National sovereignty and economic globalization: An analysis of the role of the IMF in the changing world

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NATIONAL SOVEREIGNTY AND ECONOMIC GLOBALIZATION:
AN ANALYSIS OF THE ROLE OF THE IMF
IN THE CHANGING WORLD

by

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A thesis submitted in partial fulfillment
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Master of Arts in Political Science
ABSTRACT

National Sovereignty and Economic Globalization:
An Analysis of the Role of the IMF
in the Changing World

by

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Chapter 1 outlines empirical and normative theories of national sovereignty. A comprehensive analysis of the origins and evolution of sovereignty is offered. We suggest that the notion of absolute sovereignty is antiquated and needs scientific reassessment. Recent scholarly discourse indicates that students of international relations are divided as to the role of sovereignty and the nation-state in the modern world. On the one hand, scholars who we call the critics of sovereignty are ready to abandon the notion of sovereignty as outmoded for the lack of effectiveness and viability. They contend that national sovereignty is being diffused, eroded, threatened, and challenged, and that national boundaries are being dwindled, diminished, and dissolved by sweeping forces of globalization. Others contend that the concepts of sovereignty and the nation-state are very much "alive" and relevant in the modern world. We hypothesize, submit and test empirical evidence that national sovereignty is a viable and relevant institution, while being transformed by the on-going process of globalization.

Chapter 2 discusses theories of the nation-state, while keeping in mind that the conceptualization of the nation-state is intertwined with that of sovereignty. We show
the areas of weakness and vulnerability which the nation-state is experiencing due
to the changes in the economic milieu. We emphasize the necessity for strong
domestic institutions during the age of globalization which will be indispensable in
the face of potential market fluctuations and financial crises. States will have to
strengthen their institutions to be better prepared to face globalization and its negative
effects. We show that the nation-state still has an important role to play in the modern
context and that it will remain the center of gravity in the international arena.

Chapter 3 gives a comprehensive overview of contending theories of globalization
and definitional confusion associated with the concept. We conceptualize
globalization in general and economic globalization in particular. We outline myths
and realities associated with the concept of globalization. We submit the empirical
evidence that illustrates various aspects of globalization. We analyze how
globalization affects and transforms sovereignty. Globalization calls into question
outmoded views and dogmas about international relations; it calls for a profound
scientific rethinking of the concept of sovereignty. Having said that, sovereignty and
the state are no less important and no less viable in the modern world than they
used to be. Once again, sovereignty is being transformed due to globalization while
holding its ground. It is taking on a new dimension with the ever-present globalizing
trends, i.e., new advances in technology, internationalization of financial markets,
new developments in telecommunications, and the ascendancy of supranational
institutions and regimes such as the International Monetary Fund, WTO, and the
World Bank.

Chapter 4 takes the International Monetary Fund as a case study and as one of
the manifestations of globalization. We describe the principles and the rationale
behind the creation of the IMF, its achievements and failures since its founding in
1945. Just as national sovereignty is being transformed by globalizing trends, the
IMF itself is facing the need for a profound change and structural reform. After the
general discussion of the IMF, we focus on the effects of economic globalization on national sovereignty and the role of the International Monetary Fund in that process. We outline the recent critiques of the IMF and its changing role after the collapse of the Bretton-Woods system. The IMF is considered as a vehicle of economic globalization and as a means of economic intervention through conditionality, which could pose a threat to national sovereignty. We address problems and dilemmas associated with the IMF conditionality for the present and for the future. We give our recommendations for the reform of the IMF.

Chapter V (Conclusion) discusses recent developments which point at the erosion of state-centered Realism, a theoretical construct, that views states as the dominant and unitary actors on the international level. Although theories of globalization and globalism are gaining grounds, it is early to speak of a world state and a global village. A comprehensive theory is needed, a theory that will encompass the viability of national sovereignty, the state and the effects of globalization, a theory that will reflect the realities of our times. These realities indicate the necessity for an eclectic, pluralistic and comprehensive theory of international relations where state and non-state actors are given equal consideration and are analyzed in relation with each other. This thesis is an attempt at that theory.
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The forces of globalization change our lives in many fascinating ways. My own life is a tribute to that. I met my husband Mark in Russia (Moscow) right after the collapse of the Soviet Union. And here we are, some years later, making Nevada our home, having two beautiful children, and enjoying the colorful life of the fastest growing city in the United States. Our life story has been the inspiration for this thesis.

I want to thank my husband Mark with all my heart for his continuous support, patience, and understanding while I was working on this thesis. Mark has been my inspirational and motivational beacon all this time. His warming presence and intellectual input have been invaluable for the completion of my work. Our children, Benjamin and Natasha, have been the source of strength and inspiration for me as well. I dedicate this thesis to them, my beloved ones, Mark, Benjamin, and Natasha.

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I want to thank all of you, my beloved family and friends. I dedicate this thesis to you.
CHAPTER 1

NATIONAL SOVEREIGNTY IN THEORY AND PRACTICE

All associations are instituted for the purpose of attaining some good.
The Politics of Aristotle 1 (Ernest Baker Translation, 1961)

No man is an island entire of itself; every man is a piece of the continent, a part of the main. If a clod be washed away by the sea, Europe is the less, as well as if a promontory were, as well as if a manor of thy friend's or of thine own were. Any man's death diminishes me, because I am involved in mankind. And therefore never send to know for whom the bell tolls: it tolls for thee.

John Donne

The ultimate explanation of the binding force of all law is that man, whether he is a single individual or whether he is associated with other men in a state, is constrained, in so far as he is a reasonable being, to believe that order and not chaos is the governing principle of the world in which he has to live.

J. L. Brierty (The Law of Nations 1963, 56)

Sovereignty in both theory and practice is aimed at establishing order and clarity in an otherwise turbulent and incoherent world. Its historical function has been to act as "a fundamental source of truth and meaning", to distinguish between order and anarchy, security and danger, identity and difference.


A world order is a stool on three legs: the political, the normative, and the institutional.

Samuel K. Murumba ("Grappling with the Croatian Moment" 1993, 867)

Law within the individual state is not a mere accident of historical development; it is an essential element of human association. Man, as Aristotle put, is by his very nature a social being; and he is by his very nature in need of law. Ubi societas, ibi jus. In like manner, under the conditions of modern times, the state, notwithstanding its corporate character, has become itself "a social being" in relation to other members of the international community. . . .The interdependence of states is a fact: a community of interests between states exists in as real a sense as a community of interests between individual men. The need of law between state and state is as great, although less obviously so, as the need of law between man and man.

Charles G. Fenwick (International Law 1948, 31)
Introduction

General fascination with the concept of sovereignty could be explained by numerous contradictions inherent in the evolution and the meaning of the concept. Students of law and politics attempt to resolve these contradictions by asking a seemingly straightforward question — *What does “sovereignty” really mean?* A researcher setting out to give the “true meaning” of sovereignty in the environment of the prevailing definitional confusion would be engaging in a fruitless and hopeless endeavor. To give a concrete definition of the concept that captures its multiple meanings since the thirteenth century is a truly Herculean task.¹ The “puzzle of sovereignty” is fascinating in itself because the concept carries so many meanings, associations, and connotations, it has so many levels of analysis and brings forth multiple layers of understanding. To grasp the “true and only meaning” of such a broad concept is to fight windmills in a Quixotic fashion.

In this thesis, we take an eclectic, holistic approach to the study of sovereignty. This approach combines both normative and empirical dimensions of sovereignty. We will describe and analyze theories that view sovereignty in purely normative and juristic terms as well as the ones based on a positivist and empirical footing. Having analyzed the normative theories on “what ought to be”, the understanding of sovereignty based on empiricism is offered; it is a view of sovereignty based on “what is” in a given historical context. This positivist understanding of sovereignty will be explained with the help of two guiding principles — *historicism* and *empiricism*. However, it is necessary to keep in mind that *theory and practice*, the normative and the empirical dimensions of any scientific endeavor, determine and complement each other in a dynamic relationship.

¹The oldest reference to sovereignty can be found in the Oxford English Dictionary which dates back to 1290!
When the concept of sovereignty is addressed one cannot but discern a prevailing conceptual confusion. Like so many terms in our political lexicon, sovereignty is ambiguous, broad, frequently criticized, misapplied, overgeneralized, and misunderstood. "Sovereignty" brings multi-tiered associations — the sovereignty of a monarch, the monarchical absolutism, absolute sovereignty, ruler sovereignty, popular sovereignty, state sovereignty, relative sovereignty, divided sovereignty, dual sovereignty, limited sovereignty, mixed sovereignty, positive sovereignty, negative sovereignty, political sovereignty, economic sovereignty, and so forth. It is not the objective of this paper to reconcile numerous theories, understandings, and contradictions associated with the concept. The objective is to give a comprehensive analysis of sovereignty, its continuity and change, to better understand what aspects of it are being "challenged" and "transformed" due to globalization, and what particular facets preserve status quo at the present historical moment.

Historically and linguistically, sovereignty is related to a wide range of connotations and associations — it is associated with statehood, independence, supremacy, freedom, legitimacy, and final authority. In the abstract, it implies supreme and absolute power, exclusive jurisdiction, total control, and exclusive legal competence. Sovereignty, thus, possesses political and legal dimensions. Furthermore, sovereignty has a territorial dimension which denotes exclusive jurisdiction within or over a territory, also described as demarcated or exclusive territoriality. In practice, the constraints of international law dictate that sovereignty is "reducible" through the allocation/delegation of power or the transfer of sovereign "sticks," (when a state joins an international organization, for instance).

Over the course of the centuries, the concept of sovereignty acquired various interpretations and usages, myths and misunderstandings. Sovereignty has many rich and overlapping layers which are associated with different periods and different historical circumstances. As a result, sovereignty is a contentious concept in political
theory. It has developed and evolved within a certain political environment. When it became impossible to identify the location of sovereignty in a single person (natural or corporate) or a definite body within the state, it began to personify the state itself. Subsequently, controversies over the loci of sovereignty subsided and sovereignty is now thought to reside with the state. As the state evolved, sovereignty evolved with it and acquired various connotations and interpretations. Theorizations of sovereignty have undergone reassessment and re-conceptualization as historical events unfolded and as new political and social realities took shape.

Thus, sovereignty is not an abstract or an ahistorical quantity detached from reality and the people who exercise it. Sovereignty did not evolve in a vacuum or in some mystical, abstract environment. It evolved within a historical context as a result of a dynamic and changing environment. Thus, empiricism and historicism are the proper tools for the analysis of the institution of sovereignty. A concept, an idea, is like an empty container or an empty vessel, filled with different personalities and different contents rooted in a historical reality. What was understood by sovereignty in the seventeenth or the eighteenth century during absolutism, where the monarch was conceived as the source of sovereignty, the supreme law-giver and above the man-made, positive law, would differ from a more recent perception of the state as the personification of sovereignty. The state is now conceived as the carrier of sovereign powers, which are dispersed among various organs of the government, limited by the constitution, and other domestic and international laws. In short, the semantics of sovereignty represent a fascinating puzzle for political science. Truly, the acknowledgment and acceptance that sovereignty has multiple meanings can be liberating and enriching in explaining this fascinating concept.
Sovereignty as a Stabilizing and Legitimizing Force

Sovereignty is an assumption about political power, a theory based on the idea that there is an ultimate, final, and independent authority in the political community. It is based on the assumption that somewhere within the body politic there is a final and absolute authority and no other superior authority exists outside it. Sovereignty is a type of legitimate authority; it is a framework for legitimization or the way of exercising legitimate power. Sovereignty by its definition precludes the existence of any higher legal authority above the state (the state being the ultimate embodiment of sovereignty). As an ideal, sovereignty means an absolute, supreme and final right of the state to determine the lawfulness of all acts done within its territory. It implies a complete freedom of control, which does not exist in reality. As an ideal, territorial sovereignty is understood as an absolute, final, and supreme legitimate authority within a fixed territory. In short, "a sovereign person is one who belongs to none other" (Frank van Dun 1998, 51).

The definition of sovereignty described in terms of absolute supremacy and absolute power is a juristic, legalistic theorization, of what it should be. At a normative level, sovereignty requires absoluteness; it is rigid, static, monolithic, and indivisible. As an ideal, sovereignty is an ultimate absolute authority. It is based on the belief that there is an absolute and final political power within the community, which corresponds to the internal aspect of sovereignty. This principle is extended to the international sphere, where no supreme authority exists over the collection of independent and autonomous states. In theory, sovereign states are free from the authority of other states. Each state is an independent and self-sustained unit, self-sufficing, all in itself and by itself, containing a unified legal personality, and free of any supervision from a higher international authority. In theory, states are thought to be fully independent, which is essential to the principle of sovereign equality of
all states. The two aspects of sovereignty, internal and external, are complementary and express two dimensions of the same principle.

According to the absolutist view, fully independent states exist in the state of nature, and the world is essentially in an anarchical state of affairs, each sovereign state carrying on by itself. This community of states is an artificial, legally constructed concept, where essentially each state is on its own, a veritable Hobbesian wilderness. Needless to say, this conception of sovereignty is nondemocratic and does not reflect reality. The principle that there ought, somewhere in the state, to be a repository of absolute power smacks of autocracy and absolutism. States do not exist in isolation, they are interconnected and their needs are intertwined. If sovereignty means absolute power and absolute control, and if states are sovereign in that sense, then they are above the law and international law is a delusion. If states possess absolute sovereignty (which they do not), they cannot be above international law and bound by it at the same time. States are simultaneously the creators and subjects of international law after all. In short, the perception of sovereignty in absolute terms is full of reconcilable contradictions.

What is the source and the locus of sovereignty? Is it the king? The state? The parliament? The political community? The representative assembly? The constitution? The sovereign does not need to be an individual (king or monarch); sovereignty could lie in a committee, a parliament, an assembly, a constitution, a triumvirate, or the united will of the people. Theoretically and historically, sovereignty of the king was premised on the idea that all legal and political authority was derived directly or indirectly from the king. The doctrine that all political right and all legal legitimacy may be traced back to a delegation of authority by the governed (or by a substantial portion of them) was the doctrine of popular sovereignty. The evolution of the notion of sovereignty parallels the development of the modern state. Sovereignty, as a legitimizer of political authority, has been used by men, kings,
monarchs, leaders, and states in different contexts and within different political parameters, to justify authority and to legitimize the exercise of power.

Inherent in the theories of sovereignty is the dualism between the ruler and the ruled, the governing authority and the governed, civil society and the state. In short, the body politic is characterized by dualism between the community and the state. The task of resolving the dualism whether the community or the state should be regarded as the sole source of legitimate power (sovereignty) is impossible and futile. The modern notion of sovereignty rests on the idea that there is a separation of powers between the state and the community. It has been accepted that in all body-politics it is the state that actually wields sovereignty. Within the state itself, political power is widely dispersed. Within a state, which is a corporate entity in itself, sovereignty has many sites and many locations. Even if the community is to be regarded as the whole or partial source of sovereignty, the state is the sole instrument that exercises it. In the modern context, it is a government that does the actual work of governing; it dispenses sovereign powers for the benefit of the people. 

To sum up, if the political community is the initial source of sovereignty, it is further delegated to the state and is exercised through the government. Thus, it has become conventional wisdom to associate sovereignty with the sovereignty of the state. The following definitions of sovereignty can be helpful in complementing the preceding discussion.

In Sovereignty Through Interdependence Harry Gelber describes the sovereign status in this fashion:

Sovereign status implies, at least in principle, the exclusiveness of that sovereign's authority within its own territory, a right to non-intervention in the affairs of one's state and the equality of states in terms of status and law. It involves the unique right of every independent state entity to control its own destiny, without
acknowledging any superior secular authority and without undue external pressure. This sovereign state is the protector of territorial and economic security, the provider of safety, continuity and stability, and the supreme lawgiver. If a state is a complete legal order, and the writ of its municipal law runs through its territory, it is legally and formally sovereign. (Gelber 1997, 74)

In *Sovereignty and International Order* Thomas May offers this definition of sovereignty:

... sovereignty requires the authority not be subject to, or limited by, other powers. It is difficult for people to conceive of several ruling bodies, however separate their jurisdictions, without conceiving of one of these ruling bodies as ultimately “sovereign”... . (May 1995, 288)

This realistic, practical definition of sovereignty implies that it is not plausible to conceive of two or three governments effectively ruling within one state and all claiming to be the ultimate authority simultaneously. For the purposes of order, practicality, rationality, and uniformity, citizens of a state need to have an ultimate authority in the form of one government that can have the last and final word in the multiple affairs of the state. (The state will not always have the final word, however. Consider, for instance, the decline in the economic power of the state due to economic globalization. Global market integration and internationalization of financial markets diminish political and economic prowess states are able to exercise.)

F.H. Hinsley thus defines sovereignty:

It is the concept which maintains no more — if also no less — than that there must be an ultimate authority within the political society if the society is to exist at all, or at least if it is to be able to function effectively. (*Sovereignty* 1986, 217)
Phillip Trimble gives the following overview of sovereignty from an American perspective:

From an American perspective, sovereignty ultimately rests in the people. The protection of national sovereignty is important because national sovereignty incorporates the terms under which popular sovereignty was ceded to the national government. In the United States, popular sovereignty includes, inter alia, specified delegations and allocations of authority to different levels and branches of government; direct elections of government officials; popular participation in government decisions through the press, lobbying, opinion polls, legislative and administrative hearings; and accountability of government officials to the people for their decisions. The delegation of popular sovereignty to the federal government was subject to the terms of democratic governance. (Globalization, International Institutions, and the Erosion of National Sovereignty and Democracy 1997, 1966)

As we can see from these definitions and the preceding discussion, sovereignty has undergone profound transformations as a concept and as an institution. It is evolving and will continue to evolve. Sovereignty is a reflection of a certain political and social reality. Broadly speaking, sovereignty reflects relationships between authority and political community; it underscores the state's strength and capacity to impose its will on the citizenry. It is also the locus of legitimacy and accountability. These intricate relationships of power, legitimacy, and authority closely link sovereignty to the state. They are also a consequence of so much confusion associated with the state and sovereignty. In varying degrees, sovereignty is a source of authority, order, legitimacy, stability, security, and identity. Sovereignty is the power, will, and capacity inherent in the state. As Hermann Heller succinctly put it:
... the sovereignty of the state is nothing more than the necessary consequence of its social function. The state power must be the political power which in its territory is supreme in regard to the law and, as a rule, the strongest in regard to power; otherwise it is neither a sovereign nor a state power. ("The Nature and Structure of the State", reprinted in translation in Cardozo Law Review vol. 18, 1996, p. 1181)

As an organizing principle, sovereignty is the justification and the legal and political framework for the creation and maintenance of order and stability in the society. As an organizing and legitimizing force, it is predicated on the principle that a final source of authority and site of supreme coercive power exists in the state, which reflects the political aspect of sovereignty. It also refers to the existence of a supreme law-making authority, which is associated with its legal dimension. In sum, the political and legal dimensions of sovereignty embody the intricate relationships of power and legitimacy within the state between the government and the political community.

For instance, political systems that are based on the principle of the separation of powers represent governments in which sovereignty is divided (i.e., divided sovereignty). In such political systems, sovereignty is dispersed between different branches of the government (executive, legislative, and judicial). It is not always the same branch of the government that has the final word. In the modern context, sovereignty is about a legitimate government being the ultimate repository of legitimate authority. In the real world, states are not fully but relatively independent. In sum, in any type of state, sovereignty is shared; it is dispersed and diffused among many bodies and entities; it is allocable and divisible. We believe that the same principle applies on the international arena.

But how does sovereignty manifest itself as a social reality? As mentioned earlier, the juristic conception of sovereignty is an abstraction and a legal construct. In

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reality, sovereignty is hardly absolute, monolithic, and indivisible - absolute power and absolute sovereignty are but myths. The necessities of international cooperation, maintenance of peace, the interconnectedness of states, and the constraints imposed by international law call for the partial relinquishment and the delegation of sovereignty to some international or supranational authority. In the modern context, our understanding of territorial sovereignty and the state as the sole carrier of sovereign powers is being transformed due to the powerful forces of globalization. Globalization and internationalization call for further allocation of sovereign powers. The antiquated and idealistic notion of absolute sovereignty requires careful reconsideration and reassessment when put against the test of political and social reality.

Sovereignty: A Conceptual and Theoretical Assessment

As mentioned earlier, various connotations related to sovereignty indubitably lead to definitional confusion. The prevailing conceptual confusion manifests itself in a debate, which is characterized by dichotomies and taxonomies based on contentious assumptions. One such dichotomy deals with two opposites. They represent the dichotomy between Ideal, Normative, “what ought to be” versus Real, Positivist, “what is”. Can the normative and the empirical be reconciled? Is the dynamic between them a struggle, the antithesis between the two irreconcilable understandings? Is sovereignty a societal reality, a concrete manifestation, or is it simply a fiction, an abstraction? When we address sovereignty, do we perceive it as an idealized, juristic, legalistic concept or as a concrete political and social reality, as an institutionalized phenomenon? Do we treat sovereignty from the position of natural law or positive, man-made law?

One opposing side of this dichotomy treats sovereignty as an absolute, an ideal construct, what it should be. The other understanding treats sovereignty as an
empirical and historical phenomenon, as an evolving political institution. But even in light of this seemingly irreconcilable, antithetical antagonism, sovereignty should be treated in terms of a *reciprocal dynamic between the normative and the empirical*. In sum, this dialectical antithesis, this dualism between the normative and the positivist, is inherent in the evolution of sovereignty. *Normativity and existentiality* are part of our understanding of the world. To paraphrase Hermann Heller, *existentiality and normativity of sovereignty do not contradict each other, rather, they determine each other.*

In short, reality and normativity, theory and practice feed on each other, existing in a reciprocal relationship. Sovereignty is both an evolving concept and an institution, where the normative and the positive exist in a dynamic relationship. Let us illustrate this reciprocal dynamic with two quotes from the distinguished experts on the subject. F. H. Hinsley offers his understanding of sovereignty strictly as an *abstract concept*, as an idea:

> Although we talk of it loosely as something concrete which may be lost or acquired, eroded or increased, sovereignty is not a fact. It is a concept which men in certain circumstances have applied — a quality they have attributed or a claim they have counterposed — to the political power which they or other men were exercising. *(Sovereignty 1986, 1)*

Joseph A. Camilleri and Jim Falk retort to Hinsley's remarks with their own *positivist* understanding of sovereignty:

---

2 Hermann Heller in *The Nature and Structure of the State* thus defines the basis for the state authority and the legitimization of sovereign powers: "The existentiality and normativity of the constitution-giving power do not contradict each other; rather, they determine each other. A constitution-giving power, which is not bound by common fundamental principles of law to the strata who are decisive for the power structure, has neither power nor authority, and hence does not exist."
...it [sovereignty] reflects the evolving relationship between state and civil society, between political authority and the community. Hinsley, one of the foremost contemporary exponents of the principle of sovereignty, rightly reminds us that despite loose talk about the way it is acquired, lost or eroded, sovereignty is not a fact. Rather it is a concept or a claim about the way political power is or should be exercised...

Yet sovereignty is not just an idea. It is a way of speaking about the world, a way of acting in the world. It is central to the language of politics but also to the politics of language. It is part of the more general discourse of power whose function is not only to describe political and economic arrangements but to explain and justify them as if they belonged to the natural order of things. (The End of Sovereignty? 1992, 11)

Another dichotomy associated with sovereignty separates two approaches termed the “chunk” approach and the “basket” approach. The “chunk” approach views sovereignty as monolithic and indivisible. It is absolute, and not relative. An entity cannot possess more or less sovereignty, be more or less sovereign, according to this approach. Michael R. Fowler and Julie M. Bunck thus describe the “chunk” approach:

No matter how large or small the state, each sovereign receives from the international community an identical gift upon attaining sovereign status — a package of rights and duties the same as those presented to every other entity gaining sovereignty in that same era. (Law, Power, and the Sovereign State 1995, 67)

Thus, the principle of sovereign equality flows from this conception (i.e., equality in law). Interestingly enough, the “chunk” approach is identical to the normative, legalistic conception of sovereignty, also termed de jure sovereignty. As a legal concept, sovereignty is monolithic and indivisible, signifying the formal claim, the
status of an entity as sovereign. In line with this legalistic “chunk” conception, as legal personalities, strong states and weak states have equal rights, duties, and obligations, regardless of their size, power or influence.

According to the “basket” approach, sovereignty is variable, allocable, divisible, and changeable. It is based on the “basket” of rights a particular state received, negotiated, or obtained, including limitations and restrictions imposed voluntarily, by consent or otherwise. Sovereignty could be ceded, delegated, allocated, transferred, diminished, enlarged, reduced, or increased, essentially expressing the qualitative and quantitative degree of sovereignty, not a fixed set of circumstances.

As Gregory H. Fox describes:

In the basket theorists’ view, the nature of the sovereignty enjoyed by any given entity ... is explained not simply by the status of that entity as a sovereign but also by the network of relations buttressing and circumscribing the entity’s capacity to act. When a state, for example, commits itself by treaty to a particular course of action a chunk theorist would describe that state’s surrender of prior discretion as a positive exercise of sovereignty, while a basket theorist would regard its action as a qualitative diminution of sovereign authority. (Emphasis added. The State and the Law 1995, 465)

Differences in power and resources imply (in line with the basket approach) that states do not possess “an equal core of sovereignty but have varied competences depending on the nature and quality of international relations” (Fox 1995, 465). The degree of sovereignty (depending on the qualitative sum of rights and resources) will determine the state’s effectiveness in the actual application of power; the degree of effectiveness will vary depending on a state’s military power, economic prowess, leadership, etc. This approach essentially underscores the actual exercise of
sovereignty, also termed *de facto sovereignty*; it deals with the state’s effectiveness and its ability to efficiently apply its sovereign powers.

Here the distinction has to be drawn between equality in law and equality in fact (*de jure* vs. *de facto* sovereignty). Formal status as sovereign and actual exercise of sovereignty should be delineated in the “chunk” and the “basket” approaches. There is no argument that there exist strong and weak states. But from a legal perspective, the state is either sovereign or not. States are sovereign in their status and their claim to sovereignty, having in possession formal attributes that satisfy that claim. Having ceded some sovereign powers to the International Monetary Fund or World Trade Organization does not make states more or less sovereign in their formal status or their formal claim as sovereign. They still hold the formal title as sovereign, they still possess *de jure sovereignty*, i.e. the formal claim as sovereign. What varies in this equation from state to state is the degree, the effectiveness with which they exercise their *de facto sovereignty*, i.e. the actual exercise of sovereign authority. That is why we distinguish between equality in law and equality in fact, that is, the normative vs. the empirical, the legalistic vs. the political, *de jure* vs. *de facto*. Some states are able to exercise sovereign powers more effectively than others due to a set of circumstances and conditions - a country’s physical size, economic power, wealth, political institutions, leadership, legal framework, historical development, customs, cultural traditions, the size of the population, geography, etc.

As mentioned earlier, sovereignty, as a concept and an institution, is dynamic and variable; it is not static. Legal, political, and economic processes are evolving, thus the content of sovereign rights and powers will change over time. But do the changes in the content of sovereign rights make states less sovereign? Whether they do or not might be a debatable point. The question might arise as to the point of reference in deciding what makes a state more or less sovereign, that is, more or
less sovereign in comparison to what? There is not in existence a perfectly sovereign or ideal state which all other states are compared or referenced to. For centuries, sovereign powers have been negotiated, relinquished, ceded, delegated, taken away, diminished, increased, allocated, or transferred. In short, the difficulty in quantifying the degree of sovereignty and/or sovereign authority is self-evident.

The content of sovereignty has undergone qualitative and quantitative modifications to reflect the changes in a given historical context. The content of sovereignty has been transformed over time. The denunciation of states' legal rights to torture and to wage an aggressive war changed the content of sovereignty after World War II. The right to wage war, which refers to one of the "sacred" rights of the state, has been transformed and modified. An aggressive war has been transformed from a natural expression of nationalism and sovereignty into an international crime. General acceptance of international human rights including the condemnation of genocide, murder, slavery, and torture is a political reality, which reflects changes in the content and the exercise of states' sovereign powers. The denunciation of the right to wage an aggressive war is a prerequisite for membership in the United Nations, for instance. "War has ceased to be a legalized and sanctified form of force" (Hinsley 1986, 232). In sum, without infringing on its sovereignty, a sovereign authority may choose to exercise its sovereignty by subscribing to such prudential limitations without ceasing to be sovereign (or without becoming quantitatively less sovereign). Such self-limitations and constraints form a major part of international law, which is developed by states out of necessity to meet the needs of states.

Celia Taylor in "A Modest Proposal: A Statehood and Sovereignty In a Global Age" offers a functionalist conceptualization of sovereignty, what she terms a "bundle of sticks" approach. She regards sovereignty "as a combination of several powers, rights, and obligations just as property ownership is a 'bundle of sticks' that are divisible and transferrable between original and subsequent owners" (Taylor 1997,
She hopes that this understanding would conceive of sovereignty as "an elastic term". "Recognizing that sovereignty, like ownership, contains many constituent elements may help explain why and how 'sovereign sticks' can be passed to non-state actors in the growing ranks of players in the international arena" (Taylor 1997, 755).

Essential to Taylor's conceptualization of sovereignty are the formal "claim" elements of sovereignty (which were briefly mentioned in the earlier discussion). These "claim" elements could be grouped under the heading of de jure sovereignty. It is paramount to keep in mind that sovereignty and the state are intertwined in a symbiotic relationship. Sovereignty is the essence of statehood. A state is not complete without sovereignty. For all practical purposes, fundamental attributes of sovereignty and statehood include:

1) "...[T]he physical independence of a state continues to act as a central defining characteristic" (Taylor 1997, 759). The first element includes physical independence, distinct physical identity, and separateness. Demarcated geographic territory creates the sphere of control by one state. Existence of a distinguishable and definable territory is one of the claims of statehood. Notwithstanding sweeping forces of globalization, demarcated boundaries are still significant in the international legal structure, giving a state the ability to act legitimately within those boundaries with political independence.

2) Identifiable government is another essential formal element to the claim of statehood. "...[S]ome identifiable group must exist to represent the entity claiming statehood" (Taylor 1997, 759).

3) The existence of a determinate population is another prerequisite to the claim of statehood. A group of people governed by an identifiable government will comprise a state.
4) And lastly, the *personhood*, whereby a state is treated as a legal “person”, having in possession legal rights, duties, and obligations. This signifies that the state has the ability and legal status to engage in transactions with other states.

These formal prerequisites confer on an entity the status of a sovereign state and allow the entry into the international community. According to Celia Taylor, apart from “claim” elements of sovereignty, the “exercise” elements of sovereignty are allocable. She distinguishes *autonomy, impermeability, and equality* as the “exercise” elements of sovereignty. They are the legalistic ideals of international law; in reality, they manifest themselves in various degrees. *Autonomy* refers to the freedom to act independently, to choose a course of action without constraints. Full unfettered autonomy does not exist today (just as it did not manifest itself in the past). *Impermeability* is another ideal of international law, but borders have always been porous, especially now, during the advent of globalization. As mentioned earlier, *equality* in law does not make states equal in fact. States are not equal in size and power; they have different histories, economies, developmental processes, demographics, geography, wealth, resources, etc. Thus, the sovereign equality of the states is a formal legalistic construct which denotes that *in theory all states are equal before the law, each having an equal status in reference to other states*. A weak state deserves as much respect for its territorial integrity and independence as a strong state. There is a profound difference between possessing sovereign rights and the ability to exercise them; it is the distinction between the claim to sovereignty and the actual exercise of sovereignty. It is the distinction between equality in law and equality in fact. Both weak and strong states possess the same fundamental rights and duties of self-preservation, self-defense, mutual respect for each others’ borders, and territorial integrity.

It should be remembered that sovereignty, as an idea and an institution, has evolved for *centuries*. It is over four hundred years old in its institutionalized form.
But theorizations of sovereignty date back even to the early sixteenth century. The evolution and the origins of sovereignty will be outlined in the next section to provide a deeper understanding of its meaning and application in the modern context. We will shed some light on sovereignty's colorful and dynamic evolution through the historical prism. Political scientists and students of the law commonly agree that the institution of sovereignty was formalized and institutionalized at the wake of the Thirty Years' War with the signing of the Treaty of Westphalia (1648). It became the starting point of the European state system. Here is the story how sovereignty came into "existence."

The Evolution of Sovereignty

The Peace of Westphalia (treaties signed at Osnabruck and Munster in 1648) ended the bloody Thirty Years' War of religion. It marked the beginning of the new European political order — the modern state system based on the principle that in each separate state the civil authority was supreme and independent within its own definite territory. In short, there could be only one sovereign -- a final, ultimate, and independent secular authority -- within a given territory, signifying just one legitimate source of authority. The Thirty Years' War of religion was fought between the Holy Roman Emperor and the princes who tried to contest the faith with arms. The Thirty Years' War (1618-1648) originally fought between German Catholics and German Protestants, later involved the Swedish, the French, and the Spanish.

The Peace of Westphalia freed the princes from the yoke of the Holy Roman Empire and the universal Catholic authority (the Catholic Church and the Pope) - they gained sovereignty over faith, they were authoritative over religion. It should be noted that, although the 1555 Treaty of Augsburg provided the princes with independence in choosing faith, this settlement proved acceptable neither to the Protestant German princes nor to the Catholic Emperor. They continued to contest
sovereignty over faith through arms; and the beginning of the Thirty Years' War in 1618 was the culmination of that conflict. The signing of the Treaty of Westphalia in 1648 marked the acceptance of a new norm of sovereignty by contending powers. The princes now had the right to determine the faith within their own realms and could put the principle *cujus regio, ejus religio* (whose the region, his the religion) into practice. Apart from sovereignty over faith, the princes also possessed legal and political jurisdiction within their territories.

The medieval system of Christendom with its dualism (dual rulership) and rivalry for divine supremacy between the Holy Roman Emperor and the Pope was short-lived after Westphalia. The process of the secularization of state power was accelerated by the institutionalization of sovereignty, which gave supremacy to a secular authority within a given territory. However, deeply religious and God-fearing, princes and monarchs continued to derive legitimacy in the ancient doctrine of the *Divine Right of Kings* ("the right divine to govern wrong"), which made them uphold the theocratic function. They claimed their position as the vice-regent, the consecrated representatives of God. A monarch (a prince) was a divinely appointed ruler of his community to perform secular and religious duties, thus, combining two functions -- secular, taking care of the community (his/her subjects) and theocratic, i.e., being the mouthpiece of divine and natural law. The king had the divine right (the divine ordination from God) to make the human, positive law. The king, even though deriving legitimacy from a divinely instituted authority of kingship, was the protector of the law of the community and of the community itself. Indeed, monarchs used their hereditary divinity and sanctity (the Divine Right of Kings) to strengthen their absolutist hold on power, to resist popular unrest, and to suppress civil war and opposition from the community.

*Jean Bodin* in 1576 theorized that the sovereign power came from God (*De Republica*, lib. I, cap. 8). His idea was used by the advocates of strong monarchy to
strengthen the Divine Right of Kings. They argued that the supreme and absolute nature of sovereign government authority was "further proof that it could be held only by a monarch who could be subject only to God" (Hinsley 1986, 132). Some advocates of divine monarchy and divine sovereignty continued to rely solely on its theocratic justification -- the advocates of divine royal power used "the concept of sovereignty to strengthen the older theocratic defence of the authority of the state" (Hinsley 1986, 133). The Divine Right of Kings, coupled with the new concept of sovereignty as an absolute and supreme authority, prepared the fertile soil for the further development of absolutism and the doctrine of absolute obedience. The monarch's extreme supporters of the Divine Right argued in absolutist terms that the sovereign monarch was appointed by God, was subject solely to God, and was answerable to God alone; thus, the Crown's power was absolute and unlimited. These theocratic justifications of the monarch's sovereignty notwithstanding, by the time Westphalian states came into existence, the increasing efficiency of secular political organization was accepted, and the secularization of thought and political activity was under way.

The modern secular state (vs. the ritualistic community of Christendom) was destined to become the source and the symbol of unity, and sovereignty became the essence of statehood. A prince, monarch, or king was endowed with a crucial task of state unification and was to become the source of state unity (or disunity depending on his/her "performance" - revolts and riots became the indicators of the public's discontent).

_Machiavelli's Prince_ (written in 1513) envisaged the world as comprised of states that were entirely self-sufficing and non-moral entities. Monarchs were thought to be the source of law and all power in their realm. A single monarch had to be the ultimate authority within his defined territory, with the authority to exclusively control his subjects. Machiavelli gave his monarch absolute freedom - he was freed of any
restraint such as external religious considerations or internal customary limitations, which resulted in amoral absolutism.

But even after Westphalia, when newly created states were trying to return to normalcy after a long, savage and bloody war, complete isolation, absolute separateness and non-morality of every state were impossible. The necessity for cooperation in commercial and political spheres resulted in the rise of international law. The recognition that there was a wider international community precluded the existence of the state as an absolute separate and non-moral entity. This wider community would consist of secular, national, territorial states bound to one another by the supremacy of law.

Jean Bodin (French philosopher, jurist and politician) introduced the concept of sovereignty to the discipline of political science in his acclaimed work *Six livres de la Republique* in 1576. He defined sovereignty as supreme power over citizens and subjects, unrestrained by the laws. The sovereign was above human law and was the source of it. He/she was checked only by the fundamental law, the divine and natural law. But Bodin argued that the sovereign has the divine right to make the human law, divine ordination was the basis for his prerogative. Bodin was writing during the time when there was a need for strong, unified states as opposed to loosely organized feudal entities, engaged in rivalry and war.

James L. Brierly thus describes the environment in which the formation of new modern states took place:

... unified states were emerging out of the loosely compacted states of mediaeval times, and the central authority was everywhere [throughout western Europe] taking the form of a strong personal monarchy supreme over all rival claimants to power, secular or ecclesiastical. (*The Law of Nations* 1963, 8)
Bodin equated the essence of statehood with the unity of government. A state would possess a *summa potestas*, or *majestas, souveraineté*, or what we call sovereignty. According to Bodin, a state was a multitude of families and possessions that it has in common ruled by a supreme power and by reason. What is crucial to his conception of sovereignty is the idea that *in a state there must be one final source from which its laws proceed, not a multitude of independent sources*. The essential manifestation of sovereignty was *the power to make the laws*, and since the sovereign makes the laws, logically he cannot be bound by the laws that he makes. Thus, he is above the laws that he makes. Bodin made the sovereign a *legislator*, which was a new idea at the time. It is important to emphasize that, although Bodin's sovereign was above the positive man-made law that he was the source of, his sovereignty was constrained and bound by divine law, the law of nature or reason, the law that is common to all nations, the laws of the government, the property rights of citizens, and customary law.

James L. Brierly further comments how Bodin's conception of sovereignty was misunderstood and distorted over the course of time: "Sovereignty for him was an essential principle of internal political order" (Brierly 1963, 10). Some theorists thought of Bodin's monarch as an absolutist, having in his possession sovereign prerogatives, which manifest themselves in supreme, absolute, incontestable, and unconditional authority. Later writers distorted Bodin's theory into a principle of international disorder and used it to prove that, by their very nature, states are above the law. One of these distortions was the tendency to identify sovereignty with absolute power above the law. It might have been an easy mistake to make because Bodin did go too far in theorizing that the supreme power of law-making must always be concentrated

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in a single hand. Another distortion of Bodin's ideas claimed that a state was above the law in its relations to other states. Bodin's government is "one in which the highest power, however strong and unified, is still neither arbitrary nor irresponsible, but derived from, and defined by, a law which is superior to itself" (Brierly 1963, 9). Bodin's sovereign was intended to be "a constitutional ruler subordinate to the fundamental law of the state" (Brierly 1963, 11-12). Essentially, Bodin's sovereignty was limited, and he argued not for an absolute but a limited or constitutional form of monarchy.

*Hugo Grotius* (Dutch scholar, theologian, jurist, and statesman) wrote one of the most influential books of all times in 1625. He was writing his masterpiece *On the Law of War and Peace* against the background of the Thirty Years' War. He was imprisoned in 1618 but later escaped to Paris. His *De jure belli et pacis* published in 1625 laid the foundation and became the recipe for the Treaty of Westphalia. He envisioned a world comprised of internally and externally sovereign monarchs, united only by a natural law, which was valid even if there were no God. Grotius also tried to reconcile the inherent dualism between the ruler and the ruled by arguing that the ruler's sovereignty was the personification of the sovereignty of the people. He drew a line between morality and law, and argued that there was a distinction between natural and positive law, where positive law was derived from the will and practice of sovereign states. Later, the dualism between the ruler and the ruled (the state vs. civil society) was treated and reconciled in different ways. The proponents of popular sovereignty placed sovereignty with the People, the advocates of double sovereignty make the ruler and the people each the owner of one of two sovereignties; in theories of limited sovereignty, the people retained the ownership of certain rights that limited the Ruler's sovereignty. Grotius believed in a strong monarchy but with limitations imposed by natural law. However, the fundamental law of higher binding force (the
divine and natural law for Bodin, and natural law for Grotius) was no defense to the rise of absolutism.

Absolutism became the extreme expression of the doctrine of absolute sovereignty, which implied “the complete freedom of the state from the control of any higher power claiming authority to regulate its acts” (Fenwick 1948, 29). Thus, there was this chimerical community of sovereign monarchs who were above the law in their own states as well as above the law in their mutual relations. This doctrine became a convenient argument to justify arbitrary conduct in the name of independence. Thus, a doctrine of legal anarchy developed from this line of reasoning. Absolute sovereignty implied omnicompetence and omnipotence.

Thomas Hobbes’ conception of sovereignty, depicted in Leviathan (1651), came to be associated with pure absolutism and totalitarianism. Hobbes, an English political philosopher, was writing his masterpiece against the background of the civil war and general political upheaval. Like Bodin and Grotius, he believed in the necessity for a strong sovereign. For Hobbes, sovereignty was an essential principle of order. But he took his vision to the extreme. Hobbes did not depict sovereignty from a legal perspective, as did Jean Bodin. Hobbes’ absolutism deemed the sovereign as the holder of the strongest power in the state. It conceived of the law as man-made, as “the manifestation of a ruler’s superior will” (Brierly 1963, 12). The tradition of the Roman law only reinforced the idea. According to the Roman legal tradition, the will of the prince was the law. Hobbes identified sovereignty with might and power. Where Bodin identified it with legal right and supreme law-giving authority, Hobbes believed that might, power, and strength made the sovereign. He believed that men needed for their security “a common power to keep them in awe and to direct their actions to the common benefit” (Leviathan 1651, ch. xvii). The person or body that possesses this power, no matter how it had been acquired, is the sovereign. James L. Brierly thus describes Hobbes’ vision: “Law neither makes the sovereign, nor
limits his authority; it is might that makes the sovereign, and law is merely what he commands" (Brierly 1963, 12-13).

According to the Hobbesian scheme, the sovereignty of the state was absolute, unrestrained, unlimited, irresponsible, omnipotent, and concentrated in a single center. It was unlimited, unrestrained, and omnipotent because *how can the power that is the strongest be limited by anything outside itself?* And this is how Hobbes pictured the relations of sovereigns with each other:

In all times, kings, and persons of sovereign authority, because of their independency, are in continual jealousies, and in the state and posture of gladiators; their forts, and garrisons, and guns upon the frontiers of their kingdoms, and continual spies upon their neighbors; which is the posture of war. (*Leviathan* 1651, ch. xiii)

This is a veritable Hobbesian wilderness, where every one is against every one, and where sovereigns enjoy unfettered independence internally and externally.

Great minds such as Bodin, Grotius, and Hobbes saw the need for a strong unified authority against the background of unrest, civil war, bloodshed, and upheaval. Their writings reflected the realities of their times, but they also offered a vision. Bodin, Hobbes, and Grotius are usually associated with theories of absolute sovereignty. But it was Hobbes, more than any other philosopher, who endowed his sovereign with supreme *authority over all matters*. Having said that, we have to accept that absolute sovereignty (i.e., supreme authority over all matters) is but a theory, a myth, although formulated by such a great thinker as Thomas Hobbes.

*John Locke* (1632-1704) and later *Jean Jacques Rousseau* (1712-1778) were writing during the advent of constitutional governments. They were the harbingers of a novel idea of popular sovereignty, where the people as a whole were the sovereign; thus, sovereignty lay with the united will of the people. For Locke, the authority of the state was derived from the *individual*, and its powers were the sum
of individual rights. Rousseau took this idea further and focused on a notion of rights which led to the omnipotent sovereignty of people. Rousseau's vision of sovereignty lies in the idea that supreme authority lies with the united will of the people. Generally speaking, the Enlightenment idea of popular sovereignty rests on the belief that sovereignty resides in the political community.

Political Versus Legal Aspects of Sovereignty

Is sovereignty a political or a juristic concept? It is both. The distinction between legal and political authority within a state is partly the reason that there is a prevailing confusion whether sovereignty is a political or a juristic construct. The legalistic definition of sovereignty is described in terms of supreme legal authority or a supreme law-making power. This definition could be traced back to Jean Bodin. Bodin described his sovereign as the supreme legislator, the creator of all man-made law, i.e. the highest legal authority. Bodin introduced sovereignty as a formal juristic concept, it was the quality, the legal right of a single "personal monarch entrusted by the constitution with supreme authority over the ordinary laws of the state" (Brierly 1963, 45). From Bodin's writings, sovereignty, as a juridical (legalistic) concept, evolved into supreme legal authority or a supreme law-making power.

One of the essential characteristics of the state falls within the juristic category — the state is regarded as an instrumentality for the creation and enforcement of law. The juristic doctrine of sovereignty ascribes to the sovereign state the attribute of legal omnicompetence. Sovereignty under the rise of absolutism came to be regarded as power absolute and above the law. Hobbes described his sovereign as the strongest, mightiest authority. According to his construct, the actual power of the sovereign (political or legal) has no limits. Viewed as a legal construct, sovereignty belongs to the sphere of jurisprudence and should be identified with legal right; the sovereign should be conceived as the highest legal (law-making) authority.

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Is sovereignty a political concept? How can we identify the strongest power? Viewed in terms of coercive power and strength, sovereignty then rightfully belongs in the political sphere. International lawyers and political scientists can hunt and search for the location of sovereignty either in jurisprudence or in the political realm.

The fact is that sovereignty has become both a political and juristic concept, and it should be understood and analyzed as such. That is why we make a distinction between de jure and de facto sovereignty, mainly a legal and political distinction. Thus, we can distinguish between the formal claim to sovereignty vs. the actual exercise of sovereignty. The de jure sovereignty (the legal right to command and make laws) is the formal claim, and de facto sovereignty (the ability to command, to enforce and to apply coercive power) is the actual exercise of sovereign power. It is well-known that legal power cannot survive long estranged from coercive power. In sum, legal sovereignty vs. de facto sovereignty is the distinction between legal and political aspects of sovereignty. Sovereign states have the right, by definition, to induce compliance through coercion. But can they always exercise that right in practice? Do they always have that ability? That is another issue.

Internal and External Aspects of Sovereignty. Myths and Realities.

According to conventional international law, it is possible to distinguish between internal and external sovereignty which comprise the totality of national sovereignty. The state, as the holder of sovereignty and as a legal international person, possesses territorial and personal supremacy. It signifies that the state has immunity from external interference and possesses supreme authority within its borders and over its citizenry, both domestically and abroad. Internal sovereignty signifies that a state is free to manage its affairs without interference. A state can design its governmental institutions to achieve its goals. It can adopt a constitution and write laws to suit its needs, it can levy taxes, organize the military, pass rules and regulations to determine
property rights, personal rights and liberties of its citizenry, and so on. It can regulate the conduct of its citizens and dispose of its resources to realize the purpose for which the state exists.

A sovereign state is the master of its domain, figuratively speaking. In theory, it is subject only to limitations imposed by a domestic constitution, treaties signed with other states or by the rules of general international law, i.e., the doctrine of the legal equality of the states, the right of self-defense, the principle of comity and respect for other states, and so on. Generally speaking, interference from other states (direct or indirect) would violate the sovereignty of a state. But if the states are wholly autonomous and no outside authority is above them, international relations have the appearance of anarchy. It does not imply that the Hobbesian wilderness really exists, where international cooperation is nonexistent, and where chaos, riot, and violence prevail. (Remember, Hobbes himself admitted that his theory was but a construct.) External independence simply implies that there is no higher government or higher authority. Internal and external aspects of sovereignty are complementary and coexistent.

External sovereignty relates to the conduct of foreign affairs. In theory, a state is free to conduct its foreign affairs the way it sees suitable without any supervisory control or interference from other states. This freedom allows a state to fulfill obligations assumed at the signing of treaties with other states. As mentioned above, the conventional definition of sovereignty refers to the supreme, independent, and final authority. It is the attribute of a state that refers to its right to exercise complete jurisdiction over its own territory. In international relations, states as sovereign units have the right to be independent and autonomous with respect to other states. States may differ in their power, but, as sovereign entities, all are legal equals.

Very often sovereignty and independence are used synonymously and interchangeably. The juristic conception of independence means "freedom from
the influence, guidance, or control of another or others" (American Heritage Dictionary 1992, 3rd edition, 917). In practice, a state may be strongly influenced or even coerced by other state or non-state actors. Take, for instance, the overwhelming leverage the International Monetary Fund exercises when it provides conditionality loans to developing countries. A borrower state delegates (or surrenders) its sovereignty when accepting a conditionality loan. And this is just one of many examples. Needless to say, the concept of total political independence does not correspond to reality. A state can pass "sticks" of political independence to other entities (international or regional). A state, signing a treaty, partially relinquishes its sovereignty by self-imposing limitations and restrictions (what has been termed auto-limitations).

Absolute sovereignty is nowhere to be found, it is a myth, an abstraction, a construct. In actuality, we have relative, limited, partial, dispersed, or divided sovereignty. We have states that relinquish a measure of their internal and external sovereignty because of the treaties signed with other states and due to the limitations imposed by the rules of international law and international custom. The subsequent allocation of power is not an accident, it is based on concrete circumstances of the international community and the need for cooperation. To paraphrase John Donne, no state is "an island entire of itself;" every state is "a piece of the continent, a part of the main."

Traditionally, the inter-national (i.e. inter-state) system has been characterized as "a system of discrete autonomous entities based on their defined territories, each exercising plenary authority over persons and things in that territory" (Schachter 1997, 7). It is also well accepted that the juridical and abstract conception of a state possessing absolute sovereignty falls short of reality. From Oscar Schachter:
No state, not even the most powerful, is wholly autonomous, free of constraints and influences from outside its borders. Nor is its autonomy (or sovereignty) absolute in law. It is limited by international law, which in the prevalent positivist conception is viewed as the collective expression of sovereign wills. States are equal in law, with the same rights and duties, but they of course vary widely in size, power, and values. There have always been weak and strong states. (Schachter 1997, 7)

In short, absolute sovereignty is a myth which is unrealizable and impractical. Domestic constitutions and international agreements define the scope and put limits on the exercise of sovereign powers. The theory of absolute sovereignty is misleading, inaccurate, and antiquated at best. It has been the cause of confusion, misperception, and justification of totalitarianism. If sovereignty of the state only denotes supremacy and absoluteness, then the whole body of international law would be a delusion. All attempts by scientists to reconcile the existence of international law (of which states are the subjects) with the doctrine of absolute sovereignty are doomed to failure. The way out of this conundrum is to abandon the antiquated version of sovereignty as absolute. Whether one might believe that international law is the law above the states or between the states; whether international law has primacy over municipal law or vice versa (monist vs. dualist approach); whether it is a law of coordination or subordination, sovereignty is always limited and relative in nature, and the state is never fully independent and supreme within the domestic or international realms.
CHAPTER II

THE NATION-STATE — FULLY SOVEREIGN AND INDEPENDENT?

The history and the development of sovereignty is deeply intertwined with the evolution of the state. It is the history of man-made institutions that society has inherited since ancient times. Sovereignty and statehood, regarded as the 17th-century European creations which became formalized and institutionalized at Westphalia in 1648, extend their roots into the distant past, into the Greek and Roman traditions.

What is a state? What is meant by statehood? Statehood is a quality that makes an association of human beings a state. It is said that the state is the strongest human association which performs essential stabilizing and legitimizing functions. It is a comprehensive framework and a fundamental organizing principle of the world order. Definitions and theories of the nation-state abound in political science and jurisprudence. We do not have ample space in this thesis to outline all of them. Definitions will be used that have relevance and substance for the subject at hand. Over the centuries, the concept of the state has undergone a profound transformation. As F. H. Hinsley describes:

What was once equated with the monarch, or with some physical body of men who exercised rulership, has acquired an impersonal, a legal, even a metaphysical connotation since the rise of legislatures, the expansion of electorates and the emergence of modern bureaucracies began to demand that all the elements involved
What are the characteristics that make a state a legal “person”, a juridical “personality,” in the true legal sense of the term? Public international law outlines the following components that comprise formal requirements of statehood. First, a state must occupy a certain fixed territory over which it exercises an exclusive jurisdiction. As long as a state retains identifiable physical territory, it has its physical independence. Secondly, a state must have a people (other terms are used intermittently such as a population, a political community) whose existence helps bring about the state itself. Thirdly, a state must have an assurer of order and stability. That function is entrusted with a government which performs as an internal stabilizer within the territory and fulfills international obligations. And, lastly, the fourth essential component is sovereignty which signifies an ultimate and final control over the state’s internal affairs, the derivative of which is independence from higher or outside control.

The conventional view regards the exercise of independent political and legal authority over a definite territory as one of the essentials of the state’s existence, which in turn is one of the vital characteristics of sovereignty. Gerhard von Glahn calls it “the ability to regulate its internal affairs without outside interference or control... This necessary ingredient, independence, must be as absolute as the modern legal order of the world permits it to be: even nominal subordination to an outside governmental authority must be absent” (Von Glahn 1970, 65).

As a legalistic, juristic concept (which is an ideal) a state is a supreme legislator and no authority legislates over it. A state viewed as a legalistic concept is a body possessing legally supreme or sovereign legal power. The term ‘state’ denotes the political entity which possesses the law-making authority and the right to command its coercive machinery. The state is the sole source of legality and performs a
legitimization function. It creates and validates laws of the land through its law-making bodies and enforces them through its coercive machinery. But the state no longer possesses the monopoly over the legislating function in many cases even within its own territory due to globalization and internationalization (this point will be discussed in the next chapter). As a result of certain globalizing trends, the historical unity of law and state is called into question.

Hal Draper thus elaborated the characteristics of the modern state: 1) the state exercises power over a territory; 2) it wields power through institutions or instruments of coercion; 3) it is financed through taxes imposed upon its citizens; 4) it maintains its power through the establishment of a bureaucracy, which stands apart from and above the population as a whole. (Draper, 1977)

Max Weber defined the state as “a human community that (successfully) claims the monopoly of legitimate use of physical force within a given territory” (Weber 1958, 78).

Westel Willoughby gives his definition of this much debated concept: “…by a state is understood a group of human individuals viewed as an organized corporate community over which exists a ruling authority which is recognized as the source of commands legally and, in general, ethically, binding upon the individuals composing the community” (Willoughby 1924, 3).

Amos Hershey’s definition of the state is both functionalist and realistic; it reflects the realities of the political and social environment. It views the state and sovereignty not in absolute but relative terms. He defines the state as “a permanent association of people politically organized upon a definite territory and habitually obeying the same autonomous government” (Hershey 1927, 158). Hershey outlines “essential and distinguishing characteristics” of the state which include “a people permanently organized for political purposes, i.e., the maintenance of law, liberty, and a relative equality of opportunity as conditions necessary for individual and social well-being.
A definite territory containing inhabitants ... and resources... A certain degree of sovereignty or autonomy and independence (i.e., relative freedom from a higher or an external control), and a government which is habitually obeyed” (Hershey 1927, 159).

As mentioned earlier, legal and coercive/political power cannot survive long estranged or detached from each other. Legal and political aspects of sovereignty find their embodiment in the state. As F.H. Hinsley succinctly puts it:

...no political or legal system can function unless it possesses coercive machine with which it can ultimately enforce compliance with the decrees of the regulating authority, that authority, whether it be notional or tangible, is by definition the state, and it is the concept of sovereignty which authorizes and justifies its acts. (Emphasis added. Sovereignty 1986, 223)

From the point of view of international law, a state has a legal corporate personality of its own. Having a legal identity implies that a state is subject to law. As a sovereign and independent entity, a state possesses rights, privileges, and duties attached to that status. The Fundamental Rights and Duties of States include:

-- the right of self-preservation;
-- the right to preserve the integrity and inviolability of its territory;
-- respect for territorial inviolability (integrity) of other states;
-- the right of independence;
-- the right of defensive war,
-- the right of legal equality,
-- the right to respect;
-- the right to commerce; and
-- the right of jurisdiction.
From these follow the duties such as to observe treaty obligations, to abide by rules and principles of international law, the duty to respect another state's territory and integrity, to name a few.

Transformation of Sovereignty and the Nation-State

It seems in vogue among political scientists to talk of the transformation of sovereignty and the nation-state. Vogue and fashion aside, it is the fact that sovereignty is being transformed due to the powerful forces of globalization. Does globalization change the meaning and the purpose of the state? Is the nation-state declining, withering away, disappearing? Has the state completely exhausted its usefulness? Does the state still count?

Though in its “transformed” capacity, the state is far from “dying.” In fact, it is much “alive,” although some of its economic powers have undergone profound transformation. Take, for instance, the state’s “weakened” (or modified) position in international trade and investment areas. Critics of the state hastily equate “transformation” and “change” with “death” and “decline.” Conceptual short-sightedness of this sort does not help any rigorous scientific endeavor. The state has undergone changes due to globalization and institutionalization, that is a fact. But that does not automatically render it obsolete; that does not mean that political science is ready to relegate the nation-state to obscurity and painful oblivion. Intellectuals can theorize from high planes and from their ivory towers, often obfuscating reality, but people on the “ground” still look up to the state for protection, order, and stability.

The debate over the demise or survival of the state is closely linked to the debate over the end or relevance of sovereignty. If the state is in “demise”, then sovereignty is following suit. Subsumed within that debate is the dichotomy between the critics and defenders of sovereignty, which essentially reflects the struggle between
conflicting ideologies. When the role of the state is addressed, two dichotomous positions are distinguishable. One of the positions could be placed under the rubric of the “decline-of-the-state” camp. The other position could be termed the “supremacy-of-the-state” camp. “Decline-of-the-state” proponents declare globalization and internationalization the ultimate assassins of the state. This view posits that the state-centric model of the world order should be discarded as outmoded and useless. They point to the formation of a new world order—a borderless global village characterized by a global system of law and global federalism.

The “supremacy-of-the-state” theorists emphasize that the state is and will remain the principal actor in the international arena. The formation of new states after the collapse of the Soviet Union and the Soviet bloc, claiming statehood and sovereignty, points to the relevance of the state. The continued fight of the Palestinians, Basques, the Quebec province, and the Kurds for autonomy and independence only shows that the claim to formal statehood matters. How can both of these contradictory views be true? How can the state display irrelevance and continued significance at the same time? The fact is, both positions reflect certain facets of reality in the modern world. They also reflect various changes on the international stage.

The interconnection of states has always been recognized as a fact, since the states were created. Isolation has never been practical or beneficial. However, globalization and internationalization change the dynamic between state and non-state actors on the international stage. Instant global communications is a reality. Whether national governments recognize it or not, money traders grasp the possibilities by trading over a new global electronic infrastructure, regardless of national boundaries. These powerful economic players have launched a new international monetary system governed by the Information Standard. Rapid advances in technology, instant communication, increasing openness of deregulated
markets, and the mobility of capital usher new powerful non-state actors to the world stage. The importance of powerful non-state economic actors is also a fact and should be recognized as such, especially at this juncture. Technology, deregulated markets, financial flows, and instant communication modify the dynamic in the areas where the state is perceived as "weakened" or losing its pertinence.

But because the economic power of the state is being transformed by the forces of globalization, the state is hastily declared entering the state of demise, decline, on its way out, or simply dead. "Demise-of-the-state" proponents take this view to the extreme. Recent revolutionary innovations in communications, they claim, have linked the states and their operations so much that national boundaries will be increasingly insignificant and will eventually disappear. They further argue that the global flow of goods and services and mobile capital will deprive the state of its ability to exercise independent control traditionally within its realm. Metaphors and the declarations of this sort abound. "The decline of the state" theories declare the state an entity that has lost its salience and relevance in the modern world. It is a bygone, a historical relic relegated to the past, a vulnerable and weakened creature of no use for the present or the future. An oversimplification? Indeed. But it is not just the state that is being buried alive. Sovereignty is being buried in the same coffin.

Sovereignty and the state are proclaimed to be tired political orthodoxies. The end of sovereignty is inevitable, announce the critics; sovereignty is pronounced lost or eroded. But if the state is dying, what element of it is dying? The term "transformation" could be more appropriate. And again, transformation does not imply death, irrelevance, or a complete loss of control. The international world order has been going through profound transformation due to globalization and revolutionary technological innovations; thus, the state and sovereignty are subject to change and transformation along the way. The transformations, caused by the
increasing interdependency and the integration of the world, does not render the state and sovereignty obsolete. The state and sovereignty, viable political and legal institutions, manifest resilience and persistence, and retain their vitality in the modern era.

As mentioned earlier, the modern state is the repository of sovereignty, it is the site and the locus of sovereignty. The state is the vehicle through which sovereignty is exercised. It is said that sovereignty is the essence of statehood. What is the state of the state in the modern era? When we talk of the transformation of the state, we understandably refer to the transformation of sovereignty as well. They are being transformed in tandem. (In terms of the causal relationship, it would probably be safe to attribute the cause to the state, and the effect to sovereignty.) They exist in a symbiosis characterized by the dynamic of exchange and interplay. They are dynamic, not static. The state is a fundamental human association that serves an organizational, stabilizing, and legitimizing purpose. The state comes into existence to become the source of order and stability, to carry out the social contract with its citizenry (the polis). The state is a living political phenomenon, an evolving political institution. It is a civil association and a viable form of political activity. Included with the fundamental purpose of creating order, stability, uniformity, and predictability are numerous sub-purposes. Let us enumerate the most essential ones (the degree of effectiveness, the exercise and the implementation of these functions may vary from state to state):

1) the provider of physical protection and safeguard of security of its citizens, defense of the territory, property, and individuals; protection of individuals and fundamental human rights;

2) the promotion of general welfare—the provider of the social safety net (health, nourishment, education, environment) through general welfare policies;

3) the provider of educational and employment opportunities;
4) has the *monopoly over the coercive* (violent) force; in charge of the organization for the management of power and use of force; has control over the army and the police;

5) has the *monopoly over the minting of money and coinage* (money creation function);

6) has the *power of taxation* (power to tax capital) and economic regulatory powers;

7) has *control over the interest rates*;

8) the provider of the *infrastructure*;

9) primary *source and the legitimizer of the laws* of the land;

10) the guarantor of equal protection under the rule of law; serves as a reconciliatory agent between contending parties;

10) concerned with *preservation and furthering the interests of the society* for which it is responsible.

In short, the modern Keynesian welfare state, as we know it, performs essential functions which no other entity is able to carry out. Essentially, the state is the source of sovereignty, identity, power, authority, legitimacy, and accountability. The state’s existence is not in jeopardy because it still performs particular functions that at the present time only the state is able to carry out. The state is an important instrument in performing a *managerial function*. Furthermore, it is still a *basic and central unit* of the world order, although there are non-state actors that claim significance as well.

One of the purposes for which the state is created is to promote the economic and general welfare (well-being) of its citizens. Ideally, a state should be able to set its own limits on the extent and scope of its power or jurisdiction (be it a political or economic sphere). The *economic sphere* is where the state is primarily losing some of its traditional powers in modern times. *Environmental protection* is another aspect
of governmental control that has entered the global level of concern. Ozone depletion and the greenhouse effect are no longer problems in the exclusive jurisdiction of an individual state. It is increasingly hard for states to be sole protectors and guarantors of economic and environmental protection. This development requires states to interconnect, coordinate, and cooperate, which is one of the facets of globalization.

Let us play the devil’s advocate and let us imagine for a minute that the state is “on its way out”, then we have to assume that one or several of its essential components are no longer viable. 1) Government. Most of the states in the modern world have an identifiable government, except, of course, the states torn by civil war, which precludes the establishment of a legitimate authority. 2) Territory and physical identity retain their vitality as demarcated borders still exist, which guarantees the state its physical independence. 3) Each state possesses an identifiable population. 4) Sovereignty. States retain their relative independence and autonomy. Legal personhood of a state is also retained, whereby each state has fundamental legal rights and duties, possession of which confers a formal legal status on the state and guarantees equality in law. The capacity to engage in formal relations with other such entities flows from this legal status.

Thus, all formal components of statehood are present. Reduced autonomy or the allocation of sovereignty to other authoritative bodies do not render the state obsolete or irrelevant. Furthermore, the allocation of authority (sovereignty) to some other supranational or international bodies, in my view, is an active, positive exercise of sovereignty. Otherwise, if we blindly adhere to the doctrine of absolute sovereignty of a state, then international law, General Agreement on Tariffs and Trade, North American Free Trade Agreement, World Trade Organization, the United Nations, the International Monetary Fund, and other such supranational structures should be discarded as useless. To announce the “death” of the nation-state at this juncture
is simply to deny the existence of national boundaries, national governments, political
communities, and other numerous national institutions and associations which are
viable, meaningful, and relevant in modern times.

The Delegation of Sovereignty in International Law:
The Issues of Consent and Coercion.

International law is assumed to be based on consent - express (explicit) or implied
(tacit). Needless to say, this extreme positivist view of international law does not
reflect the international reality. Consensual law is said to be represented by treaties
(conventions) where a state gives its consent explicitly and unequivocally. Thus,
the state's sovereignty is reduced (or delegated) willingly because the state
consented to it. There are numerous examples in international law when a state's
consent is not present and often imposition takes place as opposed to open, express,
or even implied consent. One of the obvious examples is the birth of new states.
When newly formed sovereign states come into existence, they have to abide by
international customs and laws already in place. New states do not formally express
consent. Due to the necessities of political and economic realities, and as members
of the international community, they have to accept the existing international norms
and customs as binding. Other examples of non-consensual impositions include
economic sanctions, quarantines, boycotts, embargoes, military or humanitarian
interventions, and withdrawal of economic assistance. Thus, the positivist myth of
international law as exclusively based on consent (express or implied) is extreme
and lacks in explanatory power.

The positivist doctrine of consent is closely linked to the 19th century nationalist
movements (and the doctrine of sovereignty), according to which the state was free
from external control and was free to give and withdraw consent based on national
needs, traditions, aspirations, and circumstances.
As mentioned elsewhere in this thesis, sovereign powers can be viewed as allocable and divisible. When sovereign sticks are allocated to an international organization (for instance, the IMF), it is viewed in this thesis as the active exercise of sovereignty. The terms "loss" and "surrender" have negative connotations and are value-laden. However, they do appropriately apply to the situations when sovereign sticks are involuntarily surrendered to other entities. The terms such as "allocation," "delegation" and "transfer" are more descriptive and neutral in nature. They are more appropriate in the circumstances when the state actively exercises its sovereignty and gives its formal consent. "Delegation" of sovereignty implies control, active exercise of power, conscious decision-making, and awareness. It also implies the ability of the state to regain the delegated authority. "Surrender" of sovereignty implies negativism, coercion, imposition, and loss of control. Thus, scientists have to be careful when using negative and value-laden terms in our political lexicon.

Disputes over the role of sovereignty in the late twentieth century take the form of a dichotomy between critics and defenders of sovereignty. The delegation or surrender (depending on the point of view) of sovereign authority to powerful international or non-state entities is perceived as the essence of the erosion of sovereignty. But this is not a new phenomenon. States have formed alliances, signed treaties, and joined various international bodies for centuries, which underscores the importance of cooperation even if some measure of sovereignty had to be delegated, transferred, or diminished. "All of international law represents a loss of sovereignty to one degree or another" (Trimble 1997, 1944). In other words, the delegation of sovereignty is inevitable under the demands and constraints of international law. In the modern context, the growing importance of international law and the leverage international organizations exercise reflect the trend towards deeper interdependence. Increasing international interdependence is a fact, it is a
reality. It had been a fact even before sovereignty itself was institutionalized and formalized. It is said that international law is a cosmopolitan enterprise. Growing interdependence dictates that international law and international institutions will increasingly affect external and internal aspects of societies.

Current transformations of sovereignty are reflections of the changes in the international world order. Traditionally, states were the recognized principal and predominant actors in the international arena. They made international law and they were the subjects of international law. Sovereignty has been the ultimate controlling and organizing principle of the world order. The ascendancy of international institutions, environmental movements, human rights law and humanitarian law, frequent humanitarian interventions, and the globalization of the world economy pose challenges to the traditional understanding of the world order. The international milieu is changing. For instance, the free movement of capital across borders and the transnationalization of corporations seem to limit the traditional taxing and regulatory powers of the state.

However, it seems likely that all these new changes and challenges to state authority will proceed in the context of world order where “transformed” sovereignty will remain, for the time being, the basic founding and organizing principle. The interdependent and interconnected world calls for even greater cooperation between states in economic as well as other matters. States will increasingly see incentives and the necessity in fashioning advantageous economic arrangements through treaties and agreements, which in itself is consensual allocation of sovereignty (i.e. the active exercise of sovereignty). Globalization, which is essentially greater international (global) integration and interdependence, will offer more incentives for greater cooperation between states and through their membership in international organizations. The overwhelming trend towards a greater acceptance of a host of
supranational decision-making authorities (GATT, NAFTA, the IMF, WTO, the UN, the International Court of Justice, and the like) is present and undeniable.

The overwhelming exclusivity of the modern state is reduced in economic, political, and legal spheres. Globalization introduces shifts in power (political and economic alike). If we assume that states allocate some of their sovereign sticks to these supranational decision-making authorities and the shift in power is concomitant, how much ceded authority will flow to these institutions? To what sorts of institutions and decision-makers do we want this authority to flow? Who is going to be ultimately accountable and responsible for the decisions made by international bodies? Who will regulate them? States through governments? Individuals? Some global authority? As John Attanasio remarks:

Further impairing their public accountability, international bureaucracies are farther removed from and consequently less sensitive to the needs of the people whom they govern. Domestic policy-makers must carefully consider to what sorts of decision-makers they are ceding sovereignty. (Attanasio 1995-1996, 32)

The perception of sovereignty as strictly territorial has undergone profound transformation. Undoubtedly, sovereignty is still deeply associated with territoriality and national boundaries. Boundaries still matter and they still exist. But economic globalization, technological innovation, the unprecedented flows of information and capital, the ascendancy of international law, and international organizations make sovereignty less attached to the fixed territory. Sovereignty gets more dispersed; sovereign prerogatives (or “sticks”) get passed on to other authoritative bodies (private and public alike) in upward and outward direction. It does not make a state more or less sovereign; sovereignty is not something that can be permanently lost through mere delegation of power to an international organization. States exercise their sovereignty by signing treaties and joining international organizations; states
do not live in isolation. The need for cooperation and growing interdependence (in economic, political, environmental, and social spheres) naturally requires states to partially cede some of their powers to an international body. As a result, decision-making is more diffused. Ultimately, it is the question of staying in control, being able to have a say in the decision-making of those international bodies.

The consequence of economic globalization is often the inability of states to have a meaningful say (not to mention a final say!) in the decisions of powerful economic entities, especially capital-controlling entities such as multinationals, money managers, investment portfolio managers, private investors, and the like. This is one of the aspects of sovereignty that is being profoundly transformed due to economic globalization, i.e., a partial loss of control in the economic sphere. As we know, to be the final authority, to have a final word in decision-making is thought to be the essence of sovereignty. That understanding needs to be corrected due to economic globalization. A state cannot always be the supreme, ultimate, and final authority. It is only natural for the state to transfer, to delegate, or surrender some of its power to other authoritative bodies. The allocation of power and partial transfer of sovereignty is a natural development in an increasingly integrated world. Once again, it should be emphasized that there is nothing new about the transfer of sovereignty when the state exercises its sovereign powers by joining an international organization or signing a treaty through consent. What is new in this development is the inability of the state to have meaningful control over powerful economic and political actors (private and public), the inability to regulate what used to be in the traditional economic and political purview of the state. These developments take away the perceived consensual character of international law. As a consequence, states are often coerced to comply with these powerful non-state actors.

These developments can be illustrated by other examples. A state is traditionally thought of as a provider of employment opportunities. In recent years global markets
have helped create new jobs and new employment sites; internationalization of production and services is the case in point. Take the Internet (the Information Super Highway), for instance, the vast virtual supranational entity that spans the globe. It has spurred the creation of numerous Internet-related jobs. A whole new Internet culture has been created: virtual stores, markets, and industries. Service and information networks have been created on the Internet. Just watch the stock market and the trading in the Internet futures! People are betting on the future of the Internet. We might not see the adverse effects for some time. In the meantime, the Internet (the virtual reality Super Highway) creates jobs, services, markets, and opportunities.

There is another new development that transforms the legal aspect of sovereignty. The state is traditionally thought to possess the competence, legitimacy, and supremacy in law-making. Historical unity of law and state has been accepted as a fact. According to the monistic approach, there is no law in societies without a state. Could there be law without a state? The traditional monopoly of the state over law-making and legitimizing functions is being transformed due to globalization. The state is traditionally thought to be the exclusive legitimizer of domestic (municipal) and international law. In the domestic arena laws are adopted and validated through appropriate bodies of the government (legislative, executive, or judicial branches are involved depending on this or that particular state). International law is thought to be the law between the states created by the states. Conventional wisdom attributes the creation of international law to the following sources: 1) treaties signed by states; 2) customary international law; 3) general universal principles of law (recognized by civilized nations); and 4) the use of judicial decisions and the work

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4 To claim that there can be no law without a state would be somewhat shortsighted. That would imply that medieval societies of Europe of the pre-Westphalian era were lawless and had no legal structures. As we know, that is not the case.
of highly qualified and distinguished jurists. The traditional exclusivity of the state over the legitimization function is being eroded due to globalization. The monistic approach which is based on the absolutism of state law needs to be reconsidered. In sum, the traditional perception of the sovereign state as an exclusive law-maker needs to be modified.

Some recent developments exemplify that the perception of the state as the sole law-creator is antiquated and outmoded – WTO, NAFTA, economic arbitration, private economic regimes, *lex mercatoria*, legal business practices, and corporate law infuse a new dynamic into law-creation. The state still serves a crucial function of providing a law enforcement framework and upholding contracts and property rights. However, recent developments in human rights, environmental, and humanitarian law reflect the same trend towards the dispersion of the law-creating function to other international authorities. The state no longer holds the exclusivity or monopoly over law-creation, it has to co-exist with other law-creating authorities. Needless to say, some of these international entities possess sovereign powers that states voluntarily and by consent ceded to them by joining these international organizations: the UN, the IMF, or WTO. Take, for instance, a considerable body of *corpus juris* created by United Nations organs and the specialized agencies. This *corpus juris* is an important instrument and part of the international “public goods” required for global trade, investment, communications, and other activities carried out mainly through non-state channels. In conjunction with that, it is said that globalization is eroding the legal doctrine of dualism which regards international and domestic law as two separate bodies of law. (*Monist* approach treats international legal principles as part of the domestic law.)

A new aspect in this trend is the existence of law-making bodies which are not comprised of member-states or were not created by states. Private contracts, organizational routines, and business practices of global (transnational or
multinational) corporations create new legal economic regimes (lex mercatoria), which are not under direct supervision of the states and make legal arrangements without formal consent of the state, which it is often coerced to comply with. This is how Oscar Schachter describes this trend:

Global capitalism and more integrated investment and trade may bypass state control, but they require international "public goods" that go beyond the province of the nation-state. That includes the sets of rules, standards, dispute-settlement institutions, and procedures that international lawyers consider their province. International markets require regimes for telecommunication and transportation, rules and procedures for financial stability and performance of contractual obligations, industrial and product standards, environmental protection rules and much more. (Schachter 1997, 10)

It should be emphasized again that states do perform a very important function in the creation and application of these legal and quasi-legal regimes. They often require validation and enforcement by state agencies. A lot of these legal arrangements are validated without formal consent by the state. Understandably, as a result of these new developments, states surrender a large portion of their internal authority to the international domain but without formal consent.

These recent developments that have been outlined here require that scientific discourses move from statism towards pluralism. The realist school of thought might need to "update" its perception of the world, according to which, the state is the principal, the dominant, and THE ONLY meaningful actor in the international arena. Powerful non-state actors call that outmoded understanding of the world into question. Furthermore, the ascendancy of human rights movements and humanitarian law shift the focus from state-centered discourse to people-centered, and individual-centered legal discourses. The growing importance of non-state actors
in the areas of humanitarian, human rights, and environmental law is shifting the focus away from pervasive state-centrism towards the humanization of political discourse. Individuals and the environment have become the subjects of meaningful political discourse that underscores this trend.

However, together with these positive shifts, negative effects of laissez-faire globalism such as growing disparities between “haves” and “have-nots” result in de-humanization of nations and individuals. What is meant by that? Essentially, markets are driven by profits and self-interest; traders and investors do not consider consequences, long-term effects, or the well-being of individuals directly affected by their actions. Thus, globalization carries both integrating and disintegrating trends, both humanizing and de-humanizing tendencies. Sovereignty should be analyzed with the vocabulary of transformation which captures growing interdependencies and linkages on different levels of analysis (local, regional, international, and global).

The next chapter will further analyze what aspects of sovereignty and state authority are being transformed by the forces of integration, globalization, transnationalization, and internationalization. What aspects of sovereignty are delegated to other actors with the state’s consent? What powers are taken away from the state unwillingly? What powers does the state retain? These and other questions will be addressed in the next chapter which focuses on various aspects of globalization and the concomitant transformation of sovereignty.
CHAPTER III

ECONOMIC GLOBALIZATION AND THE TRANSFORMATION OF SOVEREIGNTY

The growth of a global economy in conjunction with the new telecommunications and computer networks that span the world has profoundly reconfigured institutions fundamental to processes of governance and accountability in the modern state. State sovereignty, nation-based citizenship, the institutional apparatus in charge of regulating the economy, such as central banks and monetary policies — all of these institutions are being destabilized and even transformed as a result of globalization and the new technologies.

Saskia Sassen (Losing Control? 1996, xi-xii)

It is not claimed here that globalization has touched every person, location and sphere of activity on the planet, or each to the same extent; nor that globalization is a linear and irreversible process, even if it has often appeared to have a juggernaut quality; nor, in reductionist fashion, that globalization constitutes the sole and primary motor of contemporary history; nor that territory, place and distance have lost all significance; nor that state and geopolitical boundaries have ceased to be important; nor that everyone enjoys equal access to, and equal voice in, and equal benefits from the supraterritorial realm; nor that globalization entails homogenization and an erasure of cultural differences; nor that it heralds the birth of a world community with perpetual peace. Indeed, in respect of each of these points the contrary has frequently been the case.

Jan Aart Scholte (GLOBALIZATION: Theory and Practice 1996, 47)

As mentioned earlier, the nation-state and sovereignty form a symbiotic relationship. What about the relationship between the nation-state, sovereignty and current globalizing forces? This dynamic seems to have the appearance of a tide, a
wave-like motion. The dynamic between sovereignty and globalization is characterized by clash, challenge, contradiction, change, transformation, and complementarity. Globalization is similar to a swirling pool of energy that is bursting to get out, tired of being constrained. This swirling pool of energy makes one think of states, governments, peoples, and individuals, involved or not involved in the exchange of ideas, information, goods, services, money, and all other media known to man. Globalization resembles an untamed beast, inviting but dangerous, potentially beneficial but hard to grasp. Everybody knows it is around and should be tackled with, but nobody quite knows how to tame or manage it.

One tries to avoid making a mistake a lot of students of political science make—writing in general about the general and not bringing any new insights into the scientific discourse. Here, an attempt is made to avoid broad generalizations and focus on a few fascinating aspects of globalization which contribute to the transformation of traditional sovereignty. What is that particularly dynamic dimension of globalization that is transforming national sovereignty in an unprecedented way? The answer is obvious—accelerated economic globalization and the revolutionary technological innovations of the last thirty years.

A prescriptive analysis of economic globalization escapes scientific rigor due to the indeterminacy of future outcomes. The inability to prove or disprove prescriptive conclusions about economic globalization precludes this type of prescriptive analysis. Any future developments of economic globalization have numerous variables and are shrouded with uncertainties. Furthermore, numerous definitions and explanations of globalization abound. This chapter will make an attempt to make some sense of prevailing definitional and conceptual confusion. Any normative analysis of economic globalization appears value-laden, biased, ideological, and subjective. This thesis hopes to give a comprehensive framework for the understanding of economic globalization, both descriptive and analytical. The analysis will strive at objectivity
and will be based on empiricism, i.e., it does not address what should be, rather what is. If any normative episodes do crop in, it is when the views of others are quoted or analyzed. General conceptualization of globalization will precede a more focused analysis of economic globalization. Later in the chapter, the discussion will focus on current trends and developments. We will finish this chapter by outlining challenges and opportunities presented to the nation-state by the forces of economic globalization.

Contending Methodologies: Definitional Confusion

What is globalization? Globalization has become a popular term, a much-used (and often over-used) buzzword. But what does it really mean? As a concept, globalization has come to mean so many things, so many phenomena, it is difficult to give a short and concise definition. The breadth of the concept precludes clarity and certainty and underscores ambiguity. As a result, conceptual confusion ensues and pervades most analyses of globalization. Paradoxically enough, globalization as a concept is so general, so wide and so encompassing, it serves its main linguistic function by definition — the concept is globalizing in itself and within itself. A comparison can be drawn with a black hole that absorbs all the matter it comes across. Similarly, the concept of globalization “swallows” into its “definitional basket” anything that has any globalizing features or any hint of globality.

Globalization has many faces, many guises and manifestations, and that is part of the problem. Conceptual confusion obfuscates the meaning of the term. It is a popular but an ambiguous word. WHAT ARE the many faces of globalization? What associations does it evoke? A concept is just an abstraction, an empty vessel, so to speak, it acquires body and flesh when we apply it to the real world, when we put it against political realities, when we feed different sorts of knowledge into it. Though
problematic, such a broad usage of the term demonstrates that "something important is unfolding in the given historical setting" (Scholte 1996, 44).

Generally speaking, globalization denotes the process of growing interdependencies and interlinkages, it denotes increasing global integration at different levels, it signifies the relationships of interdependence and interconnectedness on a global level between regional, national, and international entities. Globalization underscores the increasing volume of transactions beyond government control and the growing number of entities outside government control. Broadly speaking, the term denotes "the extension of social relations beyond traditional divides, that is beyond national, state and country confines" (Scholte 1996, 46). According to Scholte's definition, "globalization refers to the emergence and spread of a supraterritorial dimension of social relations" (Scholte 1996, 46).

David Held and Anthony McGrew thus view globalization in the modern context:

Globalization can be conceived as having two interrelated dimensions: scope (or "stretching") and intensity (or "deepening"). On the one hand, the concept of globalization defines a universal process or set of processes that generate a multiplicity of linkages and interconnections that transcend the states and societies that make up the modern world system; the concept therefore has a spacial connotation. Social, political, and economic activities are becoming "stretched" across the globe, such that events, decisions, and activities in one part of the world can come to have immediate significance for individuals and communities in quite distant parts of the global system. On the other hand, globalization also implies an intensification in the levels of interaction, interconnectedness, or interdependence between the states and societies that constitute the modern world community. (Held and McGrew 1994, 58-59)

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5 Their article could be found in Global Transformation: Challenges to the State System, 1994, edited by Yoshikazu Sakamoto. (See Bibliography for more information on the source)
Psychologically, it denotes a growing perception that we are more and more connected, a deepening consciousness that what happens in one part of the world may affect the rest of the planet, sending ripples across, making changes felt in different places regardless of national boundaries. Technologically, it means shrinking distances through technological innovation, technical change, and advances in communications. And it is even more so nowadays, when transmission of information can occur almost simultaneously anywhere on the planet. Instantaneous transmission makes the world a very small place. It adds to a deepening perception that the world is a single place, one planet, one location. It changes our perception of “small”, “big”, “here”, “there”, and “now.” It transforms comfortable landscapes and challenges old orthodoxies.

Deep conceptual confusion is partly due to conflicting methodologies. Jan Aart Scholte thus describes the battle of wits between the contenders:

Recent years have seen an important reinvigoration of contests between orthodox and critical knowledge around the issue of globalization... Yesterday in the lexical shadowlands, today the vocabulary of globality occupies a notable place in the everyday parlance of commerce, governance, academe and entertainment. Debates over globalization relate centrally to questions of social change in the late twentieth century. Discourses of globalization have become a prime site of struggle between, broadly speaking, conservatives who deny such a trend, liberals who celebrate its presumed fruits, and critics who decry its alleged disempowering effects. (Scholte 1996, 43)

Liberal ontologies portray a rosy, over-optimistic picture of globalization as a homogenizing force that will make the world a better place and will bestow bounty on everybody. This over-optimistic view might appear remarkably short-sighted in view of deepening disparities, inequalities, and the widening gap between the “haves”
and "have-nots." Liberal camp believes in the increasing irrelevance of the nation-state in the economic sphere. Liberal discourse offers the interpretation of globalization as a homogenizing, equalizing, universalizing, balancing force that will bring prosperity, peace, democracy, and freedom to all peoples of the world. Arguably, it could be assumed that global capitalism in Western disguise (as one of the manifestations of globalization) does carry a certain homogenizing quality in economic relations and interactions. However, it is not yet apparent, for we have no empirical evidence at our disposal, that it brings prosperity and equality to all the peoples of the world. It is not evident that global capitalism is inherently beneficial, as some liberals portray. It is not evident that Western consumerism, commercialism, and capitalism are accompanied by political democracy.

Some liberal theories decry the usefulness of the sovereign state against the sweeping forces of economic globalization, i.e., global financial markets and the global corporate economy. They announce the death of the state and the end of sovereignty. The state is presented as a casualty, a victim of globalization, and globalization is viewed as an all-determining force that dooms the state to death. Interestingly enough, they do not offer any plausible or attainable alternative to state authority. It should be remarked in passing that a global state is not in existence or anywhere near completion. The nation-state still performs very important functions that markets are not and will not be willing to take on. (The analysis of these issues will come later in this chapter.)

Conservative discourse, on the other hand, might appear too categorical, out-of-date and too dogmatic in its denial that globalization is actually happening. Realism with its “power politics” orientation and pervasive statist model keeps clinging to the idea that international relations are still power relations between Westphalian territorial states which are the dominant actors on the international arena. According to the Realists, international relations are reducible to inter-state power struggle.
and high politics. The world is viewed in terms of polarities (unipolar, bi-polar, multi-polar). In its dogmatism, Realism appears deterministic, ahistorical, and static. The growing importance of international organizations and human rights movements, the ascendancy of the Greens' movements and deepening environmental concerns, the importance of multilateral military alliances (NATO), the growing independence of multinationals and financial markets, Pan-Islamism, religious resurgence, and terrorism — these international movements, multilateral organizations, nongovernmental and non-state actors assert their rightful place in the international arena. The world is not conveniently mapped in terms of fixed territorial entities we call nation-states. Paradigmatic shifts blur the traditional lines of the past, the conventional dichotomies between “here” and “there”, “internal” and “external”, “us” and “them” are not as clearly defined as the Realists wish them to be.

Furthermore, it might be noted that Realists should pay more attention to such technological innovations as electronic space (cyberspace). The growing importance of cyberspace in our everyday lives is undeniable. It exists on a “supraterritorial” plane, it does not respect national boundaries, i.e. it defies territoriality as we know it - it is timeless and infinite. Our understanding of three-dimensional territoriality, as we know it, is enhanced and transformed by the existence of cyberspace. Cyberspace belongs to everybody and nobody; no particular state can claim ownership to this revolutionary technology, and that is a globalizing idea in itself. Global networks (via digital computers, satellites, telecommunications) can connect people anywhere and everywhere in the world almost simultaneously. Realists cannot turn a blind eye to “the growing number of economic activities taking place in electronic space. Electronic space overrides all existing territorial jurisdiction” (Sassen 1996, 5). It might be helpful for Realists to incorporate this transformative knowledge into Realist discourse and analyze the growing interdependencies between communication, technology, state and non-state actors. But that is just one of the
many dimensions of globalization. It is apparent that Realists cannot simply overlook the ascendancy and the growing importance of new legal regimes for conducting transnational economic transactions. Multinational corporations and other economic transnational actors drive the globalization of the corporate economy and help develop global economic regimes.

In short, liberal and Realist theories have reached levels of abstraction detached from reality and unfit for dealing with specific issues and political realities. One might ask how these methodologies can claim these contradicting views in the face of empirical evidence. The persistence, the resilience of each camp, and their respective theories could be ideological or a mere attempt to keep their respective theories "alive" to justify their existence.

Marxist/critical/radical/emancipation theories analyze globalization in terms of the center-periphery relationship, the North-South divide, where the industrialized countries maintain the relationships of dependency, domination, and exploitation with the developing countries. These studies focus on dynamics of class relations and exploitation, on psychological and cultural oppressions that attend globalization. They focus on growing disparities among the rich and the poor, on identity and community crises, on marginalization and fragmentation of communities, and religious resurgence. Some decry globalization as the root of all evil and propose to reverse it. Some see in it a powerful potential for the activation of class struggle as a result of growing disparities and, as a consequence, recognize the emancipatory power of globalization. These studies focus on domination, exploitation and conflict as well as class, gender, power, rich vs. poor, and center-periphery relations in the age of globalization.

Those who deny globalization just have to look around and they will see the empirical evidence in abundance. Realists will be consoled by the empirical evidence which demonstrates that the sovereign state is surviving and is not anywhere near
its proclaimed death. To liberals, one can submit that the process of globalization is indeterminate and its outcome escapes deterministic and prescriptive predictions. If globalization is supposed to bestow bounty on everybody and improve the lives of the peoples of the world, they need to design some workable (and tangible) mechanisms for equitable distribution of wealth around the world. There does not seem to be any "trickling down" of wealth on a global scale. It is hard to disagree with critical discourse about disturbing tendencies of wealth distribution and growing disparities between the poor and the rich nations. In conclusion, we submit to harsh critics of globalization that the process cannot be reversed. It can be studied and understood and the transformative knowledge can be used to modify or alter existing patterns.

A Pluralistic View of Globalization

The modern world is witnessing conflicting and centrifugal forces which, ironically enough, complement each other. They form a relationship of complementarity between globalizing forces and the nation-state. It might appear paradoxical or even contradictory to those who are grounding their analysis solely on the assumption that the state must decline and die in a globalized economy. Our theory emphasizes the relationship of complementarity and co-dependency in which the globalizing trends and the sovereign state co-exist, contend, and complement each other. Does it sound contradictory? A political oxymoron? The realities of the modern world constitute a part of the evidence which demonstrates that globalization is actually happening and is transforming the world on many social levels. Simultaneously, the state is holding its ground and is being transformed in the process of globalization.

The assumption that the state must eventually decline and die in a globalized economy cannot be proved or disproved. But it does lead to a pervasive "global-national" dichotomy that distorts the relationships that exist on different levels.
between individual, local, regional, national, and global entities. The "global-national" dualization is narrow and does not help conduct a rigorous scientific analysis. A more rigorous analysis is possible if we focus on the relationships of complementarity and competition between the sovereign state and globalizing trends on different levels of analysis. Empirical evidence demonstrates that we cannot simply deny the existence of these trends.

We are faced with necessity for a pluralistic, eclectic view of the world where supranational, transnational, and state actors co-exist, co-depend, and complement each other, where they are active participants in the transformations that globalization is bringing about. **Globalization facilitates the deepening interdependencies between the state and transnational actors on different levels of analysis — individual, local, regional, national, and global.** A closer look at globalizing trends helps understand growing interdependencies between state and non-state actors, the relationships of interconnectedness that underscores their significance. In this framework, state and non-state actors are not analyzed as being more or less dominant, more or less important. They cooperate, cohabit, and compete with each other within the pluralistic framework of the modern international system. We will show that globalization brings about multiplicity, diversity, and plurality of actors on different levels but does not render sovereignty and the state obsolete.

Further Conceptualization of Globalization:

**What Is New and What Is Old About It?**

Is the concept of globalization new? Is globalization a novel phenomenon? Is it one of our latest linguistic and social inventions? In their loose form, the ideas of globality could be applied to the sixteenth or the eighteenth century just as well as to the twentieth century. It seems that such common phrases as “imperial reach”, “voyages of discovery”, “colonial” and “territorial expansion”, are but the familiar
faces of globalization during the mercantile, colonial, and imperialistic periods. The phenomenon is not new. These terms were used in different historical settings to denote the on-going historical process; as a result, linguistic innovations and changes in vocabulary enriched the language with new terms. David Broad gives the following account of the historical roots of globalization:

And the first thing we discover when we look at history is that globalization is nothing new. It began roughly five hundred years ago with the so-called voyages of discovery, which coincided with the emergence of the capitalist world economy. People like Christopher Columbus were the outrunners for merchant capitalists, who funded voyages in pursuit of new wealth in the form of bullion and tradable commodities. ("Globalization versus labor", 1995, *Monthly Review* 47 (Dec): 20(12))

Generally speaking, globalization is a continuation of a historical process. Here, globalization is viewed as a process, not as an outcome. It needs to be stressed that globalization is an on-going and unfolding process, it is unclear where and how it will end and what the end-results might be. From a psychological perspective, human beings have always looked outwards, the drive for exploration and innovation seems to be one of the human characteristics. The human drive to “go out there,” to explore, to satisfy curiosity (for whatever reasons, selfish, noble, or mercantile) seems to be centuries’ old. Inventions, space exploration, landing on the Moon, and the search for new technologies are just a few manifestations of the drive to explore, to defy time and space.

Globalization has been considerably accelerated in the last twenty years due to technological innovations and the revolution in communication and information technologies. But these globalizing trends were apparent in the 1840s when telegraphic communication appeared and when globally synchronized time was introduced in 1884. The first regulatory bodies with a worldwide remit were
inaugurated during the third quarter of the nineteenth century. Such international administrative agencies included the Universal Postal Union (1874), the International Telegraph Union (1875), Protection of Industrial Property (1883), and Copyright (1886). Telephone calls between countries were launched a hundred years ago, airline services, intercontinental short-wave radio programs grew in numbers in the 1920s. The first global broadcast was transmitted in January 1930 (with the speech of George V opening the London Naval Conference which was transmitted to 242 radio stations). Global influenza killed tens of millions in 1918-19. (See Scholte 1996, 44-48) We can see that significant globalizing trends were already on their way in the last two centuries, though on a smaller scale and at a slower pace (long before the popular buzzword was invented).

But what is new about “globalization” in the modern context? What new components and elements are we witnessing with our tidal wave of globalization? Popular culture - music, dress, movies, fashions, images -- reinforces an everyday shared experience. Cyberspace and digital media, global newspapers and global enterprises, global factories and global thinktanks, global systems of trade, finance and production, global mobile telephones and communications satellites, G7 summits and humanitarian military operations, human rights and solidarity movements, social movements, transnational networks, pollutants, ozone holes, AIDS, drugs, crime, and the decline of Earth’s biodiversity are the key phenomena of the globalization scene around us. The other key feature is that growing numbers of people are affected by globalization. Along with these fascinating changes, however, globalization is not accompanied by the development of a single global culture, global village, or a single value system. Nor is it affecting everybody to the same degree or the same way.

In 1981 John S. Maclean called to the academic community “to comprehend and explain the historical process of the increasing globalization of social relations”
What sounded like a novel idea then, now preoccupies academics of different ideologies and ontologies with the issues of globalization and globality. It is remarkable that such common phrases as “a global economy”, “global financial market”, “global governance”, “global gender relations”, “global economic regime” and the like were literally unknown until the late-1980s. And now, just a decade later, the ideas of globality are in our every day parlance in such commonplace phrases as global markets, global communications, and the like.

On December 27, 1998, CNN reported on a new technological innovation. The company called IRIDIUM announced the launch of a new product—a global satellite phone. For $3,000 one can have a true global reach, be it from a tanker out in the sea, from an airplane, or from a busy Manhattan street. It is all within one’s global reach, all due to six low-flying satellites orbiting the planet. Due to continuing technological innovations, the world is getting smaller and the distances are getting shorter, or what Scholte succinctly characterized as “the process of the world becoming a single place” (Scholte 1996, 43).

This next example is even more illustrating. It is the so-called “Y2K” problem or the “Y2K” bug (the abbreviation stands for the ‘year 2000’). It is well accepted that global networks and computer systems that span the globe are interdependent; the existence of these global networks ultimately underscores interconnectedness on a global level. In line with that, it was predicted by pessimists that on January 1, 2000 numerous computer and information networks would malfunction on a global scale. Interconnections between computer systems and information networks would fail and collapse, which would result in catastrophic results of global proportions. According to the pessimists’ prognosis, massive failures would occur that in turn would affect various businesses, industries, markets, and entities such as banks.

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stock exchanges, supermarkets, electronics, telecommunications, governments, and the military. Nuclear weapons were expected to fire, and massive shortages of food were imminent, warned pessimists. It sounded cataclysmic, phantasmagoric, and smacked of the end of the world. Those of us who took an optimistic view predicted that these systems would get reprogrammed by January 1, 2000.

The anticlimax of the "Y2K" agony resulted in minor discrepancies of a very localized nature, nothing of a global importance. (Needless to say, some resourceful and calculating businessmen earned huge sums of money, capitalizing on the "Y2K"-fearing portion of the population.) Was the fear of the "Y2K" catastrophe a manifestation of globalization? Yes, undeniably. Although global crisis did not occur, the fear that it might have happened illustrates the world's interdependency and interconnectedness as perceived by the public. In sum, psychological perceptions and fears of globalization should not be treated lightly.

It could be briefly mentioned that the construction of the international space station adds to the feeling of interconnectedness. The proliferation of weapons of mass destruction does not recognize the boundaries of sovereign states or the distances between national borders. These are just a few of the many facets of globalization on different social levels and on different levels of analysis.
Economic Globalization

The fact is that, in a world in which freedom of movement has increased, economic actors of the transnational society themselves decide where to invest and locate their activities, and they do so not as a consequence of allegiance relationships or of sovereignty issues, but after considering the best opportunities offered by a combination of geography, demography, regulations (in particular labor costs and environmental rules), local subsidies, quality of the infrastructure, prospects for political stability and so on.

Jean-Philippe Robe (Global Law Without a State 1994, 46)

As it has become apparent from the previous discussion, globalization is a multidimensional phenomenon. We can speak of cultural, economic, social, psychological, and political aspects of globalization. Now let us narrow the discussion of globalization to its particular economic manifestations. After the conceptualization part, the discussion will focus on the challenges posed and the opportunities offered by globalization to sovereign states and national governments.

In its economic context, globalization essentially refers to global economic integration. Economic globalization is also a multifaceted process. It addresses systems and relations of interdependencies between markets, producers, consumers, governments, legal frameworks, and political institutions. At one level, it means the growth and proliferation of transnational corporations, also termed global companies. It means the growing importance of global economic regimes, supranational regulatory agencies, global economic entities, and international organizations (WTO, NAFTA, GATT, the World Bank, the IMF, the EU, Wall Street, the London Exchange and the like). Another aspect of economic globalization is the proliferation of free trade zones and export-processing zones. The increasing vulnerability or weakness of the nation-state in the economic sphere is another facet of globalization.

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Saskia Sassen describes “the geographic dispersal of firms’ factories, offices, service outlets, and markets” as the “global assembly line in manufacturing . . .” (Sassen 1996, 7). A case in point is IBM’s personal computer that has the “Made in USA” label whereas 70 percent of its component parts are manufactured overseas. Another aspect of globalization is the trend towards the internationalization of services and production, and worldwide geographic dispersal. Through the internationalization of services the corporate services complex has been created. It is the network of financial, legal, accounting, advertising, and other corporate services that the global corporate economy requires.

Sylvia Ostry provides the following background for the early usage of the term “globalization” in its economic context:

Almost precisely at the time that the Uruguay Round was launched in September 1986, the eighth round of multilateral trade negotiations since the GATT was established nearly half a century earlier, the international economy was beginning a process of dramatic transformation. The term globalization was first used in 1986 and was spawned by the investment surge of the second half of the decade... Most of it was in capital- and technology-intensive sectors. Hence technology flows ... also exploded, increasing from an annual negative growth rate of 0.1 to 22% between the first and the second half of the decade. (The Nation-State in a Global/Information Era 1997, 58)

We have to analyze economic globalization by looking at it in a big historical picture. Recent developments, more specifically, the collapse of the Soviet Union and the Soviet bloc, have established capitalism as a global actor, figuratively speaking, as a hegemon in economic relations. In other words, the assertion of the world capitalist market has been complete. In the changing global environment the globalization of capitalism is one of the key features. Thus, the Western-flavored
variants of capitalism have been propelled into the world as perceived globalizing, universalizing, and homogenizing forces, bringing with them unprecedented globalization of finance, trade, investment, and production processes. Capital flows across national borders demonstrate great potential for capital mobility, whereby large sums of money can be transferred almost instantaneously anywhere in the world.

Over a hundred years ago Karl Marx predicted capital’s mobility and modes of capital accumulation; he anticipated capital’s “annihilation of space by time” (Grundrisse: Foundations of the Critique of Political Economy 1857-58, 524). Truly, economic globalization has been epitomized by twenty-four-hour, 'round-the-world financial markets. Global production lines span the world, global consumption articles circulate the world, and not surprisingly, multinational enterprises account for a dominant share of world production. For instance, Marlboro can boast of figuring in world consumption - Marlboros are distributed and smoked in over 150 countries.

What other forces contributed to the acceleration of economic globalization? It is imperative to mention the deregulation of financial markets during the 1970s and the 1980s. Furthermore, the revolutionary changes in communication and computation have set the stage for the increasing integration of the world economy. Economic policies of privatization, market liberalization, and deregulation are the other variables contributing to market integration and globalization. Economic globalization implies higher mobility and increasing flexibility of information, production, capital, and people.

The multinational enterprise is a powerful agent of economic globalization. It “is becoming the dominant funnel for trade, finance and technology flows, the key engines of global growth,” writes Sylvia Ostry in The Nation-State in a Global/Information Era (1997, p. 60). The revolution in information technology and deregulation of financial markets brought about an unprecedented increase in
financial linkages. As a result of this development, financial flows dominate over trade flows among countries. Global information networks provide access to knowledge and information that are crucial in the era of twenty-four-hour, 'round-the-world financial markets.

The virtualization and digitalization of economic activity in electronic space are worth mentioning. Here we talk about digitalization and electronic markets that extend beyond national territories and achieve unprecedented volumes. The instantaneous transmission of money and information is possible anywhere in the world. Let us take the foreign currency market. It operates largely in electronic space and has achieved tremendous volumes — a trillion dollars a day. The virtualization of this economic activity leaves central banks incapable of exercising influence on exchange rates. Another stunning example is the creation of the NASDAQ market in 1971. NASDAQ is an acronym for National Association of Securities Dealers Automated Quotations. It is a dealers' stock market that operates in cyberspace; it is an electronic market that has no physical location. Nonetheless, it is no less important than the New York Stock Exchange itself.

An unprecedented volume of retail sales (domestic, international, and global) on the Internet is another aspect of the digitalization of economic activity. In 1994 and 1995 on-line retailing generated a combined $33 million. In 1996 on-line retailing generated more than $245 million. In 1997 it reached $782 million. In 1998 on-line retailing was over $14.9 billion. It was projected that in 1999 it would top $36 billion. These increasing volumes would not have been possible without the existence of the Internet and the global reach it provides.7

7 These statistics were found on an advertising mailer from Wizard.com, an Internet provider. (1999)
Starting in the early 1990s, domestic and international economic communities witnessed the surge in corporate mergers (the trend was apparent on a national as well as a global level). The wave of mergers contributed to further integration of the global corporate economy. In short, corporate mergers represent another dimension of economic globalization. Why do companies want to get bigger? Businesses and capital are in a constant search for profits. But as profit margins get lower (remember the theory of diminishing returns), they cannot control prices in a very competitive environment. What they can control are the costs of production and distribution. Corporate mergers increase assets and efficiency levels. Diversification and dispersal add more flexibility to corporate structures and capital movement. (These corporate mergers result in giant enterprises with a vast reach, which also raises various antitrust and antimonopoly issues. But that is a subject broad enough for another thesis.)

Concomitant with that, corporate international mergers change economic systems and affect the lives of workers in various countries regardless of national affiliations. Due to its inherent nature, global finance and capital are mobile, faceless, indifferent to national loyalties and identities, and they treat all potential sites in the same selfish fashion regardless of national affiliations. That is an important facet of economic globalization — apparent indifference of mobile global capital to national divides, boundaries, needs, loyalties, and aspirations.

Let us look at a broader picture. Generally speaking, inherent in economic globalization is an idea that capital is in a perpetual search for new markets, new financial opportunities, new trade, and investment sites, ultimately geared at profit-maximization. It is in a constant search for faster production, for cheaper labor, and lower communication and transportation costs with the ultimate goal of accumulating profits. International competition has been a powerful driving force behind the accelerated globalization of production and markets. However, the race for profits
and hypermobile capital do not take into account national interests or long-term economic and social development. They are not interested in investment in stable jobs or job security (if they are, it is marginal and profit-oriented); they are in search of the most profitable opportunities around the world. The ascendancy of financial markets stimulates the global circulation of capital. Finance is in constant search of the best investment opportunities worldwide. Multinationals and global financial markets stimulate integration into the global capital market which makes it possible for money to flow anywhere regardless of national origin and national divides. They do not pursue any long-term social development strategy or promotion of greater equity. In sum, capital movement and profit-maximization are not determined by national affiliations or issues of national sovereignty.

Another aspect of economic globalization, increasingly mobile production (i.e., internationalization of production) is simply the search for lower cost locations. Multinationals move production sites from one country to another whenever the change of site brings higher returns through lower production costs. But again, byproducts of this development are large groups of unemployed, a dwindling middle class, and deepening disparities of disturbing proportions. These are the many facets of economic globalization. But what are the myths and misperceptions associated with economic globalization?

Myths and Misperceptions Associated With Economic Globalization.

First of all, the myth of total economic integration and total economic globalization has to be dispelled. The belief in the "invisible hand" and the laissez-faire, free market approach has to be carefully reconsidered. The myth of the world economy as one open free market is misleading. According to this myth, free exchange of goods and services takes place and capital flows around the globe in a free and unhindered fashion. Markets correct themselves and the balance is restored due to
the self-regulating and self-correcting functions that markets are assumed to inherently possess. Supply and demand stay in equilibrium. Any disequilibrium is corrected by the markets themselves without any interference or regulation. It is a myth and a theory, ideologically colored.

The recent crises in Asia, Russia, and Latin America show that it is dangerous to trust markets with self-regulating and self-correcting functions. It might ultimately be up to national governments to ensure effective functioning of the economic system. National governments are left to balance out economic imbalances, be it through drastic measures or with the help of an international organization (the IMF is a case in point). Where liberals are ready to discard the sovereign state as dead and useless, here it rises again as the phoenix in the time of crisis and instability. It could be the case that the government itself is partly to blame for the crisis. But the loose structure of the global financial system tends to intensify any given crisis. In short, there is still room left for a national government to watch the markets, take precautionary steps necessary to avoid crises, and extend its visible hand to rectify the situation when the crisis does occur.

Furthermore, within capitalist economies where the rich are getting richer and the poor are not getting any better, it is the national government that uses its political power to build and sustain welfare systems, which compensate for the inequality inherent in the capitalist system. The government's task of a safety net provider will become increasingly difficult as the financial structure becomes more globalized and more interdependent. The mobility of capital created through global finance and the independence of global financial markets have diminished the power, the influence, and the control of national governments over those systems. “The financial structures inseparable from capitalism on a world scale are not democratic. . . . History, unfortunately, suggests that the power of bankers and financial markets is seldom checked until after a financial crash” (Strange 1994, 247).
The myth of economic globalization as an even and harmonizing force is another pervasive ideology. It implies that economic globalization brings with it a leveling out of uneven development. The fact is that the global financial and monetary structure is highly undemocratic. The myth of economic globalization as a harmonizing force could be dispelled with the following example. Let me illustrate some of the effects that economic globalization has on countries and their monetary policies. It is a fact that during the 1989-1994 period the US dollar remained appreciated against most currencies. As a result, other countries held their foreign reserves in US denominated assets. As Masudul Alam Choudhury succinctly puts it:

Thus, when it is possible for the US monetary authorities to lower its interest rates in the face of appreciated exchange rates, then the changes in reserve situation of other countries are governed by the exchange rate mechanism. On the other hand, when US interest rates increase, these changes in reserves are determined by US interest rates. Hence, in both cases, the globalization scene for developing countries remain predominated by the interest rate and exchange rate mechanisms of the US monetary authorities in particular and of the G7 in general. The more volatile these movements are the more serious are the external sector uncertainties of countries that hold their assets in the US dollar denominated assets. (Choudhury 1996, 28)

We can illustrate the undemocratic nature of certain aspects of economic globalization with another example, which is related to the one mentioned above. The International Monetary Fund holds its reserves in the currencies of the five member countries. The Special Drawing Rights of the IMF, which is a kind of weighted monetary asset, a valuation basket in which all countries hold part of their reserve, consists of US dollars (40%), the Deutsche mark (21%), the Japanese yen (17%),
the French franc (11%), and the pound sterling (11%). The financial instruments included in the computation of the SDRs are interest rates, currency amounts, and the exchange rates of the five member countries. We have to recognize the dominant presence of G7 in all foreign reserve management structures of other countries. The effectiveness of monetary policies of other countries seems to be constrained by the exchange rate and interest rate mechanisms of the US in particular and G7 in general. In short, economic globalization seems to be dominated and influenced by the powerful presence of the US and G7, like a ruling oligarchy. It does not come as a surprise that international trade, market access, financial practices, investment choices, and liberalization policies are heavily influenced by the industrialized countries, which raises the issues of the Eurocentricity and Americanization.

The widening gap between the rich and the poor is another example of the misperceived image of globalization as an equalizing force. Malini Mehra provides these disturbing statistics:

While there are many positive aspects of globalization, such as the international exchange of ideas, cultures and goods, critical attention has focused on the unparalleled concentration of power, wealth and resources that is accompanying economic globalization. In the last 30 years -- during the UN's so-called 'development' decades -- the gap between the world's richest 20% and poorest 20% has doubled. The total assets of the world's 447 billionaires now exceed those of almost one half of humanity. (*Globalization of Sustainable Societies?* The Internet, FoEl LINK - 78)

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8 *Webster’s New World Dictionary* gives the following definition of the SDRs: “S pecial D rawing R ights is a kind of international money created by the International Monetary Fund to supplement the use of gold and hard currencies in settling international payment imbalances.” Third College Edition, Macmillan, USA, 1994.
Having dispelled some of the pervasive myths of globalization, let us analyze other *tangible* manifestations of economic globalization. One of them is the transnationalization of financial markets and the subsequent inauguration of the global financial network. It is a vital process and a significant trend, and yet, perhaps, the *least* regulated aspect of globalization.

**Globalization of Financial Markets**

When we talk about finance we mean “the provision of money in the form of credit” (Strange 1994, 228). Susan Strange defines a structure of finance as a

...market-based mechanism for the creation of credit *and* a set of institutions and enterprises set up by governments to monitor and regulate the price relations between national monies, i.e., currencies. ...The international monetary system ... consists in the arrangements between states for the management of relations between their respective national currencies, in other words, of exchange rates and related matters. (P. 229)

The analysis to follow will demonstrate the area of vulnerability that national governments are subject to, due to the globalization of financial markets. The fact is that states and governments are not in complete control over such macroeconomic indicators as exchange rates because global markets can disturb the decisions and agreements of governments. (Recent crises in Asia, Latin America, and Russia are telling examples.) And vice versa, decisions made by national governments can disturb global financial markets as well. A recent crisis in Brazil is a case in point. After the government decided to devalue the national currency, financial

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*All quotations from Susan Strange could be found in Global Transformation: Challenges to the State System, edited by Yoshikazu Sakamoto, 1994, the United Nations University Press. Susan Strange was one of the contributors; her article (Chapter 8) is entitled “The Structure of Finance in the World System”, p.p. 228-247.*

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markets and stock exchanges reflected the change, as a result, share prices plummeted. Susan Strange argues a similar point: "conversely, international financial markets could not exist without governments, and are subject to whatever rules and restrictions that states may impose upon them." (P. 230)

Susan Strange describes the relationship between states and markets quite succinctly in the following paragraph:

The financial structure in the world economy can thus be visualized as a hybrid of states and markets, a halfway house between, on the one hand, the realist conception of separate national societies, surviving on more or less discrete national economies and governed by political institutions of nation-states, and, on the other, the financiers' and bankers' perception of a single global market for monies and credit instruments and for financial services. In the former, it is state frontiers that matter. In the latter, the most significant divisions in the market are set by the different times that the sun rises and people start work, and that the sun sets and they go home. Between the international monetary system, where it seems as though national governments are the chief actors, and the financial markets, where the decisions of debtors and creditors and their intermediaries seem more decisive, there is a significant difference in the democratic dimension. National governments may be directly subject to popular interests and pressures, whereas in financial markets democratic principles take second place to supply and demand and the vagaries of the markets." (P. 231)

In short, a striking manifestation of economic globalization is "the growing transnational nature of international finance..." (Strange 1994, 233). According to Susan Strange, "... the international (or global) financial structure coexists with a lot of national financial structures..." (Strange 1994, 234). She describes it as a sort of
...hybrid, a halfway house between a completely integrated world structure and a totally unintegrated collection of national structures. ... In that structure, market forces are beyond the total control of any single national government. Indeed, with the notable exception of the United States, most governments have very little influence over it. Their vulnerability to its changing character, its volatilities, and the new risks it brings, however, is only acutely felt. (P. 234)

Transactions in the global financial structure are growing faster than are those in local, national markets. If trends are extrapolated, it could be suggested that the unregulated part of the market will eventually overtake the regulated part, argues Susan Strange.

In contrast, the market for foreign exchange is globally integrated. The price of dollars in yen or in gold is virtually uniform everywhere at any given moment. The international bond market belongs in the global structure. Stock markets worldwide have become globally integrated. Worldwide market value reached 13 trillion dollars in 1995. The shares of global companies (multinationals) are traded on all the major stock markets. This globally integrated stock market makes possible the circulation of publicly listed shares around the globe in seconds.

"The deregulation of domestic financial markets, the liberalization of international capital flows, computer networks and telecommunications have all contributed to an explosive growth in financial markets," argues Saskia Sassen. (Sassen 1996, 40) International finance was revolutionized through technological innovations. The transactions are now registered automatically, through integrated computer networks, communicating with each other by satellites. (That eliminated the need for the services of hundreds of clerks and middlemen.) The London Stock Exchange was revolutionized by the introduction of TAURUS, an automatic system of share transfers. This eliminates the need for buyers and sellers to meet face-to-face. The speed with which transactions are conducted is accelerated enormously. That
loosens the grip of national regulatory systems over lending, capital transfers, hedge funds, and capital flight. Global financial markets are in constant search of new clients due to the shrinking of profit margins, that makes them compete with each other as well as with national financial markets. Foreign banks penetrate national markets bringing with them increased competition and further deregulation of the banking system.

These trends are likely to continue. If the shift of substantial economic power from governments to markets occurs, that would signify an unprecedented loss of popular power and popular review. That development in turn could jeopardize governments' accountability, legitimacy, and competence. However, having said that, it should be emphasized that developed monetary and financial systems are engines of economic growth. The ability of financial institutions to create finance (credit) and to move it around more quickly adds to the efficiency of the world market and promotes growth. The developing financial system will become, however, more unstable, risky, and volatile as national regulatory mechanisms get weakened and money becomes more concentrated in global financial institutions. “...While the forces of globalization led by mobile capital will certainly enhance world growth, the distributional consequences of globalization impact the immobile factors of production, mainly the inhabitants of the nation state,” argues Sylvia Ostry. (Ostry 1997, 64) It is hard to disagree with this conclusion.

Multinational Enterprises As a Driving Force of Global Capitalism.

Transnational corporations (TNCs) have contributed to considerable shifts in economic power and in the balance of power in general. Global companies with “worldwide connections dominate the four intersecting webs of global commercial activity on which the new world economy rests: the Global Cultural Bazaar; the Global Shopping Mall; the Global Workplace; and the Global Financial Network.
These worldwide webs of economic activity have already attained a degree of global integration never before achieved by a world empire or nation state. The driving force behind each of them can be traced in large measure to the same few hundred corporate giants, with headquarters in the US, Japan, Germany, France, Switzerland, the Netherlands, and the UK," write Barnet and Cavanagh. They call transnational corporations (and the banks) the “midwives of globalization: they are the ones behind it and they are the ones who have benefited.”

The unprecedented power and leverage that TNCs possess is staggering. The proliferation of TNCs in the past three decades is equally remarkable. Malini Mehra provides some telling statistics on this account:

In 1970 there were 7000 TNCs, by the early 1990s there were 35,000. TNCs now account for 75% of global trade, the majority of which is between themselves. Of the world’s 100 largest economies, 51 are corporations, only 49 are countries. Ford’s economy is larger than that of either Saudi Arabia or Norway. Mitsubishi’s economy is larger than Indonesia’s, the fourth most populous country on earth, and Philip Morris’ annual sales exceed New Zealand’s GDP. The combined sales of the top 200 corporations now account for almost a third of global GDP. Despite their worldwide operations, these same 200 firms employ only 188 million people, less than one-third of 1% of the global population. . . . Less than 1% of the world’s population has any consequential part in corporate ownership. (Globalization or Sustainable Societies? The Internet, FoEI LINK - 78)

Concomitant with the expansion of global companies’ economic power is a new development in the legal sphere. TNCs challenge legal functions traditionally assigned to the nation-state. Multinationals infuse new legal practices and norms

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10 From Global Dreams, Imperial Corporations and the New World Order, quoted in Globalization or Sustainable Societies? by Malini Mehra. Could be found on the Internet, FoEI LINK - 78.
into the workings of the global integrated economy. Here is some empirical evidence to that effect.

**New Legal Regimes? Legal Pluralism?**

The state has traditionally been the guarantor of property rights and contracts, as well as the executor of fundamental functions of law-creation and law-validation. What institutions can ensure these functions in a fluid and unregulated global economy? Economic globalization has been accompanied by the creation of new legal regimes and practices. These regulatory regimes for the governance of economic relations are international commercial arbitration (*lex mercatoria*) and various institutions that perform rating and advisory functions. International commercial arbitration has been institutionalized as the primary contractual method for the resolution of transnational commercial disputes. Two agencies — Moody’s Investors Service and Standard and Poor’s Ratings Group — dominate the market in credit ratings. These debt security and bond-rating agencies are part of a private regulatory system. They have contributed to the internationalization of ratings. These regimes have become essential to the functioning of the global economy, infusing a degree of discipline and order into the workings of various economic actors. These mechanisms are not subject to government regulation and function independently of them. It is worth mentioning that these regulatory regimes have been Americanized. There is resistance (especially in Europe) to “the Americanization of the global capital market’s standards for the regulation of financial systems and standards for reporting financial information” (Sassen 1995, 18). Moody’s and Standard and Poor are the two leading U.S. agencies.

Americanization could also be traced in the legal norms, in private corporate law-making, in commercial law, and business practices, which are ascendant in international business transactions. In part it is due to the ascendancy of American
transnational legal services firms. In sum, the trade regime is a common law regime (as was pointed out earlier, the American variant of a common law regime).

*Lex mercatoria* could be defined as the global rules of commercial law, as the transnational law of economic transactions, or as a body of international legal practice. Here the role of multinational enterprises as law-makers is crucial, they seem to claim a unique jurisdiction in the global economy. Gunther Teubner calls *lex mercatoria* the "most successful example of global law without a state" (Teubner 1995, 3). The internal legal regimes of multinationals, worldwide commercial practices, standardized contracts, technical standardization, activities of global economic associations, codes of conduct, professional self-regulation, and the awards of international arbitration courts are the sources of this new positive law called *lex mercatoria*. One might agree or disagree with the postulates of monism vs. legal pluralism, but there is no denying that worldwide practices of multinationals, international commercial arbitration awards, and international standardized contracts help further develop global legal regimes. But again, international arbitration courts rely heavily on cooperation and policies of governments and states to grant awards. Multinationals conduct their business within the territorial boundaries of states. The presence of the state is real in the practices of global legal regimes. Its role as a law-validating and law-enforcing entity cannot be discounted.

We submit that national governments are still performing numerous functions which neither global financial markets nor multinationals are willing to take on. As significant and powerful economic players as multinationals and financial markets are, they lack public responsibility, accountability, and motivation. We do not want to run the risk of demonizing markets and multinationals. The point is, they are particularistic in nature, serving special groups and certain, particular interests. Multinational corporations are answerable to the global money markets and their
diffuse shareholders, dispersed across national boundaries. The unregulated global economy is the fertile ground for TNCs freedom of movement. Does that mean that the nation-state is dead? Far from it, at the present moment, there is no other workable or attainable substitute to the modern welfare state as we know it. And that is precisely the theme of the next section.

Global “Free” Markets vs. Government Regulation

Every individual endeavors to employ his capital so that its product may be of greatest value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own security, only his own gain. And he is in this led (as if) by an INVISIBLE HAND to promote an end which was not part of his intention. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it.

Adam Smith, Wealth of Nations. 1776

Laissez-faire, free market philosophy embraces the notion that markets (national, international, or global) operate most efficiently when national governments minimize their activity in the economy. In other words, it is the idea that the market system works best with only minimal governmental intervention. According to this theory, governments should provide national defense, security, police protection, determine property rights in the simplest fashion possible, enforce contracts entered into by private economic agents — and do as little as possible, or nothing else. This philosophy is closely related to the teachings of Adam Smith. According to Adam Smith, one of the adherents of this philosophy, markets are supposed to be governed by the “invisible hand”. The “invisible hand” refers to automatic market adjustments that ensure equilibrium. Smith postulated that economic freedom is an efficient way to organize an economy. Self-interest is the driving force of an economy. A free marketplace is an ideal individualistic society where buyers and sellers conduct their affairs freely with minimal or zero government regulation. The “invisible hand” of competition coordinates economic transactions in the marketplace keeping the
system in equilibrium. According to Smith, self-interest and competition harmonize with the public interest, yielding increases in national wealth.

An abstract society, outlined by Adam Smith, is supposed to portray pure capitalism, where private individuals own virtually all productive resources and make decisions that govern their uses. Once again, these decisions would be based on self-interest and not on the public interest. In reality, pure capitalism and a pure free market do not exist. The empirical evidence indicates the existence of some form of mixed economy. Even if economic globalization facilitates the spread of global capitalism, it is NOT bringing about pure capitalism or a pure free market. What economic globalization changes is the means of governmental coordination, supervision, and intervention in a globalized economy.

Arguably, if global economic players increase their independence from government regulation, the result would be the loss of control over economic transactions on the part of governments and central banks. Even if the role of the state is decreased in the global economic sphere, a modern welfare state has an important task to perform in providing social protection, safety nets, defense, and the furtherance of public and collective interests. The state still has significant economic powers — generally speaking, the state has the monopoly over the production of money (ownership of a mint), it can debase, depreciate, or devalue the currency, it can launch inflationary or deflationary policies, it can introduce the policies of protectionism, it can impose non-tariff barriers on imports, or it can raise taxes. Interestingly enough, states have to steer their course carefully as they compete for investments. Needless to say, the effectiveness and the degree with which states exercise their economic sovereignty vary from state to state. The IMF, for instance, can impose freezes on credit and money production as part of a conditionality package, which would considerably limit the state’s leverage in the economic sphere.
Apart from social obligations to its citizenry, states also have to "survive" and to compete with each other in an increasingly competitive economic environment. Investors will come and capital will flow into a country that has a favorable economic environment, however a multinational company or an investor will define it for themselves. Numerous economic transactions realize themselves within a certain territory. International trade is vulnerable to the macroeconomic policies of states—interest rates, exchange rates, tariffs, and the like. International finance is also vulnerable to the decisions of national monetary authorities. On the other hand, international markets can upset the decisions and regulations set by national governments. In short, markets and governments seem to exist in a symbiotic, interdependent relationship, in competition with each other, yet with a strong need for each other.

In sum, the world has never seen pure capitalism—neither free enterprises are completely free, nor is the state powerless in the global economy. States and markets form an alliance, a relationship of interdependency. They form a hybrid that is based on interlinkages between national monetary policies, rules, regulations, international agreements, international trade, and global financial markets. The nation-state continues to play a major role, although a transformed one under recent developments. Nonetheless, the state plays a key role in providing for social order, physical security, widespread education, economic well-being, basic welfare needs, social guarantees, protection, law-creation, law-validation, and the maintenance of the social contract with its citizens. The state is still the key guarantor of contracts and property rights. (Of course, the effectiveness of mechanisms and institutions for delivery of these guarantees and protections might vary from state to state, depending on its organization, tradition, history, and leadership.)

It is true that high mobility of multinationals and capital reduces the effectiveness of governments to regulate and conduct taxation. Individuals and multinationals
can hold their investments in various parts of the world and under many names, thus avoiding national taxation. The fact is that power and authority become more dispersed in a multiplicity of sites. That is why it is time to move from statism to pluralism, to understand various sites of authority so that we might redress the imbalances (economic as well as political) in the modern international system. A more beneficial outcome might be an alliance in the form of cooperative arrangements between governments and enterprises, some balance between government regulation in cooperation with market self-regulation and self-restraint. The state still performs very important functions to be permitted to die. Undeniably, the nation-state is being transformed by economic globalization. Though getting weaker in certain economic areas, it is still the source of political and legal authority, the repository of national identity and the guarantor of basic welfare needs. In conclusion, our modern experience portrays globalization as a contradictory process; it is fragmented rather than uniform. “Despite the importance of international relations and international private and public law, politics and law still have their center of gravity in the nation-state” (Teubner 1995, 5). These paradoxical, centrifugal trends can be reconciled by adopting the framework of pluralism where the state and other actors could be analyzed in the relationship of cooperation, competition, and interdependency.

When Governments and Markets Fail, What Then?

Here again we are dealing with a deep philosophical dilemma — leave it to the markets? Or governments? Or put an institution in place that can regulate the global economy? One may not adhere to the notion that market forces are automatic and self-correcting, nor may one subscribe to the notion that there are natural economic laws akin to the laws of physics. Economic institutions are human, man-made creations. The belief in natural economic laws would signify that we should leave

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market forces alone, and keep the status quo without trying to correct injustices, imbalances, and inequalities. The marketplace and other economic systems are but human inventions; governments and states are just as good as the human beings that created them.

At the present time, where governments fail to be effective, where markets panic and crises ensue, heads turn to the institution of “last resort” — the International Monetary Fund. It seems that in the world of economic instability and fierce international competition the presence of a stabilizing force such as the IMF is beneficial. Perfect free competition does not exist; the laissez-faire approach, which sees the markets as possessing self-correcting ability, does not correspond to reality. The magical “invisible hand” of the market becomes visible in the form of the IMF. Once again, it should be emphasized that one may not regard the IMF as an ideal institution. It needs to reform itself just as the world is being transformed by the forces of globalization. It is precisely because of accelerated economic globalization that the role of the IMF is also amplified and is in need of transformation. Weak governments, failed leadership, inefficient economic systems, poorly-designed legal frameworks, and bad fiscal policies will make states more vulnerable to independent financial markets. This precariousness might make states the ready casualties and victims of economic globalization.

Just as in domestic markets, where the debate could rage over laissez-faire policies versus government regulation, the debate continues over the regulated world economy versus laissez-faire global markets. The task is to satisfy the needs of the political community and the population, i.e., people directly affected by the decisions of governments and markets. More than any other entity, the nation-states and national governments are left with the task and the responsibility of promoting collective/community interests and looking after their population. In the environment of accelerated economic globalization, characterized by fierce
competition, market volatility, and uncertainty, the welfare state (the modern state as we know it) assumes responsibilities to look after its community. However, it is high time that markets and governments stopped treating each other as adversaries. While acknowledging that certain patterns of competition and rivalry will persist, states and markets have to strive for mutual reinforcement and cooperation. In sum, they have to form an alliance, a working relationship in the age of economic globalization so that both individualistic and collective interests are promoted and satisfied. And the role of the International Monetary Fund is paramount in establishing a constructive dialogue and serving as a balancing force between governments and markets.
CHAPTER IV

THE INTERNATIONAL MONETARY FUND AND
ECONOMIC GLOBALIZATION

If your domestic institutions are strong, then you don't need very strong global institutions. If domestic institutions inside countries are weak, it won't matter how strong your global institutions are. They will not be effective.

Robert Hormats (the Vice Chairman of Goldman Sachs International)

Since their emergence as recognized entities, States have been concerned with their role in the international order and with increasing their stature therein. Economic strength is one clear indicator of state power. To enhance their position, States throughout history have entered into legal and other arrangements to protect and further their economic interest.

Celia Taylor (Statehood and Sovereignty 1997, 775)

By virtue of their global reach, organizational strength, professional expertise, and close connections with core governments and private banks and corporations, these international institutions [the IMF and the World Bank] have acquired an authoritative status within the world economy comparable in some respects to that enjoyed by the state vis-a-vis the national economy. To this extent, the leading international organizations, of which the World Bank and the IMF are the most conspicuous, may be said to play an increasingly important initiating, monitoring and regulatory role in the reorganization of economic activity on a global scale.

Camilleri and Falk (The End Of Sovereignty? 1992, 95-96)

National economies are interlocked, commercial banking and business ownership (controlled by some 750 global corporations) transcend economic borders, international trade is integrated and financial markets around the world are connected through instant computer link-up.

Michel Chossudovsky (The Globalization of Poverty 1997, 15)
Closely linked to the issues of economic globalization and sovereignty is the role of the International Monetary Fund in the changing global environment. What seems to be at the heart of the debate over the role of the IMF is the ways and strategies for combatting, harnessing, managing, and governing globalization. Globalization is happening; it is a fact and a social, economic, and political reality. It cannot be ignored, forgotten, be rid of or put on the "back burner", it is around us. Globalization, however, is not always an equalizing, homogenizing, and balancing force, as it is often perceived by the liberal camp. Globalization underscores the stark differences between the have and have-nots, winners and losers, the industrialized and the underdeveloped. Humanity at the present time is faced with a world which is neither democratic nor equitable. Economic globalization is thought to imply market integration, free trade, liberalization, internationalization, the spread of market values, the promotion of democracy, and other integrative processes, which are said to possess a democratizing and equalizing potential. However, as mentioned earlier, economic globalization is often accompanied by centrifugal, disintegrative and conflicting trends – deepening disparities, increasing income inequalities, worsening living conditions, perpetuation of indebtedness, destruction of public safety nets, job losses, and social dislocations.

Furthermore, economic globalization and the trend towards integrated but volatile global markets increase chances of economic crises that may deeply affect and even impoverish both rich and poor countries. Thus, it stands to reason that the more integrated the world becomes, the more effective ways of international cooperation, management, and global governance are needed to offset the negative impact of globalization.

Let us start by asking a number of fundamental questions which revolve around the role of the IMF in the changing environment. This chapter is but a modest attempt to encompass a very broad spectrum of issues. What course of action are
we to take in the age of integrated global markets? Should we tame globalization? Fight it? Curtail or slow it down? Should it be managed, governed and regulated? Or should we just let the chips fall where they may and let everybody fend for themselves? Inherent in this debate is the dualism between the nation-state (sovereignty issues) and global integrated markets (economic globalization). What is the role of the government in the era of economic globalization and integrated markets? Are we witnessing a new pattern of interaction between government and market forces? How is the economic power of the state being transformed due to powerful economic actors? How and by whom should markets be regulated, or should they be regulated at all? Is the IMF an optimal regulating body or should it be reformed? Who does the IMF favor, protect and regulate - markets or states? Can it ever be an objective, unbiased force between member-states and global markets? How can it be transformed into a more democratic and equitable balancer between governments, national economies, and global markets? Should the IMF pursue a narrow or an expanded role? There are a lot of empirical and normative issues of this sort, and a lot of contentious opinions are expressed along ideological divides. At the heart of this debate lies the fundamental question about the IMF's unique role in fostering and furthering economic globalization, and in simultaneously managing and governing globalization in order to protect and strengthen states against its negative effects.

There is no general agreement on how to resolve the dualism, i.e., the contentious competition between sovereign states and global integrated markets. One side of the spectrum holds that governments should be directly involved in the economic process through participation in production and distribution of goods and services. This view assigns an active, dominant, and decisive role to the government in economic policy management. As Manuel Guitian succinctly puts it:
[This view] reflected the notion that besides providing public goods and correcting market failures, governments were also alone responsible for stabilizing cyclical economic fluctuations as well as for growth and development in the economy. (Conditionality: past, present, future, International Monetary Fund Staff Papers, 1995, v. 42 (Dec): 792(44))

The opposing view argues that instead of being directly involved in the economic process, government policies should be directed towards fostering market forces, safeguarding competition, and encouraging private initiatives. Governments should not compete or interfere with market forces; governments should establish frameworks in which market forces can efficiently operate, thus, furthering economic globalization.

According to Manuel Guitian, the latter view of economic policy enjoys wide consensus in the IMF’s membership, including both the industrial and developing countries (which is a debatable point). The perceived economic policy consensus lays out basic responsibilities of government that include “first, the establishment of a stable macroeconomic setting and the timely undertaking of policy adjustment efforts,” “second, the protection and maintenance of the country’s economic infrastructure” [investment in both human and physical capital],” and “third, the establishment, development, and safeguard of the economy’s institutional infrastructure. This responsibility includes a host of . . . governmental activities, such as the provision of an appropriate legal, regulatory, and social framework to support the functioning of market forces” (Guitian 1995, 792). These contending visions of the role of the state in conducting economic policies essentially reflect the debate over the right balance between government regulation and free markets. The International Monetary Fund takes on a role of a balancer between the two in the age of globalization.
Approaches to the IMF

The role of the International Monetary Fund is unique and inherently paradoxical in the era of globalization and global integrated markets. The IMF has a unique function of a referee between markets and governments, and that is where the paradox lies – the IMF, as a vehicle of economic globalization, promotes market forces, liberalization, competition, and open free trade. The IMF is at the same time an inter-national organization that consists of sovereign member-states, which apply for its assistance to protect and strengthen themselves against the negative effects of globalization. Is the IMF a neutral referee, objective and unbiased? Unfortunately, it is far from being objective and democratic, which will be demonstrated with empirical evidence in the discussion to follow. What approach towards the IMF’s role is feasible and practicable so that the “wheels of progress” continue to turn and so that countries are also protected against the negative effects of globalism? Surely, this thesis will not answer all the questions in a way to fit all contending visions; the great debate over the right balance between regulation and free markets is likely to continue. Let us now review the contending approaches to the role of the IMF in the modern context.

The laissez-faire, free-market approach calls for free movement of capital, goods and services, and the minimum institutional intervention (be it governmental or international in the form of the IMF). The notion that free markets are self-sustaining and market excesses will correct themselves is fundamental to this approach. According to this view, the IMF, as a “safety net” provider and a “bail-out” agency, is harmful to healthy free competition and should leave the markets alone. This approach argues that the IMF should abandon its rescue packages, stop its practice as the international lender of last resort, encourage free competition, and let markets decide on the outcome. But this “hands-off”, “leave it to the markets” approach could lead to the collapse of governments, national economies, great human
sacrifice, and the elimination of the public safety net. Ample empirical evidence demonstrates that the marketplace is not always prudent, reasonable, people-oriented, or unselfish. To be left at the mercy of the marketplace and at the time of crises be punished by it for the lack of a social safety net is not a very encouraging prospect.

This picture portrays a veritable wilderness, where each individual is left to fend for himself/herself; it represents extreme individualism at its worst, where each individual is left without any safety net in hope that market forces will take care of public needs. This extreme individualistic approach is neither fair nor politically sustainable. A firm domestic/national base provides a safety net (together with an IMF safety net in time of international crises) which the marketplace is not capable of guaranteeing. Financial markets have shown poor judgment before – they are partly the cause of the recent Asian crisis. Governments could not be totally blamed for the stock market crashes and failures of national economies. Markets are often unwilling to accept the responsibility and the blame for failures. In sum, for the sake of the poor, the dispossessed and the vulnerable, the IMF should continue to play its role as a “safety net provider” in time of crises, for the lack of market-sponsored networks for public goods.

The second approach, on the other hand, calls for heavy global and international regulation. There are a number of ideas calling for the reform of the international economic order. To tame the dangers of globalization, it is proposed to create new institutions to infuse discipline, structure, and direction to the global marketplace. The international financier George Soros argues for the supervision of international capital movements and the regulation of credit allocation. He proposes that a new authority be created as a sister institution to the IMF, what he calls the “International Credit Insurance Company,” that would guarantee international and private sector loans up to a specified amount for a modest charge. Borrowers would have to
agree to complete disclosure of all borrowings, public or private, which would help
the ICIC set ceilings on the size of the loan. ("Avoiding a Breakdown", *Financial
Times*, December 8, 1997)

Henry Kaufman, a Wall Street economist, proposes the creation of a "Board of
Overseers of Major International Institutions and Markets" to supervise and regulate
financial markets and institutions. This Board would be empowered by member-governments to harmonize and monitor the performance of institutions and markets
under its supervision. It would be empowered to set minimum capital requirements
for all institutions under its purview, to establish uniform trading, reporting, accounting,
disclosure and lending standards, and to monitor performance. It would "supervise
risk-taking not only by banks and other financial institutions but also by new
participants in the global markets." Unlike "today's reactive IMF", this Board of
Overseers would be responsible for "anticipating problems and forcing preventive
action," a sort of an early alert system that would warn us against incipient economic
crises. ("Preventing the Next Global Financial Crisis", *New York Times*, January 28,
1998)

The historian Arthur Schlesinger, Jr. calls for the creation of an international
mechanism that would function similarly to the US Securities and Exchange
Commission. He points out that the US free-market economy functions within a
broad regulatory framework and under close supervision from the SEC.

Former Secretary of the Treasury Robert Rubin stated his belief in a strong
supervisory mechanism by saying that the global economy needs "to develop and
maintain strong supervisory regimes and regulatory structures" to prevent future
financial crisis.\[11\] A proposal by James B. Hurlock calls for the transformation of the

(Spring).
IMF into a global bankruptcy court to respond to the problems of sovereign liquidity and debt default, which would give the IMF vast legal and regulatory powers. ("The Way Ahead for Sovereign Debt", Intl. Fin. L. Review, 1995 (July): 10-12)

But it makes one wonder where the so-called developing countries and reforming countries of Eastern Europe fit into this picture of omnipotent global entities. Would these agencies of global supervision be more democratic than the international bodies of the present? Interestingly enough, this centralized model of global supervision resembles the “Asian model” of centralized economic system which has been so harshly criticized during the recent Asian crisis. Furthermore, for now, national governments will resist the creation of any such omnipotent supranational entities that would fundamentally challenge state sovereignty (Haas and Litan 1998, 4-6). As it stands, globalization has already chipped away considerable fragments from the sovereign armor. However, total insulation from globalization is not possible. Tight domestic regulation in the form of trade barriers, protectionist policies, and investment restrictions is another way of insulating people from the forces of globalization. You can run from globalization but there is no hiding from it in an interdependent world with interconnected needs. Tight domestic regulation might also be harmful to domestic growth and national economies. In sum, just as extreme nationalist protectionist policies could be harmful to trade and commerce, so an unregulated international economy with no rules and no discipline could bring disaster to states, peoples, national economies, and markets.

The third approach, the so-called “managed” approach towards the relationship between the IMF and globalization is of a more moderate nature. It does not call for a drastic overhaul of the existing architecture of the international economy. Some remodeling, reforming, and reorganizing of the IMF are called for, however. The safety net provided by the IMF should be kept in place, it is believed, but business incentive and entrepreneurship should be encouraged. This managed, balanced...
approach “would eschew the heavy hand of international regulation but aim to maintain the element of risk essential to capitalism without removing the safety net provided by the IMF” (Haas and Litan 1998, 4). The IMF, a regulatory agency, is perceived to be at the helm of this managed approach by introducing reforms at both the national and international levels. (Needless to say, reforms involving the transformation the IMF itself would be beneficial.) Such IMF-led reforms include “improving the supervision of financial institutions, instituting Western-style accounting practices in banks and corporations, and opening up markets to foreign investment” (Haas and Litan 1998, 4). The provision of more accurate information to foreign creditors and lenders, and transparency are also required.

This managed approach leaves national governments with the initiative to manage globalization and to provide a safety net for the people. The IMF should also help national governments build a firm domestic base – strong economies, sustained economic growth, and help strengthen such public goods as health insurance, pensions, training, and unemployment insurance. This managed approach acknowledges that “it is still states and governments – by the practices they adopt, the arrangements they enter into, and the safety nets they provide – that will determine whether we exploit or squander the potential of this era” (Haas and Litan 1998, 6).

In echoing Robert Hormats, we believe in strong domestic institutions, in strong legal, social and regulatory frameworks which are capable of protecting the people and creating public safety nets, and which are also designed to promote various incentives. It is suggested here that strong and sound domestic institutions will be crucial in managing globalization. In other words, strong domestic institutions will be the safeguard against the negative effects of globalism. The role of the IMF should be underscored in its endeavor to strengthen domestic institutions through
structural adjustment reforms. Its mission to strengthen a country's domestic institutions in need and in deep financial trouble is paramount.

However, along with the positive aspects of the IMF participation in the management of the global economy and globalization, a constructive critique is necessary. The IMF needs to abandon its policy of applying a one-size-fits-all conditionality dogma to different countries with different circumstances. The IMF should be careful in blindly promoting free market values to the less developed countries. While forcing an entry into the global markets' wilderness on underdeveloped countries, the IMF often undermines, not strengthens, domestic institutions. The IMF should establish some "readiness" criteria for entry into the global marketplace for the less developed countries. Institutionalization of strong and sound domestic institutions should be the primary goal on the IMF structural adjustment agenda. Are structural adjustment programs not intended to strengthen domestic institutions? Promotion of strong domestic institutions through innovative and individualized structural adjustment programs should be the IMF's reformist agenda.

Thus, a radical reassessment of the IMF's structural reform practices is in order. The IMF should reaffirm its unique mission as a balancer between states and markets. Its preoccupation with across-the-board liberalization and a pervasive free market agenda, however, could be harmful to both domestic institutions and global markets. Markets will not prosper or thrive in the environment where domestic institutions are in shambles; markets and states are interdependent and co-dependent on each other. Despite global integrated markets, technical innovation, instant communication, cyperspace, and digitalization of financial markets, geography still matters; national economies still matter; states and domestic institutions still matter. It is with some measure of restraint, discipline, and regulation that we stand a chance at balancing out contradictions of our times.
In sum, the *managed approach* seems more realistic and applicable in the modern context. While new ideas on global regulatory bodies are explored and proposals are made for the drastic reform or complete overhaul of the international economic order, we have to use the resources at our disposal in the most optimal way. Just as we need strong domestic regimes and institutions, so we need to maintain strong international supervisory and regulatory bodies to be better equipped to avert future financial crises and to govern globalization. That is why it is suggested here that the IMF should be reformed and reorganized to manage the negative effects of globalization more effectively. If the IMF is destined to be the leader of any future international reforms in the decades to come, it needs to reassess fundamental economic and democratic values and to undergo an institutional reform as well.

Our methodology views the IMF from an analytical and critical perspective. The analysis includes both the empirical and the normative aspects; it looks at what the IMF represents at this given moment in history and what it should strive for in its reformed capacity. One of the criticisms focuses on burden-sharing and accountability on the part of the IMF. If governments are accountable to the public for their economic policies (be it under the guidance of the IMF or independently), then the IMF should share and carry the burden of responsibility in the implementation of IMF-sponsored programs, in order to be perceived by its members as a democratic institution. If the IMF imposes conditions through its loan conditionality, thereby forcing a partial transfer of sovereignty, it should also be accountable if the corrective measures do not cure the "ills" and result in failure. It seems a logical inference that the IMF should be more accountable for its corrective prescriptions if it takes on a more expanded role.

The managed approach to globalization puts the IMF at the center of the international economic superstructure where it plays the role of a referee, a coordinator, a manager, and a balancer between various state and non-state
economic actors, between governments and markets. *Globalization is regarded here as a process not as an outcome*. Thus, when we discuss the ways of managing globalization, we are required to find the ways of engaging governments, powerful economic actors, markets, and international financial institutions (such as the IMF, the World Bank, the WTO, and NAFTA) in a meaningful dialogue where each party's interests and views are acknowledged and weighed, and where some form of compromise is reached. The IMF could take a leadership role as a mediator between various economic and political actors—regional, national, global, or international.

If we extrapolate the current globalizing trends (cooperation vs. conflict; integrative vs. disintegrative), it could be postulated that the further delegation of sovereign authority to international and global entities will continue. If the current trends continue, and they are likely to, the importance and the mandate of the IMF will increase, not decrease. There is always a danger of institutional overreach if the IMF takes on a more expanded role. That is why the IMF needs to undergo reform and reorganization more than ever, to be better tuned to the changing environment. We will propose our own recommendations for the reformed IMF; they will be summed up succinctly at the end of the chapter. Intentionally, some of these recommendations will be included in the following discussion which centers on the role of the IMF in the changing environment.

The IMF – A Friend In Need Is a Friend Indeed?

In any scientific controversy or debate we encounter opposing camps, competing visions, contending theories—they form the dichotomy between critics and supporters—but there is nothing new about the dichotomous and conflictual nature of scientific discourse. The International Monetary Fund and its role in the changing environment is not an exception; the institution has its ardent critics and loyal defenders. Some of the issues that both critics and supporters have to address
include the following: Has the IMF been successful in promoting globalization? Has it been successful and effective in reducing developing countries’ external debt? Has it been successful in the area of currency stabilization? Have its structural adjustment programs actually succeeded in improving conditions in the debtor countries? Has the debt burden of the developing world actually been reduced? These are some of the questions that invite interest from political scientists and economists. The fact is that there is no accepted methodology on how to assess IMF successes and failures. In addition to numerous contending methodologies and typologies, there is no consensus or agreement on what constitutes a failure or success.

It is also important to emphasize that REALISM, a theory that reduces international relations to power relations between states as unitary actors and focuses on “high” politics, has been so dominant among scientists as an explanatory tool that non-governmental organizations and international organizations have been on the periphery of scientific discourse. The dominating presence of realism did not give a chance to other political and economic non-state actors at extended scientific analysis. As these non-governmental organizations (NGOs) and non-state movements gain in importance and influence with accelerating globalization, they attract the attention of the scientific community. Their role in the changing environment attracts due attention and comes to the fore of scientific discourse.

Dichotomous views on the role of the IMF in the changing environment include positivist and normative theories. Contending opinions on the role of the IMF are voiced from different ideological camps - the Left, the Right, and the Center. The successes and the failures of IMF-funded programs have been contested, approved, disapproved, downgraded, or praised. It is a matter of subjective opinion: the analyses of the IMF’s structural adjustment and conditionality reforms tend to be value-laden, ideological, and subjective. Let me begin with some criticisms of the
IMF, which are replete. One of the critical views centers on the issue of the IMF structural adjustment medicine. The IMF applies the same rigid austerity medicine (the same old "structural adjustment" orthodoxy) to all its "patients" indiscriminately, regardless of the fact that they might be "suffering" from a different malady.

Another criticism views an ever-expanding role of the IMF as too much undesired encroachment on state sovereignty. The IMF expands its mandate by including harsh structural elements in the loan conditions and goes beyond its primary objective of correcting the balance of payments disequilibrium. Critics charge that, as a consequence, economic conditions attached to the loans exert political leverage and unduly intervene into sovereign states' policies. Critics suggest that, as a result, the IMF's practices become highly politicized, they often lack popular support and popular review, and the IMF itself lacks accountability and transparency.

Another aspect of the IMF practices that invites criticism is the moral hazard of bailout packages. Critics who come from the "free market" camp charge that lenders, bankers, officials, governments, and investors take risks and pursue reckless policies without weighing the potential dangers in the belief that the IMF will come to the rescue (by performing a sort of safety net function in the time of crisis). Free marketeers charge that the presence of a "safety net" institution is harmful to free market spirit and free competition. This bailout psychology is thought to be "motivated by the belief that the IMF lulls governments, investors, and lenders into recklessness. ...The laissez-faire, free-market approach looks good in the abstract because markets reward sound investments and regulatory practices and punish poor ones. In principle, it can provide incentives for investors to avoid overly risky investments and for governments to adopt prudent policies. To international free marketeers, the safety net [in the form of the IMF] destroys this incentive" (Haas and Litan 1998, 3).
Steve Forbes, an adherent of Adam Smith's theory, charges the IMF with being “oblivious to four basic principles of economic progress: sound money (the IMF is addicted to devaluations), low taxes, property rights, and non-bureaucratic interference with the setting up and running of businesses.” (“The Scourge of the International Monetary Fund”, Forbes 158, October 7, 1996: 25)

Critics from the Marxist/radical camp charge the IMF with manipulation of market forces to serve the interests of dominant economic and financial actors, i.e., economically powerful countries. The IMF as part of a powerful international bureaucracy has the ability to “supervise national economies through the deliberate manipulation of market forces” (Chossudovsky 1997, 16). The radical/Marxist critics do not spare the IMF and call it the instrument of the globalization of poverty. They call the IMF the vehicle of impoverishment of developing countries, they argue for its dissolution or radical reorganization. Michel Chossudovsky portrays a not so complimentary picture of the IMF practices:

Since the early 1980s, the “macro-economic stabilization” and “structural adjustment” programs imposed by the IMF and the World Bank on developing countries (as a condition for the renegotiation of their external debt) have led to the impoverishment of hundreds of millions of people. Contrary to the spirit of the Bretton Woods agreement which was predicated on “economic reconstruction” and the stability of major exchange rates, the structural adjustment program has contributed largely to destabilizing national currencies and ruining the economies of developing countries. (Chossudovsky 1997, 33)

He goes even further and terms IMF structural adjustment programs “economic genocide”:

Structural adjustment is conducive to a form of “economic genocide” which is carried out through the conscious and deliberate manipulation of market forces...
Structural adjustment programs affect directly the livelihood of more than four billion people... This new form of economic and political domination - a form of "market colonialism" - subordinates people and governments through the seemingly "neutral" interplay of market forces... At no time in history has "free" market - operating in the world through the instruments of macro-economics - played such an important role in shaping the destiny of "sovereign" nations. (Chossudovsky 1997, 37)

Kevin Danaher (also from the radical camp) charges the IMF with imposing policies designed

... to facilitate the repayment of debt: that is, the steady transfer of wealth out of Third World countries to the bankers of the industrial countries. ... It is not simply a war between 'North and South,' as it is so often portrayed in the mainstream press and academic literature. Rather, it is a collaborative effort between southern elites and their northern counterparts. (Danaher 1994, 2)

Other criticisms and recommendations express the necessity for the IMF to follow a narrow mandate and not to expand its role. They recommend that the Fund should refocus from imposing major structural and institutional reforms and should rather follow its narrow traditional task which is balance of payments adjustments, balancing out sustained trade deficits and temporary shortages of foreign exchange. They recommend the Fund be more discerning in distinguishing between liquidity vs. insolvency crisis\(^{12}\), instead of treating every patient as a complete failure, as being totally insolvent, and threatening to default on sovereign debt. Here again, the crux of the matter is the IMF's indiscriminate application of its rigid "cure" without regard for the specific causes of the "malady."

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\(^{12}\) As in the case of South Korea, for instance, which did not suffer from an insolvency crisis or sovereign debt but had a temporary liquidity shortage.
Let us take the recent case of the Asian economic crisis. Before turning to the critiques of the IMF’s handling of the Asian crisis, it should be emphasized that it is short-sighted to blame the IMF for all the ills, woes, tribulations, and failures of the Asian economies. There is something to be said for the pervasive crony capitalism of the Asian economies in distress. However, the IMF’s belief in strong Asian fundamentals until the onset of the crisis taints its reputation considerably. Critics argue that the IMF did not warn about Asian economies’ overheating, although the signs of “ailment” were apparent in the form of real estate and stock market bubbles. Why did the IMF not alert them to the incipient disaster? Critics charged the Fund with not responding efficiently and effectively, for it did not have a crisis prevention strategy. Is it possible that the Fund simply missed the signs of “ailing” Asian economies against the background of outstanding economic performance of several decades? How could the Asian “miracle,” Asian “tigers,” and the Asian “model” turn into a failure overnight? How could the IMF be so demanding and unyielding now in imposing harsh austerity measures in the time of crisis when it did not advise on any preventative measures before the crisis occurred? How could the Fund have been so short-sighted (or not openly truthful?) in not acknowledging the signs of “ailing” of the Asian “miracle”?

As Devesh Kapur remarks on the Asian crisis:

> In reality, their economies were undone not by visible internal flaws, but by the unforeseen impact of the global capital flows that the IMF sought to set free. The conventional macroeconomic indicators of the Asian crisis countries were well within prudential norms. These were not profligate governments whose policies yielded large deficits and inflation. (Kapur 1998, 122)

In hindsight, it is easy to criticize Asian crisis-stricken countries for weak fundamentals and crony capitalism; however, they did thrive quite long and quite
impressively to be dubbed the “Asian miracle” and “Asian model.” It does seem ironic that the IMF used Asian countries’ weakened positions to impose heavy structural reforms to further its own neo-liberal interests and to open up insular protectionist markets. Take, for instance, South Korea. Martin Feldstien argues that, in the recent crisis, South Korea was not facing the insolvency problem, it was facing a liquidity shortage: “...this was clearly a case of temporary illiquidity rather than fundamental insolvency” (Feldstien 1998, 25).

The IMF, however, ventured to fix all South Korea’s “ills” with one stroke – lift investment and import restrictions, reform the banking system, and open up domestic financial markets for foreign banks and insurance companies. It sought to reform corporate structure and labor laws, in short, to further a free market agenda and open up protectionist markets. It demanded “a fundamental overhaul of the Korean economy” in exchange for financial rewards in the form of conditionality loans. It applied its usual medicine of “contractionary macroeconomic policy of higher taxes, reduced spending, and high interest rates” (Feldstein 1998, 26).

Critics argue that the IMF shows favoritism in its policies: the IMF is driven to rescue investors, creditors, and lenders first; they seem to be the favored beneficiaries of the IMF rescue packages. Take, for instance, the recent Asian crisis: the IMF was not bailing out Asian national economies – the disbursements provided by Fund programs have been used by collapsing Asian economies to pay off foreign creditors. Although it is well known that debts involve both public and private obligations, where both governments and private entities are involved, the IMF rescue packages seem to favor creditors and lenders. It seems that whatever little money is left over from paying off public and private debts could be used for the collapsing national economies and diminishing safety net. Thus, it appears that the most vulnerable portion of the population of the collapsing economy will have to bear the brunt and the burden of the conditionality package. What about IMF-
imposed austerity programs for the financial markets, lenders, and creditors? Should not they be taught some responsibility? Undeniably, during the time of crises, investors and lenders do take a hard hit. However, the IMF’s overwhelming focus on paying off foreign creditors at any cost and the demand for harsh sacrifices from national governments (and the most vulnerable portion of the population!) do not seem to be balanced.

Critics further argue that if the IMF does provide temporary relief and some of the structural reforms could be beneficial, such shock therapies and the demand for complete economy overhaul could have a negative effect on a national government’s legitimacy and economic growth. Such therapies can cause instability and deeper recession. In short, these corrective measures can backlash in the form of unrest and social dislocations. Critics further argue that the IMF needs to make sure that its policies do not unnecessarily interfere with the proper jurisdiction of a sovereign government. It is often too apparent that the Fund makes the industrialized countries’ agenda a part of its conditionality packages. As Devesh Kapur explains:

... [T]he disbursements were linked to the countries’ meeting a range of conditions that seem to go well beyond the IMF’s mandate. Two decades ago, fund programs typically imposed a dozen or so requirements or strictures. But the Asian countries have had to sign agreements that look more like Christmas trees than contracts, with anywhere from 50 to 80 detailed conditions covering everything from the deregulation of garlic monopolies to taxes on cattle feed and new environmental laws. (Kapur 1998, 123)

How about the “laundry list” of conditions imposed on South Korea? It included certain items that have been on the agenda of industrialized countries for some time. Very often the conditions that a crisis-stricken country is required to accept
are practiced in the major industrial European economies – protectionist labor market rules, corporate ownership structures that give controlling interest to governments and banks, state subsidies to inefficient industries, and trade barriers to imports, to name a few. As Devesh Kapur remarks: "This contradiction has less to do with an apparent double standard than with the unlikelihood of many European nations ever being subject to IMF strictures" (Kapur 1998, 126). The IMF seems to play the role of a policeman on behalf of the industrialized countries to ensure that neoliberal interests are further promoted.

In short, “a nation’s desperate need for short-term financial help does not give the IMF the moral right to substitute its technical judgment for the outcomes of the nation’s political process” (Feldstein 1998, 27). Martin Feldstein argues for a narrower role for the IMF. He reminds the Fund that it is the borrowers and lending banks that bear primary responsibility for resolving debt problems. The IMF should monitor the success the country is making, implement preventative strategies to avoid potential crises instead of operating as a bailout agency of international lenders and domestic borrowers. It should devote its energy to crisis prevention before economies relapse or collapse completely. As Martin Feldstein prescribes: “If the fund is seen more a client-focused and supportive organization than the imposer of painful contractions and radical economic reforms, it is likely to find that countries will be more willing to invite its assistance when it can be more helpful” (Feldstein 1998, 32-33). So much for the criticisms of the IMF, what do supporters have to say in defense of the Fund?

Defenders of the IMF argue that the world would have been worse off if the IMF had not been around for over fifty years. It is a fruitless endeavor, an idle exercise in speculation to hypothesize what the world would have been (either better or worse or different in other ways) had the IMF not been in existence. It does exist and will continue to exist even though its role, purpose, and importance might change
over the course of time. Realistically, it is not feasible to imagine the IMF to be dismantled and dissolved (as some critics from the radical camp call for) as long as it has a role to play. It does have a role to play. What might be needed is a profound reform and critical reassessment of the IMF in the modern context of the global integration.

Defenders of the IMF argue that structural components and conditionality prescriptions, which in their view lie at the heart of the crisis and are the causes of it, are necessary sacrifices to improve the borrower country's macroeconomic standing. These sacrifices help countries to gain market access and help improve growth rates in the long run. IMF defenders emphasize the Fund's role as a force for containing contagion from spreading to other countries. The IMF believes that in a world of integrated markets it has a role in containing the crisis from spreading to other countries or continents. Sensitivity and vulnerability of markets in one country could be the beginning of such contagion.

The IMF supporters believe that the structural elements need to be addressed at the first sign of crisis and the involvement of the IMF in crises through loan conditionality is critical. They defend the IMF as a balancer in offsetting disintegrative, centrifugal tendencies concomitant with economic globalization — income disparities and inequalities between industrialized and developing countries, deep social and economic dislocations, market fluctuations, capital flight, market volatility, and capital mobility. (There is subtle irony in the fact that the IMF, as a vehicle of economic globalization, causes some of these negative effects it is supposed to offset, by promoting the neo-liberal model, free market, deregulation, liberalization, and market-oriented strategies.) The IMF supporters defend the IMF-imposed structural elements as the cure for the causes of crises and the necessary sacrifices for the sustained development. In the supporters' analyses, the governments are perceived as the causes of failure, but imprudent decisions on the part of creditors and lenders are
somewhat downgraded. This concludes our discussion of the criticisms and supportive views of the Fund.

How did the IMF become such a powerful institution with a global reach and so much leverage? To answer this question, let us analyze the Fund’s genesis from its inception to the present time.

Brief Overview of the IMF's Creation, Purposes and Functions.

How Does the IMF Work? The IMF, one of the Bretton Woods institutions, was created in 1944 during the atmosphere of WWII when the need for cooperation and yearning for stability was felt by all warring countries. The destructive nationalist, protectionist policies of the 1930s, and unstable exchange rates, which led to a worldwide depression, made the states aware of the dangers of a chaotic, anarchical, and unregulated international economy. They made a choice between anarchy/chaos and stability/cooperation. The international economic environment of the 1930s, characterized by devastating beggar-thy-neighbor policies, competitive currency devaluations, harmful restrictions and asset and commodity price deflation, left deep scars on national economies and a few reminders of the devastating breakdown in the system. From the IMF's inception, the necessity for stable monetary arrangements and the resolution of balance of payments problems was strongly felt by all member-states. The general purpose of the IMF was to promote international monetary cooperation, to foster exchange rate stability, to facilitate the expansion of international trade, and help correct maladjustments in the balance of payments of member-states. The IMF came into official existence on December 27, 1945, when 29 countries signed the Articles of Agreement agreed upon at a

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13 The World Bank was its sister institution established in 1944, GATT was completed in 1947.
conference held in Bretton Woods (New Hampshire, USA) from July 1-22, 1944. The Fund commenced its financial operations on March 1, 1947.

As Alan Reynolds puts it: "...[T]he primary role of the International Monetary Fund was to foster global stability of exchange rates and prices by providing short-term financing to countries in which temporary balance of payments problems threatened to result in currency devaluations" (Reynolds 1998, 247). Kevin Danaher points out: "It ... created a reserve of funds to be tapped by countries experiencing temporary balance of payments problems so they could continue trading without interruption" (Danaher 1994, 3). It was understood by all signatory powers that above all, the IMF’s primary objective was to promote exchange rate stability as one of the key elements of stable international economic environment.

By accepting membership in the IMF, a member-state was allocating partial sovereignty to become a responsible participant in the international economic sphere, it also gained access to the Fund’s advice and funds. Against the background of the devastation and horrors of WW II, original members based their idealistic vision on the necessity for economic cooperation and stability. By agreeing to adopt stable exchange rates (fixed but adjustable par values) and currency convertibility, a state was relinquishing some of its sovereign prerogatives in favor of economic stability and cooperation. The membership in the IMF and the acceptance of its obligations, though constituting the allocation of sovereignty, were based on consent and necessity, whereby the members were actively exercising their sovereignty.

The Bretton Woods system (the International Monetary Fund, the World Bank, and GATT) was premised on the existence of rules that were designed to govern the management of exchange rates between the signatory states. Exchange rates were fixed to gold and the dollar. The limitations on the movement of exchange rates represented partial surrender of sovereignty, which translated into binding rules of conduct. This rule-based system required that governments make their
currencies freely convertible into others, and that they maintain the par value of their currencies within very narrow limits. These rules laid the foundation for stable rates between currencies (fixed par value exchange rates). Once these two objectives were achieved (currency convertibility and fixed par value currency) a member-state could draw on the resources of the IMF for financing deficits on current account balance of payments and capital accounts.

According to Article 1 of the Agreement, as adopted at the United Nations Monetary and Financial Conference, July 22, 1944, and entered into force December 27, 1945, the purposes for the establishment of the IMF included:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect to current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.
It is essential to emphasize that the breadth and the generality of these purposes ensured the institutional survivability and adaptability of the IMF as the international environment itself underwent changes and transformations. How did the Fund perform these broad tasks? The primary objective of promoting exchange rate stability was manifest in the IMF overseeing *the par value system* in which the value of a member’s currency was defined in terms of US dollars or gold. IMF members could not change the par value of their currency by more than ten percent without the Fund’s approval.

Opinions vary on the Fund’s success during the first two decades of its existence. For instance, Susan Strange believes in the limited success of the first decades:

> Only in 1959, when for the first time the European governments in concert made their currencies convertible, did the Bretton Woods “regime” begin to function. Its reign as a system of clear rules for exchange rate management lasted barely more than a decade, until 1971 when President Nixon declared the dollar inconvertible into gold and allowed the market, rather than the US government, to determine the dollar’s exchange rate with other currencies. (Strange 1997, 241)

It seems, however, that during the early years (1945-1971), the IMF’s role was narrow and its performance was quite successful in the postwar stabilization efforts. Certain weaknesses and qualifications notwithstanding, the Bretton Woods system contributed to the world’s economic growth and stability. In fact, the European countries lowered their inflation rates and reduced their balance of payments deficits.

The par value system collapsed in the early 1970s in favor of floating exchange rates, partly due to the explosive growth of global capital markets. President Richard Nixon announced that dollar convertibility into gold was suspended in favor of the markets as a measure of the value of currencies. When the pillars on which the IMF was resting collapsed (the par value system), there was doubt whether the IMF had
any future. Critics and supporters alike had doubts about IMF's diminished mandate. The economic environment underwent a profound change—from a rule-based to a discretion-based economic system. The IMF had to adapt to the changing environment with the help of innovative institutional solutions. Ironically, the drastically changed environment offered the IMF new reasons for existence. As Margaret G. De Vries describes:

In view of the requirements of the floating exchange rate system, it [the IMF] amended its Articles of Agreement extensively to update its legal authority. Its new mandate gave it an intensified "surveillance" role—it would monitor not only the exchange rate policies of members but also their domestic economic politics affecting exchange rates. (De Vries 1995, 1)

Why was the IMF able to survive, and not only that, why was it able to expand its mandate? The theory of institutionalization could be helpful in understanding the IMF's institutional survivability. Samuel Huntington in his theory of institutionalization described effective and viable institutions as the prerequisite for democratic political development. Huntington was describing governmental institutions. But his theory could be applied in the international context, in our case the IMF, an international organization. He measured the level of institutionalization by such criteria as adaptability, complexity, autonomy, and coherence. The IMF is highly institutionalized, which explains its survivability and organizational strength. The original purpose of the IMF was exhausted with the collapse of the fixed but adjustable exchange rates (par value system) in the early 1970s. Floating rates became the norm of monetary policies beginning in 1971. Adaptability (as opposed to rigidity) is one of the organizational characteristics that an organization acquires over time. The original

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purpose of the IMF as a “short-term monetary stabilizer” was expanded to a new role as a “long-term development financier”, comments Nigel Holloway. ("Doctor Knows Best", Forbes 161, April 6, 1998: 108(2)) The IMF successfully adapted to the changing environment by re-inventing an expanded role for itself, thus, exhibiting a high level of adaptability and complexity (i.e., institutionalization). By adapting to the changing environment of the first decade of the new millennium the IMF will have another chance to exhibit a high level of institutionalization. The adoption and the outcome of the reformist agenda still remain to be seen.

In the 1970s, the IMF manifested a high level of adaptability in its ability to adjust to the changing environment. Even after the collapse of the par value system, the IMF continued to exist with its newly-found expanded role. The role of a development financier became important after the wave of de-colonization in the 1960s and after the 1973 oil shock. The 1980s saw the IMF’s renaissance due to a severe debt crisis. Not only did it find new reasons for existence, it acquired increased significance. It became a crisis manager after the 1982 debt crisis in Latin America, and subsequently, it expanded its role to the lender of last resort and debt manager. In 1989 (after the fall of the Berlin Wall) the IMF acquired yet another significant role by becoming a development financier for new capitalist states of Eastern Europe. Camilleri and Falk observe:

The debt crisis, probably more than any other factor, has propelled the IMF to the forefront of international decision-making. Both Third World and Eastern European countries with sizeable debt problems have almost without exception had to rely on the IMF for emergency relief. However, to gain such relief and have their creditworthiness restored, they have had to accept the IMF’s harsh fiscal discipline. (Camilleri and Falk 1992, 95)
One of the reasons the IMF has been able to adapt to the changing environment is its institutional ingenuity and resourcefulness in creating new special facilities. For instance, when decolonized and developing countries of the Third World drew IMF's special attention during the 1960s, it introduced two new lending facilities – the **Compensatory Financing Facility (1963)** and the **Buffer Stock Facility (1969)**. These facilities were designed to offset declines in export earning caused by fluctuations in the prices of primary products. In the 1970s another lending instrument was introduced – the **Extended Fund Facility (1974)** designed for the medium-term needs of developing countries.

The oil shocks of the 1970s caused imbalances in external payments. Historically, high inflation, rising prices, and high unemployment were concomitant with worldwide recession. These circumstances expanded IMF role even further and placed it in a leadership position. Once again the IMF had to come up with innovative solutions to prevent exchange rate instability and competitive devaluations. **First Oil and Second Oil Facilities** were established in 1974 and 1975 respectively. The **Supplementary Financing Facility** was approved in 1977. **Stand-by Arrangements** was launched in 1982. A **Structural Adjustment Facility** was established in 1986. An **Enhanced Structural Adjustment Facility (ESAF)** was approved shortly afterwards in 1987.

The **Systemic Transformation Facility** was adopted in 1993. **Poverty Reduction and Growth Facility (PRGF)**, first adopted as ESAF in 1987, was enlarged in 1994 and further strengthened in 1999. It made poverty reduction its key element. Currently, 80 low-income countries are eligible for PRGF. **Heavily Indebted Poor Country (HIPC) Initiative**, adopted in 1996, is worth mentioning. According to the IMF, it is a comprehensive approach to debt relief which involves multilateral, official, and bilateral creditors. This list of regular and special facilities demonstrates the IMF adaptability as an institution to adjust to the changing environment. In short, it...
has been able to reinvent its role, its mission, and its mandate in order to adapt to the changing needs of its members as well as to the changing international milieu. And again, views on the IMF track record are divided between its supporters and critics.

The role of the IMF as a lender of last resort has put the Fund in the forefront of crisis resolution management. This function is akin to that of an international credit union. It is like paying an insurance policy: you just never know when you might need it, just in case something happened, and you needed cash in an expedient manner. However, the IMF insurance policy often has strings attached to it, called conditionality. A country is insuring itself for potential crises, in a manner of speaking, by joining the IMF. In its structure, the IMF essentially resembles a "financial cooperative", as Devesh Kapur describes it:

In principle, the IMF has a structure akin to a financial cooperative. A member country's contributions to the IMF (called "quotas") are based on its weight in the global economy. This weight also determines its voting power and borrowing capacity (called "drawings"). Quotas amount to an exchange of assets with little direct cost to taxpayers. For instance, in the case of the United States, its contributions entitle it to an equal amount of U.S. claims on other currencies. That is, just as other countries can draw U.S. dollars from the IMF in times of need (such as pressures on the U.S. dollar), the United States can draw their currencies (be it the Japanese yen or the German mark) for itself. In fact, the United States has drawn on the IMF on 28 different occasions, most recently a $3 billion drawing in 1978. (Kapur 1998, 116)

What about the IMF's contribution to the world economic system which is characterized by global financial and capital markets and the growing interdependence of national economies? What is the IMF's track record in promoting
and fostering globalization and global markets? Indeed, the IMF has functioned in an important capacity as a vehicle of globalization and global integration. According to Manuel Guitian:

Progressively integrated capital markets are the logical result of the past fifty years' worth of effort by the IMF's members to fulfill their objective, and the institution's mandate, of opening and liberalizing trade and current account balances. Open national markets for goods and services, leading to growing trade flows, could not but enhance closer financial and credit ties among trading nations, which is an essential factor behind the internationalization of capital flows. (Guitian 1995, 792)

At the present moment, the IMF continues to function in its enhanced capacity as an advisor, a surveyor, an overseer, a monitor of the macroeconomic management policies of states, and as a policeman in disciplining ailing indebted economies and financially weak states. It continues to perform the role of an intergovernmental forum, a consultant, an advisory agency, a crisis manager, a debt manager, and the lender of last resort. It continues to perform a surveillance role, which gives the Fund the mandate to appraise members' exchange rate policies and to assess the general economic situation and the policy strategy of each member. It serves as an international consulting entity that offers technical and financial assistance. The IMF is further increasing its regulatory function by becoming a sort of world policeman and disciplinarian in toughening up conditions of "bail-out" and conditionality packages.

Now the IMF is expanding its mandate by taking on a political agenda — Mr. Michel Camdessus, the former Managing Director for the IMF, announced a new enhanced role for the IMF in a Washington speech in February 1998. Economic deregulation, a war on corruption, reductions in costly military build-ups, increased spending on basic human needs, worker retraining programs, environmental
concerns, and a push for good governance are some of the items on the IMF's highly politicized agenda. It is a matter of debate whether the IMF has competence in those areas (some of them are of a political nature and arguably beyond its jurisdiction). As an institution, performing an important integrative function, the IMF is moving towards a more expanded role, by exerting not just an economic but a vast political leverage. Does the IMF have sufficient jurisdiction and a legitimate mandate in those areas? Again, critics and supporters are divided on this issue. There are a lot of sovereignty issues as well as the haunting question of economic and political coercion. These and other concerns will be addressed in the next section.

Legal Status of the IMF As an International Organization:
Theory and Practice

The IMF is a specialized agency of the United Nations. It enjoys a certain degree of independence and possesses a legal personality, which enables it to be a prominent decision-making authority in the international arena. It is able to enter into legal and binding agreements with member-states. The IMF is an international multilateral institution. It is a grouping of states, which is formed to further the members' interests by pooling their resources. The idea behind such an institution is to strengthen the whole by putting separate pieces together. The IMF is comprised of sovereign states that actively exercise their sovereignty by joining the Fund. Once it joins, a state's freedom of action (sovereignty) is limited. The IMF dictates its decisions to its members, thus, restraining their actions. In theory, the IMF is supposed to act on behalf of and represent the interests of all its member-states, not just the powerful few.

Membership in an international financial institution is an international act. It is an open, formal, consensual, and intentional delegation of sovereignty to a state
grouping. Thus, a member-state passes its sovereign sticks to the IMF as a practical necessity (which proves our earlier point that sovereignty is allocable and divisible). A sovereign state, by definition, reserves the right to withdraw its membership from the Fund, although the consequences of that might be detrimental to a state's economy, reputation, and economic standing. By joining the IMF, a member-state reduces its ability to act freely. For instance, a state may not freely alter its exchange rate to make exports more attractive and to boost economic growth. That might constitute exchange rate manipulation and gaining an unfair competitive advantage over other members.

Why join the IMF? Apart from facilitation of economic cooperation and international trade, the IMF provides international financing, which could be indispensable in different circumstances. A state determines, through a cost-benefit analysis, how much power and authority is allocated to the IMF, as the price of membership, which is weighed against the benefits and rights gained through the membership. (It should be noted in passing that a cost-benefit analysis of power allocation in the case of a Third World country could be a speculative exercise, for it could lack power, authority, and control over economic matters before it even joins the IMF).

Integration theorists hold that persons (states) adopt integrative behavior, in our case by joining the IMF, because of expectations of joint rewards and penalties. Haas postulated that "the decision to proceed with integration [i.e., to join an international entity], or to oppose it, depends upon the expectations of gain or loss held by major groups within the unit to be integrated" (Dougherty and Pfaltzgraff 1990, 438). A joining state exhibits pragmatism, it assesses pros and cons, relative benefits, privileges, obligations, and costs ensuing from the membership, weighs gains and "losses," and decides whether the membership's benefits outweigh the costs. In other words, rationalization is based on the perception of rewards in excess of costs. The costs include a subscription payment (quota), which is calculated on
the basis of economic power a state possesses as relative to other states, and the passage of sovereign sticks through the acceptance of obligations imposed on all members.

Other obligations include the commitment by each member-state to “direct its economic and financial policies towards the objective of fostering orderly economic growth” (*The IMF Articles*, Article IV, paragraph 1(i)). It is the IMF, an international entity, not the state, that determines and formulates what constitutes “orderly economic growth.” The IMF, as an overseer of economic cooperation and a facilitator of international trade, can pass judgment on a state’s fiscal and monetary policies (which constitute its national interest and welfare). The definition of “orderly economic growth” is often heavily influenced by the United States as the member with the largest subscription quota, by the neo-liberal vision, and by other powerful member-states. Another commitment on the part of joining states constitutes the agreement to avoid manipulating exchange rates in order “to gain an unfair competitive advantage over other members” (Article IV, paragraph 1 (iii)). If the IMF believes that a member-state is altering its exchange rate to gain that advantage, the state could become ineligible to use the IMF’s funds.

What are other real, tangible benefits of joining the IMF? The IMF is an influential financial institution endowed with the ability to transfer large sums of capital. A state receives a needed sum of money in exchange for the acceptance of terms and conditions as the cost of receiving capital. In theory, a state makes a conscious and free decision to obtain the capital. The state is thought to be exercising its sovereign powers by choice: expressly, rationally, and consciously. This delegation (or transfer) of sovereign powers is *multilateral* because a receiving state gets the funds from the *pool of capital provided by a grouping of states*. In practice, the role of the IMF as a lender of last resort serves as an incentive to be part of the organization when private and public lenders refuse to lend money. It is a kind of the Central Bank for
the international community for the states in distress. Furthermore, membership in the IMF is essential to be considered a full member and participant in the international arena, thus elevating a state’s status by having the IMF’s seal of approval. Membership in the IMF is nearly universal – it has 182 members as of March 2000. The IMF’s seal of approval provides acceptance and market access, which signal the green light for lenders and creditors to go ahead with lending. Now, let us analyze some of the IMF’s lending and financing practices, which is essential for a deeper understanding of the Fund’s role in the changing world. Does the IMF live up to its name as an international financial cooperative? Is it the democratic institution it purports to be? Has the international community created an institution that is attuned to all its members’ needs and expectations?

The IMF Conditionality: Limitations On Sovereignty

It is often assumed that all international law is based on consent (express or tacit). As mentioned earlier, this broad assumption of international law as consensual does not correspond to reality. It is a folly to assume that the delegation of sovereignty is always equated with or based on consent. Yes, undoubtedly, governments join international organizations and sign treaties by consent (thus, imposing self-limitations). By signing treaties and joining international organizations, states actively exercise their sovereignty, whereby they expressly consent through open international acts. Yes, states have to abide by established practices and norms of international customs, and norms and rules of conduct, which are deemed binding on them through implied consent.

But powerful economic actors (public or private) do not always seek governments’ consent (express or implied). Preceding chapters showed the extent to which globalization (particularly, technological innovation, information technologies, and economic integration) transforms comfortable landscapes and old, rigid orthodoxies.
States very often lack participation and often are just passive participants in the workings of private economic institutions, i.e., in the decisions of private investors, money managers, multinationals' executives, international portfolio managers, brokers, traders, or commercial banks. Through the power of the purse, whether with or without obtaining formal consent and acknowledgment from governments, non-state economic actors influence economic policies in the domestic and international spheres. They exert economic and financial leverage on states, which is a form of economic intervention, thereby causing shifts in financial and economic power. As a consequence, states are coerced to allocate sovereign “sticks” to powerful non-state actors.

The IMF's bail-out and conditionality practices constitute another form of economic intervention. The following discussion is premised on the idea that a state's consent is very limited in the IMF conditionality practices and loan requirements. In theory, partial delegation of sovereignty is bound to take place if a state consents to certain policies (conditions) in exchange for financial assistance. We will show that these conditions that states agree to have the nature of coercive impositions. This highly limited consent and imposing nature of loan conditions lead to involuntary surrender of sovereignty, which questions and undermines the legitimacy of sovereign national governments and the workability of IMF packages.

The IMF practices perpetuate the inferior vs. superior pattern and the divide between the developing vs. the industrialized world. These practices demonstrate a troubling “doctor-patient” dependency relationship between a receiving state and the IMF. The desperate circumstances of a debtor country trigger the application for a loan in the first place, which does not leave much room to maneuver or to negotiate. The IMF extends its help to those poor, indebted, and crisis-stricken countries to which no commercial bank or creditor is willing to lend. The helpless and hopeless nature of a loan request gives the IMF overwhelming leverage which is unduly
applied through loan conditionality. In theory, sovereign states should be able to negotiate with the IMF on the conditionality of loans, thus retaining significant authority (sovereignty) in decision-making, especially, if the IMF wants to be perceived as a democratic, not an oligarchic or dictatorial, institution. However, conditions are rigid and applied to all situations indiscriminately. Let us now discuss the mechanisms of loan conditionality.

*Conditionality* is a process whereby the IMF provides loans to countries on the condition that they pursue goals and policies under the guidance of the IMF. The IMF weighs the situation and assesses economic policies of the borrowing country to determine if financial support is warranted. Because the IMF is an influential lending agency, its approval is the green light for other lenders (private and commercial banks included) to go ahead with their loans. The effectiveness of IMF conditionality is highly contested. Here, the critics of the IMF from the Left and the Right join hands. Alan Reynolds remarks:

> There is, in fact, no commonly recognized group of IMF ‘success stories’ at all. Indeed, we have been unable to find a single example of IMF intervention unambiguously improving an economy’s performance over a sustained period, though we show many examples of countries that have made dramatic improvements on their own. (Reynolds 1998, 248)\(^\text{15}\)

Here, we take a critical approach towards conditionality practices of the IMF in view of the lack of unambiguous and unequivocal success stories. We will criticize the IMF conditionality strictures in light of the lack of considerable improvement of economic performance of debtor countries. In the final analysis, IMF conditionality

\(^{15}\)All Alan Reynolds’ quotations are taken from *Money and the Nation-State*, (where he is one of the contributors), edited by Kevin Dowd and Richard H. Timberlake, Jr., Transaction Publishers, 1998. His article (Chapter 8) is entitled “The IMF’s Destructive Recipe: Rising Tax Rates and Falling Currencies”, p.p. 247-301.
often translates into higher taxes, higher interest rates, higher unemployment, falling currencies, depressed economy, slow economic growth, accelerating inflation, stagnant and declining living standards, flight of capital, loss of investor confidence in a country's economy, and generally speaking, a freeze on economic activity. It would not be appropriate to blame the IMF for all the ills and woes that may befall a borrower country, but conditionality practices often contribute to or perpetuate the worsened economic conditions. The conversion of IMF loans into economic stabilization, sustained growth, and independence from any future IMF assistance remains but a lofty ideal. The freedom from the dependency relationship will remain but an unattainable goal unless the IMF launches the reformist agenda.

Ironically, the IMF has to accept criticism from its own staff on the perceived failures of structural adjustment reforms and loan conditionalities in the developing world. Mohsin Khan writes:

Although there have been a number of studies on the [structural adjustment] subject over the past decade, one cannot say with certainty whether programs have "worked" or not... On the basis of existing studies, one certainly cannot say whether the adoption of programs supported by the Fund led to an improvement in inflation and growth performance. In fact it is often found that programs are associated with a rise in inflation and a fall in the growth rate. ("The Macroeconomic Effects of Fund Supported Adjustment Programs", *IMF Staff Papers* 37(2), 1990, 196–222)

IMF conditionality lending is of the short-term nature, IMF performance targets must be met and loans repaid just within a few years: a typical loan is a stand-by letter of credit, which is a one-year agreement repayable in three to five years. A borrowing country is expected to reorient its economy most drastically in a short period of time and meet strict performance targets. As the empirical evidence shows, a typical IMF conditionality package causes recessionary tendencies and
contractionary economy in the borrowing country. Thus, "the performance targets must be met and the loans repaid over the short term, which conflicts with the long-term reorientation process," note Gary Woller and David Kirkwood Hart. (Woller and Hart 1995, 5)

It is short-sighted of the IMF officials to require that developing countries reorient and achieve within a few years what took industrialized countries decades to accomplish. Woller and Kirkwood Hart observe that "no other industrial or newly industrialized country has developed according to the IMF model" (Woller and Kirkwood Hart 1995, 5). As mentioned earlier, IMF conditionality practices represent a form of economic intervention. The empirical evidence indicates that strong industrialized countries influence the conditionality attached to the loans, thus furthering their own agendas. If it is not the "invisible hand" of Adam Smith that regulates national economies and markets, it is the visible hand of great powers and the IMF furthering the neoliberal economic model.

In practice, what seems to be in place is the perpetuation of a dependency relationship where debtor countries remain on the IMF patient, "sick care" list for decades without any chance of breaking the pattern. The IMF does not need to justify its existence by perpetuating this vicious circle. It should help the "sick" economies to get well by eliminating the pattern of dependency and inferiority, because whatever the future might bring, the IMF is likely to find a new purpose, and a new mandate for itself in the global economy.

A typical conditionality package includes the following requirements, which translate into the considerable surrender of crucial sovereign sticks. A traditional conditionality loan is essentially based on a macroeconomic, demand management approach, with the exchange rate, the interest rate, and devaluation as the singular principal variables. IMF conditionality is essentially a liberal (free market) model which ultimately reduces the role of a state in the workings of an economy.
1) **devaluation of the currency** (often repeated rounds of devaluations), with the purpose of reducing trade deficits, or current-accounts deficits (which translates into floating exchange rates);

2) imposition of a monetarist rule - restrictions on money creation or credit, limits on money growth and money supply (i.e. freezes on minting of money), which results in government policies that cut real expenditures and reduce real wages;

3) **budgetary austerity**, i.e. set targets for reducing government's budget deficits, cuts in government programs (essentially, social programs), *cutbacks in social-sector programs* (social welfare - health, education, food, housing, etc.);

4) **higher taxes and higher interest rates** (a policy which often negatively affects employment, investment and entrepreneurship);

5) **government wage controls** to lower real wage rates with the purpose of suppressing inflation, which in fact causes *deindexation of wages and inflation*;

6) **reduced consumer demand**, reduced consumption, contraction of demand, which translate into the reduction of purchasing power and shrinking of domestic markets. As a consequence, domestic production is replaced by imports;

7) the reallocation of resources to the *export sector*, export-oriented policies;

8) **trade liberalization through the deregulation** of domestic commodity markets, *removal of price controls*, which result in *higher domestic prices*, dollarization of domestic prices as they are brought to the world market levels, i.e., overall dollarization of national economy;

9) **removal of trade restrictions**, lowering barriers to imports, dismantling of foreign exchange restrictions and restrictions on foreign investment;

10) **deregulation of banking system**;

11) **privatization and divestiture** of state-owned enterprises;

12) **eliminating subsidies** to local industries.

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A borrowing country is faced with an overwhelming task to achieve all these requirements and goals within a short period of time. It is expected to make improvements, reform the economy, and pay back the loans all at the same time.

The cornerstone of conditionality and structural adjustment measures seems to be *currency devaluation*. The IMF's excessive emphasis and obsession with currency devaluations is almost anecdotal. Is the IMF's staff out of innovative macro- or microeconomic ideas? Alan Reynolds points out that there is "an element of irony and hypocrisy in the fact that industrial countries have condoned the IMF's habit of promoting currency devaluations among the less developed countries, since (1) the IMF was created to prevent such devaluations, and (2) the industrial countries have been trying to stabilize their own exchange rates through G-7 meetings and the European Monetary System" (Reynolds 1998, 250).

Economists and analysts have long been pointing out the IMF's one-sided macroeconomic approach to conditionality. The IMF emphasis on demand-side, *macroeconomic* variables such as the interest rate and the exchange rate shows the bias against structural, microeconomic, supply-side reforms. Vito Tanzi, the IMF Director of the Fiscal Affairs Department, commented on the IMF's bias and the detrimental effects that IMF one-sided approach could cause:

The design of adjustment programs should integrate stabilization with growth, or demand-management policies with structural, supply-side policies ... such as changes in various taxes and tax rates. ... The more far reaching the structural reform agreed to by the country, the greater will be that supply response (in terms of output, exports, capital repatriation, and the like). Such a supply response may imply that a less stringent demand-management policy is necessary. Excessive reliance on macroeconomic ceilings may divert attention away from the *quality*, as well as the *durability*, of the specific measures used. ... Work effort, exports, productive investment, savings, capital flight, foreign investment, and so on can be
affected by the choice of specific fiscal instruments. ... Sometimes countries have raised payroll taxes or taxes on interest income with undesirable repercussions on employment, saving, and capital flight. (Tanzi 1989, 15-23. Emphasis in original)\(^{16}\)

Let us now analyze in detail some of the effects of conditionality impositions on national economies. Limits on money growth and budget deficits are aimed at restraining domestic demand. Wage controls and devalued currency are aimed at making a country’s exports more competitive. But these policies often cause higher inflation and new rounds of devaluations. The reality is that in a global economy, with increasing capital mobility, some states will have a surplus on the capital accounts (which is a net inflow of foreign investment), which translates into a deficit on the current account. The IMF adjustment policy often suppresses investment through higher taxes and higher interest rates, causing the capital account to be in deficit. In its zeal to fix current-account deficits by promoting a current account surplus, the IMF causes cutbacks on investment and a capital account deficit, which unfortunately means capital flight (Reynolds 1998, 247-299). The IMF believes in its mission to improve disequilibriums in the balance of payments (which is thought to be synonymous with the balance of trade, neglecting capital flow) through devaluations. Devaluations are perceived as necessary to convert trade deficits into surpluses. Surpluses and export revenues are then recycled back to the IMF and foreign creditors and the servicing of foreign debt. Note the export-oriented strategies of the newly industrializing countries, which is an attempt to generate trade surpluses to meet strict repayment deadlines imposed by the IMF.

Alan Reynolds points at another contradiction in IMF adjustment programs: “The obsession with manipulating an economy into a trade surplus through currency

devaluation invariably results in high inflation, which makes it quite impossible to comply with IMF limits on the growth of money or credit" (Reynolds 1998, 250). In their desperate attempt to meet rigid deadlines and targets, governments impose higher taxes, which consequently translates into hikes in prices. And to put it simply — it is harder to repay the loans with devalued currencies. Furthermore, in real terms, adjustment therapy means cutbacks on social and welfare programs, it often ensures devastating consequences for the general population. In practice, it translates into high prices, falling real wages, shrinking savings accounts, dollarization of the national economy, stifled consumption, falling consumer demand, slower economic growth, and a diminishing social safety net. It seems counterproductive to attempt to cure macroeconomic "ills" at the expense of the most vulnerable portion of the population.

Conditionality impositions seem to undermine the safety net and the social contract between the government and the population, the assurance of which is one of the essential duties of the state to its citizenry. It seems ludicrous of the IMF to ask for drastic cutbacks on much-needed social programs and social protections in developing countries when industrialized countries themselves try to strengthen their safety nets in the age of globalization (take, for instance, the budget surplus and the social security debate in the United States). It could be suggested that the orthodox IMF-mandated policies seem to be overly rigid, recessionary, politically and economically unsustainable, and socially regressive. The IMF-mandated policies are often myopic to the political and economic realities of the borrowing countries. It should be pointed out, however, in fear of appearing myopic, dogmatic, and biased, that the blame for the country's predicaments could lie with poor leadership, bad actions, and unwise policies of politicians. These predicaments could only be further worsened by the IMF-sponsored shock therapies and poor policy choices of the country's leadership. Poor and ineffective leadership of a borrowing country could
be equally responsible for that country's predicaments. It only proves the point that the IMF should be more attentive to various variables and conditions which characterize the environment of this or that borrowing country. It also shows that a closer cooperation between the Fund and borrowing countries is necessary.

The IMF motto is short-term pain for long-term gain. According to this vision, the whole society will eventually reap the economic benefits of stabilization reforms. Economic benefits will be balanced out against the social costs of adjustment. But does the end justify the means? There is an inherent paradox or contradiction in the adjustment program that the IMF promotes. The current-account deficit equals the difference between investment and savings. To be effective, devaluation must boost savings by making it attractive to save or suppress investment by making it less attractive to invest (so that plus and minus would even each other out). What the IMF devaluation does achieve is detrimental — it suppresses and discourages BOTH savings and investment! Who wants to save a shrinking currency that is worth little in real terms? The public becomes unwilling (and rightly so) to hold a shrinking local currency, which in turn reduces demand for money and causes inflation (increases in prices). Devaluation causes lower investment (shrinking current and future income), loss of creditworthiness and loss of investor confidence.

Unfortunately, prospects for economic growth do not look promising with weak investment and freezes on credit. The IMF devaluation cure does not seem to heal effectively. By trying to bring about seemingly positive results, it causes even deeper dependency, inflationary cycles and perpetuates a negative lender-debtor pattern. The spirals of inflation and repeated devaluations perpetuate the debtor status. If a borrower country is not willing to make necessary sacrifices and fails to comply, it is punished. Its credit rating and creditworthiness fall drastically; official, private, and public loans are not forthcoming, in short, it is blacklisted.
We do not take issue in principle with the IMF attempting to help debtor countries get funding and reschedule foreign debt. We take issue with IMF's structural orthodoxy, with certain corrective and adjustment measures that are aimed at stabilization but in the end contribute to a country's deep social and political dislocations and economic disequilibrium. We take issue with what seems to be the IMF's bias in favor of creditors and lenders—the IMF makes sure that foreign lenders are paid first even though governments might not be totally responsible for policy failures. With increasing market integration and growing market volatility, it is ludicrous to favor creditors and lenders when they might be just as responsible for the failures.

The consequences of the IMF intervention are both economic and political. The IMF adjustment programs regulate social, economic, and political behavior of a borrower state, thus getting deeply entrenched into its sovereign realm. This interventionist framework has a deep social impact. The borrower countries forego their economic sovereignty, i.e., they lose considerable control over their fiscal and monetary policies. Furthermore, the IMF intervention bypasses the opinion of political community which is directly affected by the structural reforms.

Sovereign states subject themselves to conditionality and the IMF policing because they are indebted, because everybody else has turned them down, or because they are facing a deep crisis. However, the debt management offered by the IMF through debt rescheduling ensures that borrower countries get deeper in debt (sort of a vicious circle). According to this strategy, repayment of the principal is deferred while interest payments are enforced, debt is exchanged for equity and new loans are given to states on the verge of default or bankruptcy to enable them to pay off their interest arrears on old debts. As a result, the debt stock is increased. Only temporarily does this provide a solution to avert sovereign default. In exchange for "saving" the debtor country strict discipline is enforced through IMF conditionalities.
the IMF dictates its neo-liberal strictures in exchange for financial “rewards.” However, any possibility for an independent policy course or a unique national strategy is eliminated (and ignored), and any chance for an endogenous developmental process is reduced to an unattainable ideal.

It is a sovereign prerogative of a state to decide on the course of action in its economic and political spheres. Heavy imposition from the IMF in the form of unpopular or politically unsustainable IMF-sponsored reforms undermines the effective exercise of sovereignty. While the IMF’s “medicine” is “digested” and “re-processed” through the actions of national governments, harsh discipline, shock therapies, and austerity measures can cause a deep crisis. Moderation in the IMF’s prescription of devaluation medicine is highly advisable if governments (the IMF included) are to enjoy acceptance, legitimacy, and trust from the political community. 

Structural adjustment reforms could be detrimental to political stability, which might cause economic instability and further deepening of an economic crisis. The cause-effect relationship between the deepening crisis and the IMF-sponsored policies could be easily discerned, subjecting the IMF and national governments to harsh criticism for irresponsible actions (take, for instance, the case of Russia).

To sum up, to be perceived as the vehicle of stabilization and as a positive, constructive force, the IMF has to design new, innovative, and flexible strategies that will yield tangible results for the people directly affected by the structural reforms. It should be emphasized that we do not question the existence or good intentions of the IMF per se. We take issue with its track record, with its rigid conditionality strategies, with its one-size-fits-all approach, with the imposition of a liberal vision on all borrower countries indiscriminately, and with the imposition of harsh penalizing measures on crisis-stricken sovereign states. Is it not only democratic, the IMF being devoted to the spread of democratic values, that if the IMF imposes loan conditions and deadlines, and demands strict implementation of the structural

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reforms without deviation that it should also give some guarantee to the borrower
states that the prescribed strategies will have a chance of success? We will offer
our suggestions, recommendations, and possible alternative strategies at the end
of the chapter. Let us now analyze the role of the IMF in promoting global integration
and its role as a vehicle of economic globalization.

The IMF in the Globalized Economy

The diminishing capacity of the state to regulate national economic activity in a period of mounting
conflict in the international marketplace has strengthened the integrative function of international
institutions.

Camilleri and Falk (The End of Sovereignty? 1992, 94)

The increasing importance of international financial institutions (IFIs) is part of
the on-going economic globalization. As markets, regions, national economies, and
governments become more integrated and interconnected, the importance of an
international forum, a macroeconomic “surveillance” agency and a crisis manager,
such as the International Monetary Fund, cannot be discounted. Further shifts in
economic power away from national bases to international and global actors will
bring about profound shifts in traditional paradigms. These shifts, in turn, will affect
the degree of sovereign power that states are able to exercise. In conjunction with
the theorizing of economic globalization and shifts in the sovereignty paradigm,
thories of international integration offer helpful insights and deeper understanding
of the subject-matter at hand.

“Integration is hypothesized to be accompanied by an increase in transactions,
including trade, capital movement, communications, and exchange of people and
ideas” (Dougherty and Pfaltzgraff 1990, 443). But how do economic and political
systems gain and retain cohesiveness, and become integrated? The first explanation
could be outlined as such – political systems gain and retain cohesiveness because
of widely shared values among their members and general agreement about the framework of the system. Here the terms "procedural consensus" and "substantive consensus" are invoked to signify general agreement about the political framework and the legal processes by which issues are resolved, and the solutions to problems the political system is called upon to solve (Dougherty and Pfaltzgraff 1990, 431). The second explanation of integrative processes is based on the presence, or threat, of force. This view recognizes the importance of coercive power in the integration of political communities. In other words, this view posits the existence of relationships between conflict and the integration of political, economic, and social units.

Here, we take an eclectic approach — we distinguish between conflict (coercion) and cooperation as two basic patterns of international behavior intermittently at work, complementing and enriching each other. They are manifest in various economic, political, social, public, private, state, and non-state interactions. However, the cause-effect relationships of these two patterns do not automatically translate into international integration or integrative processes. They are not predetermined. Take, for instance, economic globalization, a seemingly integrative process, which is also characterized by conflicting, disintegrative, and centrifugal trends.

As mentioned earlier, the IMF was created at the wake of WWII, a massive worldwide conflict which wrought misery and devastation to the whole world. The world war, a conflict on a global scale, made states yearn for cooperation, which manifested itself in the conception of numerous international organizations. These new international organizations were a tribute to the growing consensus among states and the willingness to surrender partial sovereignty in exchange for the benefits of cooperation. The integrative processes following World War II were a reaction to the horrors and the unprecedented destruction of that war (however, to be followed by the Cold War and a new world conflict). They were also a tribute to a growing consensus among states. David Mitrany (the proponent of functionalism and
integration theories) noted that integrative processes were also a reaction to the growing complexity of governmental systems. He also suggested that due to growing complexity, essentially, *technical and nonpolitical tasks* (economic, scientific, environmental, social) facing governments had been greatly increased. He hypothesized that complex technical problems could be better resolved by experts as opposed to politicians who do not have specialized knowledge in those areas. The resolution of these nonpolitical problems should be delegated to experts from the affected countries. Mitrany believed that the proliferation of common problems would demonstrate the logic of interrelatedness and would require collaborative responses from states. He believed that growing transnational ties, the reduction of extreme nationalism, and international integration could increase the chances for a stable international environment.

Dougherty and Pfaltzgraff thus explain the integrative processes and the underlying complexity of technical tasks:

> The growth in importance of technical issues in the twentieth century is said to have made necessary the creation of frameworks for international cooperation. Such functional organizations could be expected to expand both in their numbers and in scope as the technical problems confronting humankind grew in both immensity and magnitude. (Dougherty and Pfaltzgraff 1990, 432)

Integration consists of the emergence of new structures that may overlay, but not necessarily replace the older ones. Integration is, essentially, a joining together of states, or other political or economic units *under a common authority to deal with common problems and issues facing each separate unit*. Functionalist and other integration theories focus on purposes and tasks performed by organizations; they emphasize an increase in the number of international organizations as a response to an increase in the number of tasks and purposes requiring attention.
International means between states, not global. It might seem a paradox that sovereign states, by joining international economic organizations, delegate partial sovereignty (willingly, by choice, by consent) to the IMF. The underlying idea is that there are certain functions and technical tasks that the IMF (or other international entities) can perform more effectively than separate states or governments (see the preceding discussion on functionalism). States pool their resources together to improve, combat, or transform certain conditions as they strive to achieve mutually agreed upon goals.

Charles Pentland noted that “international political integration is frequently identified with the circumvention, reduction, or abolition of the sovereign power of modern nation-states.” (International Theory and European Integration, 1973, 29) And again, partial delegation of sovereignty is viewed as a practical necessity in exchange for the benefits derived from increased cooperation and pooling together of joint resources. New integrated structures reflect a growing sense of interrelatedness between or among political and economic structures, and that is the essence of integration and, in the present context, of globalization.

The creation of the IMF, which was essentially designed to regulate exchange rates and promote exchange stability (a highly technical task), attributes to the functionalist theory. The successful inauguration of the IMF also attributes to the procedural and substantive consensus among the participating states. The IMF is an organization for functional collaboration, to use the functionalist term, which enjoys nearly universal membership – 182 countries (as of March 2000). It is crucial to understand that economic globalization gives rise to pressures for functional collaboration on banking, insurance, tax, wage, pricing, import-export, and monetary policies. Functionalist and integration theories are helpful in understanding forces underlying globalization. Functionalism, as an explanatory tool, focuses on schemes for cooperation and collaboration, whereas realism emphasizes conflict and
competition as a principal pattern of international behavior. In light of an eclectic approach, collaboration and conflict are complementary patterns of international behavior. The proposed eclectic approach also explains conflicting trends inherent in globalization — integrative processes and functionalist collaboration could be accompanied by pressure, competition, conflict, and coercion. Take, for instance, IMF conditionality, bail-out packages, and structural adjustment reforms that coerce countries into a drastic overhaul of national economies in exchange for financial assistance.

Paradoxically, inter-national organizations such as the International Monetary Fund and the World Bank, though comprised of sovereign member-states, serve as vehicles of economic globalization. The IMF promotes integration but also helps member-states “manage” the negative effects of globalization during the time of crises (liquidity shortages, defaults on sovereign debt, insolvency crises, debt rescheduling, etc.) The effectiveness of the IMF in the “management” of globalization has been a highly contentious issue as I have already mentioned. But the paradox underlying the IMF’s future is worth exploring — the IMF, as a vehicle of economic globalization, promotes substantial surrender of sovereignty but, simultaneously, its actual survival is premised on the existence of states.

The IMF As a Vehicle of Economic Globalization

At the heart of economic globalization lie the processes of integration between markets and national economies; growing economic interdependence; internationalization of information, finance, banking, production, economic transactions, services, and communications; lowering of barriers and easing of government controls; and the increasing volume of transactions outside government control. How significant is the International Monetary Fund in the realization of these trends? Indeed, its role should not be underestimated. The IMF fosters economic
globalization by promoting international trade, through its policies of trade liberalization and the elimination of foreign exchange restrictions, by promoting the liberalization of markets and the deregulation of national economies, by promoting the privatization of state-owned enterprises and industries, which, in short, are the tenets of a neo-liberal economic model. Free trade, perfect competition, and efficiency are the ideals of neo-liberalism; economic growth is its primary goal, where the market is the central organizing principle of human society. In short, the IMF has been regarded as a force promoting a neo-liberal model, and considerably influenced by US vision (the United States having the largest quota and the greatest voting power).

Generally speaking, the IMF plays an important role in promoting and regulating the internationalization and transnationalization of economic activity. The increasing influence of the IMF, a powerful regulatory body, could be explained by the decline in the states' economic power (economic sovereignty) to regulate their own economies. Such globalizing trends as free market pressures, liberalization, deregulation of national economies, the lowering of protectionist barriers, and the increasing interdependence and interlinking of national economies necessitate the IMF's leading role as a regulatory and integrative body. Furthermore, such negative effects of globalization as the increasing vulnerability and sensitivity of national economies, market volatility and global market fluctuations, and heightening capital mobility put the IMF in the vanguard as a powerful public safeguard institution and an international regulatory force.

The IMF's strategies, strictures, and prescriptions are reprocessed and digested through national governments in the form of domestic economic policies. Arguably, governments themselves are the vehicles of economic globalization through the imposition of conditionality measures disguised as national policies, allowing the subsequent allocation of economic power and sovereignty. Tight government capital...
controls and regulations are eroded, which ultimately translates into the partial loss of state sovereignty in the economic sphere. States participate in furthering and fostering the goals of globalization through IMF neo-liberal policies. In short, globalization efforts are realized and materialized within national territories, through national institutions, through the leadership of national governments under the tutelage of the IMF.

According to Joseph Camilleri and Jim Falk, the IMF has become an important element "of an emerging global superstructure which facilitates multilateral monetary and trade transactions." They further expand on the essential elements of the leverage the IMF is able to exercise:

The IMF and the World Bank ... were entrusted with the task of promoting the consolidation and expansion of the capitalist world economy. To this end they are endowed, by virtue of their statutes, with a dual capacity for global intervention. At one level they are able to use the substantial resources placed at their disposal by member countries to promote a particular pattern of international trade and investment, and set rules or guidelines on the form of the trade and payments regime. But at another level they are in a position to make the provision of economic assistance to member countries conditional on the latter's acceptance and implementation of their policy prescriptions. The power to withhold economic and financial assistance or cut off sources of international loans has enabled the World Bank and the IMF to exercise substantial and continuous leverage on a great many national economies. The key to their power lies not only in the financial resources at their disposal but in their capacity to influence the aid programmes of major governments and the lending policies of banks and other key financial institutions. (The End of Sovereignty? 1992, 94-95. Emphasis added)

In fact, a certain pattern of international trade and investment, a certain variant of capitalism, is being furthered or, arguably, imposed on developing countries and
countries in transition to market economy. It is certain that the IMF, as a facilitator of a neo-liberal model and as a vehicle of economic globalization, is an integral part of global capitalist infrastructure and a vehicle of global capitalism. It is hard to disagree with Michel Chossudovsky who remarks that: “The IMF, the World Bank and the [WTO] are administrative structures, they are regulatory bodies operating within a capitalist system and responding to dominant economic and financial interest” (Chossudovsky 1997, 16). The irrefutable empirical evidence seems to indicate that the IMF represents the interests of its controlling members with the largest quota shares. Thus, developing countries and countries in transition are coerced into certain patterns of trade and economic interaction, dictated by the major “shareholders”, and subsequently imposed on them by the IMF.

It seems that these powerful interests are served when the IMF facilitates debt-collection from indebted countries. The goal of the IMF as a debt collector is to make sure that foreign lenders and commercial banks are paid. Take, for instance, the 1980s debt crisis. Both creditors and borrowers shared blame for the crisis. But the IMF seemed favorably biased towards creditors, thus it was dubbed by Karin Lissakers as the “creditor community’s enforcer.” Jacques Polak commented that the institution was “being used by the commercial banks in the collection of their debts.”17

The costs of adjustment after the 1980s debt crisis were asymmetrically distributed between creditors and debtors, where debtor countries had to take on most of the debt burden. Needless to say, this debt-collector role taints the IMF’s credibility, undermines its effectiveness, and renders it undemocratic. Its ardent pursuit of a “no-debt-relief strategy” leaves debtor countries deeply indebted whereas commercial creditors reap the benefits of the IMF’s favoritism.

Another example of IMF bias is yielding to political pressures from major shareholders such as France, the US, Germany, Belgium, and such. These major shareholders can influence the IMF's conditionality packages to include their own agenda, for instance, to be more flexible in loan conditions, or to push or not to push for devaluations, when certain political or economic interests are served. The IMF's institutional flexibility to design suitable conditionality packages to serve the needs of major shareholders undermines its effectiveness, soundness, trust, and credibility. It also raises issues of viable international architecture for democratic global governance, and of effective international economic and financial management.

Another example of IMF bias is illustrative. The sentiment that financial liberalization, both domestically and internationally, is a critical part of the US agenda is well-known. That global financial markets bring high risks and high rewards is well-established as well. The IMF avidly promotes capital account liberalization under its mandate and jurisdiction, in line with the US agenda, regardless of the glaring asymmetry in wealth distribution around the globe. The promotion of unfettered global financial markets (the IMF is a vehicle of economic globalization after all) seems to be on the agenda of the IMF in line with the interests of powerful shareholders. As Devesh Kapur notes: "...since the poor have less capacity to bear risk, the IMF might have been expected to move cautiously in integrating poor countries into global financial markets, despite the high potential rewards" (Kapur 1998, 120-121).

The IMF's zeal and relentless effort to promote unfettered global financial markets, to homogenize and incorporate developing countries into global economic structures in light of glaring differences and uneven development seems economically myopic and politically short-sighted. In his neofunctionalist model, Joseph Nye hypothesized of the four conditions that influence the nature, the potential and the subsequent
evolution of an integrative scheme. Beside such integrative conditions as *elite value complementarity, existence of pluralism, and the capacity of member-states to adapt and respond*, he theorized the first condition as *symmetry or economic equality of units*. A relationship is said to exist among trade, integration, and level of development measured by per capita. Such compatibility appears to be important for regional, international, and global integration. He also hypothesized that *redistribution* is one of the conditions that is likely to characterize the integration process over time. Importantly, "central to the integrative process is the extent to which redistribution, benefiting some regions [states, members] more than others, is compensated by growth to the benefit of the unit as a whole" (Dougherty and Pfaltzgraff 1990, 444-445). In sum, as integration theories reveal, *the level of integration and the success of integration are conducive to the level of development of the integrating parts.*

As Devesh Kapur remarks: "The question is how to make openness to the world's capital markets less perilous. Although LDCs undoubtedly need to open up to the world's capital markets, they would be well advised to do so at a pace commensurate with their capacity to develop sound regulatory and institutional structures" (Kapur 1998, 124). As it stands at the present moment, the IMF has not been effective in protecting the developing countries from the full force of global financial flows. The IMF's integration efforts often resemble coercive tactics partly instigated by pressures from the powerful economic and financial interests.

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Conclusion: Recommendations For the Reform of the IMF

As mentioned earlier, the IMF has been able to justify and legitimize its mandate due to its adaptability and institutional ingenuity, which characterizes a high level of institutionalization. The year 1971 marked the beginning of an era of floating exchange rates that inaugurated the emergence of the global capital market. Critics of the IMF doomed the institution to death for being unable to fulfill its original purpose — the management of exchange rates. After the collapse of the global system of fixed par values, it seemed that the IMF was left with no clear mission, no clear purpose for existence, and no clear mandate. It displayed its institutional adaptability by re-inventing its mission, i.e., by becoming a crisis manager and lender of last resort, as well as the powerful instrument for debt rescheduling and debt repayment. The debt crisis of the 1980s (which especially hit hard Eastern Europe and Latin America) opened up a new field for the IMF by providing loans to debt-stricken countries, which gave the Fund a needed boost of energy and a new expanded mandate for its existence.

In recent years, the IMF has moved to the forefront as a crisis manager, and it will continue to play this essential role. The role of the IMF as a lender of last resort will continue to be crucial in the volatile economic environment. However, in light of criticisms expressed earlier in this chapter, it is high time that the IMF exhibited its institutional adaptability and ingenuity to better serve the needs of its “clients,” to be a constructive force as opposed to being a reactionary institution. It should change its rigid guidelines when applying the same old conditionality orthodoxy to all its borrower members; otherwise, institutional rigidity could be detrimental to its effectiveness. It should modify its American and Euro-centric (i.e., ethnocentric) approach to the rest of the world in order to live up to its mission and democratic values. One-size-fits-all approach could hardly be democratic at best.
What challenges does the IMF face at the present time? With globalization accelerating and interdependence increasing, the IMF will not be an effective institution in the changed world if it preserves the status quo. As Phillip R. Trimble notes:

As globalization accelerates, international law and institutions will inevitably be implicated. Currently, both are strongly oriented towards preserving the status quo. If they remain static, then market-driven "private" forces may come overwhelmingly to dominate the lives of the world's people. Decisions by corporate executives, bankers, currency traders, and information moguls increasingly could come to displace the decisions by governments on such matters as mortgage interest rates, the types of jobs available, the content of education, and attitudes towards family and religion. ... Perfectly responsive, democratic governments could find themselves unable to maintain healthy labor markets, a devout populace, or a safe environment because of "private" decisions outside of their control. (Trimble 1997, 1946-1947)

The global financial environment has changed, and so it has been harder for the IMF to preserve the status quo. Capital mobility and market volatility are the tangible economic realities that we have to face in a globalized economy. The threats of financial crises and instability will be present for as long as capital is mobile. With this ever-present danger of market instability, the IMF will continue to play the role of a crisis manager and the lender of last resort in a globalized economy potentially susceptible to financial crises. However, the IMF's ability to supply large amounts of capital on short notice has diminished considerably, which might require some modification in the Fund's resource management. In sum, technology (instantaneous transfer of funds across borders), demography (diversification and internationalization of funds), and the volatility of capital (hedge funds, capital flight) pose serious challenges to the IMF (just as they challenge sovereign nation-states).
It is not suggested here that markets and governments can be solely entrusted with averting international financial crises. But the IMF could be more effective in performing the double role as *an instrument* and as *a regulator* of states and markets. The 1998-1999 crises provided ample evidence that foreign financial flows should be regulated in some form or another. The crises demonstrated the dangers of the undisciplined global financial and monetary system. Market volatility becomes a reality when financial disturbances are transmitted so quickly, as the recent crises demonstrated. Due to market volatility, both markets and governments are more vulnerable and susceptible to failures and fluctuations. The IMF could be essential in diagnosing and warning against the signs of incipient crisis. In this alert-signaling capacity, the IMF should be given a mandate to insist on disclosure, accountability, and transparency on the part of government accounting as well as corporate and private banking. The IMF could be essential as a referee between markets and governments, injecting discipline in their interactions.

Just as the IMF might rely on cooperation, transparency, and disclosure from different public and private entities, the international community might expect reciprocity from the Fund. It should be more transparent when signing conditionality agreements and become less of a secretive organization. As Alan Reynolds remarks: “The IMF never makes public the ‘letter of intent’ the borrower signs, which outlines the conditionality to which it agrees” (Reynolds 1998, 248). In sum, it should be a two-way street with the IMF taking the lead, if necessary, to bring about the change.

We do not take issue with the prospect of increased international regulation *per se*, in our judgment, some regulation of anarchical financial and capital flows could be beneficial for the stability of the international economic system. With the increasing internationalization of economic activity, the IMF will have a role to guard against market excesses, unwise and irresponsible actions on the part of governments, creditors, and investors. It could serve as a buffer zone between markets and national
economies to offset market fluctuations. Thus, it should continue to perform an essential task of promoting financial and currency stability. The IMF should engage all interested parties – governments, investors, banks, creditors, lenders, money managers – in a meaningful dialogue. Interconnectedness is a fact, and it is high time that economic and financial entities, both official and private, recognized each other and share information and perceptions on risk management. Again, some regulation is needed to prevent the abuses of the marketplace. And the IMF is likely to increase its general supervisory and regulatory role in the future.

The IMF should become more of a democratic forum itself as opposed to a hierarchical institution based on the dominant rule of the industrialized oligarchy. The voting power of members is distributed according to quota shares, which are determined by a country’s economic importance, wealth, and the volume of its international trade. As a consequence, the industrialized nations (the US having the largest quota share) generally control and dictate IMF practices. Ironically, developing countries and countries in transition, who are most affected by IMF policies and who resort to the IMF’s assistance most frequently, have little say in IMF policy formulation. The distribution of economic power and influence, counted in quotas, perpetuates the pattern of inequality, the pattern of dependency between economically weak and strong states. Furthermore, loan conditionality imposes a neo-liberal vision on developing countries. That invariably eliminates any independent course of action a sovereign state (in theory, free and independent of outside influence) might want to pursue.

Our recommendation to the IMF would be to infuse the democratic process in “bail-out” and conditionality negotiations in order to give borrower countries more room to maneuver and to be able to fashion a package that would suit a country’s specific set of circumstances. As it insists on more accountability and transparency from governments and lenders, it should also be willing to be more accountable
and more responsible for its prescriptions. The continued expansion of the Fund’s mandate in the future implies that more sovereign powers will have to be delegated to the Fund. It will have to live up to its expanded role. To avoid being charged with institutional overreach, it might increase its effectiveness by including popular review and more participation from governments.

By including more conditions in loans and rescue packages the IMF takes away more decision-making capabilities and ultimately could undermine a government’s legitimacy. **Continued expansion of the IMF’s mandate should be accompanied by a commensurate increase in accountability and risk-sharing.** Otherwise, “...the absence of risk sharing means that these [loan] conditions amount to a form of political taxation without representation,” remarks Devesh Kapur. (Kapur 1998, 126)

In light of criticisms of conditionality practices, our recommendation to the IMF would be to lengthen the time for loan repayment and to give more flexibility on target performance. The IMF needs to reform its rigid conditionality orthodoxy in the absence of unequivocal “success” stories and try new approaches with different variables (supply-side vs. demand-side policies, strategies without devaluations, etc). The IMF should fashion and prescribe strategies and corrective measures that do not diminish or undermine public safety nets which protect the most vulnerable portion of the population. Indiscriminate, sweeping imposition of shock therapies does not cushion the most vulnerable against the hardships, risks, fluctuations, and uncertainties of structural reforms and globalization.

The IMF should replace its “shock therapy” approach with a more gradual, moderate approach geared at sustainable political and economic development. In short, the IMF should move away from shock therapies towards more moderate prescriptions. Surely, if the IMF wants the old loans to be paid off and at the same time improve the economic environment of developing countries, it should adopt strategies that are instrumental, conducive to success and not counterproductive.
to structural adjustment goals. The development model that the IMF is trying to further should be beneficial to all members of the society. The IMF's policies should not increase the misery and misfortune of individuals or nations that are members of the organization. In sum, it should adopt a more humanistic approach towards its borrower-clients.

It has often been the case that developing countries are forced to abandon harsh conditionality measures because they are economically and politically unsustainable. Without strong domestic support, any IMF-sponsored reforms will not last. The IMF should take into account unfavorable external and domestic conditions when formulating performance targets, and not to ignore them, as has often been the case. The Fund should base its performance targets on realistic assumptions of domestic and international conditions. It should be willing to negotiate and adjust performance targets in case of unfavorable or unforeseen circumstances. In sum, the IMF has to undergo a profound reform to become a more democratic institution whereby a receiving state would have more say, leverage, and negotiating power in the decision-making of the institution (often the strings attached to the loan are rigid, whereby a country cedes so much sovereignty that the idea of the exercise of sovereignty is rendered void). The IMF has to remember that the intervention does occur in a sovereign state which has to further its national interest and maintain legitimacy and effectiveness.

The IMF should consider applying various "recipes" depending on the circumstances of a receiving country and stay away from applying the same rigid ethnocentric orthodoxy in each case indiscriminately. It needs to move towards more flexible corrective strategies to reflect realities of a particular country (certain unique macro- and microeconomic circumstances, cultural traditions, customs, political situation, leadership, etc.). The IMF has to adopt a more flexible approach
and, if necessary, an element of cultural relativism in its analysis of each particular country.

The role of the IMF as a negotiator and a coordinator of debt repayment cannot be discounted. The IMF has become an important tool of financial diplomacy in the last two decades. However, the IMF should stop favoring creditors and lenders. The IMF should not be the debt collector for banks that are unwilling to accept a share of responsibility for their bad foreign loans. Lenders should be penalized for irresponsible lending of foreign currencies and reckless decisions. The IMF should change its approach to treating governments as sole causes of crises. It should help institute some protection mechanisms for governments that creditors automatically suffer a portion of their principal, so that the debt is not rolled over or extended, getting national governments deeper into debt. Finally, international bankruptcy laws should be instituted and ratified to protect governments and markets against the negative effects of globalization. As Devesh Kapur points out: “...there should be an international equivalent of domestic bankruptcy codes that would create a legal revenue for creditors and debtors to resolve their differences, and allow both sides to avert financial panics and to stop shirking their responsibilities” (Kapur 1998, 124). The IMF could be instrumental in taking a leadership role in that endeavor.

The IMF should be more effective in performing its “policing” function. Under the original Bretton Woods system of fixed exchange rates and restricted capital flows, it was impossible for governments to run large foreign debts and deficits. National debt had to be financed out of tangible, official reserves. In the 1980s the global capital market found innovative ways to transform debt into tradable, profit-making instruments. Saskia Sassen explains:

Because the financial markets have invented ways of profiting from irresponsible borrowing, they are not disciplining governments where and when it might count. In
the meantime, they will stretch the profit-making opportunities for as long as possible, no matter what the underlying damage to the national economy might be. (Sassen 1996, 46-47)

The IMF could be more effective in performing the “policing” function — disciplining both markets and governments, but it should avoid laying the disproportionate share of political and economic risks solely on borrowing countries.

The IMF exercises enormous leverage in the international arena based on the authority vested in it by the member-states. One may just consider the fact that the IMF is empowered to enter into legal and binding agreements with sovereign states. If current trends continue, the IMF is likely to acquire more power from borrower countries. The IMF applies pressure through conditionality packages and subsequent intervention into countries’ internal affairs. Take another instance of the IMF’s exercise of power — the case of the former Yugoslavia. After Yugoslavia’s dissolution, when the IMF declared that it “has ceased to exist”, the IMF was exercising sovereign powers in an economic jurisdiction by allocating assets and obligations to the new states.

The IMF is likely to continue to exert not just economic but political leverage, thus increasing the scope of its mandate to other non-economic areas. The IMF’s anti-corruption campaign is an example of this trend. The IMF has taken an active stance in its opposition to corruption. The IMF is now applying new policies in its lending practices to tackle corruption. In August 1996, the IMF applied this new anti-corruption policy to Kenya — a $220 million loan was suspended accusing Nairobi of failing to stop widespread bribery. The IMF guidelines generally recognize the necessity for addressing governance issues, including instances of corruption, on the basis of economic considerations within its mandate. But of course, as far as corruption is concerned, the line between economics and politics is very fine. In
short, the IMF will continue to increase its mandate by applying more economic and political pressures through its "rescue" and conditionality packages. As a result, sovereignty will be further ceded to the IMF, with or without formal consent of the sovereign states. This trend, however, raises the issues of coercion and undue interference in the affairs of a sovereign state.

On sovereignty issues, sovereign states do have the right to pursue an independent course, to choose their destiny, to mobilize national resources, and to determine what course should be taken to best serve and further national interests. Excessive intrusion on the part of the IMF into the internal workings of a sovereign state takes away autonomy and independence. It is argued that the IMF cannot supply political solutions, it is also well-known that the IMF was originally created to handle highly technical non-political tasks. I have mentioned the Fund's institutional ability to adapt. But the Fund's widening agenda makes it vulnerable to politicization and renders it less effective as an institution. The multiplicity of tasks undermines the institution's integrity and coherence, as well as "impairs bureaucratic effectiveness and erodes institutional autonomy" (Kapur 1998, 126). As a result, its technocratic reputation is tarnished, its credibility suffers, and it is accused of institutional overreach. As for the IMF, it should exercise institutional self-restraint; to be more effective, it needs to clearly define its mission and be accountable for its performance.

It is not suggested here that our recommendations will reconcile all paradoxes and dilemmas facing the IMF. For instance, what should the IMF do to reconcile its role as a vehicle of economic globalization and the facilitator of free trade with its heavy impositions through conditionality practices? The neoliberal approach the IMF fosters (or imposes through conditionalities) centers on the withdrawal of the state from economy, the minimum of government intervention, and the enhancement of the role of the market in the economy. Paradoxically, the IMF promotes globalization, free trade, liberalization of markets and economies, and the free market
approach by becoming *more intrusive* in the workings of national economies and national governments through its conditionality practices. The IMF's free market approach discourages state intervention in economic affairs, while it believes in its institutional mandate to restructure and overhaul the entire economy of borrowing countries. There is subtle irony in the fact that the facilitator of globalization, liberalization, and the free market approach should not "lead by example" by enlarging its mandate and regulatory function. We are not against greater regulation or the IMF's good intentions on principle, it is the cause-effect relationship that should be carefully reassessed. The IMF is in strong need of democratic accountability, risk, and burden-sharing. If it is taking on a greater role and an expanded mandate, it should improve its performance in general, and especially in its conditionality practices. In sum, a *structural adjustment reform* of the IMF itself should be a strong priority.
A NEW NORM OF SOVEREIGNTY

It could be suggested that a new norm of sovereignty is being realized in the changing world. The debate over sovereignty and its significance in the modern world lies deep at the heart of a fundamental debate over order vs. disorder, community vs. anarchical individualism. As an evolving institution, sovereignty is not fixed in time and space; it mirrors the changes in the world. Sovereignty reflects historical, political, legal and social realities of the time; it is context-oriented and multidimensional. Our understanding of sovereignty changes with a new dynamic in the historical context. The content and the substance of national sovereignty are being transformed due to the forces of globalization, just as our perception and theorization of the state are changing. The state and sovereignty are changing in tandem. This illustrates the transitional, variable, and dynamic nature of sovereignty. In short, it is in flux.

If decline-of-the-state theorists see the increasing irrelevance of the state as the consequence of globalization, we, on the contrary, suggest an enhanced role for the state. The state will have to take on a harmonizing function between globalization and growing disparities between winners and losers of globalization. That is a new evolving role for the state. How can the state achieve this goal? Tangible results could be achieved through a more active participation in international organizations.
and fora, and a closer cooperation with markets, although it might necessitate further delegation of sovereign authority. Stronger domestic institution will be the key to successful management of globalization. Here lies the paradox of our time, state will have to strengthen their institution to better manage globalization, while globalization itself demands further delegation of state authority to other supranational entities that can more effectively perform certain tasks.

A new pluralistic framework within the paradigm of sovereignty will have to be developed. It signifies that we will continue to look at the world through the prism of transformed sovereignty, where states will have to share power, responsibility, and legitimacy with non-state actors. The exercise of sovereignty is not just about where it is located or who holds power, it underscores the effective exercise of power. If the state can delegate some of its sovereignty to a body, which can be more effective in performing certain tasks, then we should do not decry the subsequent loss of sovereignty as something negative or detrimental. Apart from the issues of effectiveness and necessity, the issues of accountability and legitimacy will have to be addressed – who will be ultimately responsible and accountable for the actions? In the final analysis, would accountability lie with the state or could it be delegated? The ultimate challenge to the state is likely to be how to stay accountable and retain legitimacy and credibility within the changing patterns of authority. In the foreseeable future, the state will still be looked upon as the basis for public trust and the unifying force for body politic.

Globalization is thought not only to diminish the relevance of the state, but to erode sovereignty in considerable ways. But to assume that sovereignty is being eroded, lost, diminished and relinquished at this moment in history is to assume that it has been absolute until now. To assume that the transfer of sovereignty is a new phenomenon, concomitant with globalization, and only characteristic of our times is to commit fallacy. All international law requires partial delegation of
sovereignty. The transfer of sovereign "sticks" might take new forms in the modern times, but the allocation of sovereignty per se is not a new phenomenon. But the images of 'the end of history' and predictions of the death of sovereignty and the state indicate certain hysterical, apocalyptic tendencies at the beginning of the new millennium. These predictions are gross exaggerations, oversimplifications, and misperceptions of the current trends.

Sovereignty and the state are man-made institutions and fundamental human associations, which perform essential functions. The state persists and continues to matter; it is a social man-made unit, necessitated by human associations and complexities of body politic. There is simply no other entity in existence which is able to provide general welfare or to perform essential social functions, and there is no global village being formed at the present time. Though it is in vogue to speak with the vocabulary of globality, a lot of seemingly globalizing trends are still within the boundaries of the inter-national, state-to-state interactions. There is no global court, no global bank, no global currency, no global welfare institutions, and there is no economic body collecting global tax. The membership in the international community and international organizations, such as the UN, is predicated on the claims to sovereignty and statehood. The claim to sovereignty is a necessary condition for a state's recognition as an equal member. (As mentioned earlier, weak and strong states are equal in law and in their formal claim to sovereignty, but some states do not in fact rule effectively.)

As the earlier discussion showed, empirical evidence indicates that sovereignty is always limited in nature. As an ideal, as an absolute, sovereignty requires absoluteness, which it has never manifested, not even during the era of monarchical absolutism. European monarchs even during the time of absolutism had to abide by the treaties they signed and by the norms of customary international law. Louis XIV of France le Roi soleil ('the Sun King', 1638-1715) came to symbolize the
monarchical absolutism carried out to the extreme. Even the omnipotent Louis XIV who declared *L'état, c'est moi*, was restrained by domestic pressures and powerful interest groups. He had to buy the allegiance of powerful parties, interest groups, soldiers, bureaucrats, merchants with money and privileges; and popular demands had to be satisfied. By the 19th century the powers of European monarchs were checked by rising national assemblies, national constitutions, more inclusive suffrage, and the rise of the notion of popular sovereignty. Revolutions and revolts against the ruling sovereign bodies indicated the discontent of the population, and remained powerful checks on the sovereign's powers.

There has never been a sovereign body that possessed absolute sovereignty or absolute power, or ruled unchecked. There have always been some limitations and checks on sovereignty, in the form of divided and limited sovereignty, or in the form of dual sovereignty (as in a federal system). Sovereignty has never been absolute as a legal and political reality. The existence of international law and international organizations imply a partial transfer or "loss" of sovereignty. States have never been truly self-sufficing units. The complexity of political communities and states, diversification and interdependence of needs have put legal, moral, and physical limitations of the states' freedom of action. Changes in international environment and decline in the international freedom of action after WWII did not mean that sovereignty was no longer valid.

In our times, the globalizing trends and reduced economic power of the state do not render sovereignty irrelevant. Treaties, international institutions, international customary law are but a few manifestations of the so-called "erosion" of sovereignty. The state is still the main repository of sovereignty, despite the fact that it has transferred or lost some of its sovereign sticks, either by consent or not. Sovereign authority is largely about efficiency, legitimacy, competence, and the effectiveness of governments. States delegate their authority to international organizations.
because those international bodies can more effectively and more efficiently perform certain tasks in certain fields. International organizations are founded and spring into existence to serve certain needs of member-states.

The notion of absolute sovereignty implies that the state possesses absolute and complete freedom to act as it chooses. An absolutist definition of sovereignty has to be left to rest on the shelves of history. In reality, no state has possessed this kind of omnipotence. In practice, sovereignty implies that there is no superior external authority over and above the state – there is no global government or ruling body higher than a state. It is the condition in which a "collection of states, all insisting on their independence, were brought to recognize that they do not exist in isolation but are forced to live with other states" (Hinsley 1986, 226).

Towards an Eclectic and Pluralistic Theory of International Relations

An inclusive, horizontal, elastic, eclectic, and pluralistic model of sovereignty should be developed. The present developments dictate that we need to move away from describing sovereignty with such terms as "supreme", "superior", "exclusive", and "absolute". According to this inclusive model, sovereignty means a relatively independent and final authority within a fixed territory in a dynamic interdependence with other state and non-state actors. This relative independence still reserves the state the fundamental right to determine its destiny, but of course, with limitations mentioned above. Rigid and static, vertical and hierarchical understandings of sovereignty do not fit in the modern context. Sovereign states understood as supreme in power, rank or authority, and fully independent of all others is simply a fiction. Sovereign states are relatively independent of each other, but they are bound together by common interests. Sovereign actors, fully independent and autonomous, bound by no authority (temporal or ecclesiastical)
do not exist, and in fact have never existed. New rhetoric of interdependence and interconnectedness has to enrich our political lexicon.

The traditional understanding of sovereignty has to be modified. Traditional legal and political theory that holds that the state is the sole and primary actor in the international arena, and that sovereign states have an absolute authority in all matters within their territory has to be changed. A pluralistic and inclusive norm of sovereignty based on empiricism and historicism will prove a useful tool in understanding today's world. If an institution is established with the purpose and this purpose changes over time, the institution has to adjust. It has to be recognized that sovereignty is a reflection of political thought and political reality of a particular age. As Joel P. Trachtman remarked:

The state's power and responsibility depends on its ability to bring people together to get what they want... No single formula, no single definition of "sovereignty" can possibly achieve this goal. Thus, sovereignty must be dynamic and variable. (Trachtman 1994, 415)

Thus, sovereignty can be viewed either in terms of the delegation of power or the loss of sovereign sticks. A state can be viewed as actively and consciously exercising its sovereignty by allocating certain powers to other international or supranational authorities. The sovereign state thus reserves the right to withdraw its membership from such an organization if it chooses to. Or a state can be viewed as losing its sovereign sticks, without consent, if powerful non-state actors operate beyond its control, thus reducing some of its power.

The Realist model of the nation-state as the exclusive and the sole legitimate actor on the world stage has to be modified to reflect the realities of today's world. The state-centric framework that endows the state with exclusivity no longer reflects the reality. Governmental and non-governmental organizations, capital-controlling
private sector, other various state and non-state actors have to be recognized and included. The recognition and the inclusion of these various actors into the new pluralistic model is imperative for further scientific discourse. The claim that states are the only meaningful actors on the world stage is outmoded. The state will remain, to paraphrase Hinsley, *a viable working assumption about political authority* (Hinsley 1986, 216). Sovereignty will remain the foundation and the center of gravity for the maintenance of law and order in the international community, its organizing and stabilizing principle. The new model will still conceive of the state as the central organizing feature, but other meaningful players will have to be included in this pluralistic paradigm. We have to recognize that the transfer of sovereignty can happen between states, states and international organizations, or state and non-state actors. As other international and non-state actors continue to assume some of the "traditional" sovereign powers, we have to recognize the shift from a pure state-centric model to a more pluralistic model, where these other actors are recognized and included.

A stateless society remains an ideal in the *who-knows-when* future. The state and sovereignty display the signs of longevity and resilience. They are destined to play yet one of the leading parts in the on-going international drama. At this day and age, it would be short-sighted to think that we are already living in a borderless society where geographical boundaries ceased to matter. That kind of world at the current stage in history would be highly anarchical and chaotic. Though porous due to globalization, national borders still matter. As Oscar Schachter remarks:

> The critical fact is that states alone have provided the structures of authority needed to cope with the incessant claims of competing societal groups and to provide public justice essential to social order and responsibility. The territorial nexus has a profound significance beyond natural resources. Territory ... is a primordial matrix. (Schachter 1997, 22)
In the modern political and social context, the state matters, and the national still matters. As Martii Koskenniemi outlines a fundamental reconciliatory function of the state: “Within the state, the various conceptions of economic and managerial effectiveness, individual rights, or just principles, meet and find reconciliation” (Koskenniemi 1996, 28-29).

The state offers certain essentials that neither markets nor global “networks” are capable or willing to provide — the territorial state promises “an arena in which all in the defined territory have access to common institutions and the equal protection of law” (Schachter 1997, 22). Generally speaking, the state offers protection, certain privileges and benefits that non-governmental organizations or markets cannot deliver effectively. (Of course, the effectiveness of each individual state is another matter.) The state remains yet a basic structure of authority, capable of offering protection to its citizens on the basis of equity and justice. It offers a legal and political framework, an organizational and institutional structure. In general terms, the state provides order, stability, organization, and predictability as opposed to chaos, anarchy and uncertainty.

An eclectic approach to sovereignty allows to reconcile the dichotomy between political and legal theorizations of the concept. Should we view sovereignty in its totality, as monolithic and indivisible? Or should it be viewed in terms of “sticks” that can be reduced and divided? This eclectic approach is crucial in reconciling the distinction between the political and legal aspects of sovereignty. It can be reducible when we consider the political dimension and the actual exercise of sovereignty. The legal dimension of sovereignty views it as a totality when we talk about a formal claim to sovereignty.

In conclusion, in a turbulent and uncertain world, the state and sovereignty remain relevant; they remain a viable vitality in the world order. They retain relevance, substance and pertinence. Though globalization re-maps some of our familiar
landscape, the principle of sovereignty will remain the accurate logic of the modern world politics. Globalization does not doom the state and sovereignty to its imminent death unless it can be shown that new patterns of meaningful authority have emerged or are being developed. Although recent developments that have just been outlined require that scientific discourses move from statism towards pluralism, at the present time in history, sovereignty and the state serve as the foundations of the modern system of international law. Changes due to globalization notwithstanding, *sovereignty gives a meaningful and accurate description of the modern world.*

The Role of the IMF for the Future

The role of the IMF will not diminish but will increase in a globalized integrated economy. The IMF will continue to oversee and facilitate economic cooperation through its macroeconomic and, it is hoped, soon-to-be-adopted microeconomic approaches. It might eventually take on a more expanded economic jurisdiction in the performance of global surveillance in the areas of global liquidity management, interest rate stabilization, debt management, and capital and financial flows. This expanded role in the stabilization and regulation of the global economy might require enlarged resources and expanded power. The IMF will continue to play the role of *lender of last resort.* It will continue to provide financial and technical assistance, although, it is hoped, with better results. The IMF will play the role of a *mediator* between governments and markets in a globalized economy characterized by increasing volatility and high capital mobility. As a *crisis manager* and lender of last resort, it will continue to prescribe corrective strategies based on conditionality, whereby states will be forced to surrender a considerable portion of their sovereignty in exchange for financial support. Disciplinary and regulatory mechanisms at the Fund’s disposal will *continue to set limits to the scope and effectiveness of national sovereignty.* The IMF’s functions as a mediator and a *disciplinarian* will expand as
markets and national economies become more integrated, and as markets become more volatile. The IMF should continue to monitor national economies and markets more vigilantly to prevent panics, imprudent borrowing and market excesses.

It is argued that the IMF does not provide political solutions to political problems, and that it does not have any control over the quality of the state's leadership. But the nature of its conditionality tutelage puts the burden of responsibility on the IMF. It is proposed that, in the future, the IMF should expand its advisory and supervisory role when it comes to conditionality loans and their implementation. The IMF should be more actively involved in the "on-site" disbursement of conditionality loans or funds to avoid misappropriations or laundering of funds (a recent case of Russia is a sad testimonial to that effect, which necessitates IMF's direct involvement in the loan's appropriation in a borrowing country). The IMF should be more actively and directly involved in the supervision and the actual implementation of adjustment reforms in the receiving country.

Furthermore, the IMF should be more effective in strengthening domestic institutions of borrower countries if it wants its programs to succeed. Many borrower countries completely lack the institutions (banks, treasuries, tax collection agencies), necessary to implement its programs. Thus, it should play an important role in institution-building and the institutionalization of borrower countries' economies.

The IMF and a borrowing country form a sort of a symbiotic relationship through the delegation of sovereignty. The IMF cannot shirk its responsibilities when it expects a borrowing country to strictly follow up to 80 conditions and comply with all the rigid deadlines. Conditionality policies deeply affect political and social realities of the majority of the public on the receiving end. In sum, the Fund and its most powerful "shareholders" will need to take more responsibility and accountability for the decisions they make and the conditions they impose.
We do not intend to run the risk of sounding over-pessimistic or over-optimistic. We want to believe in the solubility of the problems we are facing; we do not subscribe to a pessimistic diagnosis based on the problems' intractability. Markets or governments do not always know best, but neither does the IMF. No universal cure and no universal panacea has been found. The alleged consensus on the acceptance of the neoliberal approach does not depict the full picture—economic and political coercion is a fact, imposition through loan conditionality is a fact. There is no consensus on international monetary and exchange rate policies for the present time or for the future. However, if the IMF wants to be viewed as a leader and a positive force, it needs to undergo a profound reform. It has to be sensitive, flexible in dealings with debtor countries, analyze and pay attention to a country's circumstances, and then tailor the programs that will improve, not worsen, already deplorable conditions.

A strengthened and transformed IMF will require more sovereign powers to be allocated to deal with challenges presented by globalization. More national sovereignty will be delegated (or surrendered by coercion) in the process. As a crisis manager, the IMF will be presented with the task of effectively countering the negative consequences of market-driven globalism. It will continue to play a leadership role of the watchdog in the world's monetary system because of increasing economic interdependence. It will gain more relevance as an overseer and a monitor of the world system. Its surveillance role to encourage the adoption of sound economic policies, and to foster a more orderly, stable exchange rate system will increase. But, again, the increase in power should be accompanied by a commensurate increase in accountability, responsibility, risk- and burden-sharing.

There is an urgent need for greater coordination and deeper linkages between international organizations, governments, and markets. For lack of any other regulatory financial agency with an almost universal membership, the IMF's role as...
a stabilizing force is essential. The negative strains and effects of globalization should be addressed at national, international, and global levels. The IMF could be more vocal and instrumental in this discussion, especially knowing that its structural adjustment measures deeply affect safety nets and public services. The IMF should help *strengthen the state* to deal with the negative effects of globalization; and it should help establish cost-effective social safety nets to protect the most vulnerable in an increasingly competitive environment.

Undoubtedly, the international multilateral institutions are only as good as the states that created them. Contradictions and limitations, inherent in the IMF, only mirror contradictions and limitations of the economic system and the structures of global governance that imperfect nation-states have constructed. What entity is going to *prevent* or *regulate* IMF institutional excesses and abuses? The Imperfect states themselves? For the absence of higher authority, member-states and the international community at large have to be more outspoken and honest about the state of affairs. Once again, the international community and especially the powerful industrialized countries should not preserve the *status quo*, which is characterized by the *structural divide between debtors and creditors, the rich and poor, the strong and the weak*. This structural division renders the idea of the IMF as an international cooperative ludicrous. At the present time, being the mirror reflection of the world, the IMF perpetuates the structural divide and the dependency relationship. The Fund should act promptly on its pledge to reduce (and eliminate) the poorest countries' debt burden. The implementation of debt relief programs should be the Fund’s key priority.

What about the distant future? Let us conjure for a minute that globalization will eventually wipe off all boundaries and distinctions (to use the liberal terminology) and will bring about a homogenized society. The world will witness the creation of a global village, our own Paradise-on-Earth, our own *Utopia*. The nation-states will
eventually wither away in a big global melting pot. Sovereignty will become obsolete and forgotten, only to be studied by inquisitive scientists. The existence of the IMF will be called into question, because its existence is predicated on the survival of the states. But by then it will probably be transformed into a global regulatory and supervisory entity with a global reach...

Until then, the international community has to face up to the challenges of economic globalization and change the existing status quo. The “structural” reform of the IMF could be the first step in that difficult endeavor.
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