From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World

JESWALD W. SALACUSE*

I. Introduction

The Third World consists of a disparate and amorphous group of over 120 African, Asian, and Latin American countries that together account for about seventy percent of the world's population.1 Despite their enormous diversity in cultures, political systems, and ideologies, for nearly fifty years Third World countries have shared a common declared national goal: "development." Their drive to achieve development over the last five decades has influenced broad areas of national life, including their laws and legal institutions.

The definition and focus of "development" has shifted and evolved over time. In the 1950s and 1960s, development meant simply economic growth as measured by gross national product per capita in individual developing countries.2 Later, concerns about the equitable distribution of the results of economic growth and the needs of the Third World's poor would gain an increasing place on the development agenda.3 In time, both policymakers and scholars came to see that development was not a purely economic phenomenon but that it also had social, political, and institutional dimensions, causes, and objectives.4

---

*Jeswald W. Salacuse (J. D., Harvard University, A. B., Hamilton College, Diplome, University of Paris) is the Henry J. Braker Chair of Commercial Law at the Fletcher School of Law and Diplomacy, Tufts University. This article is based on a seminar given by the author at the Institute of Advanced Legal Studies, University of London.


2. "A less developed country is simply one with real per capita income that is low relative to the present-day per capita income of such nations as Canada, the United States, Great Britain, and Western Europe." PAUL SAMUELSON, ECONOMICS 765 (9th ed. 1973).


4. See, e.g., 3 GUNNAR MYRDAL, ASIAN DRAMA 1859-78 (1968).
Since the end of the 1980s, development has become increasingly linked to the protection of the environment. As a result, government policy makers, international organizations, and scholars now stress the need for "sustainable development," which one may define as development that does not take place at the expense of future generations.5

While the concept of development has been subject to change and evolution over time, it is important to note that throughout the last five decades government policy statements, academic discussions, and practitioners' conversations have tended to use the word development in two different ways: development as a set of goals and development as a process by which those goals might be attained. In fairly consistent fashion, development as a set of goals has generally included increased economic productivity, reduced poverty, improved health, and expanded education, among others. Development as process has concerned the way of achieving national economic and social goals. The development process has particularly preoccupied policy makers, foreign assistance agencies, and academics as they have struggled to determine the interventions that would best achieve Third World development goals. Legal practitioners and scholars working in development have also been concerned primarily with the development process—specifically how law helps or hinders, fosters or hobbles, the attainment of increased productivity, better health, and higher standards of living in developing countries.6

Until the 1980s, most developing country governments, with a few exceptions, as well as many international organizations, had in mind a similar model of the development process as they went about their work. That model of how development goals should be attained greatly influenced government policies and institutions. It also profoundly affected national legal systems and the way government officials, lawyers, and legal scholars thought about law and its role in development. Since the late 1980s, most developing countries, in varying degrees, have abandoned that first model of development (Development Model I) and have evolved a new model (Development Model II) that supersedes it. This fundamental change in development models is in many ways as significant a transformation for developing countries as was the movement in the 1950s and 1960s from dependent to independent political status. This transformation is partially reflected in the change of name used to describe the Third World: the "developing countries" of the 1960s have become the "emerging markets" of the 1990s.

The change in development models raises new challenges for law, lawyers, the courts, and legal education throughout the Third World. Just as Development Model I influenced

5. The concept of sustainable development received particular impetus from the Brundtland Commission. Its report stated:

Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts:

• the concept of "needs," in particular the essential needs of the world's poor, to which overriding priority should be given; and

• the idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs.


the evolution of legal systems after independence, Development Model II is also shaping and making new demands on national legal infrastructures. The purpose of this article is to explore the implications for Third World legal systems of the shift from Development Model I to Development Model II.

Developing countries are enormously diverse in culture, economics, politics, and law. They certainly have not marched in lock step as they pursued economic development. Nonetheless, certain trends appear clear. The goal of this article is to sketch them.

II. The Nature of Development Model I

Probably all Third World countries entered the decade of the 1960s with a fundamental belief that their governments had the primary responsibility for bringing about economic development. By government, of course, one meant the executive branch, for legislatures and judiciaries in most developing countries were generally considered weak and lacking the technical expertise to play a significant developmental role.

In the minds of most officials, lawyers, and scholars, the belief in government's dominant role evolved into a definite model about the nature of the development process. This model had four basic elements: (1) public ordering and state planning of the economy and society; (2) reliance on state enterprises as economic actors; (3) restriction and regulation of private enterprise; and (4) limitation and control of the country's economic relations with the outside world. Let us consider each in turn.

A. Public Ordering and State Planning

It was an article of faith throughout most of the Third World that development would not take place unless the state planned and directed economic and social life. Policy makers might differ on the extent of such public ordering and the precise role to be accorded to private enterprise, but few persons denied the need for significant state intervention. In their view, private enterprises, groups, and organizations, left to their own devices, were incapable of bringing development to the Third World. It was up to the government, through planning, to guide and direct the various actions that would lead to development. The planning of economic and social development became a fundamental duty of the state, a duty that became enshrined in laws and constitutions. Through planning, governments


8. See id. Professor Edward S. Mason, a leading development economist of the day, summed up the prevailing attitude: "The plain fact is that throughout the underdeveloped world, the pressures for economic development are all but irresistible. A government that fails to seize the levers of economic development, or at least make the attempt, is probably not long for this world." EDWARD S. MASON, ECONOMIC PLANNING IN UNDERDEVELOPED AREAS: GOVERNMENT AND BUSINESS (1958).

9. "The state alone was credited with the ability to think and act in the long term interests of its citizens." Corbridge, supra note 3, at 3.

10. For example, Turk. Const.(1982) art. 166 provides:

The planning of economic, social and cultural development, in particular the speedy, balanced and harmonious development of industry and agriculture throughout the country, and the efficient use of natural resources on the basis of detailed analysis and assessment and the establishment of the necessary organisation for this purpose are the duties of the State.

Measures to increase national thriftiness and production, to ensure stability in prices and balance in foreign trade transactions, to promote investment and employment, shall be included
determined which economic sectors were to receive favorable treatment, how credit was to be allocated, where investments would be made, what economic targets the private sector was to attain, and even what prices were to be paid for commodities and products.  

The nature of the planning process varied from country to country. In some, like Algeria, state economic plans were highly directive and had the force of law;  

in others, like Mexico, development plans were merely indicative, general guides to decision-making. Whatever the nature of planning, all governments—Marxist and non-Marxist alike—seemed to agree that economic development could not take place without proper state planning. "The truth is," wrote Arthur Lewis, who won the Nobel Prize for his work in development economics, "we are all planners now."  

As a result of this belief, Third World governments created planning ministries, departments, and institutes, and they devoted significant material and human resources to the preparation, adoption, and supervision of planning documents, which in most cases took the form of a multi-year development plans. Foreign aid agencies and international organizations provided large amounts of support in an effort to make development planning efficient and effective.

B. RELIANCE ON PUBLIC SECTOR ENTERPRISES

Not only was the economy to be shaped and controlled by government policies and actions, but government was also to be the primary economic actor in many sectors. In order to implement state economic plans, most countries vastly expanded their public sectors, creating numerous government corporations and public enterprises to carry out all sorts of economic activities from insurance and transportation to manufacturing and retail sales. Both officials and scholars judged this expansion necessary if development was to take place, since the private sector in most developing countries was small, lacked adequate financial resources and technical expertise, was unresponsive to state needs, and in many cases was controlled by foreigners or government opponents. As Harvard University's Professor Edward Mason, a leading development economist of the day, wrote in 1958, "... development plans in general evince little confidence in the capacity of private initiative and the free market to do the job."  

In many cases, governments created completely new

in the plan; in investments, public benefit and requirement shall be taken into account; the efficient use of resources shall be aimed at. Development activities shall be realised according to this plan.

The procedures and principles governing the preparation of development plans, their approval by the Turkish Grand National Assembly, their implementation and their revision, and of the prevention of amendments liable to affect the unity of the plan shall be regulated by law.

15. See generally Lewis, supra note 11; Keith B. Griffin, Planning Development (1970); Richard L. Meir, Development Planning (1965); Jan Tinbergen, Central Planning (1964).
16. Mason, supra note 8, at 43.

VOL. 33, NO. 4
public enterprises; in others, they expropriated private companies, both national and foreign-owned, to establish them.\footnote{17}

C. RESTRICTION AND REGULATION OF THE PRIVATE SECTOR

A consequence of state planning and reliance on public sector enterprises was increased, massive regulation and restriction of the private sector.\footnote{18} In order to direct the private sector toward the achievement of pre-determined developmental goals, Third World governments subjected private enterprises to pervasive regulation on such fundamental matters as investment, prices, currency exchange, trading operations, business formations, technology transfers, and wages and salaries of workers. The private sector could undertake few activities without first obtaining permission from a planning ministry or other government department.\footnote{19} The systems that emerged seemed based on a fundamental legal principle: no economic activity was to be permitted unless the state had specifically approved it. The pervasiveness of regulation was so great in India, for example, that business executives came to call the country the “License Raj.”

D. RESTRICTIONS ON FOREIGN INFLUENCES IN THE ECONOMY

Developing countries in the 1960s and 1970s not only sought political independence, but they also demanded economic independence. Accordingly, they adopted policies of “self reliance,” expropriated foreign investments, promoted “import-substitution industries,” restricted the inflow of foreign capital and technology through heavy regulation, and curtailed the import of foreign goods through high tariffs and rigorous exchange controls.\footnote{20} For example, annual nationalization of foreign-owned property grew steadily from 1960 and reached its peak in the mid-1970s.\footnote{21} The basic thrust of these measures was to restrict foreign influences on developing country economies and to control economic interactions with the outside world. The drive for economic independence also led many developing countries to create their own steel mills, automobile plants, and airlines despite the fact that they did not have the markets, finances, or technical expertise to support them. The


\footnote{18} With regard to this phenomenon in Latin America, see Sebastian Edwards, Crisis and Reform in Latin America 175 (1975). For Egypt, see Jeswald W. Salacuse, Back to Contracts: Implications of Peace and Openness for Egypt’s Legal System, 28 AM. J. COMP. L. 315 (1980).

\footnote{19} With respect to Pakistan, see Clair Wilcox, Pakistan, in Planning Economic Development 52, 68 (Hagen, ed., 1963).

\footnote{20} For a discussion of legislation and regulation enacted by East African states to reduce foreign influence in their economies, see Pavlo Sebalu, East African Community, 16 J. AFR. L. 345, 360 (1972). “In the recent past, the most significant developments which have affected the growth of the community have been: (a) measures by the Partner States to remove the control of the economy from the hands of non-citizens and putting it into the hands of citizens or of the state by nationalisation [sic] or State trading Corporations; (b) exchange control . . . ” Id. See generally A. M. Akimuni, A Plea for the Harmonization of African Investment Laws, 19 J. AFR. L. 134 (1975) (discussing numerous examples of governmental interference with foreign economic activity).

Third World became littered with inefficient and unprofitable public enterprises permanently dependent on government subsidies for their continued existence.

III. Implications of Development Model I for Third World Legal Systems

The choice of Development Model I by many countries not only affected their economies, but it also influenced their legal systems. First, Development Model I, with its emphasis on state planning, public ordering, and heavy regulation, relied heavily on public law to achieve its objectives and accorded private law only a limited role in the development process. More fundamentally, it led governments to see law's basic purpose as bringing about desired social and economic change, rather than merely setting down the rules within which persons and organizations would conduct their economic and social activities in accordance with their individual interests. Implicitly or explicitly, governments and scholars seemed to believe that law was a tool for social engineering; therefore they embarked on programs of legal reform whose goal was to abolish certain social and economic practices and institute new ones in their place.

Even when governments undertook to reform private law, their goal was not usually to codify existing practice but rather to bring about change that accorded with developmental goals. The 1950s and 1960s witnessed the enactment of a spate of new codes and laws whose basic thrust was to change family structure and land tenure patterns, two areas seen as keys to social and economic change. For example, Tunisia in 1956, under its then President Habib Bourgiba, introduced the Code of Personal Status, which outlawed polygamy, granted new rights to women, and made judicial divorce the exclusive means to dissolve a marriage, leading one noted Islamic law scholar to label it as "...that most radical document of modern Islamic legislation." The late Professor Rene David, an eminent comparativist who drafted a civil code for Ethiopia based on European law with little reference to the customs of the Ethiopian people, justified these legal experiments by declaring: "The African Revolution needs to be brightened by a program bestowing the order and the rules of society that Africa wishes to install." Nearly all Third World countries have dualist legal systems consisting of traditional law based on indigenous institutions and practices and "modern law" derived from a former colonial ruler. During the era of Development Model I, Third World governments generally gave little role to indigenous law and traditional legal institutions in their development planning and in some cases sought to suppress them. At best, governments of the day viewed traditional law as unimportant; at worst, they considered it an impediment to modernization and national unity since in most cases it was based on ethnicity, religion, or tribal custom.

Second, as a result of the growth of public law and regulation on everything from the price of rice to the ownership of land, the state increasingly limited the individual's freedom

of contract. Development Model I generally called for restricting the private ordering of transactions. In the middle of the nineteenth century, Sir Henry Maine, the great English legal historian, perceived the history of civilized society as a “movement from status to contract,” as individuals rights were determined less and less by the status of their birth and more and more by agreements which they made.26 Viewing the growth of state economic regulation in the 1950s and 1960s, Professor Robert Seidman, a long-time observer of the Third World, saw a movement from “contract to plan,”27 a shift from private ordering to public ordering of economic and social activity.28

Third, in order to implement Development Model I, many Third World governments enacted legislation to weaken the institutions of private property and to endow the state with increased power over land and natural resources. Unrestricted private property was seen as an obstacle to national development. In addition to expropriating foreign and national economic interests, developing country governments passed laws to limit the individual’s right to own and use land29 and declared the state to be the ultimate owner of all lands and natural resources.30

During the era of Development Model I, a plethora of new laws and regulations mushroomed where none had existed before. Public enterprise laws, foreign investment codes, currency control regulations, nationalization decrees, land tenure and use legislation, and price regulations, to name just a few, filled the law books, and became the fundamental preoccupation not only of government officials, but of lawyers and legal scholars as well. This new public law, not the commercial code, became the basic law of economic and business activity in the Third World.

At the constitutional level, Development Model I required a strong national executive endowed with expanded powers and unfettered by the constraints of accountability to other branches of government.31 Increasingly, developing countries expanded the powers of their presidents, instituted one-party systems, and relegated the roles of their legislatures to approving executive decisions. In many parts of the Third World, the military, in the name of development, swept aside civilian governments and seized virtually absolute power.32

Throughout the Third World, the courts had only a limited role in the legal orders shaped by Development Model I. Indeed, in a variety of ways both direct and indirect, developing country governments sought to weaken the independence of the judiciary and make it clear that the court’s basic function was to support the executive in its all important

29. For example, in Egypt, shortly after the Free Officers’ Revolution of 1952, the Nasser government expropriated and redistributed all land holdings in excess of 200 feddans (i.e., slightly more than 200 acres), prohibited any future ownership of land in excess of that amount, and set maximum rents and minimum terms on tenancies for agricultural land. See SAAD M. GADALLA, LAND REFORM IN RELATION TO SOCIAL DEVELOPMENT IN EGYPT 31–45 (1962).
30. For example, Law No. 64–46 of June 17, 1964, J. O., July 11, 1964, p. 905, declared all unregistered lands, an area comprising over 95 percent of the country, to belong to the state.
32. See, e.g., BENJAMIN O. NWABUEZE, A CONSTITUTIONAL HISTORY OF NIGERIA (1982).
task of pursuing development. At the same time, the ranks of government lawyers increased substantially to draft, interpret, and apply the new law and regulations, while the private practice of law in some countries stagnated as a result of government opposition and the loss of private clients from nationalizations and expropriations.

Lawyers and legal scholars generally did not challenge Development Model I or question its impact on the legal system in their countries. Rather, they tried to determine how they, through their skills, teaching, and scholarship, could best support it. Their efforts gave birth to a new field of legal inquiry and action, "law and development," whose aim was to determine how law might contribute to the processes of economic and social development in the Third World. In time, critics challenged the work of the law and development movement, pointing to the failure of many efforts at legal change to bring about development. They argued that the cause of the failure lay in practitioners' lack of understanding of Third World societies and the nature of the relationship between law and development. While this criticism was valid in many instances, another cause of these failures may also have been the inadequacy of the prevailing development model that drove many of the law and development efforts of that period.

IV. The Emergence of Development Model II

By the mid-1980s, Development Model I was beginning to lose its hold on the minds and actions of policy makers, aid agencies, and international financial institutions. Several reasons explain this loss of influence. First, Development Model I had quite simply failed to bring about development. By the 1980s, the economies of most developing countries were stagnant, burdened with enormous debt, and saddled with inefficient public enterprises requiring constant government subsidies. As one high ranking Asian official who had formerly been a strong advocate of Development Model I explained: "We have painfully learned that the state can not do everything. It can not house everyone, feed everyone, or give everyone a job. We need to let other institutions in society do these things." Whereas the perceived failures of the market in the 1950s and 1960s had argued for the strong state

---

33. For example, in a speech to Algerian judges in 1969, President Houari Boumedienne declared that whereas the European judiciary had traditionally seen itself as the protector of the interests of the individual, the Algerian courts were to play a far different role. Instead of acting as the monitor and potential antagonist of the government, the Algerian judicial system was to be "an instrument for the realization of the revolution and for its consolidation." President Houari Boumedienne, Speech to Algerian Judges (Sept. 19, 1969), in Vi Revue Algerienne Des Sciences Juridiques, Economiques et Politiques 1239-45 (1969). The Nigerian Military Government took a more direct approach to controlling the judiciary by enacting the Federal Military Government (Supremacy and Enforcement of Powers) Decree, 1970, which provided:

Any decision, whether made before or after the commencement of this Decree, by any court of law in the exercise or purported exercise of any powers under the Constitution... which has purported to declare or shall hereafter purport to declare the invalidity of any Decree or Edict... or the incompetence of any of the governments in the Federation to make the same is or shall be null and void and of no effect whatsoever as from the date of the making thereof.

See NWABUEZE, supra note 32, at 207.

34. For a discussion of this phenomenon in Egypt after the Revolution of 1952, see FARHAT ZIADEH, LAWYERS, THE RULE OF LAW AND LIBERALISM IN MODERN EGYPT 159 (1968).

35. See Trubeck, supra note 25, at 1091.

36. See Merryman, supra note 6, at 457-83.

intervention implicit in Development Model I, by the 1980s the attention of practitioners and scholars was on the failures of the state. The second major reason for the abandonment of Development Model I was that powerful external forces were insisting upon fundamental changes in Third World economic policies, often as a condition to financial and developmental assistance. The World Bank, the International Monetary Fund, western bilateral aid agencies, and international commercial banks advocated a set of new policies, known as the "Washington Consensus," which required the elimination of budget deficits, strict control of the money supply, privatization of state-owned enterprises, and an openness to international trade and investment. Together, these policies represented a new model of development, Development Model II.

Third, the end of communism in Eastern Europe and the Soviet Union in 1989 deprived many developing countries of sources of moral and material support for Development Model I. The Soviet and Eastern European systems had stood as examples of what many Third World countries hoped to achieve through state intervention, but the collapse of those systems in 1989 represented an undeniable failure of Development Model I. After 1989, the states of Eastern and Central Europe sought to build market economies and began calling themselves "emerging market countries," a label that many Third World nations would also adopt as they abandoned Development Model I for Development Model II.

Finally, the successful example of certain high-growth Asian states that had avoided many of the elements of Model I, particularly its restrictions on foreign capital and private enterprise, also prompted a search for a new approach. This search ultimately led to the formulation of a new model of development: Development Model II. The elements of Development Model II are in many ways the exact opposites of those in Development Model I. Let us consider the four most important ones.

A. RELIANCE ON MARKETS AND PRIVATE ORDERING

Acknowledging the failure of state planning, many developing countries, in varying degrees, turned to markets as mechanisms to allocate society's resources. Thus, decisions on investments, commodity prices, and credit allocation were increasingly to be made by private actors in the market rather than by bureaucrats in government agencies and state planning departments. Whereas approximately one billion persons lived in market economies in 1985, by 1995 that number had quintupled to five billion people.

39. The term "Washington Consensus" is said to have been coined by John Williamson, a U.S. economist in 1989. It consisted of ten broad reforms: (1) fiscal discipline; (2) reordering public spending priorities away from politically powerful groups, such as the military, and toward basic services and infrastructure; (3) tax reform; (4) financial liberalization; (5) competitive, stable exchange rates; (6) trade liberalization; (7) reduction in barriers to foreign investment; (8) privatization of state enterprises; (9) deregulation; and (10) property rights reform. See Stephanie Flanders, A New Washington Consensus, FIN. TIMES, Mar. 14, 1997, at 2.
40. For many developing countries, the example of their former colonial rulers may have been more influential than the example of the Soviet Union in leading them to adopt Development Model I. The colonial system incorporated most of the elements of Development Model I. The new governing elites after independence took control of that system and adapted it to achieve development, their primary national goal.
Development Model II de-emphasized state planning and heightened the role of markets in the economy. One symbolic manifestation of this change has been the fact that Third World nations increasingly chose to call themselves "emerging markets" (a term originally coined within the international financial community), rather than developing countries. More concrete consequences of this change have been the elimination or political down-grading of planning ministries, the abolition of fixed rates of exchange and the adoption of floating currency exchange rates, the allocation of credit and loans to businesses through the forces of supply and demand and credit worthiness (rather than by government decision and political influence), the elimination price controls, and the growth of capital markets.

B. PRIVATIZATION

The Third World's emphasis on the public sector to develop its economies resulted by the 1980s in a plethora of inefficient state enterprises whose existence depended on continued government subsidies. Their governments, prodded by international financial institutions, concluded that the only answer to the problems posed by public enterprises was to sell them either wholly or partially to local and foreign private investors. This transfer of assets from the public sector to the private sector, from the domain of public ordering to that of private ordering, is known as "privatization." Developing countries undertook privatization for a variety of reasons, including the elimination of state subsidies to inefficient government enterprises, the relief of governmental budget deficits through proceeds from the sale of public enterprises, the reduction of foreign debts (which in many instances had been caused by public sector growth), the improvement of inefficient state-owned enterprises by subjecting them to private sector management and discipline, and the desire to foster the development of a market-oriented private sector.

The extent of privatization in the Third World has varied from country to country. In many nations, it has been rapid and massive. Between 1990 and 1994 alone, proceeds from privatization by developing countries as a group totaled over $100 billion. By 1996, over 100 countries had privatized some of their state-owned enterprises, and annual revenues received from the sale of these assets in 1994 and 1995 were running at a rate of approximate $80 billion. This major transformation has led to the creation of vast numbers of new private enterprises, numerous publicly traded companies, and many stock markets throughout the Third World. For example, whereas total capitalization of developing country stock markets in 1985 was less than $250 billion with less than 9,000 listed companies, by 1995, 19,000 companies were listed on emerging market stock exchanges with a total capitalization of nearly $2 trillion. At the same time, acts of expropriation, which had been so prevalent in the 1960s and 1970s in developing countries, have virtually ceased.

42. In 1975, 87 percent of developing nations had some type of fixed exchange rate. By 1996, the proportion had fallen below 50 percent. See FRANCISCO CARAMAZZA & AZIZ JAHANGIR, FIXED OR FLEXIBLE? GETTING THE EXCHANGE RATE RIGHT IN THE 1990s 2-3 Int'l Monetary Fund, Economic Issues No. 13, 1998 (visited Sept. 25, 1999) <http://www.imf.org/external/pubs/ft/issues13/index.htm>. The authors point out that when one accounts for the relative size of economies, the shift from fixed to flexible exchange rates is even more pronounced: "In 1975, countries with pegged rates accounted for 70 percent of the developing world's total trade; by 1996, this figure had dropped to about 20 percent." Id. at 3.

43. See Guislain, supra note 17, at 16-20.
44. See CHART ECONOMIST, Mar. 23, 1996, at 106.
45. See Guislain, supra note 17, at 1.
C. DEREGULATION

The pervasive regulatory systems required by Development Model I eventually came to be seen not as a means of directing economies toward growth, but as obstacles to economic activity and development. For example, the Peruvian economist Hernando De Soto examined the regulatory system in Peru and concluded that law was imposing such high costs on legitimate economic activity that economic actors were forced to operate outside the law in the "informal sector." For De Soto and others who studied the problem, regulation in the Third World had become a brake on development. Not only did it thwart economic initiative, but it also permitted elites and oligarchies to exploit the poor and created significant opportunities for governmental corruption by bureaucrats who had gained a monopoly on awarding valuable permits, licenses, and authorizations.

The abandonment of Development Model I, the consequent reduction in state planning and the new reliance on private ordering and private actors in the economy necessitated a reduction in economic regulation. Developing countries eased or abolished many of the regulations enacted during the era of Development Model I. Mexico, for example, appointed a "deregulation czar," reporting directly to the President and Council of Ministers, and his efforts served to accelerate the process of Mexican reform. Price controls, exchange controls, and business licensing requirements have become less pervasive under Development Model II than they were under Development Model I. Many countries, abandoning one of the fundamental principles of Model I, seem in varying degrees to be moving toward a new basic legal norm: all economic activity is permitted unless specifically prohibited.

D. OPENING ECONOMIES

The economies of developing countries in this new era have exhibited a new openness to the rest of the world, particularly with regard to trade and investment. The failure of closed economies and economic self-reliance to bring about increased standards of living, improved health conditions, and other development goals, coupled with a need for new capital and advanced technology, have led Third World countries to adopt a more open and outward orientation toward the rest of the world.

Import substitution as a policy has yielded to export orientation, and tariffs on imports have been reduced. The result has been an expanded role for foreign trade in the Third World. For example, whereas exports and imports accounted for thirty-three percent of developing country gross domestic product in the mid-1980s, by the mid-1990s they amounted to forty-three percent of the GDP. Although many, if not most, Third World governments tended to emphasize the need to control foreign direct investment in their laws and policies during the 1960s and 1970s, today nearly all have moved in the direction of actively promoting foreign investment in their territories. They have come to see foreign investment not as a threat to their economic independence but as a means for obtaining

49. See World Development Report, supra note 7, at 63.
the capital, technology, management skills, and links to the world market that are necessary for development but which their countries often lack. While direct foreign investment (valued in 1996 dollars) amounted to less than $20 billion in 1987, developing countries received nearly $120 billion in 1996. Foreign portfolio investment in Third World stock markets has also grown dramatically.

The above-cited statistics do not fully reveal the new and enhanced role of private foreign capital as a source of development finance in the Third World. In 1982 foreign direct investment in developing countries accounted for only about eight percent of total external flows (with portfolio investment at an insignificant one tenth of one percent); in 1996, out of all external financial flows to developing countries, nearly forty percent consisted of direct foreign investment, with portfolio investment accounting for an additional sixteen percent. Private direct foreign investment thus became the largest single source of external development finance for developing countries. By contrast, official development finance fell to only fourteen percent of the total financial flows to the developing world in 1996. The 1990s witnessed a new willingness by developing countries to engage the rest of the world in new ways and to participate actively in the global economy.

The change from Model I to Model II has by no means taken place uniformly and completely in all developing countries. Public enterprises, state planning agencies, and heavy regulation continue to exist in varying degrees. Models are, after all, merely intellectual constructs and simple theoretical patterns; they are not reality. Nonetheless, the last decade has witnessed a significant policy reorientation throughout the Third World. As a group, developing countries, by virtue of these major changes in policies, have made a significant shift in development models, a shift that may be represented as follows:

<table>
<thead>
<tr>
<th>DEVELOPMENT MODEL I</th>
<th>DEVELOPMENT MODEL II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>From:</strong></td>
<td><strong>To:</strong></td>
</tr>
<tr>
<td>2. Reliance on Public Enterprises</td>
<td>2. Privatization</td>
</tr>
<tr>
<td>3. Pervasive Regulation</td>
<td>3. Deregulation</td>
</tr>
</tbody>
</table>

V. Implications of Development Model II for Third World Legal Systems

The shift from Development Model I to Development Model II has important implications for Third World legal systems. First, the idea that law is a tool for social engineering and that legislation can bring about sweeping change in human behavior is much less prevalent now than it was thirty years ago. Developing countries are no longer seeking to "brighten their revolutions" with radical codes and laws. Instead, law has become a set of

51. See id. at 63.
52. See INTERNATIONAL FINANCE CORPORATION, FOREIGN DIRECT INVESTMENT: LESSONS OF EXPERIENCE (No. 5) 10 (1997).
53. See id. at 15.
54. See id.
rules within which persons and organizations conduct their affairs. Rather than relying on coercive pressure to bring about change, as was so common in early days of the development era, the law now tends to employ incentives to affect behavior.\(^5\)

A second major consequence of the shift is that Model II represents a movement from plan back to contract, from public ordering to private ordering of economic activity.\(^6\) Organizations and individuals have gained increased legal freedom to arrange transactions through contract. Conversely, the form and substance of economic transactions are less and less mandated by governmental regulations and directives. Of course, this new emphasis on markets and private ordering has meant a heightened role for private law in the economy, and the need for a private law system capable of sustaining sophisticated business and market transactions.

Central to this process have been efforts to strengthen the recognition and enforcement of property rights and the enhancement and liberalization of the law of contract.\(^7\) In the view of policy makers and officials pursuing Model II, an effective property rights system supports economic growth and wealth creation by rewarding effort and good economic judgment by actors in the market. A wide distribution of property rights within a society can also contribute to social stability by counteracting excessive concentrations of power in the political system.\(^8\)

For many developing countries that had either allowed private law to languish or actively sought to limit its application during the era of Development Model I, the need for wide-ranging law reform and new legislation has become paramount. With the advent of Development Model II, many developing countries, often with the help of foreign advisers, have undertaken legal reform programs to write new commercial codes, company laws, and land laws. They have also worked to pass legislation on secured transactions, bankruptcy, stock exchanges, competition, and taxation.\(^9\)

In addition to an enhanced role for private law, Development Model II requires a new approach to regulation. While "deregulation" is one of its basic elements, Model II does not demand the end of all regulation. Regulation of markets and private transactions is necessary to be sure that the rules of the game are clear and that the private players abide by those rules and play fairly. The concern in many developing countries to enact anti-competition legislation and insider trading and stock market rules are examples of the kinds of regulation required by Development Model II.\(^60\) Markets as means of allocating society's resources require a minimum level of regulation not only to protect participants but to maintain society's confidence in those markets as fair and efficient resource allocators. Whereas the role of regulation in Model I was essentially to direct transactions in particular ways that the government judged necessary, the role of regulation in Model II is to protect participants in the market from fraud, coercion, and abuse by other participants. Model II

---

6. For an examination of Egypt's early movement in his direction, see generally Salaçuse, supra note 18.
8. See World Development Report, supra note 7, at 49.

WINTER 1999
implies a shift in focus from directive regulation to protective regulation, from governmental marching orders to defensive governmental oversight.

The shift from the closed economies of Development Model I to the new openness of Development Model II has also resulted in much greater participation by developing countries in international legal arrangements, many of which they had previously avoided or resisted. Thus, the number of Third World countries participating in bilateral investment treaties, the World Trade Organization, the International Centre for Settlement of Investment Disputes, and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to mention a few, has grown dramatically as a result of the new openness required by Development Model II.

New legislation and treaties alone are not sufficient to make the transition from Model I to Model II. Developing countries also require institutions capable of supporting and applying the new legislation. In particular, the judiciary, the neglected or suppressed institution of Model I, is crucial to making Model II work. In a market economy, the courts become the final arbiters of conflict among private actors in the economy, a role played to a significant extent by bureaucratic institutions in a Model I economy dominated by public sector enterprises. Moreover, the courts also assure that government officials obey the law and stay within the bounds of discretion accorded them by legislation. The proper functioning of markets and the private sector necessitate the existence of clear rules that will be respected by government as well as private actors. In short, the effective and efficient markets envisaged by Model II require "a Rule of Law," and the courts are essential to its existence.

For courts to play the role required by Model II, many developing countries, often with foreign assistance, have undertaken judicial reform programs to strengthen the indepen-

61. As of the end of 1996, 1,300 bilateral investment treaties had been signed, all of which involved at least one developing country. Two-thirds of this number had been concluded in the 1990s, i.e., after the abandonment of Model I. See Kenneth J. Vandevelde, Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties, 36 COLUM. J. TRANSNAT'L L. 500, 503 (1998).

62. As of December 20, 1998, 133 states, the majority of which are developing countries, were members of the World Trade Organization. By contrast, at the time of the Kennedy Round of GATT negotiations (1964-67), only 62 countries participated in the GATT, the predecessor to the World Trade Organization. See WTO: About the Organization Members (visited Oct. 11, 1999) <http://www.wto.org/wto/about/organsn6.htm>.

63. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, opened for signature Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159. As of 1998, 144 states had signed the convention and 129 had ratified it. See INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, 1998 ANNUAL REPORT 4 (1998). In 1984, by contrast, 90 countries had signed and 86 countries had ratified the convention. See INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, 1984 ANNUAL REPORT 6 (1984). The increase in membership is largely attributable to developing countries. Of particular interest is that the 1990s witnessed many Latin American countries, such as Argentina, Chile, Columbia, Peru, and Venezuela joining ICSID, thus overcoming the strictures of the Calvo doctrine (yet another manifestation of the drive for economic independence) which had previously caused them to refrain from participating in international arbitration arrangements.


ence of the judiciary, improve the training of judges and court personnel, provide courts with the necessary material resources, modernize the judicial procedures, increase access to justice, and develop alternative methods of dispute resolution. The specific goals of judicial reform efforts have included increased efficiency and dispatch in handling cases, depoliticizing the appointment and promotion of judges, a reduction in levels of corruption among judicial personnel, and heightened technical knowledge of the sophisticated transactions of a Model II economy and increased ability to judge disputes that may arise in connection with them. Similarly, private attorneys have had to assume new and expanded roles to serve the new players in the private sector. They need to have new skills to plan, negotiate, and structure transactions on behalf of their clients. The emphasis in training lawyers for Model II is less on social engineering and more on transaction engineering. Accordingly, legal education in the Third World will also need to accommodate the shift from Development Model I to Development Model II in its curriculum and teaching methods.

More generally, the experience of the last fifty years may reveal something about the nature of law in developing countries, or at least about the "modern law" that applies to modern economic transactions. Most developing countries have pluralistic legal systems consisting on the one hand of indigenous law and on the other of "modern law" which in most cases has its origin in a foreign country, often a former colonial power. While indigenous law has been relatively stable and persistent over the years, the imported element has been subject to sudden and major swings and shifts, from its wholesale importation during the colonial period, to its rapid readjustment during the era of Development Model I, to its equally rapid and profound re-adaptation in the current enthusiasm for Model II.

In each of these three phases, the shape and content of the law was driven by a prevailing economic ideology, whether it was French or British colonial mercantilism of the late nineteenth century, Arab or African socialism of the 1960s, or the Washington consensus of the 1990s. In each of these three phases, government leaders and policy makers viewed law as a tool to achieve predetermined ends, and they readily borrowed those tools from foreign legal systems through legal transplants and foreign advisors. Rarely did they look to indigenous legal traditions for support in advancing the prevailing economic model of the day. Thus, just as the law of Model I did not arise organically out of the societies to which it was to apply, in many cases one may say the same thing about the new law that Third World governments have enacted to support Model II. Because the new law may not be sufficiently adapted to Third World societies, it too may in the end prove too weak a reed to support economic development.

VI. Conclusion

The shift from Model I to Model II among developing countries is not necessarily permanent. Just as the failure of Model I led to change, the same fate may happen to Model II. While Model II may indeed bring about increased productivity, it may do so at a cost that Third World societies ultimately judge unacceptable. What are those costs? They may be considerable. First, Model II, with its emphasis upon markets, may allocate social resources to areas which society ultimately judges inappropriate. Second, it may create

unacceptable divisions between rich and poor and among classes and castes in societies that are politically explosive because of their social and ethnic pluralism. Third, corruption may grow to the point that markets are distorted and the public determines Model II to have created a system that is fundamentally unfair. Fourth, it may facilitate through market transactions the exploitation of the weak by the strong, the poor by the rich. Finally, the unrestrained application of Model II may lead to irreparable damage to the environment, the culture, and the social values of the countries of the Third World. The financial crisis that began in Asia in 1997 has provoked concerns in some quarters about the fairness and effectiveness of market economies. Among the complex factors that led to the Asian crisis, one cause, according to some scholars, was the inadequate system of corporate governance prevailing in many Asia countries, a system resulting in insufficient disclosure, lack of transparency, over-investment in non-productive activities, and management's inadequate concern for the rights of investors.67

The important task of the law in this new era must be to create a framework that will minimize the costs of Model II while maximizing its benefits. The failure to do so may mean a drift back toward Development Model I or perhaps a search for Development Model III.

67. See Kris Hurley et al., Corporate Governance in Emerging Markets, 3 EDI Forum 14 (Fall 1998).