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Avoiding the Middle-Income Trap

Edited by Randall Peerenboom and Tom Ginsburg

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Law and Development in Middle-Income Countries

*Introduction**Randall Peerenboom*

In 1960, there were 101 middle-income countries (MICs). By 2008, only thirteen had become high-income countries (HICs).¹ Why do so many MICs fail to develop after a promising start, becoming mired in the so-called middle-income trap?

This volume addresses the special challenges MICs confront from a theoretical and a practical perspective. These challenges include maintaining sustainable economic growth while curbing rising income inequality and environmental degradation; creating social safety nets to protect those disadvantaged by economic reforms and globalization; reducing financial volatility and avoiding the crises that have frequently followed in the wake of financial liberalization; combating corruption; meeting Millennium Development Goals (MDGs) such as adequate health care, free primary education, and poverty alleviation; building the institutional capacity required for effective governance and a market economy; and maintaining social and political stability in the face of rising expectations and demands on the state.²

This is the first volume on MICs that addresses law and development issues from the perspective of political, administrative, and legal institutions and policies. Most of the existing literature that specifically discusses MICs, including empirical studies that sort by levels of wealth and distinguish between low-income countries (LICs), MICs, and HICs, is by economists or development specialists. There are many articles, for example, on international trade, foreign investment, financing and the banking sector, fiscal policy and currency exchange, technology transfer, and taxation, as well as traditional development topics such as infrastructure, rural development, urban planning, the environment, social welfare systems, and health care. There has been very little work, however, by political

¹ World Bank, *China 2030: Building a Modern, Harmonious, and Creative High-Income Society*, 2012, 11, available at <http://www.worldbank.org/en/news/2012/02/27/china-2030-executive-summary>.

² See, generally, the World Bank reports cited in the following text, and Independent Evaluation Group (hereafter referred to as IEG), *Development Results in Middle-Income Countries: An Evaluation of World Bank Support*, 2007, available at http://siteresources.worldbank.org/EXTMIDINCCOU/Resources/MIC_evaluation.pdf.

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scientists, sociologists, legal scholars, and regulatory theorists on political and administrative reforms, rule of law, and good governance in MICs as a separate category of analysis.³ This volume begins to fill the gap. The goal is to provide international development agencies and domestic policy makers with feasible recommendations to address the wide range of technically, politically, and socially complex issues that MICs face.

OVERVIEW OF MIDDLE-INCOME COUNTRIES

There is a general consensus about the goals of law and development programs: sustainable economic growth, establishment of rule of law and good governance, and consolidation of some form of constitutional democracy that protects human rights. Nevertheless, despite billions of dollars and the best efforts of international and domestic actors, the results of law and development projects have been on the whole disappointing. The World Bank's ongoing study of good governance concludes that there is no evidence of "any significant improvement in governance worldwide, and if anything the evidence is suggestive of a deterioration, at the very least in key dimensions such as rule of law, control of corruption, political stability and government effectiveness."⁴

While there has been considerable attention to failed and transitional states and the obstacles they face, much less is known about the particular issues facing MICs or what they should do to increase their chances for success. This is unfortunate, as 70 percent of the world's population, and one-third of the world's poor, live in

³ There is a large literature on regime types by political scientists and the relationship between regime type and economic growth, rule of law, good governance and human rights, as well as many books and articles on democratic transition and consolidation, authoritarian resilience, etc. There is also a large literature on rule of law, good governance, and law and development by legal scholars, legal practitioners, and development specialists in the rule-of-law promotion industry. See, e.g., Thomas Carothers, ed., *Promoting the Rule of Law Abroad: In Search of Knowledge* (Endowment for International Peace, 2006); David Trubek and Alvaro Santos, *The New Law and Economic Development: A Critical Appraisal* (Cambridge University Press, 2006); Michael Trebilcock and Ronald Daniels, *Rule of Law Reform and Development: Charting the Fragile Path of Progress* (Edward Elgar, 2008); Linn Hamberg, *Envisioning Reform: Improving Judicial Performance in Latin America* (Pennsylvania State University Press, 2007). There are also various works on particular issues or topics related to rule of law – including several works on rule of law in authoritarian countries (e.g., Tom Ginsburg and Tamir Moustaafa, ed., *Rule by Law* [Cambridge University Press, 2008]); rule of law in particular country contexts or regions (e.g., Randall Peerenboom, ed., *Asian Discourses of Rule of Law* [Routledge, 2004]); or particular institutions, usually the judiciary. However, on the whole, most of the literature does not distinguish between rule of law and good governance challenges in LICs, MICs, and HICs, or address the specific challenges of MICs.

⁴ Daniel Kaufmann, et al., *Governance Matters*, 2005, 6, available at <http://www.worldbank.org/wbi/governance/pdf/govmatters3.pdf>. See also Wolfgang Merkel, "Measuring the Quality of Rule of Law: Virtues, Perils, Results," in *The Dynamics of Rule of Law in an Era of International and Transnational Governance*, ed. Michael Zürn, Andre Noelkamper, and Randall Peerenboom (Cambridge University Press, 2012), 21–47.

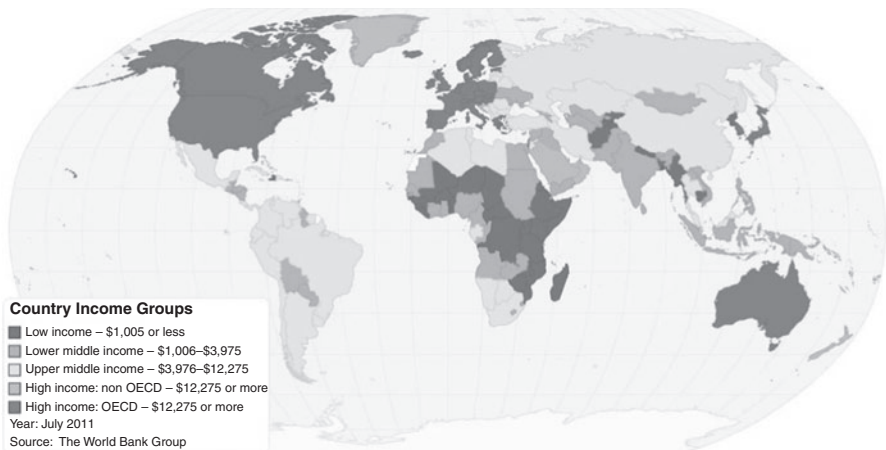


FIGURE 1.1. A global map of MICs.

MICs.⁵ The World Bank considers countries with gross national income (GNI) per capita from \$1,026 to \$12,475 to be MICs.⁶ There are currently 108 MICs (see Appendix).

As the Figure 1.1 indicates,⁷ most countries in Asia and Latin America are MICs. There are also many MICs in Central and Eastern Europe (CEE) and the Middle East. In recent years, the number of African MICs has risen, though most of Africa remains in LIC status.

A World Bank study found that while MICs have grown at an average rate of 3.7 percent since 1995, they have not been able to achieve sustainable high-quality growth. Income inequality rose in more than half of the MICs, with regional disparities particularly pronounced in some countries. Aggregate growth has also come at a cost of serious environmental degradation, including rising carbon dioxide emissions, deforestation, and severe air and water pollution. Moreover, while MICs have been relatively more successful in reducing poverty than LICs, poverty remains a serious problem in many countries. MICs also confront critical health challenges. HIV/AIDS remains a grave, and in some countries worsening, problem. Some 70 percent of MICs are failing to meet their MDG of reducing child mortality by two-thirds.⁸

⁵ IEG, *Development Results in MICs*, supra.

⁶ More specifically, the World Bank classifies countries with GNI per capita of \$1,025 or less as LICs, \$1,026–\$4,035 as LMICs, \$4,036–\$12,475 as UMICs, and \$12,476 or more as HICs. 2011 GNI per capita is calculated using the World Bank Atlas method. See <http://data.worldbank.org/about/country-classifications>.

⁷ *Country Income Groups (World Bank Classification)*, available at <http://chartsbin.com/view/2438>. On the website, the names of the country are displayed when the cursor moves over them.

⁸ IEG, *Development Results in MICs*, supra.

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Although some MICs have improved institutional capacity, institutions remain weak relative to developed countries, particularly in transitional states or states undergoing major political instability. Three out of four MICs showed no improvement in combating corruption. Ten MICs are in the bottom 10 percent of the World Bank's corruption index, and two out of three are below the global average (Appendix). Judicial corruption has undermined public trust in the courts and undermined efforts to implement rule of law.⁹ Programs to increase judicial independence have proven disappointing.¹⁰ Litigation is often expensive and time consuming. Access to justice remains limited (Botero, Chapter 10). These institutional constraints, including those in the legal system, may severely constrain the ability of MICs to make sound choices that can help them break through to more developed status.

In sum, MICs must address many complex challenges, while being limited by resource constraints and weak institutions. Moreover, MICs have had to face these challenges without much guidance from international development agencies and law and development scholars. International development agencies are only now beginning to focus on the special challenges facing MICs (Booth, Chapter 15). The World Bank, for instance, issued a new strategy paper for MICs in 2006, but the strategy is so new that it has yet to be fully evaluated. That this is the World Bank's third strategy paper in six years reflects the difficulty that the World Bank has had grappling with the complex issues confronting MICs.¹¹

To be fair, attempts to address the problems of MICs face significant challenges, including the wide diversity of MICs and the lack of clear models.

MICs are a varied group, socially, culturally, economically, and politically. They range in population size from 1.4 billion in China to small islands such as Palau with a population of just twenty thousand. The per capita income of the wealthiest MIC is twelve times that of the lowest. In ten MICs, 40 percent of the population lives in poverty; in ten others, less than 5 percent does. Prior to the HIC-created global financial crisis, two out of three MICs had growth rates of more than 2 percent, with some enjoying growth rates of more than 6 percent; conversely, ten were suffering from negative growth rates. The nature of the economies differ in terms of the relative importance of rural agriculture versus urban industry; amount and mix of

⁹ Transparency International, "Global Corruption Report: Corruption and Judicial System," 2007, available at http://www.transparency.org/publications/gcr/download_gcr#download.

¹⁰ IFES/USAID, "Guidance for Promoting Judicial Independence and Impartiality," 2002, 6, available at http://www.usaid.gov/our_work/democracy_and_governance/publications/pdfs/pnacm007.pdf; Carlos Santiso, "The Elusive Quest for the Rule of Law: Promoting Judicial Reform in Latin America," *Revista de Economia Politica/Brazilian Journal of Political Economy* 23, no. 3 (2003), 112–34; Randall Peerenboom, ed., *Judicial Independence in China* (Cambridge University Press, 2010).

¹¹ World Bank, "Strengthening Bank Group Engagement on Governance and Anticorruption," in *Development Results in Middle-Income Countries*, 2006; World Bank, *Enhancing World Bank Support to Middle Income Countries – Management Action Plan*, April 2004; World Bank, *Report of the Task Force on the World Bank Group and the Middle-Income Countries*, April 2001.

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imports and exports; reliance on natural resources; openness to foreign investment and trade; financial and service sector liberalization; and access to global capital markets. They also vary widely in institutional capacity. A few are in the top quartile of the rule-of-law index; others are in the bottom quartile (see Appendix). Some are theocracies; others are atheistic. Some are democratic, or undergoing democratic transition; others are authoritarian or undergoing reversion to authoritarianism. Coming up with uniform advice for this diverse set of countries is likely to be impossible, and there are no one-size-fits-all solutions.

Another reason so little is known about how to address the problems encountered by MICs is that so few have managed to break into the exclusive club of wealthy states that enjoy rule of law, good governance, and adequate protection of human rights. The thirteen countries that graduated from MIC to HIC status between 1960 and 2008 are Spain, Greece, Portugal, Ireland, Israel, Japan, Hong Kong, Singapore, Taiwan, South Korea, Mauritius, Puerto Rico, and Equatorial Guinea.¹² In recent years, several CEE countries have also joined the upper ranks. Slovenia, Croatia, Slovak Republic, Czech Republic, Poland, and Hungary are now all HICs by World Bank standards, albeit all, with the exception of Slovenia, in the 12,480 to 18,500 GNI per capita range. There are also a number of oil-rich countries, such as Saudi Arabia, Kuwait, Oman, Bahrain, United Arab Emirates, and Qatar, as well as a number of small countries, often island states whose economies rely heavily on tourism and the provision of financial services to companies looking for tax havens, such as the Isle of Man, Cayman Islands, Barbados, and the Bahamas, or revenue from casinos and gaming (Monaco and Macau) (Appendix).

THE RESEARCH AGENDA: SALIENT ISSUES AND TOPICS

The preceding overview highlights several topics for more in-depth research and analysis, which we will begin to address in this volume and return to in the conclusion.

First, given the diversity among MICs, is “middle-income country” a useful analytical category? The World Bank further divides MICs into upper middle-income countries (UMICs) and lower middle-income countries (LMICs). Does that distinction provide additional analytical leverage? Do certain issue areas require additional subcategories or another basis for classifying MICs other than GNI per capita?

Second, is there a single middle-income trap? Alternatively, are there several or many middle-income traps? Or, is it just a myth that will be dispelled over the coming decades as more and more MICs become HICs? What are the obstacles (political, legal, economic, cultural, and institutional) to achieving sustained growth

¹² World Bank, *China 2030*, 11.

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and establishing a legal system and governance institutions that would compare favorably with those in HICs?

Third, apart from wealth, what, if anything, do the countries that have successfully negotiated the transition from MIC to HIC status share? Are there any discernible patterns among the successful MICs with respect to politics, legal systems, cultural characteristics, institutions, colonial history, population size, or ethnic diversity? What distinguishes successful countries from the less successful countries, particularly those in the same region? Are there particular strategies that are within the control of policy makers that the successes share?

Fourth, why have East Asian countries been so successful? Many attribute their success to the developmental state (Subramaniam, Chapter 3), or more broadly to a particular sequencing of economic, political, and legal reforms that define the East Asian Model.¹³ Are there background conditions that have enabled high growth? Is the East Asian export-led model sustainable in the postcrisis global economic order where rich countries must rein in consumption and increase savings to reduce debt? What challenges are Malaysia and China facing as they seek to move beyond MIC status, and what challenges are HIC Japan and Singapore now facing? What, if anything, can countries in other regions learn from successful East Asian states? Are there other models for MICs to follow? Does the recent ascension of several Eastern European MICs to HIC status provide an alternative to the East Asian Model? If so, what are the relative advantages of each approach? Has the Washington Consensus been thoroughly discredited? Is there a new Post-Washington Consensus (PWC) consensus? Should MICs be abandoning the neoliberal minimalist state in favor of a more interventionist New Developmental State (Bugarcic, Chapter 7), and what exactly does that entail?

Fifth, what is the relationship between politics and development in MICs? Successful East Asian states experienced long periods of rapid growth under authoritarian regimes, were relatively stable, and democratized, if at all, at relatively high levels of wealth. In contrast, Latin American countries have a long history of regime change and instability. Yet for every successful authoritarian regime, there are numerous gross failures. And while many democracies seem to be trapped in transition – caught in a stable but bleak state of poverty, government malfeasance, and despair – most HICs are democratic, and democracy promotion remains the aim of many bilateral and multilateral programs. Accordingly, regime type alone does not explain MIC success or failure. Nevertheless, different regime types may face different traps or challenges, or give rise to different pathologies that inhibit growth, good governance, or the rule of law. Are there discernable general patterns? Beyond regime types, what types of political reforms and institutions are necessary or best suited to overcoming the challenges facing MICs?

¹³ Randall Peerenboom, *China Modernizes: Threat to the West or Model for the Rest?* (Oxford University Press, 2007).

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Sixth, in recent decades, MICs have had the benefit of a supportive global environment, including “relatively open trade, rising flows of foreign direct investment, steady growth in the world’s major markets, sharply declining transport costs, increased intraindustry trade, and the introduction and spread of information and communications technology.”¹⁴ By contrast, MICs also face new challenges arising from globalization and an international trade regime that have led to greater global inequality and limited the ability of MIC governments to set and pursue certain policies in their national interest – including some policies pursued by now developed countries during their high growth periods (Shaffer and Sutton, Chapter 4; Yu, Chapter 5). With the World Trade Organization (WTO) and Trade-Related Aspects of Intellectual Property Rights, the rules are more extensive, detailed, and subject to coercive enforcement. How have MICs adapted to the new international economic order? Have some MICs been more successful than others in adapting to the new rules of the game? Much has been made of the rise of Brazil, Russia, India, China, and South Africa (the BRICS), and their role in the failed Doha Round of negotiations. Will divisions arise among the BRICS or between the larger MICs and smaller MICs? Will differences in interests on the part of LICs, MICs, and HICs undermine global trade agreements, accelerating the recent trend toward bilateral and regional trade agreements?

Seventh, although there is a close relationship between wealth and rule of law and good governance (Peerenboom, Chapter 16), debates continue about the direction of causality.¹⁵ Moreover, even if wealth is closely related to rule of law and good governance, what are the implications for policy makers? The existing empirical studies do not shed enough light on how to achieve economic development, or the particular institutional arrangements necessary for rule of law or good governance. Nor do they shed much light on the path or sequencing of reforms. How have international donor agencies such as the World Bank and the UN Development Programme (UNDP) sought to address the special challenges for MICs? What policies and programs have they developed or should they develop to target MIC issues? Conversely, how do MICs take advantage of donor assistance to adopt and adapt the many “lessons learned” from decades of efforts to promote rule of law and good governance?

Eighth, MICs face a series of pressing socioeconomic issues from education to health care to labor rights to the environment. Socioeconomic issues are particularly problematic in MICs because citizen demands rise exponentially, and yet the government lacks the resources to meet all legitimate demands and institutions

¹⁴ World Bank, *China 2030*, 6.

¹⁵ Alberto Chang and Cesar Calderon, “Causality and Feedback between Institutional Measures and Economic Growth,” *Economics and Politics* 12 (2000): 69; Roberto Rigobon and Dani Rodrik, “Rule of Law, Democracy, Openness, and Income,” *Economics of Transition* 13 (2005): 533; Daniel Kaufmann, et al., *Governance Matters III: Governance Indicators for 1996–2004*, 2005, available at <http://www.worldbank.org/wbi/governance/pdf/govmatters3.pdf>.

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are still relatively weak compared to institutions in HICs. How many of the limited resources available to MICs should be allocated to the provision of these key public goods? What are the implications for long-term growth of allocating funds to these goods rather than to infrastructure or the development of key industries? How should the fiscal burden and the operational tasks of providing these public goods and services be allocated among the government, markets and the private sector, non-governmental organizations, and family networks? Should disputes over economic and social rights (ESR) be tried in the courts or resolved through political and administrative channels? Are state-centered formal dispute-resolution mechanisms effective only if supported by broader social movements?

METHODOLOGY

The volume is interdisciplinary. There are contributions from legal scholars, political scientists, and sociologists. Some of the chapters are quantitative while others are qualitative. Some address theoretical issues while others focus more on practical issues and implementation. Some chapters focus on the state while others focus on civil society and nonstate actors and institutions. Most chapters are explicitly comparative, with authors drawing on the experiences of countries in Europe, Latin America, and Asia, while others are case studies of one or two countries.

Given the broad nature of the topic and the variation within MICs, no single volume can address all of the important topics or cover all regions, much less all countries. We have focused on Latin America, Asia, and CEE because these are regions dominated by MICs. Although the Middle East is considered in some of the broader quantitative studies, we have not included individual chapters on the Middle East because of space limitations, and, more importantly, because the Middle East is currently very unstable and unpredictable. It may be the case that the “Arab Spring” and subsequent events will lead to radical changes in the political, economic, and legal systems in many countries in the region – or it might not. Furthermore, the close relationship between oil and wealth in the Middle East makes the policy and institutional environment rather *sui generis* relative to other regions.

Although we have not been able to cover everything everywhere, we believe the topics covered are of great importance for MICs. We hope the lessons learned will be of use to policy makers and donor agencies working in the area, and the questions raised will provide scholars the impetus for further research.

LAYOUT OF THE VOLUME AND CHAPTER SYNOPSES

The volume is divided into five parts. Part I examines politics and constitutional developments in MICs, and the choice of different development models. Part II addresses the role of MICs in a global economy, and focuses on the regulatory, legal,

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and political-economy dimensions of trade by examining the WTO and intellectual property (IP) rights. Part III discusses governance and legal issues, including civil service sector reforms; the relation between the judiciary and the military; anticorruption efforts; and access to justice. Part IV takes up socioeconomic issues, focusing on the role of the courts and other institutions in addressing labor, environmental, and health challenges. Part V explores the evolving strategies of international donor agencies for MICs in light of lessons learned about legal transplants from previous decades of law and development projects. Chapter 16 summarizes key findings and identifies areas for future research.

Part I. The Politics of Development in Middle-Income Countries

In Chapter 2, Tom Ginsburg captures in a nutshell the crux of “the middle-income trap”: institutions suitable for growth at the early stages of development may no longer work for later stages. Yet the ruling regime may stick with the strategies and institutions that have worked to date because those strategies generated the economic growth that underpins regime legitimacy, as well as political returns that lock in particular structures. The problem is, therefore, one of path dependency, and ultimately a political challenge as much as an economic or technical challenge. He notes that one of the key differences between HICs and most MICs is that the former enjoy a relatively more autonomous legal system. Courts must be given sufficient autonomy over a wide enough range of issues to avoid political and economic commitment problems; encourage investment and innovation; and facilitate commerce. He then discusses the need to overcome the “legal middle-income trap” in which courts lack sufficient autonomy or scope, arguing that a successful resolution requires both the right political conditions and institutional underpinnings. He turns to Malaysia to illustrate what happens when the institutional underpinnings of judicial empowerment are present but favorable political conditions are lacking; the Maldives to illustrate what happens when favorable political conditions exist but the requisite institutional underpinnings are absent; and South Korea to show what can happen when both the right political conditions and the requisite institutional underpinnings are present.

In Chapter 3, Surain Subramaniam draws on the political economy and comparative politics literatures to explore the impact of politics on development in HIC Singapore and MIC Malaysia. In both countries, the development model was based on a developmental state that limited political freedom in exchange for delivering rapid economic growth, improved governance, and higher standards of living. Subramaniam attributes the greater success of Singapore to political economy factors. In Malaysia, the development model locked in quotas for majoritarian ethnic Malays as a political response to conflicts arising from a divided society. As a result of this strategy, growth has stalled, and the transition toward legal autonomy has been undermined, as described by Ginsburg. Thus Malaysia has become mired

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in both an economic and legal middle-income trap, leading to political opposition and a social backlash.

At the same time, Singapore's development model is also under pressure, with citizens clamoring for political liberalization. In a test of modernization theory, Subramaniam examines whether structural changes resulting from having achieved advanced economy status are facilitating gradual institutionalization of political liberalization, thereby moving the developmental state model beyond performance legitimacy toward a more liberal democratic model. Both Singapore and Malaysia illustrate the complex ways in which state-led modernization and economic growth and development intersect with pluralistic understandings of modernities; political and cultural identities; and democratic aspirations at the societal level to influence the trajectories of economic and political development.

Part II. Middle-Income Countries in a Globalized Economy

In Chapter 4, Gregory Shaffer and Charles Sutton note that while the WTO was designed to serve the interests of Europe and America, larger MICs have adapted to the rules of the game and become more adept in using the legalized trade regime and trade negotiations to advance their own interests. During the failed Doha Round, the G20 coalition, led by Brazil and India, resisted U.S. and European Union demands, and fought to protect their domestic policy space, including the ability to use industrial policies to develop their manufacturing sector and protect infant industries. Large MICs such as Brazil and more recently China have also developed the capacity to utilize WTO dispute settlement to defend their trading and domestic policy interests. They have likewise become more active in negotiating bilateral and plurilateral trade agreements, with HICs and with other MICs. Shaffer and Sutton emphasize that size matters: countries with large economies measured by aggregate GNI, such as China and India, exercise much greater power than countries with smaller economies, such as the Maldives, even though the Maldives has a higher GNI per capita than both India and China. Nevertheless, smaller MICs may sometimes benefit in trade negotiations or dispute settlement by piggybacking on other countries, including larger MICs, when they share common interests.

In Chapter 5, Peter Yu points out that the global IP regime already incorporates income categories similar to HIC (developed), MIC (developing), and LIC (least developed), with duties of assistance imposed on developed countries and favorable policies extended to developing and least developed countries. However, in discussing the politics of the IP regime, Yu, like Shaffer and Sutton, cautions that aggregate GNI is more significant than GNI per capita. Thus he develops a theory of middle intellectual property powers (MIPPs) based on six characteristics: a fast-growing and large aggregate economy; increased technological and innovative capabilities; emergence of local stakeholders; presence of alternative forms of innovation; uneven