

## **THE 2018 HAROLD WINCOTT MEMORIAL LECTURE**

### **Can economic multilateralism survive?**

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### **INTRODUCTION**

A major battle is being waged globally that ranges from trade to finance, climate, the internet and many other policy fields. It is a battle about the organising principles of international economic relations, whose outcome will be a determinant for global prosperity, the preservation of global commons, and peace. The last time such a battle took place was three quarters of a century ago at the time of the Atlantic Charter, the Bretton Woods negotiations, and the failed attempt to create what was then called an international trade organisation. The outcome of yesterday's battle paved the way for decades of prosperity; today's battle could instead herald a dark future for the global economy.

Economic multilateralism is under attack from the Trump administration. Whereas in April 2009 in London the G20 leaders claimed that 'a global crisis requires a global solution', President Trump's security and economic advisers wrote in 2017 that 'the world is not a "global community" but an arena where nations, nongovernmental actors and businesses engage and compete for advantage'. In 2018, he himself endorsed trade wars, saying they are 'good, and easy to win', and initiated sanctions against several major trade partners.<sup>1</sup>

Britain and the EU are firmly on the side of an international economic relations regime that prevents beggar-thy-neighbour behaviour, and ensures equality of rights between nations and an adequate provision of global public goods – what we loosely call multilateralism.

Rightly so: in an increasingly interdependent world, global rules must be applied and global commons must be taken care of. Climate preservation, biodiversity, financial stability and internet security, to name just four of them, will not emerge from market interaction or from the uncoordinated initiatives of national governments. Nor will they be engineered by a benevolent hegemon.

But the champions of multilateralism would be wrong not to acknowledge that the problems they are facing exceed those created by the Trump administration. Problems did in fact start earlier: US grievances against the weakness of trade-related disciplines at the World Trade Organization (WTO) preceded the Trump presidency; Asian grievances against the International Monetary Fund (IMF) did not start with it either; and certainly neither did popular grievances against financial liberalisation.

Problems also run deeper. Extensive economic and financial integration challenges and disrupts the traditional Westphalian model of international relations;<sup>2</sup> global commons call for increasingly coordinated action at a time when we are instead witnessing a major, nearly universal rise in the demand for national sovereignty; the emerging global power, China, claims that global rules that were written by incumbent powers cannot form the basis for tomorrow's world order; and economic relations are increasingly made hostage to geopolitical power struggles.

Many of the supporters of economic multilateralism instinctively endorse a defensive agenda. They present themselves as the defenders of a global order under attack. They recall the achievements of the WTO and the Bretton Woods institutions and emphasise that addressing today's mounting challenges requires strengthening international cooperation.

In a sovereignty-conscious, heterogeneous, multipolar world, however, the deepening and broadening of the late twentieth century order is not a realistic programme. It is likely to be a losing proposition. Rather, those who oppose the transactional approach to international economic relations should start from a clear view of the problems that multilateralism is facing and come up with a precise solution set they could rely on to address these problems. They should formulate a new multilateral agenda that acknowledges the partial obsolescence of the post-World War II order and proposes new solutions.

What I would wish to do in this lecture is to discuss what the analysis of past and present forms of international collective action can teach us and how it may contribute to devising this new agenda. To this end, I will first look back and compare global governance achievements to plans made in the early 1990s after the fall of the Berlin Wall and the beginning of the opening up of China; second, I will discuss the roots of the problem the global economy is facing; third,

I will review alternative agendas for global collective action; fourth, I will assess the lessons from emerging governance arrangements; and fifth, I will derive from my analysis a few policy implications.

## **A LOOK BACK**

It is hard to dispute that a step change in the intensity and nature of international economic integration has taken place over the last three decades, since in fact globalisation entered our vocabulary in the early 1990s. This change encompasses a series of dimensions, the most prominent of which have probably been the integration of formerly communist countries, especially China, into the global economy; the development of knowledge flows and what Richard Baldwin (2016) called the ‘second unbundling’; financial account liberalisation and its consequences for the transmission of financial shocks; the rise of concerns over global commons such as climate and biodiversity; and, lately, the emergence of a new commodity made up of data.

It is in the 1990s that these transformations took shape. Not by accident, the 1990s also witnessed an intense reflection on the organising principles of this new global economy. And a strategy was devised to cope with it, which essentially consisted in strengthening and completing the institutional architecture of the post-war economic system.

Let me be clear. It would be exaggerated to speak of a full masterplan. But the spirit of the times was certainly that there would be, on the one hand, liberalisation and a broadening of the scope of the market and, on the other hand, the building of a strong policy architecture.

The WTO was indeed created in 1995, and plans were made to:

- create a world competition system hosted by the WTO;
- negotiate a Multilateral Agreement on Investment (MAI);
- give the IMF formal competence over the financial account;<sup>3</sup>
- cooperate on financial stability issues – initially within the Financial Stability
- ‘Forum’; and
- agree on a binding regime for climate change mitigation – the Kyoto Protocol.

For some years, it seemed that world economic relations were on their way to being structured by a seven-pillar institutional architecture made up of hard institutions – that is, universal, treaty-based organisations equipped with resources, instruments or coercion powers.

The WTO-based global trading regime would be complemented by parallel regimes for competition and investment; the Bretton Woods institutions would be strengthened to cope with free capital flows and complemented by a body in charge of financial stability; and the rise of environmental concerns would be reflected in the institutional architecture of globalisation through the building of a universal framework for climate change mitigation or, more ambitiously, the creation of a World Environmental Organisation (Figure 1).

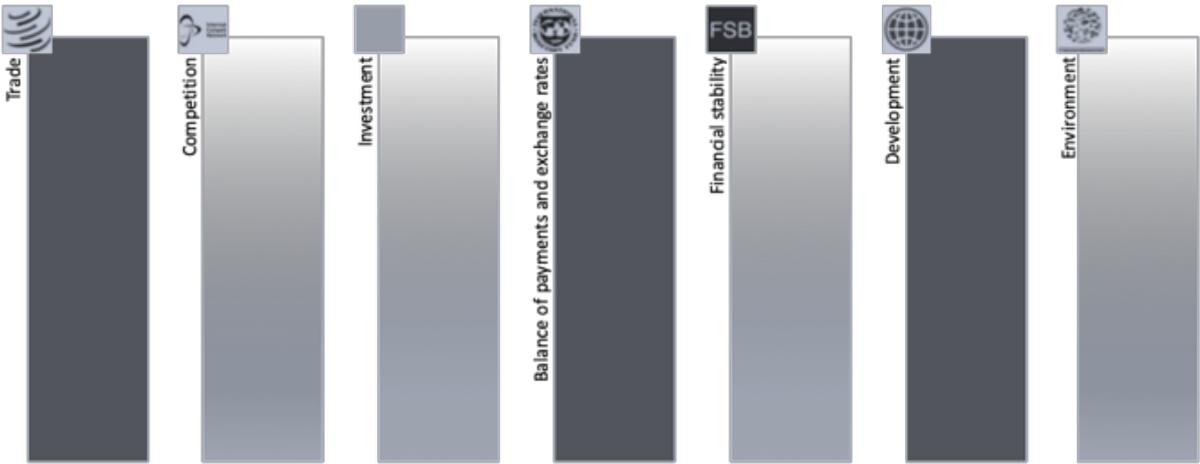


FIGURE 1 Global governance as seen at the turn of the millennium: A seven-pillar architecture. Note: Dark areas indicate the-existing institutions, light areas indicate yet-to-be-created institutions.

Much of this vision did not materialise. And setbacks took place well before Donald Trump’s election:

- An international competition system was considered in 1995 by the EU, then abandoned.<sup>4</sup>
- The MAI negotiations collapsed in 1998.
- The extension of the IMF mandate was discussed in 1997 and subsequently abandoned.
- A Financial Stability Board (FSB) was created in 2009 in the aftermath of the global financial crisis. Although hailed as a ‘fourth pillar’ of the global architecture, however, it was not equipped with strong powers.

- The Kyoto Protocol was signed in 1997 but was de facto abandoned after the US pulled out in 2001. It was substituted by the non-binding Paris Agreement of 2015.

The outcome is therefore quite different from the late 1990s vision (Figure 2).

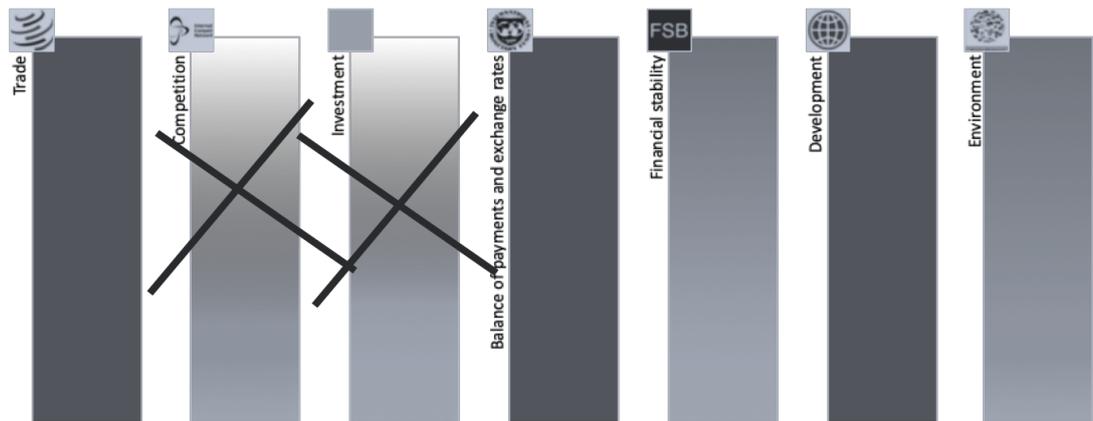


FIGURE 2 The outcome: An incomplete architecture.

Furthermore, if we look now at the performance of the existing institutions, the least we can say is that it has not fulfilled the promises made in the 1990s. The WTO was created in 1994, but it has not given rise to any new multilateral momentum. Rather, what we have witnessed is a burgeoning of regional agreements (Figure 3).

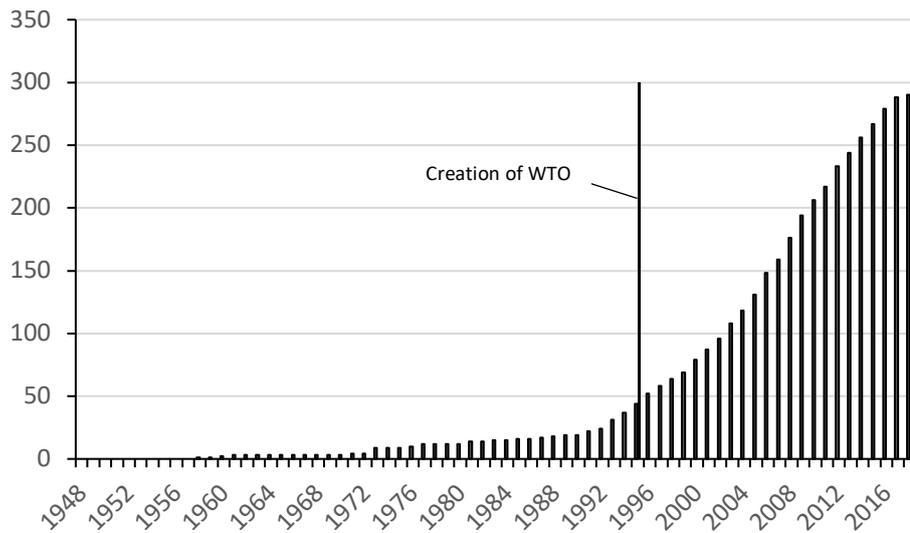


FIGURE 3 Number of regional trade agreements in force, 1948–2018.  
Source: WTO.

The evolution of the IMF has also disappointed expectations formed at the turn of the millennium. It was not given the legal and financial means to steer a financially integrated economy. Furthermore, in spite of the decision taken in 2009 at the London summit to increase its resources, its role in the global financial architecture has been curtailed. As the recent Tharman Report (G20 Eminent Persons’ Group 2018) pointed out, it is by now only a component of the global financial safety nets, alongside national reserves, bilateral swap lines and regional financial arrangements (Figure 4).

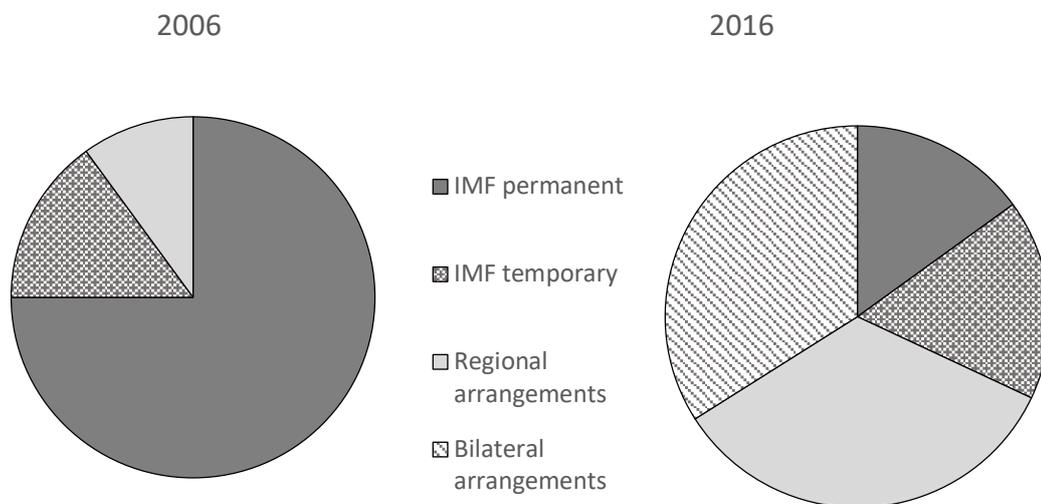


FIGURE 4 Structure of the global financial safety net, 2006 and 2016.

Source: Tharman Report (G20 Eminent persons' group 2018).

So it is fair to say that the strategic vision of the 1990s has by and large not materialised. The surge in interdependence resulting from liberalisation, technology and the growing importance of global commons has not been accompanied by a parallel strengthening of the institutional architecture of global governance.

## **THE ROOTS OF THE PROBLEM**

I should not spend too much time discussing why the global governance programme failed to materialise. It would take long because the reasons are partly economic, partly political, and partly geopolitical. I have discussed elsewhere the role played by geopolitics and by growing doubts about globalisation (Pisani-Ferry 2018). Let me only mention three factors that are important from the perspective I am developing here.

### **NEW PATTERNS OF INTERDEPENDENCE**

The first reason is the growing disconnect between the post-war global governance regime and the actual shape of interdependence within today's global economy. We have been used to thinking of interdependence in terms of flows of goods, capital and other factors of production in and out of individual economies of different sizes and degrees of openness. As pointed out by Hyun Shin of the BIS (2017), in this sort of representation economies are like islands connected by ship routes for goods and factors. This image is still predominant in a large part of the public and in the mind of many policymakers, but it is increasingly at odds with reality.

- Countries are not relatively homogeneous economic entities anymore. In the 'second unbundling' world described by Richard Baldwin (2016), knowledge and technology flows have turned many of them into combinations of world-class clusters of economic performance and areas of backwardness.
- Global value chains (GVCs) have transformed global trade, blurring the distinction between sectoral importers and exporters that traditionally underpins the organisation of trade negotiations; as a GVC involves both, they have also blurred the distinction between trade linkages and financial linkages.
- Financial globalisation has made net savings flows – current account balances – less significant in the transmission of shocks than gross credit flows, co-movements in asset

prices and balance-sheet valuation effects arising from gross cross-border holdings of financial assets. Significantly, the global financial crisis did not arise from the much-discussed ‘global imbalances’ (net savings flows) and it did not contaminate Europe through capital flows or exchange-rate movements. Rather, transmission took place through the much less commented stock interdependence between Europe and the US.

- The internet serves as a global infrastructure for both domestic and international transactions, without any distinction being made between them – my email to my wife sitting in the same room may be travelling across borders before it reaches her.
- Finally, interdependence through climate change or the degradation of biodiversity is taking place without any transaction happening between countries.

New patterns of interdependence also give rise to much more significant asymmetries than are accounted for by traditional models. The dominant role of the US dollar in international credit and trade invoicing especially gives rise to significant asymmetries in the functioning of global interdependence. As developed by H el ene Rey (2013), the islands-based representation of financial globalisation that prevailed in the early 2000s is being substituted by a hub-and-spokes one that emphasises the centrality of the US financial market and the significance of US-determined global financial cycles. Research by Gita Gopinath (2017) and colleagues also tend to challenge the traditional representation: the trade impact of bilateral exchange rates is diminishing in importance while the dollar exchange rate is becoming a major determinant of trade and finance. Put simply, trade between country A and country B may be less affected by their bilateral exchange rate than by their exchange rates vis- -vis the US dollar.

The centrality of the US financial market and of the dollar was highlighted in the global financial crisis. Banks which were cut off from direct access to dollar liquidity because of the lack of collateral denominated in the same currency had to turn to their national central banks for support. But these central banks, in turn, could only provide a helping hand thanks to bilateral swap lines extended by the US Federal Reserve to selected partner institutions. The crisis revealed the profoundly asymmetric character of the global monetary and financial system.

So we may still be counting the ships entering and leaving the islands’ harbours, but this accounting is telling us less and less. Research is gradually coming up with better models of interdependence that takes into account vertical integration, trade–finance linkages, network effects and deep-seated asymmetries in the operation of the international system. Yet we are

still a long way from having elaborated a fully adequate representation and from being able to draw from it the proper governance consequences.

CONCENTRATION

The second reason why the global governance programme failed to materialise is the extreme concentration of economic weight in today’s global economy. The WTO has 164 members, the IMF 189 and the UN 193, but for most practical purposes the countries which really matter are at most 10 per cent of this membership. This is illustrated by the distribution of global GDP or by a simple indicator such as the share of the top ten countries in the world total (Figures 5 and 6).

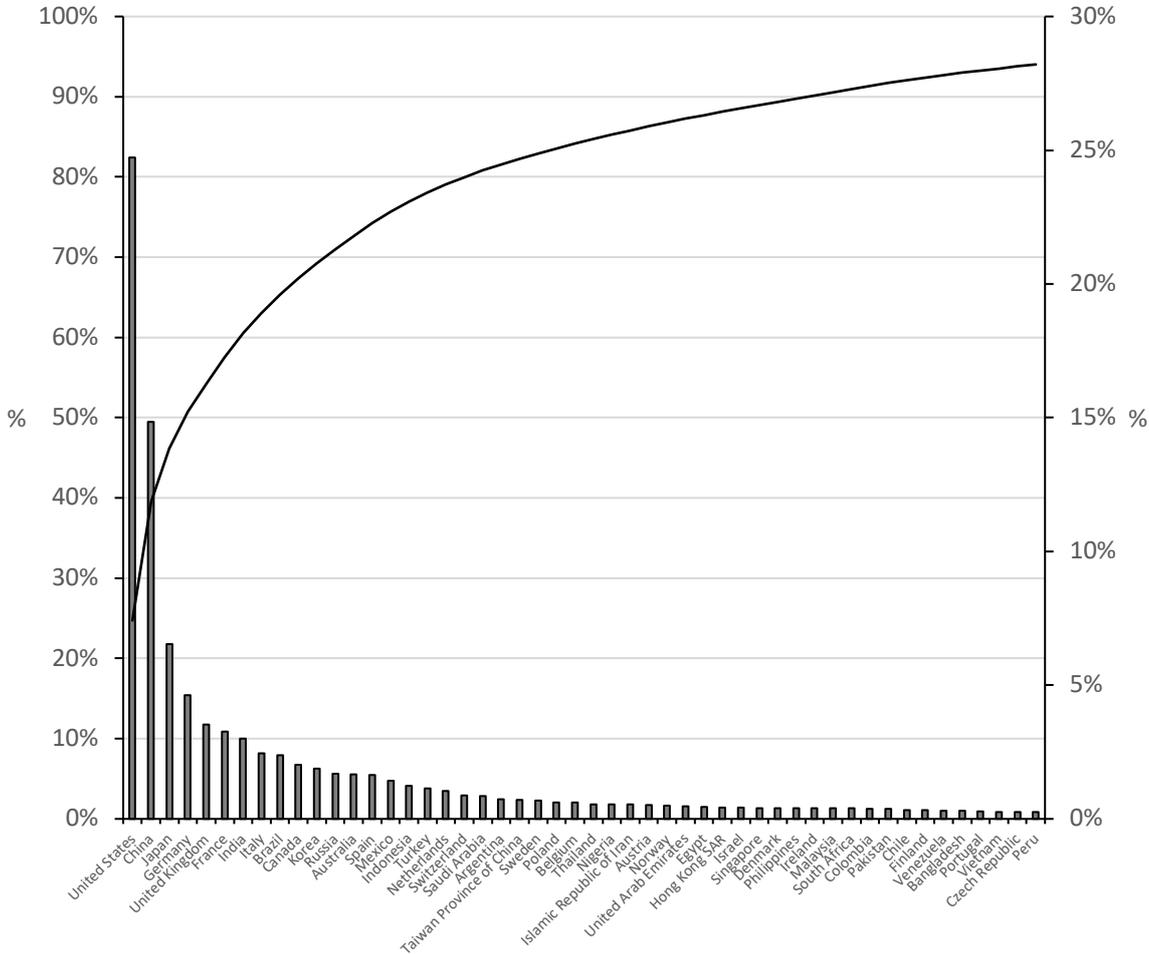


FIGURE 5: International distribution of global nominal GDP, 2016.  
 Note: Individual countries’ dollar GDP shares of world total, columns, left-hand scale; Cumulative share, line, right-hand scale. Countries represented on the graph are the 50 largest by GDP.  
 Sources: Author’s calculations with IMF World Economic Outlook data.

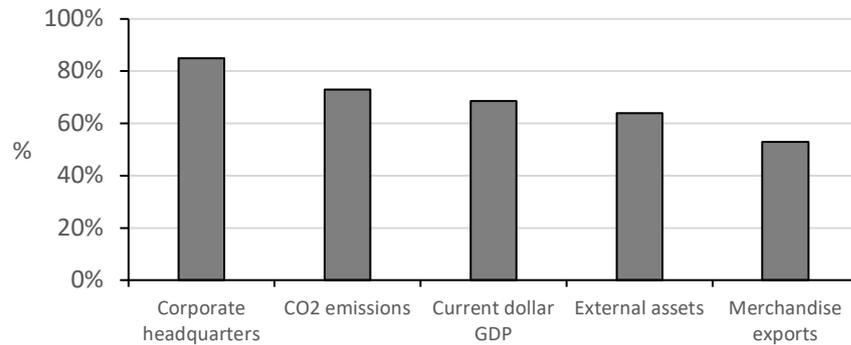


FIGURE 6 Share of top ten countries for selected indicators, mid-2010s.  
Source: Author's calculations based on various sources.

Such data illustrate what could be called the 'WTO curse': the paralysis that threatens universal institutions. This especially applies to those, like the WTO, where decision by consensus is the rule. Those, like in the Bretton Woods institutions, where votes are weighted and decisions are taken in a compact board by qualified majority, are better-equipped to avoid paralysis, but qualified majority voting is something the global community was not ready to consider any more in the 1990s and is even less ready to consider today. The sheer number of participating countries or entities is by itself a major impediment to the implementation of the global governance agenda.

This much more numerous global community is also more diverse in terms of development levels. In 1944 the poorest of the countries participating in the Bretton Woods Conference was probably Haiti, whose GDP per capita was a tenth of that of the US. Today, Haiti's GDP per capita is less than one-fortieth of that of the US (Figure 7).

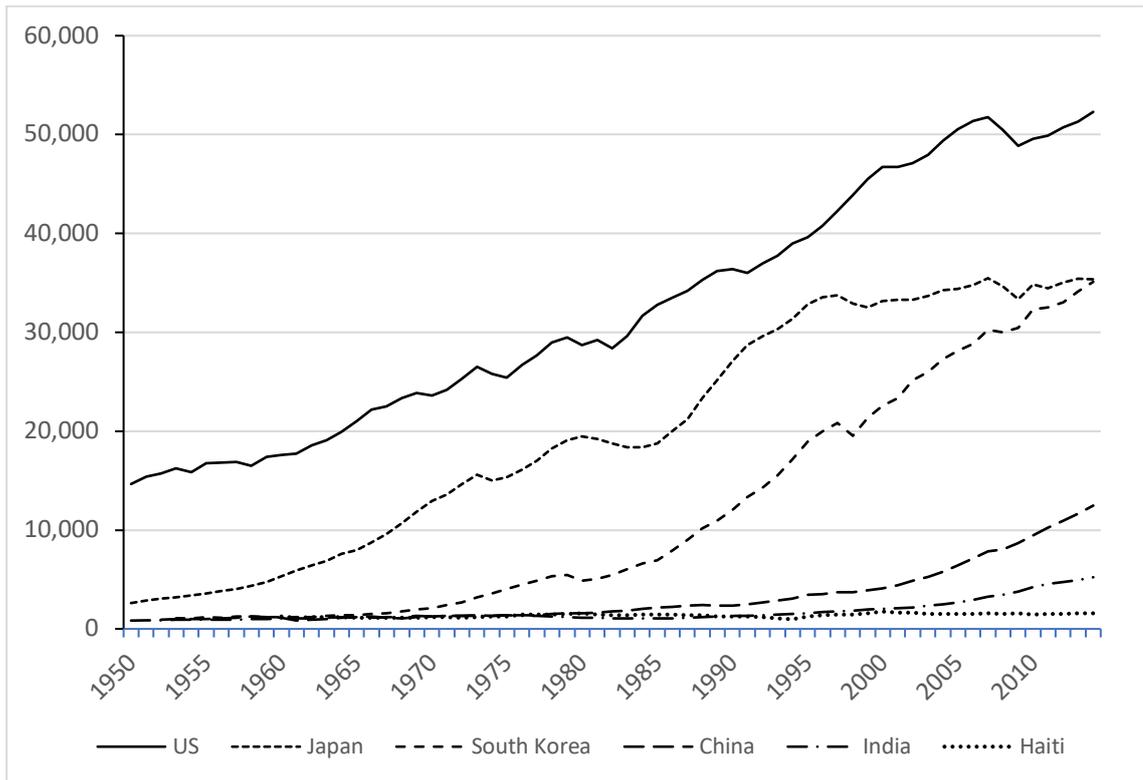


FIGURE 7 PPP-based GDP per capita, selected countries, 1950–2014.  
 Note: 2011 international dollars.  
 Source: Penn World Tables.

Development heterogeneity is evidently a major issue in an international system whose founding principle is the equality of rights amongst nations. It must be recognised that it has not been tackled adequately. The ‘developing country’ status has become as much a political as an economic characterisation – two-thirds of WTO members, including China, are still categorised as ‘developing’ – but there is no official list of them. And as noted already, nations have become increasingly heterogeneous entities.

### MULTIPOLARITY

The third reason is the increasingly multipolar character of the global economy. In 1950, according to the data compiled by the late Angus Maddison, the share of the US in global GDP measured in purchasing power parity terms was 28 per cent. The next country was the UK with a 5.7 per cent share. Such an overwhelming disproportion was unprecedented: in 1870 Queen Victoria’s empire accounted for about the same proportion of world GDP but China was a close second with 20 per cent – though admittedly it was also a remote second.<sup>5</sup>

China and the US are now neck and neck with about 16 per cent of global GDP each.<sup>6</sup> The situation therefore resembles the one observed in 1913, when the US was about to overtake

the British empire as the world economy’s powerhouse. But there are two major differences. First, China is far from being dominant in a number of essential fields where the US remains unrivalled – science, finance and the military, just to name the three main ones. Second, we also have the EU – also 15 per cent if we are still counting Britain in it – and then India with almost 8 per cent, a share that is rapidly rising.

The interwar period provides testimony of the difficulty of leadership transition from an incumbent power to a rising but reluctant new hegemon. As forcefully analysed by Adam Tooze (2014), US unwillingness to rise to the challenge of global leadership was a major factor behind the post-World War I descent into crisis and conflict. But what we are facing today is not only the rise of the emerging power and the relative decline of the incumbent, but the emergence of an increasingly multipolar global economy in which two, possibly three or four, world-class powers will coexist. This is illustrated by the evolution of a simple Herfindhal index of global economic power.

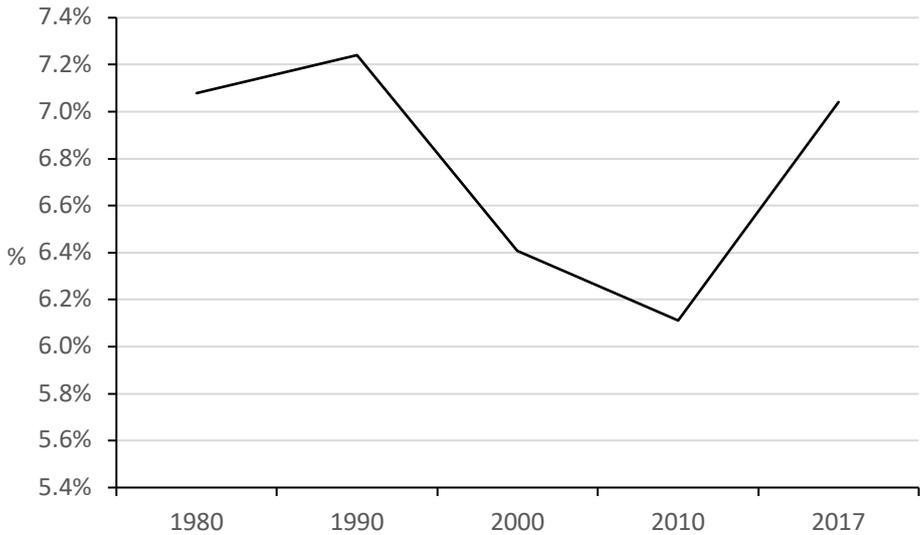


FIGURE 8 Herfindhal index of global economic power, 1980–2016.

Source: Author’s calculations with IMF World Economic Outlook data. The index provides a measure of the concentration of economic power measured by PPP GDP. The sample is limited to countries already existing in 1980 (or whose evolution has been retrofitted, as for the former Soviet republics). EU members are treated individually.

The problem is that we know little about the functioning of a multipolar system. We do have a reasonably good understanding of the functioning of a hegemonic system – here, economists and political scientists converge to describe it as an implicit contract whereby the hegemon benefits from rents and takes on exorbitant duties (Eichengreen 2012; Ikenberry 2018). The quid pro quo is especially striking in the monetary field, where the hegemon trades off the ‘exorbitant privilege’ of issuing the international currency against the fiscal risk of

providing emergency liquidity to the foreign users of its currency (Gourinchas et al. 2017). This framework of analysis gives us a reasonably good hunch of why the incumbent power may decide to change the rules of the game if it perceives that the exorbitant duties exceed the exorbitant privilege, or simply if its time preference is such that it prefers to convert long-term benefits into short-term rents. We also understand why a power vacuum in between two hegemonic regimes may be dangerously unstable.

But we do not understand how a truly multipolar system would work. We do have a reasonably good understanding of how an oligopoly works in normal times, and actually we do have examples of such oligopolistic functioning in fields like international trade negotiations or competition policy. But what is harder to determine is how exorbitant privileges and exorbitant duties should be shared among the major powers. International negotiations can define principles and rules that apply to all participants in normal times. They can hardly determine how discretionary power arising from economic centrality will be exercised in crisis times. They can hardly decide who should be the guarantor of the system, which risks they should be ready to take, and what costs they might be willing to incur to preserve the integrity of that system. This is certainly a lesson we have learned from the euro crisis.<sup>7</sup>

Furthermore, even an agreement on principles may be difficult to reach if the leader of the largest economy expresses scepticism vis-à-vis the global order. Chinese claims that the rules of globalisation have been written by the incumbent powers to their own benefit, and that other countries do not have the same ownership of them, is a stark reminder of the difficulties involved in sharing responsibility for maintaining the global economic order.

## IMPLICATIONS

It would not be fair to say that international organisations have remained immobile in view of these tectonic changes. They have developed new analytical tools such as the WTO's measurement of trade in value added, and they have put in place new instruments such as the IMF's surveillance of global capital markets and systemically important countries. From a strict governance standpoint also, changes have been noticeable: voting rights within the Bretton Woods institutions have been revised, albeit slowly and reluctantly. It remains true, however, that what emerges from the analysis is the obsolescence of the global governance system. Since the mid-1990s, the basic structure of the global governance set-up has remained too dependent on the 'islands' representation; the institutional architecture of globalisation has not been fundamentally reformed to address emerging challenges; and reforming existing institutions has been painful and slow.

## ALTERNATIVE ARRANGEMENTS FOR COLLECTIVE ACTION

The conclusion from the preceding assessment is that the proponents of multilateralism would be wrong to set themselves the goal of preserving and completing the late-twentieth century global governance agenda. Conservation is an appropriate strategy to cope with a temporary shock, not to respond to major upheavals. But what is the alternative? A good starting point for answering this question is to assess how global governance has evolved.

### EMERGING ARRANGEMENTS

Casual observation suggests that the vacuum left by non-existing institutions is being filled, at least partially. In a series of fields we have witnessed over the last few decades the – rather disorderly – emergence of a variety of arrangements, sometimes outside the prevailing global governance system, sometimes within it or at least in connection with it. Such arrangements include bilateral agreements (in development finance, for financial safety nets), regional agreements (for regulation, trade, development, financial safety nets), coalitions of the willing-type agreements (for trade), multilateral frameworks for bilateral agreements (for information exchange on tax matters), informal voluntary cooperation arrangements between independent authorities (amongst central banks or competition authorities), pledge and review agreements, either at global level (for climate) or amongst a subset of players (for banking regulation), multi-stakeholder fora (for the internet and also climate change mitigation), and purely private arrangements (for the setting of standards, e.g. accounting standards).<sup>8</sup>

These arrangements have often departed from the standard template for global governance and have introduced a number of innovations:

- Many have relaxed the *universal membership constraint* to build regional or thematic clubs involving the most relevant players.
- Several have eliminated the *legal constraint* that required cooperation to be rooted in international treaties.
- A number of them have overlooked *institutional constraints* to build informal coordination procedures amongst key players without having recourse to formal institutions.

- Some have put aside the principle that international cooperation be based on *specified obligations* to instead put the emphasis on nudge and incentives arising from reputational concerns, opinion pressure or market pressure.
- And a few have got rid of the *Westphalian constraint* to include non-state players such as sub-national governments, private companies or non-profit associations.

It would not be an exaggeration to say that the global governance landscape has undergone a similar transformation to that experience by the European physical landscape in the eighteenth century when the well-ordered *jardins à la française* were substituted by less formal and symmetric English garden-type arrangements. Universal, treaty-based, institutions supported agreements that rest on state membership and define the obligations of their members have become the exception rather than the rule.

As institutions tend to proliferate, is not easy to measure the extent and scope of these various types of arrangements. A rough count would give the same weight to a wide-ranging and powerful organisation like the IMF and to whatever unheard-of sectoral body. In fact, Gray (2018) finds that only half of the existing international organisations are actually active. About 10 per cent are dead and almost 40 per cent can be considered as ‘zombies’ that maintain semi-regular operation but fall short of the mandate they were initially given.

A simple effectiveness yardstick can be provided by the degree to which the Group of Twenty relies on institutions. As the G20 has for ten years served as an anchor and a priority setter for global collective action, communiqués by heads of states and governments provide a basis for selecting institutions of major relevance and for assigning each of them a weight. The graphs in Figure 9 are based on the frequency of mention of institutions in the communiqués of the G20 meetings at head of state and government level from Washington 2008 to Buenos Aires 2018 (see details in Appendix A). They provide information on the nature of the institutions called to duty by the leaders, with the obvious caveat that their selection is biased towards those dealing with what has been the top priority of the G20 during the sample period: finance.

The evidence is that over the last ten years the G20 frequently relied on non-universal, informal and non-Westphalian institutions (Figure 9). Close to half of the institutions called to action by its communiqués are non-universal ones, a quarter of them are non-Westphalian and a quarter also (partially overlapping with the former) informal.

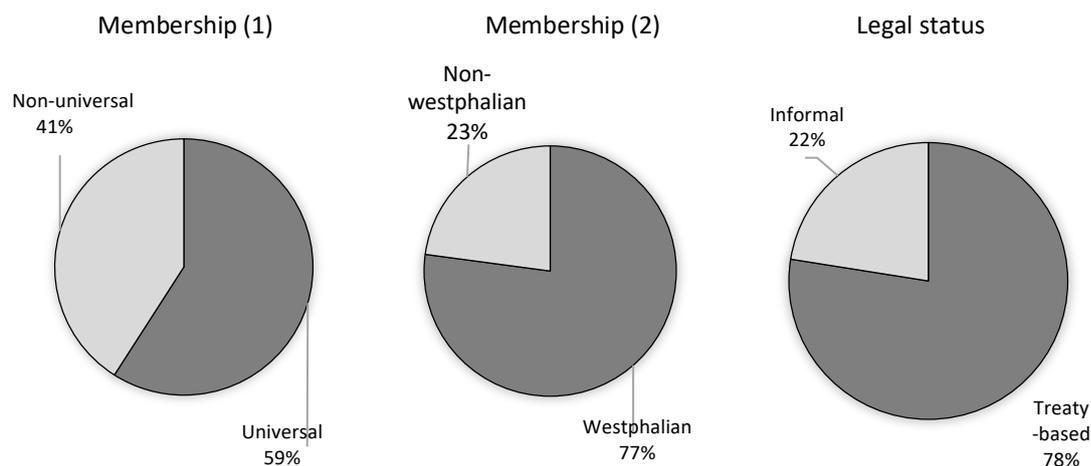


FIGURE 9 Characteristics of institutions called to action by the G20 leaders, 2008–2018. Source: Author’s calculations based on G20 leaders’ communiqués (see Appendix B).

### CAN ALTERNATIVE ARRANGEMENTS DELIVER?

Can ad hoc, sometimes loose arrangements substitute the would-be pillars of the governance architecture? Can they be effective in addressing collective action challenges? Academics and seasoned practitioners of international organisations are often critical – at least they find such arrangements perplexing. They point out that universal rules and institutions have been designed for good reasons. First, they provide participation incentives and avoid free-riding; second, they ensure discipline and prevent predatory, beggar-thy-neighbour behaviour (this is the very purpose of the IMF’s Article 4 or of the WTO dispute settlement procedures); third, they protect the weaker countries – this is for example the role of the WTO’s Most Favoured Nation (MFN) provision; and finally, they promote cost-effective solutions (multilateral liquidity insurance through participation in the IMF and the exchange of emission permits are cases in point).

Critics are right to point out that faith in ad hoc arrangements can be a fig leaf for endorsing ineffectiveness. Innovative proposals for less demanding forms of international cooperation put forward by practitioners and international relations scholars are often suggestive, but by the same token they often fail to convince that roadblocks to effective and efficient collective action are dealt with systematically enough. To take only two examples, the very Westphalian ‘sovereign obligation’ concept put forward by Richard Haass to highlight the duties of sovereign states to their neighbours and partners (Haass 2017) and the anti-Westphalian ‘creative coalition’ concept proposed by the Oxford Martin Commission for Future Generations led by Pascal Lamy (Lamy et al. 2013), belong to two opposite traditions

but what they have in common is the absence of a systematic treatment of participation incentives and enforcement challenges. In both the Westphalian world of Haass and the post-Westphalian world of Lamy, it is unclear why and how participants overcome the collective-action problems. Neither approach offers a compelling solution to them.

## THE PITFALLS OF SIMPLE MODELS

By the same token, however, we should beware of analysing reality through the lenses of overly simplified models that may yield forceful results but misrepresent the true nature of the interactions at work. Obstacles to successful cooperation are pervasive, but they are not as systematically decisive as suggested by the economists' Mickey Mouse models.

In economics, insights from such models have often gained currency beyond what is justified in view of their hypotheses or scope. This has applied to collective action following the seminal work of Mancur Olson and his forceful warning that 'unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interests' (Olson 2065, p. 2). In the international field, it has become common wisdom that the purpose of collective action is to cooperate in the production of global public goods, that the corresponding problem is best represented by a two-players or  $n$ -players prisoner's dilemma game, and that any arrangement that does not overcome the associated obstacles is bound to fail.

Reliance on a prisoner's dilemma structure to represent global collective action problems can, however, be misleading. As observed by Todd Sandler, since Olson's *Logic of Collective Action*, 'public goods have served as the "poster-child" of collective action problem' while 'in reality, public goods are just one kind of collective action problem' (Sandler 2004, p. 18). By the same token, Sandler points out that 'most collective action problems are not Prisoners' Dilemmas but some other relevant games' (Sandler 2004, p. 29).

Let me take three examples to clarify this point.

If envisaged in a static framework without endogenous technical progress, *climate change mitigation* provides the example of a true prisoner's dilemma game. In a multiple-countries setting, each of the players faces a strong incentive to free-ride and to leave to the others the burden of investing in the reduction of greenhouse gas emissions. As demonstrated by William Nordhaus, one of the 2018 Nobel Prize recipients, voluntary climate coalitions are inherently unstable (Nordhaus 2015). This implies that collective action can only be sustained by relying on a coercive system that ensures externalities are internalised. This is a case where the basic model applies.

But assume now, as in the model of Daron Acemoglu, Philippe Aghion and co-authors, that instead of working with a given set of technologies, climate change mitigation relies on endogenously developing clean technologies that initially do not match the productivity of the dirty ones but have the potential to develop and reach or exceed that level (Acemoglu et al. 2012). This transforms the game and the purpose of public policy: instead of the full internalisation of the climate change externality, it may take as a goal to foster what Laurence Tubiana, a key person behind the COP21 agreement, called a ‘convergence of expectations’ conducive to the development of clean technologies (Tubiana 2018). Such convergence may in turn help reach the critical mass of private investments that will make it possible to overcome the initial cost disadvantage of the clean technology, and thereby put the economy on a different trajectory.

The consequence from moving from a static to a dynamic setting is a change in the nature of the underlying game. The Nordhaus setting is underpinned by a static prisoner’s dilemma game whose non-cooperative equilibrium results in a price of carbon well below its global social cost. Instead, the Acemoglu et al. approach results in a game where a critical quantum of aggregate action is enough to yield benefits. In concrete terms, what matters in such a setting is whether the automobile industry will invest in developing the next generation of combustion engine or rather in designing zero-emission vehicles. It will choose the latter as long as it anticipates that a sufficient part of the future global market will be covered by strict emission regulations or a high enough carbon tax. The fact that some countries, even important ones, deviate from the collective commitment will not change the direction of investment as long as others hope to derive from it a competitive advantage in future technologies.<sup>9</sup>

Take now *financial stability*. Here also there are strong cross-country spillovers, but a country’s financial stability depends first and foremost on its own policies and on the soundness of its own financial institutions. Each country’s authorities have an incentive to act – unless they believe that partners won’t act and that it is therefore pointless to incur the costs of limiting risk-taking at home if the global financial system is bound to collapse. With such weakest-link interdependence, what cooperation requires here is much less than compulsion or sanction – rather, enough transparency to create trust and convince each player that its efforts are not going to be frustrated by its partners’ lack of commitment.

Such a reading may help explain the functioning of the FSB and the international regime in place for banking regulation, whereby standards are negotiated by all the members of the club, while each country is free to adopt, implement and enforce them. Trust is provided by a review mechanism: the member countries’ performance is reviewed on a quarterly basis by the

Basel committee and the result of this evaluation is made available to market participants and the public. The rationale behind the arrangement is that the underlying game is an *assurance game* where the cooperative outcome rests on a minimum quantum of action from all participants.<sup>10</sup> With such a game, the combination of peer pressure and market pressure suffices to elicit cooperative behaviour. Furthermore, an assurance game's cooperative equilibrium is stable. What is required for it to prevail is a sufficient degree of trust between a subset of important partners.

Take finally the *issuance of an international currency*. Here, clearly, economies of scale are such that one, at most two, countries will be providing the essential vehicle for global trade and finance. As for disease control, a field where the US is freely providing to the rest of the world the information on diseases it collects and monitors, the issue of free-riding does not arise, as only one country needs to act. The key questions are which country takes leadership and provides the corresponding benefits to its partners – at what price; and whether it can be trusted and can resist the temptation to use its privilege to serve its immediate national interests.

#### AN OSTROM-LIKE RESEARCH AGENDA

The upshot is that there are different types of interactions and different types of games which do not necessarily call for the same type of governance response. What is required to elicit trust in the partners in a cooperative game is not the same as what is needed to prevent the free-rider curse in a game where the incentive to renege on commitments is too strong to be resisted.

This has significant implications for international arrangements: in a world where games differ, we should neither put faith in loose arrangements through which hard collective action problems are purportedly tackled, nor assume that nothing short of a strong public organisation equipped with coercion powers can provide the institutional framework of cooperation. Scholars and policymakers should be more modest and more empirical, and they should endeavour to find out, at a very granular level, which arrangements can solve which problem.

What I am stating here is in fact close to what Elinor Ostrom wrote a few years ago about the variety of arrangements in place at grass-roots level for managing local commons such as rivers, lakes or forests. Her research aim was to 'dig below the immense diversity of regularized social interaction . . . to identify universal building blocks used in crafting such structured interactions' (Ostrom 2005, p. 5). In a similar way, an agenda for devising arrangements conducive to global collective action should:

- analyse critically arrangements in place to find out what is the underlying collective action problem they are aiming at providing a solution to;
- determine which are the mechanisms through which this solution is being engineered;
- determine if they actually deliver results;
- assess their robustness; and
- examine whether these arrangements are *sui generis* or replicable.

## LESSONS FROM EMERGING ARRANGEMENTS

What does the empirical analysis of existing arrangements tell us? Here, I am going to limit myself to a few fields and give a snapshot of the early results from an analysis undertaken within the framework of a project initiated jointly with George Papaconstantinou at the European University Institute. The project involves a review of existing arrangements in several sectors on the basis of the framework I have presented (Appendix B). Results at this stage are far from comprehensive but they are nevertheless informative.

### CLUBS, INCENTIVES AND PRIVATE PLAYERS

Table 1 reviews the membership, institutional backing, mechanisms and effectiveness of arrangements in five key fields.

TABLE 1 Summary governance arrangements in place in five fields

	Trade	Competition	Global financial safety nets	Banking	Climate
Membership	Universal + clubs	Club	Universal + clubs	Club	Universal
Interdependence structure	Multi-level networks	Oligopoly	Hub and spoke	Oligopoly	Global common
Anchoring in global rules	Yes	No	Yes	No	Yes
Mechanisms	Rules-based + specific agreements	Informal cooperation btw authorities	Rules-based + specific agreements	Pledge and review	Pledge and review
Institutional support	WTO	ICN (weak)	IMF	BIS	IPCC
Non-government involvement	Significant	Quasi-judicial process	Limited	Significant	Significant

Effectiveness	Significant	Remarkably effective so far	Yes but costly	Yes but risk of capture	Yet to be tested
Robustness	Significant	Vulnerable to changes in national legislations	Multi-level cooperation problematic	Vulnerable to disruption (non-banks, third countries)	Lack of effectiveness may threaten permanence

Four trends emerge from preliminary observations. *The first is that variable-geometry or club arrangements tend to predominate.* Clubs are the name of the game in almost all fields but climate change mitigation, which by nature aims at universal reach – and even there, it is being discussed as a potential option. In trade, which was once governed by universal rules, action has moved from the multilateral agreements within the framework of the WTO (the last of which now dates back a quarter of century) to regional, plurilateral or critical mass agreements that bring together self-selected partners.

Clubs prosper because they are smaller, more flexible, better tailored to the needs of cooperation between the players who really matter, and better suited to a heterogeneous world where capabilities and preferences differ. Most of these clubs are open-door groupings, to which new members can opt in at will or after a relatively light screening process – on the condition, obviously, that they commit to abide by the rules of the club. Several also rely on multilateral principles. Especially, trade agreements remain anchored in the multilateral system and they rely on its core principles such as national treatment or the MFN clause. In this regard it is important to note that club agreements may be at least as much complements to the multilateral order as they are substitutes.

The second trend is *a general reliance on incentive mechanisms.* None of the emerging governance arrangements involves formal compulsion backed up by sanctions. The pledge and review template, whereby participating countries or institutions do not abide by mandatory rules but commit to following common principles and to implementing common standards, and accept that their behaviour be monitored and reported, has become one of the main conduits for overall coherence – if not the main one.

The overall effectiveness of such mechanisms is open to question, but it is fair to say that where they are in place they seem to be delivering more than predicted by naive models. Banking regulation is a telling example: knowing the intimate relationship between national regulators and the industry, one would expect the political economy of banking regulation to result in international divergence. It is true that the Basel standards are not implemented with the same toughness in Europe, the US and Asia. But it is even more striking that they do exist in the first place and do have some traction.

The third trend is *weak institutionalisation*. In many fields, either existing institutions serve as a conduit for organising policy coordination or coordination takes place in a purely informal setting. The extreme case in this respect is global competition policy: national authorities – in practice, mostly the EU and the US – cooperate informally on an essentially bilateral basis.<sup>11</sup> Each recognises that in case consumers are at risk of being affected in a ‘direct, substantial, and reasonably foreseeable effect’,<sup>12</sup> partner authorities have the right to take decisions that apply to firms in its jurisdiction – for example to impose asset divestiture as a precondition to clearing the way to a merger. This principle, which is known as the *effects doctrine*, dates back to the US Sherman Antitrust Act of 1890. They also refrain from ruling on a case if there are grounds to think that it would be more adequately addressed by another jurisdiction (this is known as the comity principle). Not unlike central banks, which cooperate extremely well but retain full independence, competition authorities have thus organised the coexistence of overlapping authorities that cooperate without having recourse to any overarching global institution.

Finally, *a number of arrangements deliberately involve non-government players*. This is especially true of the Paris climate agreement whose architects regarded this involvement as a substitute for the lack of legally grounded implementation mechanisms. But evidence of private involvement is strong in other fields including trade, banking regulation and obviously the governance the internet. Private-sector participation as well as that of NGOs and civil society is seen both as a way to improve the design of regulation and as a mean to ensure better implementation.

## MECHANISMS

Are these mechanisms up to the tasks they are assigned to? Is it a new chemistry at work that involves variable geometry, incentives, informality and the involvement of third parties? And can this new chemistry offer an alternative to the old global governance model? It is a fact that clubs and the reliance on incentives are mutually reinforcing. A strength of clubs is that enforcement of commonly agreed commitments is not dependent on binding mechanisms or sanctions. But a member that does not fulfil its commitments can be expelled or pressured to leave. It is hard to remain part of a club one does not want to meet the requirements of. Universal institutions are instead more dependent on the existence of binding obligations and formal enforcement mechanisms, for which there is very little appetite in a more multipolar, sovereignty-conscious world.

Incentives can also be strengthened by private-sector involvement. This evidently takes place in cases when compliance with commonly agreed soft standards requires action by private companies. The implementation of capital and liquidity ratios for banks is not just a matter of enforcement but of ownership by the banks themselves. Once compliance becomes a matter of reputation for a financial institution, the hand of the regulator does not need to be heavy. As said, climate action also relies on similar mechanisms.

It would, however, be dangerous to overestimate the power of soft law and coalitions of the willing. Weaknesses and vulnerabilities are blatant. This is evidently the case for climate action, which rests on non-binding agreements. Commitments and delivery on commitments are being reviewed (the December 2018 Katowice agreement on measurement and reporting is an important step in this regard), but little can be done in case a participating country does not commit to a high-enough target or does not deliver on its commitment. And unless the participants in the emissions reduction agreements introduce border adjustment taxes, there is nothing beyond naming and shaming they can do to correct the distortions created by non-participating countries. As things stand, there is no evidence that the 2015 Paris Agreement on climate change will result in ambitious enough commitments and delivery.

Clubs can also degenerate into exclusive groupings that primarily serve the interests of their members and help maximise their collective market power. This is an old discussion in the field of trade policy, but it equally applies to mutual financial assistance or standard-setting. The lesson from the trade field is that for clubs not to be welfare-reducing globally, they should be anchored to common universal principles and assessed compatible with them.

An important test case in this respect is the Chinese Belt and Roads Initiative. The BRI has many dimensions, several of which are undoubtedly conducive to development. But in one respect at least it departs from commonly agreed principles: whereas in recent decades advanced countries devoted considerable efforts to untying international development lending from commercial interests and to submitting the settlement of insolvency cases to multilateral principles, China's initiative represents a significant backtrack from the approach promoted by international institutions. It risks fortifying the bilateralism, conflicts of objectives and asset-grabbing practices that have proved so detrimental to international development.

Another weakness of soft mechanisms is their vulnerability. This for example applies to the club formed by the competition authorities and the mechanisms through which extraterritorial decisions are made mutually compatible. The arrangement in place is remarkably effective in that it has been able to address global competition problems on the sole basis of an organised coexistence between the main national authorities. But its effectiveness

and its ability to defuse potential tensions rest on a strong consensus between authorities whose mandates are similar and that enjoy a similar degree of autonomy vis-à-vis political authorities. Should the US administration (whose Department of Justice is directly involved in competition policy decisions) take issue with an EU decision affecting American interests, or should China apply to the competition field its overall industrial policy philosophy, the prevailing consensus could break down.

The last risk is capture by private interests. Banking regulation through a club mechanism is a good example. At one level it is effective, but the price paid for enlisting the banking sector has been regulatory capture, of which the failure of the Basel II banking regulation accord of 2004 remains a vivid illustration (Constâncio 2018).

## **POLICY IMPLICATIONS**

Let me finally move towards addressing policy implications of what I have developed and to indicate what sort of guidance analysis provides to think about the contours of a renewed multilateral agenda.

I would wish to offer five such conclusions.

First, and again, *we should acknowledge that completing the post-war legal and institutional architecture is not the way forward any more.* The set of rules and institutions we have inherited should not be regarded as a half-finished cathedral whose completion is a task assigned to the current generation. The WTO and the Bretton Woods institutions are no Sagrada Familia. Rather, they are a strong asset, of which current policymakers must make the best possible use.

Second, *existing club-type, incentive-based soft global governance arrangements provide a wealth of experience to learn from and build on.* They should neither be dismissed as insufficient nor hailed as a panacea. They should be assessed critically to understand why some of them are effective and why others are not. It is certainly hard to find the right balance between complacency and scepticism, but I am afraid that it is what needs to be done.

This assessment requires hard work because it can only be carried out at very granular level, on the basis of a precise reading of the interaction involved, the resulting game structure, and the nature of the collective action problem that is to be solved. The problem policymakers are facing is that they are not very well equipped for this sort of assessment. There is a role for good policy research here, in that it could provide them with a toolkit for this sort of *ex ante* evaluation.

Third, *a case can be made for anchoring clubs in universal principles*. As indicated, such principles are needed to avoid letting clubs becoming exclusive and degenerating into ad hoc, beggar-thy-neighbour coalitions. The template here is trade, where regional agreements, preferential agreements and plurilateral agreements are governed by general WTO provisions such as national treatment and the most-favoured-nation clause. This also applies, in a less formal way, to international finance and the role of regional financial safety nets.

This anchoring is a way to combine the flexibility of clubs with essential principles that underpin international economic relations. It should serve as a guarantee against the risks of welfare-reducing agreements, especially in the fields of trade, investment and finance.

Fourth, *we should think more systematically about the involvement of the private sector and more generally the non-state sector in governance arrangements*. A governance system that does not rely on a strong legal basis and that cannot rely on sanctions is inevitably inclined towards involving stakeholders as a way to increase its effectiveness.

This has been the strategy explicitly followed for the Paris climate agreement, with some success. And there are numerous other examples, from sectoral regulations to the internet. There is nothing wrong about this approach, but it should not serve as an excuse for shirking policy responsibility. The market can be part of the mechanism design, but the market won't do the job.

Lastly, *we should change the way we think about international institutions*. They should not be regarded as sectoral empires for technocrats, but as poles of expertise able to devise solutions, support initiatives and provide monitoring.

Institutions are the global governance's social capital. Such capital is scarce and, as discussed already, the likelihood that new global institutions are going to see the light is low. So a case can be made for maximising the value that existing institutions can deliver.

Governing the world through a large network of specialised international institutions was a viable option as long as each would administer a specific domain on the basis of a specific universal treaty. But if global governance is set to evolve more in the direction of a constellation of clubs, such an approach would be a sure recipe for balkanisation and rigidification. Rather, international institutions should be regarded as poles of expertise able to devise solutions for a variety of problems. Some already provide examples of such a role: the World Bank was not initially designed as a knowledge bank, nor the OECD as an assessor of educational achievements. These institutions have been able to evolve and tackle problems as they emerged. Effectiveness does not require delegating competence to powerful global institutions, but it does require institutions that are able to tell the truth, experiment and propose.

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Let me close with the question I started from: can economic multilateralism survive? Only reality will tell us. But if it is to survive, it will be in a significantly different form from the one we inherited from the architects of the global economic regime. Its supporters would be well inspired to take notice and formulate an agenda for what could be called ‘parsimonious multilateralism’ or, probably better, ‘critical multilateralism’: an approach that focuses on the essential and ensures that the best use is made of necessarily limited legal, institutional and financial resources.

## **APPENDIX A**

### **Mention of international institutions in G20 communiqués**

The Group of 20’s leaders routinely call upon existing international institutions to explore new issues, organise consultations or implement political agreements entered into at heads of states and governments level. Their communiqués therefore provide a basis for measuring the role of international organisations.

The basic material consists of all G20 leaders summits’ communiqués from Washington (2008) to Buenos Aires (2018). Communiqués and important annexes were read carefully. Each mention of an international organisation was noted, including acronyms, full names, and periphrases (e.g. ‘International Monetary Fund’, ‘IMF’, ‘the Fund’). Repeated references to sub-bodies or groupings were counted separately (e.g. UN, UNCTAD, and UNFCCC; or BIS, and BCBS).

Further analysis was based on the subsample of organisations mentioned more than ten times over the period (Figure A1).

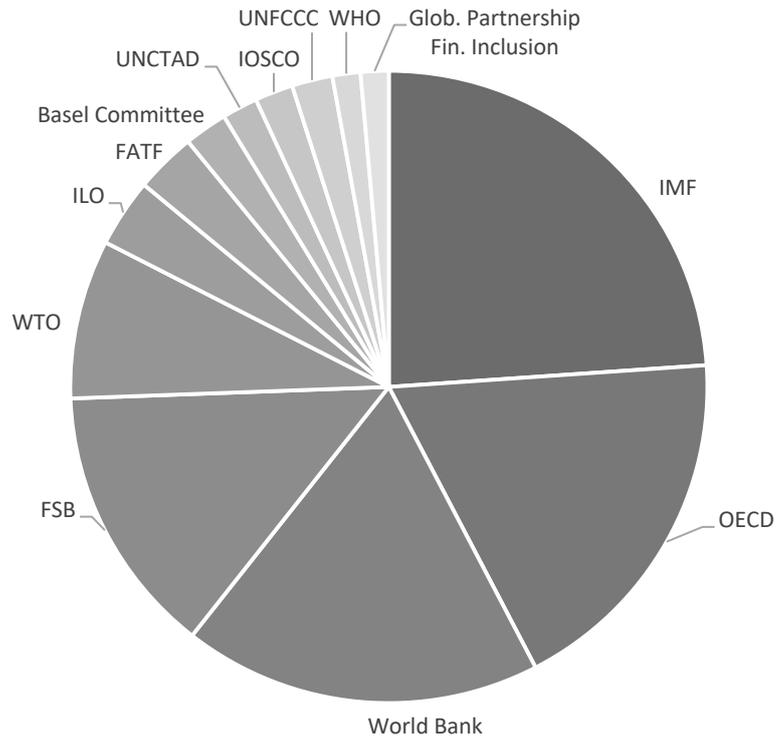


FIGURE A1 Main organisations mentioned in the G20 communiqués.

## APPENDIX B

### The European University Institute’s Transformation of Global Governance (TGG) Project

The TGG project was launched in Spring 2018 by George Papaconstantinou (School of Transnational Governance) and Jean Pisani-Ferry (Tommaso Padoa-Schioppa chair, Robert Schuman Centre). Its aim is to critically review new types of global governance arrangements that have emerged in recent years.

Building on a common analytical framework, the review is intended to help find out what can be learned from emerging global governance templates and what are the conditions for their effectiveness. Ultimately, the goal is to provide sound intellectual underpinnings to an agenda for reforming global governance.

Following the inaugural Tommaso Padoa-Schioppa lecture delivered on 9 April 2018, a series of specific seminars are being organised within the framework of the TGG project. The following topics are being addressed:

- International trade and the WTO system (Florence, 20 June 2018)
- Banking regulation (Milan, 13 September 2018 – co-organised with the Florence School of Banking and Finance)

- Cross-border effects of competition policy (Brussels, 16 October 2018 – co-organised with Bruegel)
- Governance lessons from post-WWII History (Florence, 14 November 2018)
- Taxation governance in global markets (Paris, 19 February 2019, co-organised with the OECD)
- Climate change mitigation governance (Paris, 28 March 2019, co-organised with the European Climate Foundation)
- Global financial safety nets (London, 2 April 2019, co-organised with the LSE)
- Internet regulation (Berlin, 12–13 April 2019, co-organised with the Hertie School of Governance)

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## NOTES

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<sup>1</sup> Respectively G20 leaders (2009), McMaster and Cohn (2017), and Trump (2018). See also Bolton (2018).

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<sup>2</sup> The Treaty of Westphalia of 1648 laid out the essential principles of international relations. It especially stated that states are sovereign, legally equal and free to manage their internal affairs. Westphalian models treat states as the only legitimate players in international relations.

<sup>3</sup> The Bretton Woods system did not envisage financial-account liberalisation as a policy goal. Whereas the IMF's Article of Agreement are explicit about the desirability of lifting restrictions to current-account restrictions, they are silent on the financial account. In 1997 the IMF tried to gain formal competence over the financial account but it failed to reach consensus on this reform.

<sup>4</sup> In 1995 the Van Miert report commissioned by the EU proposed the establishment of an international competition system with a home in the WTO.

<sup>5</sup> Calculations with data from the Maddison Project Database of the University of Groningen. <https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2018> (accessed 27 December 2018). I use the UK + Australia + New Zealand + India as a proxy for the British empire.

<sup>6</sup> The IMF puts China a few percentage points ahead of the US. The difference comes from different calculations of PPP GDPs.

<sup>7</sup> Even though the Eurozone is equipped with mechanisms for qualified majority decision, they have barely been used in the euro crisis.

<sup>8</sup> The list does not include the substitution of collective mechanisms by individual mechanisms such as the accumulation of foreign exchange reserves as a substitute to relying on the safety net provided by multilateral financial institutions.

<sup>9</sup> Technically, the underlying game can be thought of as an  $n$ -player assurance game where the aggregation function is the simple sum of national contributions.

<sup>10</sup> Unlike for climate change mitigation, the aggregation function is a Min of the significant countries' individual contributions (weakest-link game).

<sup>11</sup> Some multilateral cooperation also takes place within the framework of the very loose International Competition Network (ICN), but critical relationships are bilateral.

<sup>12</sup> 15 U.S.C. § 6a. Conduct involving trade or commerce with foreign nations. [http://www.stern.nyu.edu/networks/ShermanClaytonFTC\\_Acts.pdf](http://www.stern.nyu.edu/networks/ShermanClaytonFTC_Acts.pdf) (accessed 31 December 2018).