Global Governance: Demise or Transformation?

Inaugural Lecture of the EUI’s Tommaso Padoa-Schioppa chair

9 April 2018
Jean Pisani-Ferry
In Tommaso Padoa-Schioppa’s words

“Two mistakes, two myths. The first is that the market can regulate itself. The second is that the state can and must have unlimited sovereignty.”

“Such serious imbalances were allowed to build up for so long [...] because the ‘own house in order’ doctrine was in complete mismatch with the management of the global economy [...] A house in order is not a city in order. There are commons that bear no relation with what goes on within houses, but between houses. [...] this means financial and commercial relations, exchange rates, health, the seas, the climate, and the fraction of humanity that is dying of hunger. The commons can only be managed in common. This implies supranational authorities.”

Contre la courte vue, Odile Jacob, 2009
What do we mean by global governance?

An international legal order?

« All law is in essence a system of compulsion [...] If international law is authentic law, law in the same sense as the juridical systems of individual States, then it must, just like these systems, be a system instituting compulsion; it must obligate the States which are subject to this law to a specific rule of conduct, and lay down a definite sanction to meet in case that a State may not proceed in this fashion. »

Hans Kelsen (1934)

Or a loose network of ad-hoc arrangements?

« I have spoken of the economic World-State—of all those complex international arrangements concerning post-offices, shipping, banking, codes, sanctions of law, criminal research, and the rest, on which so much of our civilized life depends. This World-State is unorganized, incoherent. It has neither a centre nor a capital, nor a meeting place. The shipowners gathered in Paris, the world's bankers in Madrid or Berne, and what is, in effect, some vital piece of world regulation is devised in the smoking room of some Brussels hotel. The World-State has not so much as an office or an address. »

Norman Angell (1915)
Outline

1. Why global governance matters
2. A model on the retreat
3. Collective action beyond the standard paradigm
4. The Transformation of Global Governance project
Global governance matters considerably

1. **Unprecedented level of interdependence**
   - Trade, investment, finance / Migration / Information / Knowledge
   - Global value chains and the 2\textsuperscript{nd} ‘unbundling’ (Baldwin, 2016)
   \>	extbf{Much to do beyond putting own house in order}

2. **Disruptions in the making**
   - Digital transformation both undermines states and provides them w/ new weapons
   - Technological potential for further ‘unbundling’
   \>	extbf{Urgent need for effective models of global governance}

3. **Rise of global commons**
   - Depletable resources (climate, biodiversity)
   - Global threats (financial instability, nuclear proliferation, terrorism, drugs)
   \>	extbf{Unprecedented challenge for international collective action}

4. **Power shifts**
   - ‘Great convergence’ and the rise of multipolarity
   - US-China power struggle to dominate next decades
   \>	extbf{Global governance key to help escape Thucydides’ trap (Allison 2017)}
And Europe has a major stake in it

1. Part of the EU’s raison d’être
   • In a liberalized global economy, EU is not defined by its economic borders anymore
   • The “shaping of globalisation” is part of its new narrative: “Globalization confronts us with new economic, social, environmental, energy and security challenges. We aim at shaping globalisation in the interests of all our citizens, based on our common values and principles. For this even the enlarged Union cannot act alone.” (European Council, 2007)

2. A natural advocate of rules-based governance at world level
   • A Kantian agent in an Hobbesian world
   • Also regards itself as a microcosm and laboratory of globalization

3. An effective global player
   • Competition: “The world’s regulator” (WSJ)
   • Data: GDPR to become global standard (Zuckerberg)
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The mantra

« A global crisis requires a global solution »

Leaders’ Statement, G20 London Summit, 2 April 2009
Success and disappointments

One success: 2008-2009 coordinated response to the global financial crisis
- Elevation of G20 to leaders’ level
- Standstill on protectionism
- Macro reflation + one-off increase in IMF resources
- Financial regulatory initiatives

But several setbacks
- Failure of Doha round, spread of trade regionalism, resurgence of unilateralism
- Multilateral financial architecture not commensurate to financial globalisation
- No collective response to growing migration pressures, cybersecurity threats
- Paris agreement on climate change a second best

Contributing to lopsided globalisation
- Aggravating threats to depletable resources (biodiversity)
- Saving flows going upstream
- Fragmentation of the Internet
Change of paradigm?

**XXth century global governance paradigm** based on:
- Multilateral legal order: enforceable, common but differentiated obligations
- Universal membership
- Global institution equipped with decision-making conflict resolution powers

➢ **Ideal-type throughout post-WW2 era**

This model is on the retreat
- Apex reached in mid-1990s with creation of WTO, attempted Multilateral Agreement on Investment, attempted broadening of IMF mandate and Kyoto protocol
- Since then, initiatives have stalled (trade) and effectiveness has diminished (IMF)
- Expansion to new fields blocked (Copenhagen climate agreement)
- Legitimacy challenged (EM’s attitude, US stance)

Evidence of **global governance gridlock** (Hale, Held and Young 2013) attributed to:
- Growing multipolarity
- Institutional inertia
- Harder problems
- Fragmentation
Why (1)? Broad economic factors

Second thoughts about real globalisation in the advanced world
• Social dislocation leads to popular questioning of multilateral rules of the game
• Accusation by US government – and others – that China is engaged in forced or undue technology transfers detrimental to advanced countries’ interests

Second thoughts about market opening and financial globalisation in emerging world
• Opening of services markets has benefitted advanced countries, while manufacturing relocation has benefitted a handful of EMs only (Baldwin 2016)
• No agreed framework or instruments for mitigation of destabilising capital movements

Move away from comparative static, deterministic setting
• Growing importance of dynamic increasing returns
• Uncertainty, risk and irreversibility
Why (2)? Increased interdependence complexity

Reasons for stalemate:

- **Emerging countries matter more:** Increasing diversity of preferences and equity issues
- **Internationalisation levels differ:** Integration beyond the border takes place within clubs
- **Increasing salience of private players:** Challenge to traditional institutions

Even when there are reasons for action:

- **Production has changed:** Zero marginal cost industries give rise to global monopolies
- **Global commons matter more:** Who owns them?
- **Power of finance is overwhelming:** Global institutions have turned small
Why (3) ? Geopolitical and political factors

Global governance born out of WW2
- Multilateralism as an antidote to war (Atlantic Charter / UN principles / Bretton Woods institutions / Havana Charter)
- Trust in the ‘glue of free trade’
- An anti-Faustian bargain: US benevolent hegemon locked in rules and institutions of its own design and committed itself to virtue (Ikenberry 2000)

Common beliefs:
- Free world doctrine
- Prosperity a condition for political and social stability

These attitudes do not prevail anymore in a multipolar world
- US is reconsidering wisdom of ‘anti-Faustian bargain’
- China is uncertain about willing to commit to virtue
- Broken promises of globalisation are fuelling populism in advanced countries
- Balance of power has tilted towards sovereignty-conscious developing countries
Result: Fragmentation and fragility

Unilateralism
• Trade and investment
• Financial self-insurance

Regionalism
• Trade and regulation
• Finance (regional financial safety nets in Europe, Asia)

Ad-hoc clubs
• Specialised groupings
• Coalitions of the willing

Growing complexity
• Spaghetti bowl of overlapping institutions and arrangements
• Interaction of global and regional structures
• Public-private interaction (standards, development)
• Purely private governance (e.g. accounting standards)

Anchoring role of rules and institutions significantly curtailed

Remaining anchor is political rather than legal or institutional
• G20, ad-hoc summits
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A paradigm that never fully prevailed

1. Special status of the US
   • Unilateralism not without precedents: ITO, WTO ratification, ICC, IMF resources

2. Global governance has not really followed the template
   • Essential pillars (enforceable multilateral order / universal membership / effective institution) cannot be found jointly anywhere
   • In several fields (e.g. investment, competition, Internet) they never existed

3. The model was not without problems
   • Conflict between global rules and national democracy (Rodrik 2011)
   • Questionable ability of specialised institutions to deal with cross-sectoral issues (ex. trade and climate, labour, finance)
   • Politicisation of UN system
Institutional diversity: Incompleteness or adaptability?

• Standard approach regards multiplicity and heterogeneity of global institutional arrangements as incompleteness

➢ Search for missing pillars

Can it also result from adaptability?

• Avoid Panglossian bias: There are true global governance failures
• Yet also surprisingly effective forms of collective action
• There are other templates than neoclassical symmetry
An Ostrom analogy

« The most important lesson for public policy analysis derived from [my] intellectual journey is that humans have a more complex motivational structure and more capability to solve social dilemmas than posited in earlier rational-choice theory.

Designing institutions to force (or nudge) entirely self-interested individuals to achieve better outcomes has been the major goal posited by policy analysts for governments to accomplish for much of the past half century. Extensive empirical research leads me to argue that instead, a core goal of public policy should be to facilitate the development of institutions that bring out the best in humans.

We need to ask how diverse polycentric institutions help or hinder the innovativeness, learning, adapting, trustworthiness, levels of cooperation of participants, and the achievement of more effective, equitable, and sustainable outcomes at multiple scales »

Elinor Ostrom, 2009 (emphasis added)
Example 1: Bank capital ratios

- Banking sector safety involves strong collective action dimensions
  - Social benefit of banking safety exceeds national benefit (financial stability a public good)
  - Furthermore, lower capital ratios may yield short-term competitive advantage
  - So standard prediction: insufficient capital in the absence of binding rules

- BCBS only sets non-mandatory standards, yet has succeeded in raising capital ratios
  - No legal obligation to comply, only peer pressure (legislation is national prerogative)

### Basel 3 capital ratios, 2011-2017 (source BIS)

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<td>2017</td>
<td>20.0</td>
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- Europe
- Americas
- Rest of the world
Why it *has* worked

**Systemic banks now globally better capitalised than pre-crisis. Why?**

- G20/FSB endorsement and monitoring
- Strict BCBS compliance assessment procedures

**How it may have worked**

- Incentive to cooperate if there is sufficient trust (assurance game)
- Intellectual consensus (epistemic community)
- Political consensus (popular uproar against bank bail-outs)
- Market punishment for weak standards or weak enforcement
- Regulatory limitations to cross-border activities of weak-standard countries’ banks

rupted standards + transparency have triggered race to the top

**Will it last?**

- Possible fallout if US retreats from Dodd-Frank
Example 2: Taxation

Particularly difficult issue
- Capital flows, global value chains have created global taxpayers but taxation remains at core of national sovereignty
- Diverging interests, especially related to size
  - All countries compete for tax revenues, but
  - Small countries within OECD gain from providing tax shelters (e.g. through bank secrecy)
  - Very small jurisdictions (aka tax havens) gain from applying no taxation whatsoever
- EU an illustration of the magnitude of the problem

Yet meaningful results
- **Corporates:** Multilateral anti-treaty abuse convention (MLI) effective 1/7/2018
- **Individuals:** Bank secrecy effectively eliminated 1/9/2018 via Multilateral, automatic information exchange between tax authorities

Major issues remain (transfer prices, extractive industries, digital taxation) and corporate tax avoidance remains massive

But real achievement within relatively limited time span (two decades)
Why it *has delivered* more than expected

**Basics**
- Large countries share common interest in fighting tax evasion and avoidance
- Large vs. small countries battle – in the end large countries have won
- Major role of US stance

**Opportunity**
- Post-GFC political uproar against tax avoidance
- Fight against tax avoidance lumped together with financial stability measures

**Strategy**
- Large countries largely united, but were blocked within EU and OECD by unanimity rule
- Political endorsement by G20 helped overcome enduring stalemate within existing organisations
- OECD secretariat that had technical competence was effectively drafted by G20
Example 3: Climate

Standard approach leads to conclude Paris agreement bound to fail

- Climate epitomises the challenges of international cooperation
  - Pure public good / uncertainty / irreversibility / strong intertemporal dimension
  - Major international equity issue (stock/flow dimension)
  - N-country prisoners’ dilemma leading to incentive to cheat, instability of coalitions
  - International carbon leakages
  - Limited verifiability
- Scholars have concluded tackling climate change requires
  - Global carbon tax (Gollier & Tirole 2016), or
  - Punishment mechanisms (Nordhaus 2015)

Paris accord does not solve any of these challenges (does not even pretend)

- Intended contributions fall short of required emissions cuts
- No verifiability of implementation of pledges
Why it may work

From a static standpoint, Paris agreement notoriously insufficient

• « Little tangible has been acted upon [in Paris], that could put our planet on a better path [...] The promises are incomparable, they are insufficient, they would be costly if implemented, and it's a safe bet that, given they are unbinding, they will never be implemented fully anyway » (Tirole, 2016)

But it has created a momentum. How?

• Active, forceful epistemic community

• Significant China-US climate deal in the run-up to the Paris conference (end 2014)

• COP21 mobilised non-state players (firms, cities) competing for first-mover advantage

➤ Underlying rationale: dynamic increasing returns in the competition between clean and dirty technology model (Acemoglu, Aghion et al., 2012)

• Key in such model is not to reach the CO2 emission threshold but the R&D threshold above which clean technology overtakes efficiency of dirty technology

• Absent international cooperation, clean technology cannot reach the efficiency threshold

• Partial agreement may be sufficient to increase the probability of clean tech success to a level that triggers critical mass of R&D investment into it

• Fragile coalition (especially after US withdrawal), but may deliver change
## Summing up

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<th></th>
<th>Banking regulation</th>
<th>Taxation</th>
<th>Climate</th>
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<tr>
<td>Membership</td>
<td>Most relevant countries</td>
<td>Ad-hoc and variable</td>
<td>Universal (before US left)</td>
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<td>Soft law</td>
<td>Soft law</td>
<td>Reputation game</td>
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<td>Institution</td>
<td>Effective</td>
<td>No, but effective secretariat</td>
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<tr>
<td>Epistemic community</td>
<td>Yes</td>
<td>Increasingly</td>
<td>Yes</td>
</tr>
<tr>
<td>Public opinion pressure</td>
<td>Yes, after GFC</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Political endorsement</td>
<td>Yes, by G20</td>
<td>Yes, by G20</td>
<td>Nominal at least</td>
</tr>
<tr>
<td>Market pressure</td>
<td>Yes, after GFC</td>
<td>No</td>
<td>Increasingly</td>
</tr>
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</table>
Example 4: Global financial safety nets

**Strong rationale for global safety nets**

- Cost effectiveness - Reliability - Equity

Yet increasing reliance on:

- **Self-insurance** through reserve accumulation
- **Bilateral credit lines** (from China) and **dollar swap lines** (from US)
- **Regional financial support** (Europe, Asia)

Current set of solutions is:

- Costly
- Politicised (for swap lines)
- Complex (several competing lenders)
Why the global solution *does not* prevail

While financial account liberalisation has magnified the need for financial safety nets,

- **IMF members have refrained from increasing its resources and responsibilities commensurably**
- **Borrowers** have increasingly retreated from the multilateral solution
  - Political reasons:
    - Distrust for IMF, stigma
    - Perception of US/Europe domination of IMF governance
  - Financial reasons:
    - IMF resources insufficient (especially in European case)
- **Creditors** have also increasingly resorted to bilateral lending for reasons of:
  - Power politics (US dollar swap lines, Chinese credit lines)
  - Autonomy in setting the terms of lending (Euro area)
Example 5: Internet governance

Case of innovative non-institutional solutions

• Fast-growing, fast-transforming domain
• Started off as global – but without legal or institutional framework
• Multi-stakeholder approach (ICANN, IGF) initially effective and flexible

Now confronted to major challenges:

• Competition
  • Big tech companies de facto setting the governance agenda as an oligopoly
  • US has reversed position on net neutrality
  • US-based monopolies subject to remedial action by EU competition authorities

• Fragmentation
  • Diversity of preferences (1st Amendment vs. German prohibition of hate speech, different stance on privacy)
  • Separate Chinese Internet

• New issues: Security (hacking, weaponisation), privacy, responsibility for content
Why it may unravel

Prevailing governance model was not built to address today’s issues

• ICANN has narrow role

• Internet Governance Forum has broad role but:
  • Mandate is to « discuss, facilitate, interface, inform and inspire ». No negotiation or decisionmaking role whatsoever
  • All stakeholders « meet as equal »
  • No standing secretariat, almost no publications, no active website

Not able to tackle mounting concerns:

• Monopolistic behaviour
• Security challenges
• Privacy concerns
• Responsibility for information spread

➢ May result in overall fragmentation
Outline

1. Why global governance matters
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A What Works for What agenda

Global governance:
• An increasingly scattered field
• Very diverse outcomes – successes and failures

Evidence that *neoclassical architecture is not the way forward*

What’s needed:
• A proper analytical framework
• A diagnosis kit for problem identification
• A toolkit of governance templates
• A method for mapping templates onto problems
The research agenda

Find out what works and what does not – and why. And for that:

• Intense dialogue between scholars and practitioners

• **Multi-disciplinary approach**
  • Law
  • History
  • Political science / International relations
  • Economics

Another Ostrom analogy (2005, ch 1, emphasis added):

« Can we dig below the immense diversity of regularized social interaction [...] to identify **universal building blocks** used in crafting such structured interactions? If so, what are the **underlying component parts** that can be used to build useful theories of human behavior in the diverse range of situations in which humans interact? [...] My answer to these questions is yes »
Beware of stylized models

Basic global public good model too simple to fit reality (Sandler 2004)

- Prisoner’s dilemma structure: suggests no cooperation without compulsion
- But solution to collective action problem depends on the nature of the game
- For example incentive to cooperate stronger and equilibrium more stable in assurance (aka stag hunt) games or weakest-link games

- Other overly simplifying assumptions
  - Identical players (no concentration, no heterogeneity of preferences)
  - One-shot game (no reputation)
  - Comparative statics (no technical progress, no uncertainty)

❖ Simple models intended for pedagogical purposes can mislead policymakers, make them think problems are simpler than they are
Building blocks

**Institutions:**
- Membership, Rules, Decision-making, Assessment, Enforcement

**Players:**
- Number
- Nature
- Diversity of preferences

**Interactions:**
- Game structure
- Time dimensions

**Attributes:**
- Beliefs
- Knowledge
- Commitment
- Trust
Key issues to analyse:
Collective action coordinates

1. **Players**
   - Number of relevant players (degree of concentration) varies considerably across fields
   - Nature of relevant players (public / private, state / non state) also varies enormously

2. **Preferences**
   - Heterogeneity of preferences / economies of scale trade-off differs across fields

3. **Aggregation technologies and pay-offs**
   - Different aggregation technologies imply different incentives to cooperate
   - Prisoners’ dilemma games ≠ assurance games ≠ leadership games

4. **Time**
   - Technical progress / uncertainty / irreversibility

5. **Equity**
   - How significant are the concerns about international / intergenerational equity?
Key issues to analyse (2):
Coordinates of effectiveness

Attributes
1. **Beliefs**: Common aims and values
2. **Knowledge**: Role of epistemic communities
3. **Commitment and trust**: Political guidance

Institutions
1. **Membership**: Relevant players
2. **Decision-making** rules
3. **Assessment** capabilities
4. **Enforcement**: Direct or indirect (mechanism design)
The work programme

• Review significant cases of ‘success’ or ‘failure’
• Build on Hale and Held (2017)

• Dedicated sectoral workshops (to be held jointly with EUI institutes / other institutes and think tanks) with:
  • Experts
  • Policy-makers
  • Private-sector players
  • NGOs

• Determine
  • Coordinates of underlying problem
  • Strategy followed to solve it
  • Adequacy of strategy
  • Reasons for success and failure
Epilogue: The bigger question

As to history, the powerful lesson of the collapse of the pre-1914 world [...] is that an economic order cannot flourish without a supporting political order and that such a political order is not compatible with the absolute sovereignty of nation-states. The 19th century saw an impressive rise of liberalism and a first wave of a truly large-scale globalisation. [...] What was missing in that world was not the economic order, but the political and institutional order necessary to sustain it. We may be in a similar situation today. »

TPS, « Interdependence and Cooperation: an Endangered Pair?", remarks at the Governor's Dinner of the Basle Committee, 27 June 2005

“Will we be capable of creating a new world order without first suffering through the hell of an upheaval comparable to the early years of the 20th century? We cannot be certain that we will not repeat the same mistakes, and perhaps the same tragedies, of a century ago.”

TPS, Contre la courte vue, 2009
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