, Latin American politics have a tendency to be extremely volatile. It always seems that with every new politician, fake promises, corruption and exploitation reappear. The last two administrations, however, have proven that this condition is not universal. The two past Brazilian presidents came from opposing parties and had disparate ideologies, but they still knew the importance of legitimizing the newly established democracy. Brazil did not succumb to populism like Venezuela or Bolivia, it does not face the possibility of a one-party system like Mexico, and it did not cave in to self-interested, oblivious leaders like Argentina. Despite the remaining political tension within the legislative and other spheres of power, the Brazilian democracy as a whole is more consolidated.

Fourth, Brazil emerges out of this economic meltdown more resilient than before. Unlike what happened in previous years, this crisis passed by relatively swiftly in Brazil. The drops in the financial and real economies happened, but they did not last long. São Paulo's Bovespa/BM&F is now the world's fifth largest stock exchange and its main index, the Ibovespa, has already returned to pre-crisis levels. In fact, the largest IPO of 2009 to this date came from a multinational headquartered at Brazil.[14] Brazilian banks swam against the current, as they kept posting profits even at the peak of the downturn. The local financial system is relatively immune to what happened abroad because Brazilian banks are well-hedged, not too exposed to international markets, and then do not take excessive risks. In fact, banks benefit from the new healthy increase in domestic consumption and credit. As to the real economy, the effects of the crisis also seem to fade away. Industry and agriculture, which depended more on exports, took a heavy hit, and this lead to many lay-offs. Expectations, however, proved to be worse than the reality. Businesses are re-hiring their former employees and, in some cases, even increasing their workforce. Consequently, Brazil posted in September of 2009 an unemployment rate of 7.7%, lower than that of the US.[15]

Fifth, Brazil already demonstrates certain virtues typical of developed powers. More than half of its electricity comes from carbon-free hydroelectric plants, and around three-quarters of the news cars sold are biofuel. Ethanol is one of Brazil's greatest economic and environmental assets. Unlike the corn ethanol produced in the US, Brazilian ethanol comes from sugar cane. The advantage of this variety is that it is cheaper, more efficient and it uses a raw material not vital for humans (and thus, not affecting food supplies).[16] A popular misconception is that Brazilian farmers deforest the Amazon to create space for more sugar cane fields; in reality, most plantations are located thousand of miles away in the São Paulo state and new farms emerge in unpopulated open plains southeast of the Amazon.

Another strong trait Brazil has is the power of its private sector. Not only do Brazilian banks, oil, mining and construction companies rank highly compared to its foreign counterparts, but other industries also show rapid development domestically and abroad. Embraer (which was once owned by the state) is now the world's third largest airplane manufacturer, while the Belgian-Brazilian InBev recently purchased Budweiser, America's largest beer company. Brazilian capitalism now flourishes stronger than ever, ready to succeed in a competitive and globalized world.

Sixth, Brazil's image abroad grants it a degree of soft power. Brazilian culture, soccer and lifestyle generally interest and appeal to people. It attracts immigrants and tourists from abroad, and having a good reputation is key for a state to convene its power. Moreover, Brazil also profits on its own image abroad; the brand "Brazil" sells various commodities, like flip-flops and soccer jerseys. Not surprisingly, this soft power may have influenced the global community in awarding the 2014 FIFA World

Cup to Brazil and the 2016 Summer Olympics to Rio de Janeiro. This appeal attached to Brazil's image is constantly reflected in its international interactions. Brazilians feel welcome anywhere they go, and most people associate their first thought of Brazil to something positive. That might also account for why few (if no) states view Brazil as an enemy. In fact, Brazil is a rare case of a nation who is rising without making other nations feel bothered or insecure. Brazil's charisma and relatively untainted reputation are definitely unique assets few other developing countries possess.

## Conclusion

The current state of Brazilian economy and politics does consolidate it as an emerging major power. Despite all of the challenges it still has to overcome, everything seems to be working in Brazil's favor. Its recent stability on both the economic and political fronts make it stand above many other developing countries. Not only that, but Brazil's impact abroad and its domestic qualities make it stand out even more. In 2010 Brazil will once more hold elections and a new president will emerge. The top two candidates (one of whom has a PhD in Economics from Cornell) come from opposing parties, and possess different views on what the government should do. What they do share, though, is the vision of Brazil as a global leader. Regardless of the outcome of this election, it is very unlikely that Brazil will derail. A lot still has to change and Brazil should not get ahead of itself, but for now it can claim that its ascension to the pantheon of major powers is legitimate.

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Photo Courtesy of:

*"Map of Brazil." Wikimedia. 31 Oct 2009. http://wikimediafoundation.org/wiki/File:Brazil_topo2.PNG*

# *Withdrawing the Case of Uganda from the Jurisdiction of the International Criminal Court*

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## Can Alternative Justice Mechanisms Offer a Substitute to Prosecutions?

The trend from international armed conflicts toward internal insurgencies has altered our common understandings of classical strategic wisdom. While traditionally under the politics of imperialism, wars were settled with the winning state's decisive acquisition of territories over that of another state, in internal conflicts rebels choose to protract asymmetric warfare by employing low-scale guerrilla tactics rather than attempting to decisively hold a territory. Clausewitz's observation that war is a mere continuation of politics by other means is thus nuanced by the unlikelihood that the solution to those long-lasting conflicts will be of a military nature, flipping the logic of Clausewitz's maxim on its head – politics as war by other means. As a result, burdened with such intractable conflicts, governments are often forced to make political gains through political negotiations instead of through military conflict.

Another element of the modern international system however clashes with this imperative to negotiate for peace. Under the precepts of international law, states are compelled to prosecute rebels for crimes committed during war. Ironically, as many commentators have already argued, this constraining force may do more to hinder the process of peace than to abet it. In this sense, international law obligates states to maintain an antagonistic stance toward rebels, while concurrently negotiating for peace. Nonetheless, politics implies bargaining, and when negotiating to end internal insurgencies, the ransom for peace often consists of rebels' demands for immunity from charges. States are thus confronted with a dilemma: if peace and justice are exclusive, which should they pursue?

An archetypal case study is that of Uganda, where the state has been struggling against an armed group, the Lord's Resistance Army (LRA), for more than 20 years during which the warring parties have allegedly committed numerous international crimes. Recently, peace has finally seemed attainable as promising negotiations between the government and the LRA known as the Juba talks were launched in 2006, only to be derailed in 2008 by the apparent indecision of the rebels. The LRA is now reportedly active in the adjacent Democratic Republic of Congo, the Central African Republic, and South Sudan, leading many to conclude that the peace process has definitely collapsed. Only a few months after the failure of its latest military offensive, and more than two decades since it first resorted to that strategy, the Ugandan government is debating again launching a new offensive.[2] For several observers and stakeholders, the origin of this momentary failure can be traced to a 2004 request by the Ugandan government to involve the International Criminal Court (ICC), after which ICC prosecutor Luis Ocampo-Moreno issued five arrest warrants for top LRA commanders.[3]

Predictably, while the ICC was attempting to ensure that justice would be provided to victims, peace negotiations were turning sour over that same issue.

It is worth asking: can ICC prosecutions really contribute to a sense of justice? If not, are there alternative means of fostering both peace and justice? Can these alternative means of administering justice legally replace prosecutions under the twofold legal framework of general international law, and of the Statute of the ICC? This article will argue that although the ICC attempts to further justice in Uganda, its prosecutions may not be the most effective way to contribute to that goal. In this regard, it will be suggested that the peace vs. justice schema only offers a tunnel view of available alternatives to address violations. Measures that are non-prosecutorial and quasi-judicial potentially offer a much greater contribution to both peace and justice than ICC prosecutions. Whether there is a legal basis for the replacement of the ICC prosecutions by these mechanisms is however disputed. The legality of conditional amnesties is at the forefront of this debate. Yet, after a careful examination of all legal considerations, we will conclude that international law, at large, as well as statutory law, offer enough leeway for certain types of alternative justice mechanisms to lawfully replace ICC prosecutions. Building on that conclusion, this article will argue that the ICC should recognize herein an opportunity to further its goal of ending impunity, and choose to favor an interpretation of law that accommodates it.

## The Peace vs. Justice Dilemma in Uganda

The ICC indictments were initially saluted across Uganda. But in countries experiencing internal conflict such as Uganda, the notions of peace and justice are often difficult to reconcile. Or rather, their reconciliation exposes priorities that are at odds in the short-term, but, in the long-term, necessary for stability.[4]

Observers both within and outside Uganda have weighed in on this peace vs. justice dilemma with opinions on where the emphasis should be placed differing vastly. On the one hand, political actors such as the United Nations and prominent human rights groups have been in favor of maintaining the ICC indictments.[5] Accountability for international crimes, they argue, constitutes a strong foundation upon which peace and stability can be built and sustained. On the other hand, a vocal faction of Ugandan officials and local Acholi leaders has argued that the ICC indictments are a major political obstacle to peace by short-circuiting the amnesty and reconciliation process and prolonging the war.[6] Their stance is motivated by declarations by the rebels to the effect that signing a peace agreement is contingent upon being absolved from formal criminal responsibility.[7] Similarly, some members of the international community have firmly maintained that the trade-off with peace is untenable. Even major international bodies such as the United Nations Security Council (Security Council) have weighed out the possibility of ending the prosecutions.[8]

The recent resurgence of LRA attacks has seriously reshaped the debate about the halting or straight out withdrawal of the ICC prosecutions over the Ugandan rebel leaders. Nevertheless, although peace is now much more elusive than it has ever been in recent years, this debate's apparent anachronism may only be temporary. Indeed, claims by security experts that the LRA was weakened in 2005 when Sudan withdrew its support to the group still prevail. The Security Council has also recently agreed that the government of Uganda should continue its peace efforts.[9] The LRA, in other words, may still be enticed to the negotiation table. It is, thus, still worth taking a step back and exploring alternative options to the ICC program of prosecutions. When this time comes, the international community should avoid a repetition of history, and

come prepared to respond to demands that it decides on peace or justice – that is, halting the prosecutions, or seeing the conflict resume again.

## Can There Be Justice Beyond Law? Traditional Justice and TRCs

Scholars have long pondered about the competing value of prosecution against that of alternative means of justice such as traditional justice mechanisms when comparing the notions of retributive and restorative justice. Retributive justice systems, such as that embodied by the ICC, seek to redress violations of the law through punishment. However, one can argue that justice can also be defined in other terms. Sociologists of law and critical legal scholars emphasize the importance of deconstructing law, so as to make visible the purpose a specific law serves, its moral intent aside, in a given context.[10] Mark A. Drumbl argues that, despite the near universality of the ideas of repudiating great evil and the need for accountability for victims, the categorization of great evils as *crimes* is less certain. The artificiality of the universalism of international criminal law seems starkest at the procedural level.[11] Indeed, as Drumbl argues:

> The modalities of international criminal law, in particular those related to punishment and sentence, tend to universalize through ideological preference instead of through an independent assessment of the social psychology of the violence […] [But t] he choices are not binary: namely, either to accept the received wisdom of existent internationalized institutions, on the one hand, or the void of impunity.[12]

It is in this perspective that alternative approaches to justice, such as the restorative approach, have undertaken to redefine the responses to crimes.

Ugandan traditional justice mechanisms were initially championed as substitutes to ICC prosecutions on grounds echoing those put forward by critical legal scholars such as Drumbl. Indeed, dissatisfaction with ICC prosecution has led scores among those opposing ICC prosecutions to question the rationale and impact of an eventual sentencing of perpetrators by the ICC, arguing that it would likely not have a preventive effect in the community. In comparison, they claim, traditional justice is more suited given that it prioritizes reconciliation and reintegration.[13] There are several ceremonies that are traditionally practiced by northern Ugandans which act as retributive mechanisms. Mato Oput (meaning 'drinking of the bitter herb or root') is the main one discussed as suitable for Joseph Kony and other LRA members, particularly those sought by ICC arrest warrants.[14] Mato Oput is traditionally used to resolve inter-clan disputes, such as the killing of a clan member by an individual of another clan.[15] In terms of its purpose, it is "…both a process and a ritual ceremony to restore relationships between clans in the case of intentional murder or an accidental killing."[16]

The effectiveness and viability of such traditional methods to administer justice was, however, recently put into question. In essence, their inappropriateness stems from the fact that they were originally intended to deal with single violations, and were only recently transformed into mechanisms to administer justice for larger conflicts. By many accounts, such adapted ceremonies may have little or no resonance with the local population and on their willingness to forgive the perpetrators.[17]

The debate that has surrounded the substitution of ICC prosecutions with traditional justice mechanisms, although offering no clear answer, has had the merit of opening a breach into the prevalent view among decision-makers that retributive means of accountability are always the preferred way to hold individuals accountable for their international crimes. Specifically, this debate has directed researchers to measure opinions among Ugandans about other transitional justice mechanisms, often inspired by the notion of restorative justice. The recognition that truth and reconciliation commission

(TRC) was another popular alternative to prosecution has emerged as the fruits of their labors. In that regard, a widely cited recent survey conducted with Northern Ugandans reveals that 92 percent of respondents agreed that a truth-telling process was needed in Uganda.[18]

***"Measures that are non-prosecutorial and quasi-judicial potentially offer a much greater contribution to both peace and justice than ICC prosecutions."***

TRCs rest on the principle of reconciliation versus punishment that advocates of the notion of retributive justice have defended. They generally involve the establishment of a quasi-judicial body, with a fact-finding mandate but no direct power to punish offenders. Their goal is the reconstruction of the history of a certain period to facilitate reconciliation in a given society. Full amnesty for the perpetrators of international crimes usually depends upon completion of their testimony. In other circumstances, TRCs have been widely discussed as capable, if conducted genuinely, of providing justice.[19]

The arguments that favor restorative justice mechanisms tend to assume one of two forms – which echo those of stakeholders in favor of substituting ICC prosecutions in Uganda. The first is legal. It allows that restorative justice mechanisms offer a superior form of justice when a state has faced mass atrocities, irrespective of political compromises. For instance, Martha Minow argues that TRCs, "…are not a second best alternative to prosecutions… When the societal goals include restoring the dignity to victims, offering a basis for individual healing, and also promoting reconciliation across a divided nation, a truth commission may be more powerful than prosecution."[20] That is, restorative justice may allow breaking the cycle of violence by gaining insights into what occurred in the past and why. Retributive justice may not be capable of obtaining this understanding because it considers that a violation of law is centered around the offence to the state rather than to the victim[21] The state "…therefore, essentially owns the conflict and determines how to respond to it", while victims and offenders are to some extent subsidiary to the process.[22] Instead, restorative justice recognizes crime as being primarily directed against individuals. Those who are most affected by the crimes should thus become actively involved in resolving the conflict.[23]

Furthermore, some argue that restorative justice mechanisms may also be preferable politically. Recalcitrant perpetrators may be more likely to participate in restorative mechanism than to expose themselves to the demands of a tribunal in societies where power is fragmented and perpetrators are capable of resisting arrest. Thus, even if under ideal circumstances prosecutions might be preferable, non-prosecutorial restorative alternatives may be justified as a necessary political compromise for a peaceful coexistence. In that sense, alternative mechanisms may achieve greater justice than that which would be realized by retributive justice.[24]

The conundrum of whether the termination of the ICC prosecutions would lead to peace is certainly complex, and this discussion does not pretend to bring closure to this debate.[25] Nevertheless, building on the tentative conclusion that prosecutions at large may not be the preferable way to establish justice in Uganda, this article will focus on testing the legality of replacing ICC prosecutions with alternative means of justice, i.e. TRCs, or traditional justice mechanisms. We will measure these alternative means of justice against the precepts of general international law, as well as against the ICC's statutory law.

The Legality of Alternative Justice Mechanisms in the Context of an ICC Prosecution.

**Legal Basis of Alternative Justice Mechanisms in General**

## International Law

Three mechanisms allow for the withdrawal of a case under ICC's jurisdiction. They are the Security Council deferral, the prosecutorial discretion to abandon a case on the basis of the interests of justice, and the challenge of the Court's jurisdiction on the basis of the principle of complementarity.

To decide whether the alternative mechanisms of justice identified above – TRCs and traditional means of justice – can replace the ICC prosecutions, one must initially consider the general legal framework. General international law regulates all withdrawal mechanisms and, in some cases, may *per se* make it unlawful to withdraw a case.

When considering the validity of the legal basis of alternative means of justice, one essentially considers a delimited area, where law and extra-legal mechanisms meet. Indeed, although they are extra-judicial, alternative justice mechanisms are paired with a judicial status providing them with a legal context. To that effect, the 2000 Amnesty Act was adopted in Uganda before there were discussions of traditional justice. Its proponents have suggested that when a case is handled with traditional justice, it is to be paired with the granting of domestic amnesties on the judicial level.[26] Similarly, a Ugandan TRC could conclude with the granting of domestic amnesties to most criminals dealt with, if not all.

In order to determine whether a case could lawfully be withdrawn from the ICC, it is necessary to assess whether the state's decision not to prosecute through the amnesty of alleged perpetrators is valid under general rules of law. If it is valid, domestic and international courts can recognize amnesty for international crimes. The most relevant rules of international law for this discussion are those governing the obligation to prosecute.[27]

The premise we follow is that if the obligation to prosecute clashes with the granting of amnesty, it will also conflict, by extension, with the alternative justice mechanisms being employed. In such a circumstance, not prosecuting would be in breach of international law.

The duty to prosecute varies according to the category of international crime and remains contentious with respect to certain international crimes. Due to space constraints, we will only touch upon this debate superficially. The common view to which we adhere is that there is a duty to prosecute only when stipulated by treaty law.[28] In Uganda, the accusations specifically concern war crimes committed in non-international armed conflicts and crimes against humanity. With reference to war crimes committed in non-international armed conflicts, the duty to prosecute is not solidly established in treaty law.[29] As for crimes against humanity, no specialized treaty codifies their applicable rules, including the prosecution of such crimes.[30]

In sum, the boundaries set by general international law do not clearly outlaw the practice of not prosecuting the alleged gross violations of international law committed by LRA members in Uganda. The ICC could thus, in principle, recognize the legal framework of alternative justice mechanisms – the amnesties – for crimes committed in Uganda. Another fundamental question is whether these plans would be acceptable under the statutory basis for the ICC to stop the proceedings it has undertaken. Indeed, because these proceedings have passed the state of the investigation and charges have been issued, their replacement involves withdrawing the case from the Court. It will thus be necessary to evaluate whether the Rome Statute allows for the substitution with non-prosecutorial methods of justice.

***"The choice of alternative mechanisms of justice is made within the realm of State sovereignty, unbound by a clear duty to prosecute in Uganda."***

### *Legal Basis in ICC Statutory Law*[31]

#### *Deferral by the Security Council*

Three provisions of the Rome Statute have been identified as entry points to withdraw ICC prosecutions, which, once halted, would be replaced, by TRCs or traditional means of justice. A first mechanism provided for in the Rome Statute for a case to be withdrawn from the jurisdiction of the ICC is for the Security Council to defer it. This competence is regulated by article 16 of the Rome Statute. According to this provision, the Security Council can adopt a resolution under Chapter VII of the UN Charter requesting the abrogation of investigations or prosecutions for a period of twelve months. The request may be renewed under the same conditions.[32] Morten Bergsmo and Jelena Pejic argue that when negotiating article 16, the drafters were mindful of political stalemates exemplified in situations such as Uganda's, where peace and justice seem to be in conflict.[33] In this case, for Vera Gowlland-Debbas, international law prescribes that the objective of maintaining or securing peace prevails as chapter VII resolutions overcome, by law, other obligations.[34] In that spirit, the provision has been described by Gowlland-Debbas as, "… the vehicle for resolving conflicts between the requirements of peace and justice where the Council assesses that the peace efforts need to be given priority over international criminal justice."[35] If this is true, then the deferral is a viable means to allow for some amnesties.[36]

Article 16 of the Rome Statute is ambiguous regarding its role in shaping proceedings substituting ICC prosecutions when deferring a case. Indeed, the Rome Statute does not stipulate that a Security Council deferral be accompanied by effective action by that body to maintain or restore international peace and security, e.g. a program of accountability for perpetrators of international crimes, as previous drafts of article 16 have mandated.[37] However, the final version of the article, as adopted, favored giving the Security Council a wide margin of discretion. Accordingly, the Security Council can consider that the deferral *per se* constitutes a sufficient action; it could also alternatively take a step further and decide upon the adoption of further measures to this end. In the absence of a clear relationship between a Security Council deferral and the nature of substitute methods of accountability – prosecutorial or not – the national system of a State is temporarily relieved of its obligations to the ICC.

*A fire sweeps through a refugee camp for those displaced by the conflict between the Lord's Resistance Army and the Ugandan Government*

Thus, if the Security Council deferred the case of Uganda, the substitute mechanisms of accountability put in place by Uganda could take many forms, as long as they are in line with the Council's duty to preserve peace and security.[38] In the eyes of the international community, the choice of alternative mechanisms of justice is made within the realm of state sovereignty, unbound by a clear duty to prosecute in Uganda. In short, when a case is deferred at the Security Council, one should be "…acutely

conscious that [the] indiscriminate exercise of this power in purported pursuit of peace will emasculate the ICC, and undermine efforts to strengthen deterrence and institutionalize human rights norms."[39] On the other hand, the deferral could allow for valuable non-prosecutorial mechanisms to be employed in order to administer justice.

***Withdrawal through Complementarity***

Complementarity is another way by which an ICC case can be withdrawn. Complementarity signifies that the ICC recognizes the primacy of national jurisdictions, to which it is complementary, over its own. Thus, the Court cannot take a case when a state exercises its jurisdiction over the crimes set out in the Rome Statute in circumstances defined in article 17, namely genuine ability and willingness of domestic judicial proceedings.[40] The ICC should however assume jurisdiction in certain circumstances, even where national investigations or prosecutions have occurred, but lacked 'genuineness'. What is more relevant to the case of Uganda is that when considered *a contrario*, the wording of the article 17 provides that the ICC may stop an investigation or prosecution on the basis that it is inadmissible, even when proceedings are already underway at the ICC. This is made clearer under paragraph 2 of article 19, which allows the states ordinarily having jurisdiction over a case and persons accused or summoned by the Court to challenge the admissibility of the case at the ICC. This practice is called a 'challenge'. To be successful, the challenger will however need to prove that the proceedings substituting those of the ICC are genuine, that is, that they are a product of the state's willingness and ability, i.e. that substitute proceedings meet international legal standards.[41]

To this day, the ICC has developed no substantive case law on the admissibility of cases.[42] It can however be speculated that if one follows a strict interpretation, article 17 does not warrant the admissibility of certain amnesties if they are supplemented by investigations. Yet, on the contrary, it can be argued that article 17 leaves room for the inadmissibility of these amnesties when the article is interpreted widely.[43] To discuss this, we look at articles 17(1) and 17(2). Both provisions rule when a case is inadmissible.

First, under article 17(1)(a), a case is inadmissible where, "…it is being investigated or prosecuted by a state which has jurisdiction over it…"[44] For some commentators, the use of the word 'or' can suggest that all that is required to preserve the primacy of a national process is that one or the other proceedings be in progress. Thus, if a case is investigated but not prosecuted, the ICC cannot assume jurisdiction. Additionally, since the Statute does not specifically require that an investigation be criminal or police-related, it would seem a quasi-judicial investigation is sufficient so long as its goals meet the standards expected of a criminal investigation: i.e. it establishes the facts and the responsibility of a crime through a systematic inquiry.[45]

The context of the article, however, suggests that certain conditions limit investigations that could be acceptable under article 17. First, article 17(1)(b) seems to contain such a condition. The article's subparagraph addresses a similar situation as paragraph (a), yet differs in that it does not apply to cases currently being investigated, but rather, to cases investigated in the past. Paragraph (b) however specifies further that when limiting itself to an investigation, the state must have made the "decision" not to prosecute.[46] This condition appears to imply that prosecution must at least be an option for an investigation to meet the inadmissibility test of article 17.[47]

Further, articles 17(1)(a) and (b) both require the Court to determine whether the decision not to prosecute resulted from the genuine unwillingness or inability of the state. This again constrains the investigative alternative justice mechanisms that could withstand scrutiny by the Court. First, a relevant provision is 17(2), which details what is meant by 'unwillingness'.[48] The chapeau

of the article clarifies that the criterion of unwillingness shall be assessed with "…regard to the principles of due process recognized by international law…"[49] This reference suggests that investigations, even if they are quasi-judicial, must guarantee basic fair trial rights to the accused in the procedure.[50] Similarly, paragraph (c) indicates that, to withstand scrutiny by the Court, an investigation should be conducted independently and impartially.[51]

Another relevant provision essential in evaluating the conformity of alternative justice mechanisms is article 17(2)(a). The article sets an additional constraint on investigations in that a case should not have been addressed by an investigation made "… for the purpose of shielding the person from criminal responsibility…" to be inadmissible to the Court.[52] The prime concern of this provision was to preclude proceedings that deviate from awarding criminal responsibility, i.e. sham proceedings.[53] As a result, as notes Carsten Stahn, where the prosecutor cannot prove that the intent of a proceeding is devious, or contrary to the apparent actions, alternative justice mechanisms may be validated as genuine proceedings.[54] Thus, to fall below the threshold of this article and meet the Court's test of inadmissibility, alternative justice mechanisms should be "…guided by the (objective) aim to promote reconciliation, rather than by the (subjective) intent to twist and bend the rules of criminal trials for the purpose of impunity."[55]

Finally, article 17(2)(c) constrains investigations that could withhold scrutiny. The article states that the proceedings must be conducted "…in a manner which […] is consistent with an intent to bring the person concerned to justice."[56] Interpreting this article depends on what is understood by the notion of 'justice'. If the notion is narrowly associated with criminal justice, there is little room for alternative justice mechanisms that do not retain the possibility of criminal prosecution. However, if the notion of restorative justice can be reconciled with more common conceptions of justice, then the granting of an amnesty is a possible outcome. In that case, the level of deference that the ICC will reward to alternative justice mechanisms may depend on whether their outcome implies a mandatory sanction.[57] For example, the East Timorese TRC made the granting of impunity dependent on the performance of a visible 'act of reconciliation', such as community service, reparation, a public apology and other acts of contrition.[58]

Another factor that can make a case inadmissible before the ICC is the inability criterion. However, as this criterion is exclusively linked to the issue of prosecutions carried out by the judicial system, as laid out by a provision in the Rome Statute, it is unnecessary for the Court to evaluate the conformity of quasi-judicial investigations to this criterion in order to assess their validity. Indeed, the only circumstances provided for in article 17(3) to identify the inability to undertake proceedings are the collapse or unavailability of a national judicial system.[59] Since the alternative justice mechanisms contemplated are *extra-judicial*, there is no need to evaluate the ability of Uganda's *judicial* system.[60]

Recent TRCs have been construed, both procedurally and substantially, following those boundaries by which alternative justice mechanisms could be interpreted as prosecutions and could allow for a case to be withdrawn from the ICC. The TRC of South Africa and East Timor are good examples. Building on these experiences, this is a framework to which an eventual Ugandan TRC could conform in order to successfully challenge the ICC's complementary jurisdiction. Would Ugandan traditional justice mechanisms likewise meet the minimal requirements set for investigations by article 17?

In their present form, it is unlikely that traditional justice mechanisms would satisfy the test of article 17, as they would clash with some of the conditions discussed above. First, Ugandan traditional processes do not perform

the function of an investigation. For instance, Mato Oput requires the establishment of facts, and the process is not final until the perpetrator has admitted his motivations for the crime, expressed remorse, and established the circumstances of the crime.[61] Yet, critics have remarked that the investigation would exclude women, who only play a marginal role in the establishment of truth in Mato Oput.[62] Further, Mato Oput clashes with article 17(1)(b) because it does not retain the option to prosecute as an outcome of the investigation should the accused for instance fail to cooperate with the investigative organ. Also, given the apparent lack of legitimacy of traditional justice ceremonies within the population, as previously discussed, one may question whether Mato Oput represents a genuine intent to bring perpetrators to justice as required by article 17(2)(c). Related to this, the sanctions provided by Mato Oput may be indicative of an intent to bring an individual to justice. In that regard, traditional ceremonies do require the public acknowledgement of wrongs, but only if this is done willingly.[63] However, LRA leaders have repeatedly denied their crimes, and it is unlikely they will admit to them willingly.[64] Illustrative of this is a conversation Professor Tim Allen reports he had with LRA brigadier Sam Kolo just before the latter was going through the healing rite. Allen reports that the ex-LRA member had signified to him the ceremony did not really mean anything to him. Further, while Mato Oput also provides for sanctions in the form of compensations, Kolo had also made clear to Professor Allen that he would not pay compensations to his victims.[65]

***Withdrawal through the 'Interests of Justice' Provision***

Article 53(2) of the Rome Statute appears to bestow the prosecutor with the necessary discretion to conclude that, when not in the 'interests of justice', there is not a sufficient basis for prosecution.[66] Paragraph (c) further specifies that the prosecutor shall guide his decision by taking into account "all… circumstances", detailed in the remainder of the provision.[67] The first question to address is whether it is indeed possible to drop a case on the basis of this provision. The standard test for interpreting treaty rules as laid down in article 31 of the Vienna Convention on the Law of Treaties (VCLT) forms the basis of interpretation of any provision found within a treaty. Article 31 calls for the interpretation of a treaty "…in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." [68]

*The International Criminal Court, located in The Hague, the Netherlands, prosecutes individuals accused of war crimes and crimes against humanity*

Following this set of interpretative guidelines, an argument can be made to the effect that a non-prosecutorial program could be accommodated under this article 53. Indeed, the VCLT holds that, "[r]ecourse may be had to supplementary means of interpretation […] to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure."[69] Commentators who have taken the

position that the dropping of prosecutions is not permitted on the basis of the interests of justice predicate their argument on the object and purpose of the Rome Statute, which focuses on ending impunity for international crimes, and the punishment of these crimes.[70] However, in the absence of ICC case law on this article to guide one's interpretation of the ordinary meaning of its terms – in particular the terms 'interests' and 'justice' – the consideration of supplementary means of interpretation, such as the circumstances of a treaty's conclusion and its preparatory work, appears justified.[71]

Looking into the debate surrounding the adoption of article 53 affirms that alternative justice mechanisms could count as valid substitute mechanisms to prosecution at the ICC under this article. Indeed, the drafters did not define the exact content of 'interests of justice'. Rather, they left ambiguous their views on the issue of whether or not amnesties and TRCs would be invalidated by the Rome Statute.[72] As noted by Manjsuli Ssenyonjo, drafters would have addressed single amnesty or truth and reconciliation commission policies directly in the ICC Statute had they agreed on this in Preparatory Commission meetings preceding the Conference. For instance, drafters could have added a provision on the withdrawal of referrals.[73] Rather, they left the authority to the ICC to develop jurisprudence on the matter – intentionally according to a number of individuals.[74] Thus, in the light of its specific mandate, it is clear that the ICC must be committed to ending impunity through prosecution of the LRA leaders. However, the 'creative ambiguity' of article 53 does not appear to clearly preclude the prosecutor's use of the notion of interests of justice to drop prosecutions in favor of non-prosecutorial programs in exceptional cases.[75]

Returning to the case of Uganda, is it possible to drop the indictments in the 'interests of justice'?[76] Many commentators are of the opinion that prosecutorial discretion is the most plausible avenue to accommodate alternative justice mechanisms, such as amnesty and TRCs.[77] It is unclear, however, what level of deference the prosecutor will view as being appropriate when confronted with the decision as to whether to shelve indictments in the 'interests of justice'. Certainly, the prosecutor would base his position on general considerations of international law such as the duty to prosecute, as we have already done. Beyond that, the Rome Statute provides little guidance as to what 'interests of justice' could make a case inadmissible. As was seen in the previous discussion, article 53 nevertheless identifies circumstances that can be useful in offering guidance.

First, in reviewing whether respecting an amnesty and not prosecuting would better serve the 'interests of justice', the prosecutor would look at the circumstances to which the article obliges him to take into account. The 'interests of victims' appears to be the main parameter related to the notion of the 'interests of justice' that could argue in favor of dropping ICC prosecutions in the case of Uganda. However, this criterion lacks a clear definition. As was noted above, the provision seems to imply that certain factors can, at times, outweigh the paramount interest in having the accused criminally investigated and prosecuted. As Professor Allen suggests, taking into account the interests of the victims could imply that, "[a]t the very least, the victims can affect what it is appropriate for the Court to do."[78] In that regard, an above-cited survey conducted with Northern Ugandans reveals that respondents seek both peace and justice, and that they are willing to have perpetrators granted amnesty, but not unaccountability. Looking at the details, 76 percent of the respondents want the perpetrators to be held accountable, with a preference for punishment (66 percent). In parallel however, 56 percent would favor the granting of amnesties, paired with measures such as an apology, and confession.[79]

In sum, the survey's results suggest that for victims, alternative justice mechanisms

constitute an alternative avenue, but not necessarily to the exclusion of prosecution. As was discussed above, this is not a condition traditional Ugandan justice mechanism clearly meets, as Mato Oput for instance does not give the option of prosecuting. It is likely, however, that a TRC with a proper mandate, including an option to sanction, could meet the victims' expectations as suggested above. Furthermore, a majority of the survey's respondents wanted the opportunity to speak publicly about the abuses they had suffered, a goal that can also be fulfilled by a TRC.[80]

Commentators have also attempted to find additional guidelines that could likely guide the prosecutor. These guidelines are, however, tentative, lacking a clear judicial basis. Two broad criteria can be distinguished. First, the prosecutor should look at the validity of the substitute justice program the state will employ, evaluating for instance their democratic basis, the effectiveness of the investigation of the facts, and the existence of some type of sanctioning mechanism.[81] Second, consideration should be given to the 'necessity' to depart from the standard criminal prosecutions.[82]

***"A majority of the survey's respondents wanted the opportunity to speak publicly about the abuses they had suffered, a goal that can also be fulfilled by a TRC."***

These standards also point to the likelihood that the prosecutor would not withdraw a case on the basis of the 'interests of justice', if substituted with traditional justice mechanisms. This can be perceived when evaluating the validity of the substitute justice program. As noted by Darryl Robinson, the required substitute justice mechanisms are not dissimilar from those relevant to a withdrawal based on complementarity discussed above, although not as clearly guided by legal criteria.[83] In that context, the point was made that traditional justice mechanisms in Uganda are not adequate justice programs, a conclusion that is maintained even in the context of article 53.

'Necessity' to depart from the standard criminal prosecutions as outlined above concedes that prosecution that could further engender conflict is sufficient enough reason to decide not to prosecute international crimes.[84] In that sense, the case has already been made that withdrawing prosecutions in Uganda is overwhelmingly perceived as necessary to ending the conflict and attaining peace. However narrowly should the necessity condition be interpreted, one can hardly envision a scenario more indicative of necessity than one where there is a clear trade-off with peace. This criteria does not only flow from legal principles, but also from a political evaluation that the prosecutor is compelled to make.[85]

The bottom line is that prosecutorial discretion in all jurisdictions is a prerogative that vests the prosecutor with a strong liberty of action. In common law systems, the prosecutor typically enjoys the authority to select and pursue criminal cases.[86] Normally, however, guidelines are promulgated to guide prosecutorial decision-making. At the ICC, such regulations are being drafted. Incidentally, they lean towards including consideration of circumstances in which an investigation or prosecution might "exacerbate or otherwise destabilize a conflict situation" or "seriously endanger the successful completion of a reconciliation or peace process."[87] In spite of this, until they are applicable, the prosecutor's discretion remains, in principle, nearly unlimited. Certainly, the Pre-Trial Chamber may conduct a review of the prosecutor's discretionary decisions,[88] but nothing indicates that the Pre-Trial Chamber will oppose the merits of dropping prosecutions if they are rigorously based on realistic political considerations.

**Which Withdrawl Mechanism is Preferable?**

In retrospect, abandoning a case on the basis of complementarity or on the basis of the 'interests of justice' offer more positive contributions to the achievement of justice as a result of the strings these notions attach to the substitute procedure. As it is, article 16 provides that a case may be abandoned in isolation to the general framework of justice developed in the Rome Statute. In contrast, abandoning a case on the basis of the 'interests of justice' or on the principle of complementarity, requires the fulfillment of certain criteria with regard to the administration of justice. Thus, although the means of accountability put in place in Uganda are essentially a question of domestic standing, their choice is also closely linked to the legal regime put in place by the Rome Statute.

Indeed, initiating prosecutions at the ICC prompts the state to reinforce its domestic judicial system. Complementarity is a mechanism that encourages states to respect their obligation to investigate and prosecute major international crimes by acting as a catalyst for their compliance.[89] According to the drafters of the Rome Statute, complementarity should have stimulated judicial activities as a consequence of the reluctance of States to surrender their national criminal jurisdiction to the ICC, i.e. *before* the Court would exercise its jurisdiction over it. The relationship between the concurrent jurisdictions would thus have been antagonistic. The practice of self-referrals has however, modified this calculation. Rather, the development of constructive tensions between the ICC and domestic jurisdictions has become a common function of complementarity when a State reclaims its criminal jurisdiction after having voluntarily dispensed with it, i.e. *after* the Court exercises its jurisdiction over it.[90] Thus, by taking decisions that involve constructing norms for what domestic criminal justice should look like for adjudicating international crimes, the Court has embarked on the course of setting minimum requirements for national standards of criminal justice systems throughout the world.[91]

Hence, when the Court exercises or threatens to exercise its jurisdiction on judicial proceedings, it pressures the state to raise its judicial standards. For example, the complementarity principle has prompted Uganda to raise the standards of its judicial system.[92] If it wishes to replace ICC prosecutions by its own, Uganda will likely need to prove its genuine willingness and ability to investigate or prosecute LRA leaders. In effect, the ICC's principle of complementarity has influenced Uganda into enhancing its prosecutorial capacity. This catalytic influence can be perceived from diverse direct indicators. For instance, Uganda has made efforts to adjust its judicial system to prosecute international crimes through the implementation of the Rome Statute, even though this is not an obligation in and of itself under the Statute.[93] Furthermore, it has sought to introduce amendments to exclude the leadership of the LRA from receiving amnesties shielding them from criminal responsibility.[94] All of these measures are aimed at facilitating a prosecution.

In the same way, the Court can decide to resist dropping prosecutions of LRA leaders until the alternative quasi-judicial mechanisms are sufficient in meeting the ICC's standards of adequacy. In other words, the ICC can pressure states to raise the standards of their alternative justice mechanisms. On this subject, the above discussion has revealed that the ICC would probably adopt a triple standard. If the case is deferred by the Security Council, the ICC would have little power to shape substitute justice mechanisms according to its own standards. With relation to the interests of justice clause, the scope of appreciation of the Court for non-penal proceedings would be broader than with relation to the complementarity notion. Indeed, the interests of justice clause does not force the ICC to inspect and approve the judicial system of a state as strictly as that of the complementarity clause. In contrast, under article 17, the scope of what substitute

mechanism would be considered acceptable is much narrower as the complementarity regime sets a minimum requirement for a case to be dropped.[95]

In sum, by adopting a broad approach to complementarity, the ICC has the opportunity to set minimum standards for non-prosecutorial alternative justice mechanisms. Ultimately, this is a chance to further both the general goals of international criminal justice, and those of the ICC to end impunity. This is not a negligible prospect; alternative justice mechanisms are bound to proliferate in correspondence with the multiplication of protracted internal conflicts. The adoption of such an approach would greatly enlarge the scope of accountability initiatives the Statute deals with. Indeed, as noted by Christopher K. Penny, "[c]ompared to amnesty and truth commissions, post-conflict criminal prosecutions is a relatively rare method of addressing atrocities."[96] Rather than declining the opportunity of measuring quasi-judicial mechanisms against its standards, the ICC should thus shape a policy of complementarity by which it engages with the common reality of quasi-judicial mechanisms.

## Conclusion

This article has explored the role of the ICC in promoting impunity for violations of international criminal law in Uganda. As was discussed, the case of Uganda at the ICC exemplifies a perceived peace vs. justice dilemma that threatens to stall the debate on means to fight impunity in internal conflicts. Indeed, as negotiating peace to resolve protracted internal conflicts becomes more common and, in parallel, the ICC's complementary jurisdiction compels states parties to the Court to commit to prosecuting international criminals, these priorities often seem to clash.

However, this article has shown that it is possible to evade the tragic difficulties of choosing between peace and justice. Indeed, the appearance of exclusive options is arguably no more than the result of an ideological choice. While all societies distinguish between good and evil, addressing this through the lens of retribution is one option among others. Another option that we have defended is the restorative paradigm of justice which appears to be equally valuable, if not more so than retributive justice in cases such as that of Uganda. Indeed, recent history has demonstrated that transitional societies benefit more from restorative means of justice which appears more sustainable than retributive justice. Moreover, restorative justice mechanisms often allow reaching the necessary political compromise to settle a peace deal. Political actors engaged in solving the conflict in Uganda have raised this debate to advocate that traditional Ugandan justice mechanisms provide benefits retributive mechanisms do not offer.

Further, mindful of the peace vs. justice dilemma, we proposed to discuss whether these alternative mechanisms of justice – TRCs and traditional justice mechanisms – could lawfully replace the ICC's program of prosecution. To do so, it was necessary to explore the general international legal obligations regulating amnesties, since they provide a legal context to the alternative justice mechanisms discussed. After concluding that the general international legal rule does not clearly preclude amnesties, we looked at its statutory basis. We found that in the case of Uganda, the Rome Statute contains three mechanisms that could allow for the withdrawal of the case at the ICC: a Security Council deferral, a withdrawal on the basis of 'interests of justice', and a withdrawal following a challenge of admissibility on the basis of complementarity.

For all three mechanisms, we found that the case can be made that prosecutions can be dropped and substituted by alternative justice mechanisms. The mechanisms, however, place different conditions on the substituting domestic jurisdiction. First, the Security Council deferral only minimally discriminates

between substituting accountability mechanisms of different value, offering little incentive for the domestic jurisdiction to raise its standards. Second, the 'interests of justice' clause compels the state employing alternative justice mechanisms to raise them to a certain standard, but only on the basis of unclear, and therefore weak, guidelines. Finally, the withdrawal of a case on the basis of a challenge of the Court's complementarity offers a more significant contribution to justice. This is because complementarity can act as a catalyst, pressuring states to raise the standards of substituting domestic procedures – even quasi-judicial ones – to meet the criteria set out in the Rome Statute.

As a result of this, when complementarity is involved in conditioning the appropriateness of a withdrawal – based on article 19, or to some extent when dropping a case on the basis of article 53 – traditional Ugandan justice mechanisms do not meet the standards required to allow the Court to drop a case. Thus, under these scenarios, the case of Uganda would be maintained at the ICC. Alternatively however, a TRC could meet the necessary threshold to withstand scrutiny by the Court, and allow for the dropping of the case of Uganda. In this case, the Court would have much to gain. On the one hand, it can raise the global standard of justice for all cases where accountability is dealt with in non-prosecutorial ways. On the other hand, it furthers peace by bringing satisfaction to the victims, while holding their aggressors accountable.

## Endnotes

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5 Human Rights Watch, 'ICC Takes Decisive Step for Justice in Uganda' (14 October 2005) <http://hrw.org/english/docs/2005/10/14/uganda11880.htm> accessed 15 February 2008; Amnesty International, 'Government must back first ever arrest warrants by International Criminal Court' (Press Release) (14 October 2005) <http://web.amnesty.org/library/Index/ENGAFR590102005?open&of=ENG-UGA> accessed 14 February 2008.

6 For instance, in early 2004, the head of the Uganda government's Amnesty Commission joined members of Parliament and religious leaders from Northern Uganda in opposing the ICC investigation. ––, 'Kony: Amnesty, not Arrest' *All Africa News (The East African)* (27 January 2004) <http://allafrica.com/stories/200402170874.html> accessed 15 January 2008.

7 LRA peace negotiating spokesman Ayo is quoted as saying: "If ICC drops the case, then we will sign the peace agreement and peace will return to northern Uganda." *See*, ––, 'Ugandan rebels refuse to sign peace deal while facing arrest warrants' *The Associated Press* cited by *International Herald Tribune* (London 11 October 2006) <http://www.iht.com/articles/ap/2006/10/11/africa/AF_GEN_Uganda_Rebels.php> accessed 12 April 2008.

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9 UNSC Presidential Statement 48 (2008) UN Doc S/PRST/2008/48

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15 ––, 'Peace First, Justice Later' (2005) Refugee Law Project Kampala Working Paper No 17, 1, 24 <http://www.refugeelawproject.org/resources/papers/workingpapers/RLP.WP17.pdf> accessed 12 April 2008.

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19 *See* generally the seminal work of Priscilla B. Hayner, *Unspeakable Truths* (Routledge, New York 2001).

20 Martha Minow, *Between Vengeance and Forgiveness: Facing History after Genocide and Mass Violence* (Beacon Press, Boston 1999) 88-9.

21 Charles Villa-Vicencio, 'Why perpetrators should not always be prosecuted: Where the International Criminal Court and Truth Commissions meet' (2000) 49 Emory L.J. 205, 211-14.
22 Mark S. Umbreit, Betty Vos, Robert B. Coates & Elizabeth Lightfoot, 'Restorative Justice: An empirically grounded movement facing many opportunities and pitfalls' (2007) 8 Cardoso J. Conflict Resol. 511, 515.
23 Umbreit, 515-16.
24 Kent Greenawalt, 'Amnesty's Justice' in Robert I. Rotberg & Dennis Thompson (eds), *Truth v. Justice: The morality of truth commissions* (Princeton University Press, Princeton 2000) 194-98. (Greenawalt-a)
25 The grid of analysis of conflict resolution theory offers a fruitful point of entry into this debate. *See* e.g. David Lanz, 'The ICC's Intervention in Northern Uganda: Beyond the Simplicity of Peace vs. Justice' (2007) Institute for Human Security Working Paper Series 1, 17-20.
26 The term "domestic amnesty" refers to a national or municipal law which has the effect of discharging from criminal prosecutions. In that sense, the 2000 Amnesty Act declares an amnesty "…3. in respect of any Ugandan who has at any time since the 26th day of January, 1986 engaged in or is engaging in war or armed rebellion against the government of the Republic of Uganda by – 1. actual participation in combat; 2. collaborating with the perpetrators of the war or armed rebellion; 3. committing any other crime in the furtherance of the war or armed rebellion; or 4. assisting or aiding the conduct or prosecution of the war or armed rebellion." Amnesty Act 2000 (Uganda).
27 Traditionally, the duty to prosecute is seen binding states only, thus binding Uganda, but not the ICC who is neither a party to the relevant treaties, nor necessarily a subject of customary international law in this regard. Under modern international however, it is generally accepted that international organizations and especially bodies concerned with ensuring and developing the rule of law internationally such as the ICC, should abide by the relevant rules of international law. *See* e.g. Henry Lovat, 'Delineating the Interests of Justice' (2007) 35 Denv. J. Int'l L. & Pol'y 275, footnote 38; Naomi Roht-Arriaza, 'Amnesty and the ICC' in Dinah Shelton (ed), *International Crimes, Peace, and Human Rights* (Transnational Publishers, Ardsley NY 2000) 78.
28 *See* for e.g., Christopher C. Joyner, 'Redressing Impunity for Human Rights Violations' (1998) 26 Denv. J. Int'l L. & Pol'y 591; Carla Edelenbos, 'Human Rights Violations: A duty to prosecute?' (1994) 7 Leiden J. Int'l L. 5; Naomi Roht-Arriaza, 'Non-treaty Sources of the Obligation to Prosecute?' in Naomi Roht-Arriaza (ed), *Impunity and Human Rights in International Law and Practice* (OUP, Oxford 1995); Diane Orentichler, 'Settling Accounts: The duty to prosecute human rights violations of a prior regime' (1991) 100 Yale L. J. 2537.
29 *See* e.g. Denise Plattner, 'The Penal Repression of Violations of International Humanitarian Law Applicable to Non-International Conflicts' (1990) 30 IRRC 414; Sonja Boelaert-Suominen, 'Grave Breaches, Universal Jurisdiction and Internal Armed Conflict: Is customary law moving towards a uniform enforcement mechanism for all armed conflicts?' (2000) 5 J. Conflict and Security L. 63. A competing view holds that, according to an emerging customary rule, certain crimes committed in non-international armed conflicts should be prosecuted on the basis of the same system of 'grave breaches' (codified in the Geneva Conventions and their Additional Protocol I) with which war crimes committed in international conflicts are prosecuted. *See* e.g. Antonio Cassese, *International Criminal Law* (OUP, Oxford 2008) 88.
30 Faustin Z. Ntoubandi, *Amnesty for Crimes against Humanity under International Law* (Martinus Nijhoff Publishers, Leiden 2007) 132. A minority of commentators argue that a custom to prosecute crimes against humanity has recently developed. *See* Bruno Simma & Andreas L. Paulus, 'The Responsibility of Individuals for Human Rights Abuses in Internal Conflicts: A positive view' (1999) 93 Am. J. Int'l L. 302, 310; M.Cherif Bassiouni & E.M. Wise, *Aut Dedere Aut Judicare: The duty to extradite or prosecute in international law* (Dordrecht, Boston and Martnus Nijhoff Publishers, Leiden 1995) 21.
31 This section builds on the work of Jessica Keller, who conducted a discussion similar to the one undertaken. Keller, however, comes to a different set of conclusions. *See* Jessica Keller, 'Achieving Peace with Justice: the International Criminal Court and Ugandan Alternative Justice Mechanisms' (2007) Thomas Jefferson School of Law Legal Studies Research Paper No. 1018539 1,39 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1018539> accessed 19 April 2008
32 Rome Statute of the International Criminal Court (adopted 17 July 1998, entered into force 1 July 2002) U.N. Doc. A/CONF.183/9, art 16. The source of the power of the Security Council to defer proceedings before the ICC stems from its responsibility to maintain international peace and security. Luigi Condorelli & Santiago Villalpando, 'Referral and Deferral by the Security Council' in Antonio Cassese, Paula Gaeta & John R.W.D. Jones (eds), *The Rome Statute of the International Criminal Court: A commentary* (OUP, Oxford 2003) 646. The responsibility to maintain international peace and security is enshrined in Article 24 of the UN Charter, which states: 'In order to ensure prompt and effective action by the United Nations, its Members confer on the Security Council primary responsibility for the maintenance of international peace and security, and agree that in carrying out its duties under this responsibility the Security Council acts on their behalf.' This is further complemented by actions the Council may take under Chapter VII of the Charter when having determined the existence of a threat to peace, breach of peace, or act of aggression. Article 39 of the UN Charter States: 'The Security Council shall determine the existence of any threat to the peace, breach of the peace, or act of aggression and shall make recommendations, or decide what measures shall be taken in accordance with Articles 41 and 42, to maintain or restore international peace and security.' United Nations Charter (adopted 26 June 1945, entered into force 24 October 1945).
33 Morten Bergsmo & Jelena Pejic, 'Article 16: Deferral of investigation or prosecution' in Otto Triffterer (ed), *Commentary on the Rome Statute of the International Criminal Court* (Kluwer Law International, The Hague 1999) 377.
34 United Nations Charter , art 103. Vera Gowlland-Debbas, 'The Role of the Security Council in the New International Criminal Court from a Systemic Perspective' in Laurence Boisson de Chazournes and Vera Gowlland-Debbas (eds), *The International Legal System in Quest of Equity and Universality*: *Liber Americorum Georges Abi-Saab* (Kluwer Law International, The Hague 2001), 629-50.
35 Bergsmo, 378.
36 This opinion is defended by e.g., Yasmin Naqvi, 'Amnesty for War Crimes: Defining the limits of international recognition' (2003) 85 IRRC 583, 592; Darryl Robinson, 'Serving the Interests of Justice: Amnesties, truth commissions and the International Criminal Court' (2003) 14 Eur. J. Int'l L. 482, 502-03 (Robinson-a). For contrary opinions, *See* Jennifer J. Llewellyn, who makes the remark that the Security Council deferral is only valid for one year, and as a result does not resolve the question of the validity of an amnesty. Jennifer Llewellyn, 'A Comment on the Complementarity Jurisdiction of the International Criminal Court' (2001) 24 Dalhousie L.J. 192.
37 Condorelli, 648.
38 The UN Charter also requires that actions should be consistent with the purposes and principles of the UN, including the promotion and respect of human rights. United Nations Charter, art 24(2). Thus if preexisting law required prosecution, it is not clear that the Security Council could override it through a deferring resolution. As this is not clearly the case with the crimes at hand, a Security Council deferral would probably not breach this provision.
39 Nick Grono, International Crisis Group, 'Negotiating Peace and Justice: Considering Accountability and Deterrence in Peace Processes' (Presentation at the International Conference on Building a Future on Peace and Justice in Nuremberg 2007) <http://www.crisisgroup.org/home/index.cfm?id=4922&l=2> accessed 18 April 2008.
40 It is the Court that has the responsibility to determine the admissibility of a case. The chapeau of Article 17 States that "…the Court shall determine that a case is inadmissible." Rome Statute art 17.
41 Rome Statute, art 19.
42 *See Decision on the admissibility of the case under article 19(1) of the Statute* ICC-02/04-01/05-377 (10 March 2009) 11-12; 27.
43 *See* Llewellyn, 202-04; Carsten Stahn, 'Complementarity, Amnesties and Alternative Forms of Justice: Some interpretative guidelines for the

International Criminal Court' 3 J. Intl' Crim. J. 695, 709-16; Claudia Cardenas Aravena, 'The Admissibility Test Before the International Criminal Court Under Special Consideration of Amnesties and Truth Commissions' in Jann K. Kleffner & Gerben Kor (eds), *Complementary Views on Complementarity* (TMC Asser Press, The Hague 2006). For a contrary opinion, *see* John Dugard, 'Possible Conflicts of Jurisdiction with Truth Commissions' in Antonio Cassese, Paula Gaeta & John R.W.D. Jones (eds), *The Rome Statute of the International Criminal Court: A commentary* (OUP, Oxford 2003) 501-03.

44 Rome Statute, art 17(1)(a).
45 Llewellyn, 203; Stahn, 710-11; Darryl Robinson, 'Comments on Chapter 4 of Claudia Cardenas Aravena' in Jann K. Kleffner & Gerben Kor (eds), *Complementary Views on Complementarity* (TMC Asser Press, The Hague 2006) 144-45 (Robinson-b).
46 Rome Statute, art 17(1)(b).
47 Llewellyn, 203; Stahn, 712; Robinson-b, 144-45.
48 Stahn, 712.
49 Rome Statute, art 17(2).
50 Stahn, 712.
51 Rome Statute, art 17(2)(c). Stahn, 712.
52 Rome Statute, art 17(2)(a).
53 Sharon A. Williams, 'Article 17: Issues of Admissibility' in Otto Triffterer (ed), *Commentary on the Rome Statute of the International Criminal Court* (Kluwer Law International, The Hague 1999) 393.
54 Stahn, 714-15.
55 Stahn, 715.
56 Rome Statute, art 17(2)(c).
57 Stahn, 714-15.
58 UNTEAT Regulation No 2001/10, par. 27.7.
59 Rome Statute, art 17(3).
60 Cardenas Aravena, 135.
61 ––, *Roco Wat I Acoli*, 55-6.
62 ––, *Roco Wat I Acoli*, 64; Peace Women, 'Perspectives and Experiences of Women in Northern Uganda in the ICC' (Press Release) (23 November 2004) <http://www.peacewomen.org/resources/Uganda/WomenUgandaICC.html> accessed 20 March 2008.
63 Joanna R. Quinn, 'Beyond Truth Commissions: Indigenous Reconciliation in Uganda?' (2006) 4 *The Review of Faith and International Affairs 31*, 36.
64 Joseph Kony appears to believe LRA atrocities were justified. He is reported to have stated: "If you picked up an arrow against us and we ended up cutting off the hand you used, who is to blame? You report us with your mouth, and we cut off your lips. Who is to blame? It is you!" Allen-a, 42.
65 Allen-a, 166.
66 Rome Statute, art 53.
67 Article 53(2)(c) reads: "If, upon investigation, the Prosecutor concludes that there is not a sufficient basis for a prosecution because: … (c) A prosecution is not in the interests of justice, taking into account all the circumstances, including the gravity of the crime, the interests of victims and the age or infirmity of the alleged perpetrator, and his or her role in the alleged crime; the Prosecutor shall inform the Pre-Trial Chamber and the State making a referral under article 14 … of his or her conclusion and the reasons for the conclusion." Rome Statute, art 53(2)(c).
68 Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 **U.N.T.S. 331, 8 I.L.M. 679**, art 31.
69 Vienna Convention, art 32.
70 *See* e.g., Human Rights Watch, 'The Meaning of "the Interests of Justice" in Article 53 of the Rome Statute' (Policy Paper) (June 2005) 3-4 < www.hrw.org/campaigns/icc/docs/ij070505.pdf> accessed 14 February 2008.
71 Vienna Convention, art 32.
72 Bergsmo, 709.
73 Manisuli Ssenyonjo, 'Accountability of Non-State Actors in Uganda for War Crimes and Human Rights Violations: Between amnesty and the International Criminal Court' (2005) 10 J. Conflict & Security L. 405, 425.
74 Gerhard Hafner et al., 'A Response to the American View as Presented by Ruth Wedgwood' (1999) 10 EJIL 108, 112. Darryl Robinson suggests on the basis of his presence at the negotiations that the lack of clear guidelines derived from the negotiation process is intentional. Robinson-a, 483. This hypothesis appears to be further confirmed by Philippe Kirsch, the Chairman of the Rome Diplomatic Conference. According to an interview with Mr. Kirsch, "… the provisions that were adopted reflect 'creative ambiguity' which could potentially allow for the prosecutor and judges of the International Criminal Court to interpret the Rome Statute as permitting recognition of an amnesty exception to the jurisdiction of the court." Michael P. Scharf, 'The International Criminal Court: Consensus and Debate on the International Adjudication of Genocide, Crimes Against Humanity, War Crimes, and Aggression' (1999) 32 Cornell Int'l L.J. 521-22.
75 *See* e.g. Robinson-a, 485-6.
76 Arguably, the prosecutor has already taken a position on the question. Indeed, under article 53(1)(c), the prosecutor must preclude proceedings as early as before the investigation if this is not in the interests of justice. Rome Statute art 53(1)(c). Considering this was not done before the investigation of the situation of Uganda was carried out, the prosecutor implicitly affirmed that proceeding was in the interests of justice. The prosecutor's analysis may however be re-opened at any time, under article 53(4), based on "…new facts or information." Rome Statute art 53(4) For Morten Bergsmo and Pieter Kruger, these new facts "…would have to be of such a nature as to create the possibility that they could eliminate the former shortfall in the information which led to the decision." Bergsmo, 714. Undoubtedly, in the event of an historical peace treaty in Uganda, the prosecutor could consider that a trade-off for amnesty qualifies in that regard.
77 *See* e.g. Dugard, 486.
78 Allen-a, 129. This is also a view the ICC has embraced in discussing its policy orientation. The ICC paper on policy issues published in late 2003 indeed notes: "The Prosecutor will encourage States and civil society to take ownership of the Court…", and his office "…will take into consideration the need to respect the diversity of legal systems, traditions and cultures." ICC-OTP, 'ICC Paper on Some Policy Issues Before the Office of the Prosecutor' (September 2003), 2-5 <http://www.icc-cpi.int/library/organs/otp/030905_Policy_Paper.pdf> accessed 19 January 2008.
79 Pham.
80 Pham.
81 Thomas Hethe Clark, 'The Prosecutor of the International Criminal Court, Amnesties, and the "Interests of Justice": Striking a Delicate Balance' (2005) 4 Wash. U. Global Stud. L. Rev. 389, 408-09; Robinson-a, 497-98.
82 Robinson-a, 497.
83 Robinson-a, 500.
84 Orentichler 2548; Juan E. Méndez, 'Accountability for Past Abuses' (1997) 19 Human Rights Quarterly 4.
85 *See* e.g. Alexander K.A. Greenawalt, 'Justice Without Politics? Prosecutorial Discretion and the International Criminal Court' (2007) 39 N. Y. U. J. Intl' L. 583. (Greenawalt-b)
86 Greenawalt-b 599-600.
87 International Criminal Court, Draft Regulations of the Office of the Prosecutor (3 June 2003) 47 <http://www.icc-cpi.int/library/organs/otp/draft-

regulations.pdf> accessed on 3 April 2008.

88 Rome Statute art 53(3)(b).

89 *See* Jann K. Kleffner, 'Complementarity as a Catalyst for Compliance' in Jann K. Kleffner & Gerben Kor (eds), *Complementary Views on Complementarity* (TMC Asser Press, The Hague 2006).

90 Kleffner 84-8.

91 Eric Blumenson, 'The Challenge of a Global Standard of Justice: Peace, Pluralism and Punishment at the International Criminal Court' (2006) 44 Colum. J. Transnat'l L. 801, 804-05.

92 This initially raised some questions as to how it would impact an eventual challenge to the case's admissibility under ICC jurisdiction. For many commentators the fact that the case of Uganda was not initially deemed admissible on the basis of Uganda's judicial system's unwillingness or inability, but rather because Uganda had willingly kept inactive and not initiated any proceedings, called for a different operationalization of complementarity. Indeed, when there is such a waiver of the state to exercise complementarity, it is unclear what consequences this should have on the state's efforts to reclaim its primary jurisdiction. For Mohamed M. El Zeidy, the state may outright not be allowed to request a withdrawal of the case on the basis of complementarity. Mohamed M. El Zeidy, 'The Ugandan Government Triggers the First Test of the Complementarity Principle' (2005) 5 Int'l. Crim. L.R. 83, 108-09. On the contrary, suggests Payam Akhavan, this could rather result in that there may be no requirement for the reclaiming state to establish its willingness or ability as a precondition for the exercise of jurisdiction since this was not a concern in the first place. Payam Akhavan, 'The Lord's Resistance Army Case: Uganda's Submission of the First State Referral to the International Criminal Court' 99 Am. J. Intl' L. 403, 414. If these interpretations are confirmed, the complementarity principle may well lose its capacity to act as a catalyst for compliance. It is however unlikely that the ICC, who is the prime judge of when it should initiate the exercise of its jurisdiction under article 13 of the Rome Statute, will adopt such a limiting interpretation. The notion that the ICC admits cases on the basis of "inaction" as a sufficient basis for admissibility is cautioned by an interpretation of Article 17 developed in an informal expert paper prepared for the Office of the Prosecutor in 2003, in which experts developed the condition. The experts purport to find a third contingency in the two contingencies specified in Article 17(1)(a): "…the most straightforward scenario is where no State has initiated any investigation (the inaction scenario). In such a scenario, none of the alternatives of arts. 17(1)(a)-(c) are satisfied and there is no impediment to admissibility. Thus there is no need to examine the factors of unwillingness or inability; the case is simply admissible under the clear terms of Article 17." ICC-OTP, 'Informal Expert Paper: The principle of complementarity in practice' (2003), paras 17-8 <http://www.icc-cpi.int/library/organs/otp/complementarity.pdf> accessed 19 January 2008.

93 Barney Afako, 'Country Study V: Uganda' in Max Du Plessis and Jolyon Ford (eds) *Unable or Unwilling? Case Studies on Domestic Implementation of the ICC Statute in Selected African Countries* (ISS Monograph Series, Institute for Security Studies, Pretoria 2008) 95.

94 Afako 96.

95 Robinson-a, 498-500.

96 Christopher K. Penny, 'Can Justice and Peace be Reconciled?' The Role of International Criminal Law' in Helene Dumont & Anne-Marie Boisvert (eds), *La voie vers la Cour Penale Internationale: Tous les chemins menent a Rome* (Editions Themis, Montreal 2004) 151.

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# Cornell International Affairs Review




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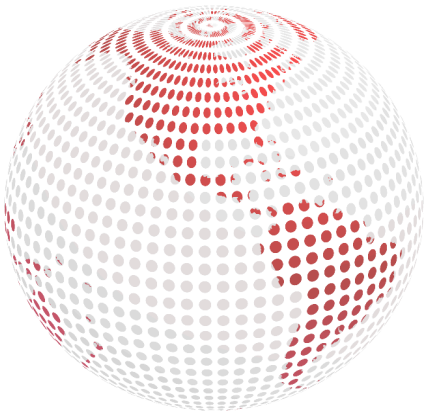

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