Global Governance:
Demise or Transformation?

Progress report on the Transformation of Global Governance Project 2018-2019

EDITED BY

George Papaconstantinou and Jean Pisani-Ferry

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The Transformation of Global Governance

The Transformation of Global Governance Project is a horizontal initiative at the European University Institute, a joint endeavour of the School of Transnational Governance and the Tommaso Padoa-Schioppa Chair in European Economic and Monetary Integration at the Robert Schuman Centre for Advanced Studies.

More information on the project is available at: tgg.eui.eu

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Introduction: A Research and Policy Agenda

George Papaconstantinou and Jean Pisani-Ferry [1]

Why is international cooperation successful in some fields and not in some others? What are the most promising templates for international collective action in the present context? These are the questions at the origin of the "Transformation of Global Governance"[2] project that we initiated at the European University Institute as a joint endeavour of the Tommaso Padoa-Schioppa chair of the Robert Schuman Centre for Advanced Studies and the recently created School of Transnational Governance.[3]

The motivation for addressing these questions stems directly from policy concerns. The rise of interdependence, its new and deeper patterns, as well as the emergence of true global commons of which climate is the most epitomic as well as the most important all call for enhanced and more effective forms of international collective action. At the same time, concerns about sovereignty, geopolitical rivalries and heterogeneity across nations limit the ability of the global community to engage in such an action. The institutional architecture of globalisation remains seriously incomplete, multilateralism is on the retreat, and the global insti-

1 We are grateful to Adrien Bradley of the EUI for very effective research assistance throughout the project.

2 The Transformation of Global Governance Project is a horizontal initiative at the European University Institute, a joint endeavour of the School of Transnational Governance and the Tommaso Padoa-Schioppa Chair in European Economic and Monetary Integration at the Robert Schuman Centre for Advanced Studies. More information: https://tgg.eui.eu/

3 The Tommaso Padoa-Schioppa Chair was established in 2014 in honour of the former Italian Minister of Finance and member of the Executive Board of the European Central Bank. It is jointly funded by Italian institutions (Banca d'Italia, Banca Intesa, Generali) and the EUI. Its first holder was Professor Richard Portes.

tutions that constituted the pillars of global governance have weakened.

In short, the global community is confronted to the need to to address heightened challenges with enfeebled instruments.

The issue

"*A house in order is not a city in order*", said Tommaso Padoa-Schioppa in one of his latest writings. "*There are commons that bear no relation with what goes on within houses, but between houses [...] The commons can only be managed in common. This implies supranational authorities*" (Padoa-Schioppa, 2009). Growing concerns about global commons are indeed a distinctive feature of the present times. Deepening global interdependence increasingly challenges the once-prevalent view that international collective action problems can be regarded as second-order if governments follow sound, but domestically-centred policies – the Own House in Order doctrine.

The last sentence of Padoa-Schioppa's quote, however, is problematic: It may be right that supranational institutions equipped with legally enforceable instruments would provide the best possible response to the modern tragedy of the commons, but the probability that they would be created in today's geopolitical and political conditions is virtually nil. Today's world is not one where international law institutes "compulsion" (Kelsen, 1934). It is closer to a world governed by an "unorganised and incoherent" World-State that has "neither an office nor an address" (Angell, 1915).

There might furthermore be fewer true "global commons" than generally thought. After it was developed by World Bank economists at the turn of the millennium (Kaul, Grunberg and Stern 1999), the "global public goods" concept started being applied in an indiscriminate way to a large set of concerted action issues, many of which did not really exhibit the features of a true global public good. Somehow any common resource problem was metaphorically looked at as a global public good problem, which led to the conclusion that nothing short of a global institution equipped with financial resources and/or legally grounded powers could help solve it. In the same way, any international coordination problem was metaphorically looked at as a prisoners' dilemma problem, with the conclusion that nothing short of a binding coordination mechanism could help solve it.[4]

The policy coordination and collective action problems raised by

4 See Pisani-Ferry (2019a, 2019b) and Rodrik (2019).

international interdependence are in fact subtler than suggested by simplified models. Theoretically, their underlying game structures are diverse, and not all of them call for the same degree of centralisation (Sandler, 2004). In a whole range of cases, creating trust, ensuring transparency, defining common objectives and monitoring outcomes goes a long way towards addressing these problems; in others, leadership helps internalise externalities. Institutionally, there is also much more variety: in the same way that the local arrangements uncovered and analysed by Ostrom (2009) escape the black-and-white alternative between market and state, the scope of possible – and existing – arrangements is much wider than the textbook alternative between independent policymaking and compulsory coordination or centralisation.

These observations provided the basis for our research agenda: to explore and assess how international collective action and coordination issues are being addressed in a range of fields, to determine which problems the international community is confronted to, to decipher how these problems are being addressed, and to determine how effective are the corresponding mechanisms.

Method

Global governance covers a huge range of fields. There are nowadays some 2400 international organisations and 200,000 UN-registered international treaties and actions that cover both the fundamental and the minuscule aspects of international interaction.[5] Political scientists have devoted considerable effort to the analysis of international arrangements and they have turned the study of global governance into an active subfield of their discipline. To this end, they have created concepts such as "regime complexes" (Alter and Meunier 2009, Alter and Raustiala 2018) or "orchestration" (Abbott, Genschel, Snidal and Zangl, 2015). Importantly, they have also produced comprehensive assessments of the state and perspectives of global governance (Hale, Held and Young 2013, Hale and Held 2017).

Our perspective is different. First, our aim is more normative than positive: we are interested in policy outcomes and for this reason in finding out what works, why, and whether arrangements that prove successful in one field can be replicated in others. Naturally, this cannot be

5 See Alter and Raustiala (2018).

done without relying on a precise analytical framework, but one that can ultimately help formulating prescriptions. Second, while we acknowledge and try to incorporate the insights from other disciplines, we approach the question as economists. We are not blind to the wealth of research accumulated in other fields, but we reason primarily with the concepts and tools of economic analysis. This can lead to quite different outcomes. Third, we focus in priority on the main channels of present-day economic interdependence.

We do not start from a holistic approach, rather from a limited set of fields, each of which corresponds to a significant channel of interdependence. We have selected eight such fields (see Box below): three of them correspond to the basic channels of international economic interdependence (**international trade**, **capital flows** and **cross-border migrations**, i.e. the mobility of goods, capital and people) – of which two (trade and capital flows) also correspond to key pillars of the post-WW2 global governance regime; three explore what can be called deep integration issues, the relevance of which has risen with economic opening and its sometimes unintended consequences: the **extraterritoriality of competition policy**, **tax competition and coordination**, and the **regulation of international banking**; one (**climate change mitigation**) epitomises the challenge of managing global commons; and one (**internet governance**) embodies new form of interdependence arising from data flows.

In each case, we aim to determine:

- *The nature of interaction at work*. This may be more challenging than it looks, because interactions evolve and may change in nature over time as interdependence deepens or as a consequence of technology. Indeed, one of the significant consequences of globalisation has been the obsolescence of the interaction models that underpinned existing coordination and governance arrangements;[6]

- *The corresponding game structure*. This depends on the interaction at work and the way of aggregating the individual players' outputs that is best suited to represent the common policy aim;

6 A telling example is the obsolescence of the interdependence through net savings flows (i.e. current account balances) and exchange-rate fluctuations model that underpinned IMF surveillance. In a world of free capital movements and deep international integration, a major channel of interdependence arises from gross credit flows and cross-border assets holdings. Underestimation of the consequences of this emergence was a key factor behind the failure of international surveillance in the run-up to the Global Financial Crisis. See Pisani-Ferry (2009b) for other examples.

- *The identity of the players.* These can be states only, or a subset of them, or other players such as subnational entities, firms, individuals, or NGOs. Interactions vary considerably depending on the degree of concentration of these players and the heterogeneity of preferences among them;

- *The preferences of the players.* Are they homogeneous or is there a wide dispersion of desired outcomes?

- *The constraints that the various players are facing.* These can especially (but not exclusively) be of a political nature;

- *The intertemporal dimensions involved.* This includes aspects related to uncertainty and how it affects the different players' perspective.

After having characterised the problem, the second step of the analysis is to assess the governance arrangements and how they contribute to solving the problems identified. As said, the range of outcomes goes from outright failure to remarkable success. Our aim is to determine why this is the case. We start by asking what is/are:

- *The membership in the governance arrangement.* Is it universal, or partial, for example in a setting where the main players cooperate within a club?

- *The mechanisms leading to cooperation.* Are there common rules, and if so how are they enforced? Are there incentive-based mechanisms such as pledge and review procedures? How effective are these mechanisms?

- *The institutional support that cooperation can rely on.* Is it provided by a dedicated international institution, and if so of which nature? What is the role of epistemic communities in informing negotiation?

- *The overall effectiveness of the mechanisms in place.* Do they resolve or at least address adequately the original international collective action problem? Do they produce other side-effects?

First output

The first step of this research has been the organisation of a series of seminars dedicated to the analysis of specific fields. Most of these seminars have been (or are being) co-organised with specialised institutions and all of them involve academics, field experts, policymakers and other stakeholders (from private institutions or NGOs).

Ten seminars on the transformation of global governance

1. *International trade* (with the Robert Schuman Centre, EUI): Florence, June 2018
2. *The extraterritoriality of competition policy* (with Bruegel): Brussels, October 2018
3. *Capital flows and the Global Financial Safety Nets* (with the LSE): London, April 2019
4. *The regulation of international banking* (with Bocconi University and the Florence School of Banking and Finance): Milan, September 2018
5. *Tax competition and tax coordination* (with the OECD): Paris, February 2019
6. *International migration* (with the Migration Policy Centre): Florence, May 2019
7. *Climate change and climate action* (with the European Climate Foundation): Paris, June 2019
8. *Internet governance* (with the Hertie School and the Oxford Internet Institute): Berlin, November 2019
9. *Historical perspectives on trade, finance and macro coordination*: Florence, November 2018
10. *Geopolitical perspectives*: TBD (likely to be organised in the US)

Eight seminars have been organised since the project started in Spring 2018, the outcomes of which are presented in the following sections. Seven of them covered specific sectors and an eighth, smaller-scale one, was devoted to the lessons to be drawn from the history in the fields of trade, finance and macroeconomic coordination.

Migrations is the only case of outright failure of international governance: with the (increasingly disputed) exception of asylum, there is no comprehensive regional, let alone global migration regime to speak of. This is despite the importance of the challenge and the significance of the spill-overs across host countries. There are several reasons for this state of affairs: wide heterogeneity of preferences, the strong distributional consequences of migration, its intensely politicised nature, the lack of an authoritative epistemic community, and the fragmentation of governance into different regimes corresponding to different layers, without the support of any strong institution. This failure has major economic, social and political consequences, with little hope that things may change in the years to come. The backlash with the Global Compact on Migrations, despite it being softer than soft law, is indicative of the extreme difficulty of collective action.

Global governance is experiencing serious challenges in the two fields where it was best established and had delivered the most, *international trade* and the *global financial safety nets.* Trade is suffering from widespread dissatisfaction with the existing regime, feeble rule enforcement, a weakening of its central institution (the WTO), a strong tendency towards plurilateral solutions and the creation of clubs which does not need to result in fragmentation, but is likely to in the absence of a strong multilateral core. The global financial safety net is also undergoing a process that may lead to fragmentation. Again, regional safety nets and bilateral arrangements such as central bank swap lines can be regarded as complements rather than substitute to the IMF: absent a major overhaul, it would be an illusion to rely on a single institution to respond to the diversity of the liquidity needs of countries and financial institutions. The reality, however, does not only reflect a natural evolution: although the Fund remains nominally at the centre of the system, distrust for the central institution has grown.

These problems have some common roots: in both cases a mismatch between the nature of interdependence and a governance regime predicated on an increasingly outdated model of international interaction; a growing differentiation across participating countries, some of which are engaged in new forms of deep interdependence while others remain part of a mostly shallow integration model; and an intensifying dispute between the incumbent and the emerging countries, which concerns either the rules of the game (for trade) or the power balance within the governance regime (for finance).

The three fields where governance is confronted to deep integration issues exhibit similar patterns of paradoxical progress despite weak institutionalisation and weak mechanisms. In *competition*, institutions in the major countries and the EU acting independently on the basis of similar mandates have been able to define and implement principles that organise the coexistence of their extraterritorial reach. They have taken advantage of a strong EU-US oligopoly providing leadership, with China emulating and not contesting. There are questions however on whether this progress will be tested in the future by negative spill-overs from other policy areas (trade, industrial policy) in a more adversarial geopolitical setting.

In *banking*, common standards are being implemented in a fairly coherent way despite the lack of any mandatory requirement. The coordinate-and-review model in operation has proven effective for the harmonisation of banking solvency and liquidity standards, with the EU playing an important leadership role. The adequacy of the international standards resulting from this "confidence game" is however disputable, while the regulatory regime is vulnerable to disruptions emanating from new entrants and from outsiders such as fintechs, new platforms and market places.

In *taxation*, major tax avoidance challenges have been tackled, prompted by acute public finances needs in a series of countries and public opinion pressure for international tax fairness following the crisis. Further action has started to tame corporate tax avoidance. Progress initially concentrated in those tax areas with a conceptually simple problem to solve (abolishing banking secrecy) and where the interests of the largest advanced and emerging sovereigns participating in the G20 are aligned (with US leadership). Action has relied on existing (but not tax-specific) international arrangements and on the support of a nimble institution, the OECD, that had not been designed to this end. Corporate taxation and the challenges of digitalisation have not been successfully tackled yet. They will be more difficult to address, if only because of their distributional dimensions.

Climate change mitigation is of particular interest because the international community has endeavoured to attack with a pledge-and-review mechanism a problem that can in principle only be tackled through hard law and a sanctions system. The novelty of the Paris agreement is that it is meant to gain strength by involving a strong epistemic community, sub-national governments and a variety of private players, from NGOs investors and to major companies. From a static point of view, it is bound to fail. Dynamically, it may achieve results if endogenous technical progress is significant enough and if even a soft agreement succeeds is sufficiently credible for private investors and corporations to bet on the ultimate success of decarbonisation. The risk, however, is one of increased divergence between the behaviours of the front-runners and the laggards that the Paris agreement brought under the same umbrella.

A seminar on *history* was indispensable, if only to correct the usual tendency to idealise the past. We may feel that there was a golden age of global governance, but a critical examination of the past shows that the framework of rules and institutions was never comprehensive enough to cover the multiple channels of interdependence, that complains about its fragmentation date back to the 1970s, and that the rules-based regime was never entirely rules-based.

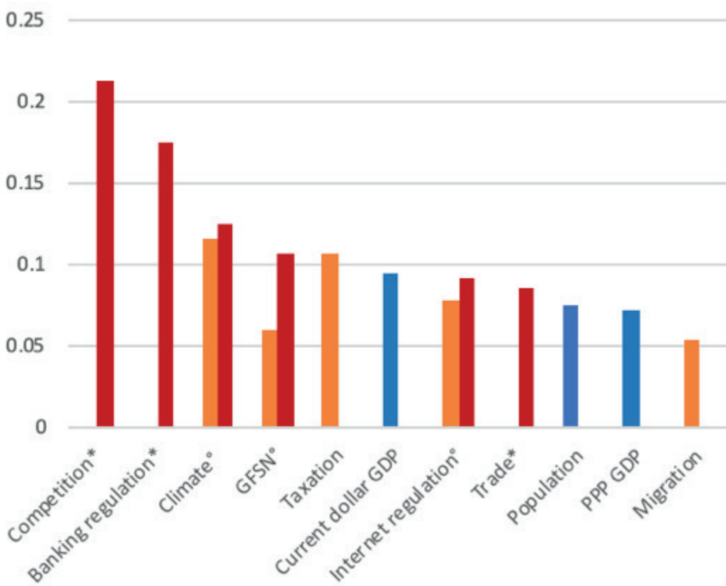
Summing up, analysis of the cases examined so far suggests that overreliance on the traditional forms of global governance may be misplaced. Established rules and experienced institutions are no guarantee of effectiveness, while softer forms of collective action have in some cases delivered surprising results. While these insights must be underpinned by more systematic analysis, they do not invalidate the hypotheses we started with.

The leadership dimension

As indicated, prime candidates for explaining why cooperation is more successful in some fields than in others are the heterogeneity of preferences and the nature of the interaction at work, which in turn determines what are the incentives to cooperate and to deliver on commitments. Another important dimension is concentration: whether the essential interactions take place between a small group of players or whether actual participants in the game are many.

The eight fields selected for this study are significantly different in this regard. Calculations indicate that the Herfindhal index of concentration for a variable that is representative of the interaction at work varies considerably across fields. These differences are due both to the distribution of activity and power across countries globally, and to the fact that the EU (or the Eurozone) acts mostly as one in certain fields whereas member states decide independently in some others It is certainly not by accident that cooperation has delivered more than expected in fields where the concentration of players is the highest.

Figure 1: Concentration Index (Herfindhal), various fields, late 2010s



Source: Own calculations. See Pisani-Ferry and Mazza (2019) for details. Variables considered are market capitalisation for competition, bank assets for banking regulation, gross external assets for the GFSN, exports and imports for trade, CO2 emissions for climate, the corporate tax base for taxation, the number of internet users for internet regulation, and the stock of inward migrants for migration. A star indicates that the EU (or the Eurozone for the GFSN) is assumed to play as one in the field. In the fields indicated with a °, competence belongs to both the EU/EZ and the member states. Two values of the indicator are therefore reported: when the EU is considered a single player (left column) and when member states are considered acting individually (right column). GDP, PPP GDP and population serve as benchmarks.

Next steps

The next steps for the Transformation of Global Governance Project involve conducting two additional seminars, while completing the analytical work to date with quantitative evidence and a formal analysis of the various governance cases.

- *Internet governance:* The decentralized and multi-stakeholder internet governance model has come under strain and seems increasingly inadequate to cope with Issues of security, privacy and more generally data sovereignty and concentration in the hands of a few private actors. Important analytical and policy questions centre around coordination and control in the presence of externalities; international equity regarding equal and non-discriminatory access; and intertemporal issues, brought about by the irreversibility and path dependency of outcomes in processes such as large data flows, privacy, or security.

- *Geopolitical perspectives:* Geopolitics, once largely separated from the governance of economic interdependence, are increasingly relevant for the analysis of sectoral cooperation arrangements. Some claim that interdependence is now at risk of being "weaponised" (Farrell and Newman, 2019). In this context, and after taking stock of the findings from the previous sectoral seminars, this event will review current geopolitics through the lens of global governance. The seminar will examine the significant changes to the balance of power between the US, China, and the EU, and what they may mean for the future of global governance.

The analytical work to date and the result from the sectoral seminars will be complemented with the incorporation of systematic evidence on the character of the collective action problems global governance should address, the nature of the resulting game, the arrangements in place to tackle cooperation incentive, and the evolution of these characteristics over time. Indicators on the intensity and structure of interdependence as well as on the heterogeneity of preferences of the players involved and the degree of concentration among them will also be added. This will involve empirical work in a number of sectors (trade, competition, migration, global financial architecture, banking, taxation, climate change, digital infrastructure) across a number of dimensions highlighting structural and governance characteristics.

The analytical and policy conclusions of the project will be presented and discussed in a 2-day conference to be held at the EUI in Spring 2020, bringing together participants from academia, policy making, business and civil society. A series of sectoral papers as well as a publication on the transformation of global governance are foreseen as outputs of the project, which will also feed into teaching at the School of Transnational Governance as well as in executive training at the EUI.

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Section 1

International trade

The Governance of International Trade: Reshape or Demise?

Seminar insights[1]

Bernard Hoekman[2], George Papaconstantinou and Jean Pisani-Ferry

1. **The geopolitics of trade have changed.** Whilst free trade was once meant to create bonds, trade policy is now used confrontationally in a power struggle between the US and China with spillover effects for the rest of the world. Because of its enforceability, trade policy is increasingly used as a substitute for the lack of other instruments to promote issues that have little to do with it. There is danger in these developments.

2. **Widespread dissatisfaction with the global trade system predates Trump.** Most US grievances (about dispute resolution, the abuse of developing country status, weak rules for subsidies, China) pre-date the Trump administration. It's not only the US: there is widespread dissatisfaction with the outcome of past multilateral negotiations and the functioning of the world trading system. Sentiment of being treated unfairly is shared in both developed and developing countries.

1 The seminar was held on 19-20 June 2018 in Florence (Italy), jointly organised with the Global Governance Programme at the European University Institute's Robert Schuman Centre for Advanced Studies.

2 Professor and Director, Global Economics at the Robert Schuman Centre for Advanced Studies, European University Institute.

Dissatisfaction stems from:

- In advanced countries, the rapid erosion of technology rents that benefitted all, including relatively unskilled employees (aggregate factor), and the lack of appropriate policies that could have tilted the sharing of trade gains between producers and consumers (distributional factor);

- Developing countries worry that manufacturing relocation away from advanced countries has benefitted a handful of EMs only and that insufficient market opening in advanced countries has prevented food-producing countries from benefitting;

- China feels it has been subject to discriminatory rules by advanced countries.

Future outcomes will hinge on:

- Whether, in advanced countries, the growing current challenge to the positive-sum game nature of international trade can be reversed or complemented with policies which convince (and compensate) an increasingly skeptical electorate;

- Whether, in certain developing countries, the values underpinning international trade can coexist with increasingly politically illiberal regimes.

3. **Trade principles are sound but trade rules and institutions are outdated**. The nature of international trade has changed fundamentally with the development of global value chains (GVCs) and the blurring of the distinction between goods and services. It is bound to change further as a consequence of the digital revolution. Multilateralism, national treatment and the most favored nation principle remain essential. But the trade negotiation architecture is increasingly outdated:

- GVCs challenge traditional specializations and trading interests;

- The categorization of participants in global trade on the basis of development level is at odds with growing heterogeneity within countries;

- Increasingly important 'behind the border' issues (regulation, competition, taxes, intellectual property protection) are not properly addressed.

4. **Clubs are the way forward, provided they abide by a set of strong principles.** Plurilateral agreements and critical mass agreements are nimble instruments that can be used in an open, non-discriminatory way. They can serve to fight the abuse of consensus and tackle the diversity in degrees/patterns of integration and national preferences/priorities. Their purpose remains ambiguous: Are they temporary patches, flexibility instruments, conduits for gradual emergence of new forms of multilateralisation or a basis for alternatives to existing multilateral arrangements? It is highly desirable that variable-geometry agreements be rooted in strong multilateral principles and be regarded as complements rather than substitutes to the multilateral order.

5. **Trade is shifting to digital and trade policy and is increasingly linked to other policies**. As the economy and trade are increasingly digitalised, traditional trade governance norms and instruments have become increasingly ineffectual or irrelevant. With this trend set to continue, future governance outcomes will depend on the current system's ability to develop tools and governance formats which are more in tune with these new digital trade patterns and characteristics. The long-standing debate on whether trade issues should be treated in isolation, or understood instead in conjunction with other policy areas (trade *and* environment, trade *and* labour standards,…) has decidedly shifted in favor of the latter. This is due both to the structural transformation of trade patterns but also to an understanding that this may be tactically the only way to save an open trade regime. The remaining question is whether this trade-*plus* policy stance will act to further destabilize open trade or instead help save it.

6. **The EU should address the Trump and China challenges simultaneously**. The EU shares some of the US grievances towards China but opposes its transactional approach. It should voice its concerns to both partners. It should position itself as an active proponent and, alongside the US and China, as one of the key potential architect of a reformed trade system. A "WTO 2.0" hinges on China-EU-US cooperation. The battle will be a hard-fought one as China and the US may share an interest in a purely transactional management of their rivalry.

Future outcomes will hinge on:

- whether the US will go "all the way" in rejecting the multilateral system of rules, or instead will stay within it, all the while challenging its individual tenets and pushing for reforms;

- whether the EU will be willing or able to assume the mantle of the main defender of this system, or be bogged down by its internal contradictions and weaknesses;

- whether China will be convinced to "play by the rules", or instead veer towards an illiberal regional and confrontational solution;

- whether the WTO membership will support and implement reform efforts, or instead the WTO will be pushed to irrelevance.

7. **Broadly speaking, there are three ways forward for trade governance:**

- Attempting to **salvage the multilateral system**, by rewriting some rules, buttressing its institutions, and generating political support for it. In the current circumstances, this not only seems like an unlikely outcome, but also one at odds with the structural transformation of international trade under way.

- **Further breakdown**, with countries increasingly opting for unilateral action or pursuing bilateral deals, in essence destroying the current system in all but name. This is currently perhaps the most realistic scenario, but also one with the most downside for trade, growth and more generally the future of global governance.

- **A new plurilateral system** which draws and builds on the characteristics of the current multilateral system, but also recognizes the need to amend and complement it in way that reflects the diversity of trade patterns and actors. This would be by far the most desirable – and probably also relatively likely – outcome; as a hybrid however, much will depend on its specific characteristics, i.e. on how far it will deviate from current multilateral rules.

Keynote – Trade governance today[3]

Lim Hng Kiang, Former Minister for Trade of Singapore

The trade governance system no longer reflects current geopolitical and business situations. *Paralysis within the WTO makes it necessary to develop new rules for the new economy. Nevertheless, it would be wrong to break with the Doha Development Agenda, and unilateral action is not useful. Bypasses exist within the current framework, and issues may be discussed in other fora (OECD, G7/20, APEC). These can be opportunities to set rules in areas currently not dealt with. This is particularly salient regarding China, which needs to be involved constructively and induced to lead.*

The election and actions of President Trump are a shock mandating adjustment*, but on a deeper level, he represents a backlash against free trade and a rules-based governance system. While it may be true that by some measures the US is quite open, the perception of unfairness towards it is more important. Complacency in explaining the benefits of trade liberalisation and globalisation, as well as insufficient adjustment policies have soured the political base in developed countries. While some argue for such policies to be equally multilateral, it may be preferable to develop them domestically.*

It is becoming less pertinent to analyse trade on an international basis. *Competition is no longer really between states, but between companies, between cities. Major developed and developing states should recognize this, not expect special and differential treatment, and focus on writing rules for the 21st century.*

3 Summary by Adrien Bradley.

Seminar minutes

Adrien Bradley

Session I - Has global trade governance broken down?

Multilateral trade governance has not broken down completely yet — but collapse is threatening. Optimists argue that trade continues to grow and trade facilitation agreements are still being agreed upon (both within the WTO framework and plurilaterally), while none of the threatened massive trade disruptions have occurred yet. Pessimists argue that the agreements being struck are stopgap at best, while the WTO and the multilateral trading regime face an existential crisis.

There is consensus to observe that many of the challenges the WTO face predate the current US President and his outright rejection of the multilateral system. While President Trump's unilateral actions and offensive rhetoric have been baffling, the grievances they express are not new. US complaints about China, the categorization of emerging powers as developing countries of power-grabbing by the WTO's arbitration system were already expressed by previous administrations. What has changed is that Trump appears to prioritize above all else outcomes rather than rules , procedures or alliances with like-minded states. Tackling the stalemate therefore requires to be "tough on Trump but also tough on the cause of Trump".

The WTO functions according to several principles that now contribute to paralyse it and to fuel these grievances.

- It is member-driven: rather than propose initiatives or make decisions, it has more of a convening or facilitating function.
- It is incomplete in terms of coverage (e.g. services and investment).
- It has no independent monitoring and verification capacities, relying instead on state notification.

The single undertaking principle makes it easy for one issue to derail an agreement; the consensus principle makes it easy for one country to do the same. Now, the long paralysis of the Doha round has, in all likelihood, made a single undertaking unrealistic to pursue for the future.

Bypassing the consensus principle remains a possibility, provided for by art. IX of the WTO agreement itself. But it is an unattractive option for member states, as they fear that departure from unanimity might end up putting them in the minority someday.

The most pressing problem is the threat to the Appellate Body, where the Trump administration is blocking the nomination of new judges due to a perceived mission creep that constraints the scope for transaction with trade partners, and more generally to a perceived unfairness of its decisions towards the US. This heightens the risk of an all-out trade war. Only two reactions could reverse the dynamic of punitive measures and counter-measures: a high-level initiative, or untenable market pressure.

Perceived unfairness towards the trade governance system, however, lies much more widely than with just the US government: China's perception is that it has paid a steep price to accede to the WTO, has been subject to discriminatory and disadvantageous rules, and has still managed to succeed while remaining very polite to boot. In the EU and the US, citizens are anxious about the distributional consequences of trade liberalization, which are not being compensated for by domestic policies. Governments in both the US and Europe point to persistent distortionary Chinese practices (intellectual property infringement, state aid, direct or indirect control of commercial companies). Large emerging economies which might have an important role to play in upholding the system are in fact a heterogeneous group, requiring different incentives to buy into it.

Despite this crisis there is a systematic abandonment of leadership due to a lack of both willingness and capacity. Governments remain silent, but so does business. Scant progress can be observed on the issues of tomorrow (e-commerce, data), while older issues remain undealt with. It is possible that China and the US might strike a bilateral deal which would seal the irrelevance of the WTO and undermine the whole trade governance system as it currently exists.

A better alternative would be for the US, the EU and China (each accounting for roughly equal shares of global trade) to stop blaming each other for free-riding, and to reaffirm their common commitment to a system of multilateral trade principles. This system should be designed so as to provide a level playing field. Some suggest that since the US is suffering decline, while China is cautiously ascendant, the EU, by default, should lead the way. It may, however, have to focus on solving its own internal problems with the Single Market and EMU first.

Session II - Trade structures and trade institutions

While the rules and institutions governing trade have remained largely static for 20 years, the structure of trade has been changing. After Baldwin's Second Unbundling (which, by disaggregating knowledge from location, triggered the global value chain revolution) we are witnessing the incipient Third Unbundling (disaggregating service from location, through telepresence and telerobotics). Companies and cities now play a far more important role than when the rules were designed. This has made pre-existing gaps between rules and reality yawn wider, threatening to dissolve the already fragile consensus over the principles underpinning those rules.

Three problems arise. First, that of multipolarity. The high noon of multilateralism of the 1990s is being relegated to a distant past by the advent of a much more multipolar world. Against this background, the definition and mechanics of multilateralism are increasingly contested. The system requires some good will for consistent application, but strategic competition is creeping back in: trade is never just a tool, but can be an objective per se. The US exemplifies this currently. There is also scope for opportunity, as multilateralism was launched precisely in a multipolar context.

Second is the problem of late joiners to the system. The special and differentiated treatment they benefit from fuels resentment towards the multilateral system: while they feel they have made significant concessions and benefited little, incumbent trading countries feel the opposite. This has led to the rise of status quo-prone or garrulous new powers, like China or India.

China presents a particular problem as it seeks to reshape its trade environment through its Belt-and-Road Initiative (BRI) and promotion of the RCEP as alternative or complement to the CPTPP/TPP-11. The BRI can be seen as China's alternative to creating a parallel WTO. Support for it in the region should not be underestimated as China provides badly needed infrastructure. On one hand, it can be argued that China understands its weight and seeks to be modestly constructive both regionally and globally, and that space should be made for it understanding its internal dynamics. On the other hand, it can be argued that China has "emerged without having converged", and is simply playing veiled power politics. An important question is how to involve China in a constructive governance agenda, and on which issues: connectivity and the environment may be suitable.

Third, technological advancement is leading the world into a zero marginal cost knowledge economy with the potential to radically shift comparative advantages (though it is debatable whether this takes place more predominantly on a geographic basis due to legacy issues or a functional one). With only loose, difficult to enforce disciplines, the current rules over intellectual property rights and state subsidies cannot prevent a brutal erosion of technological rents enjoyed by developed countries to the benefit of countries capitalizing on this gap between rules and reality. This is a major concern vis-à-vis China.

The question is how to (re)establish and maintain core principles. Fast-changing trade structures call for distinguishing the foundational principles of trade, which should remain invariant, from the operational rules, which need to be adapted as trade patterns evolve. Since it is easier to create new rules than to reform existing ones, recent practice has been to bypass WTO blockage through club arrangements, which often explore deeper regulatory policy coordination.

Session III - Clubs and the new trade governance arrangements

Wide differences in development levels and degrees of economic integration call for a differentiation of trading arrangements. Arms-length exchange of goods and deep integration within the framework of global value chains and bundles of goods and services cannot be governed in the same way. The latter especially do not require border provisions but also behind-the-border provisions. As the WTO is increasingly unfit for purpose, countries are bypassing it through club arrangements, with the more or less sincere hope of integrating the rules thus agreed upon into the WTO framework.

There are three main forms of club arrangements compatible with WTO principles: preferential trade agreements (PTAs); plurilateral agreements (PAs); and critical mass agreements (CMA). PTAs are exceptions, provided for by WTO rules, to the most-favoured nation (MFN) principle, and are generally concluded on a regional basis. PAs allow subsets of the WTO membership to agree to certain disciplines applying to signatories only; CMAs are agreements among a set of countries that have the greatest stake/interest in an issue, with the benefits of whatever is agreed extended to all WTO members, whether they join or not. They are all, primarily, responses to the abuse of the consensus requirement, put in place to tackle the differences in sectoral priorities and patterns of integration among states within the WTO.

PTAs, while to some extent discriminatory and trade-diverting, can extend to regulatory policy, allowing for the creation of harmonized rules and thus deeper economic integration, dealing with the gaps in WTO rules (although some argue they do not have a good track record in that respect). On the other hand, they generally do not address certain distortionary policies giving rise to large spill-overs, like state subsidies or production origin requirements. Excepting the CPTPP/TPP-11, they are generally closed clubs, lacking clauses allowing for third-party accession.

PAs and CMAs, as a form of "open plurilateralism", may be useful to multilateralise some PTA elements within the WTO framework. However, it appears that they can only work for some issues and operate at a lower level of ambition, acting more as a focal point for good practices fostering regulatory convergence instead of actively mandating it. Nevertheless, relying on the WTO framework, they offer greater transparency and accession opportunities, lower administration costs, and a surer dispute settlement mechanism. Different trade instruments can be considered depending on the issue or objective at hand and the size of the set of countries involved.

At the end of the day, any system of clubs will have to build on basic trade principles, and will require institutional machinery that would be inefficient to re-create for each club. The WTO can provide the needed support functions and other machinery clubs will need. The MFN and national treatment principles, endowed with the necessary flexibility, ensure multilateral reciprocity. The WTO's single undertaking principle, however, is a major constraint, and is arguably no longer realistically achievable due to the abuse of the consensus requirement. On the other hand, in negotiation there is a temptation to link issues, so as to pair gains and concessions and present a give-and-take narrative; though this may only be applicable if a country enjoys actual leverage.

An underlying issue is the purpose of the trade arrangement: trade per se, or trade as a vector to project influence. It is obvious that the latter is the case for the US and China, and less so for the EU. When this is the stake, incentives to participate must go beyond those of just trade. More generally, these arrangements can serve as patches to the trade governance system; alternatives to it, or a means to make it evolve.

Session IV - Governance implications of the interaction between trade and other policy areas

Stimulating trade, at some point, begins to necessarily involve some regulatory coordination in order to maintain a level playing field, and turns into deepening economic integration. Four major policy areas interact with trade in this sense:

- First is currency. Countries may seek to benefit by manipulating the exchange rate to their advantage, and managed trade and managed exchange rates may be trade-offs. In a world of floating exchange rates, however, prices adjust leading to short terms gains only at best. In terms of governance, this issue is best managed by its proper institution, the IMF.

- Second is tax policy. It is claimed by some in the US that the WTO ignores distortions caused by the fact that not all countries impose VAT. This is not necessarily discriminatory under WTO rules and can be addressed in its current framework, but could benefit from dialogue (with the OECD for example).

- Third is environmental policy. Trade policy has long ignored the negative externalities it entails which drive climate change. One way to address these could be Nordhaus' proposal of a Climate Club, a club arrangement imposing tariffs on non-members as a sort of carbon border tax; it appears difficult to craft one in a non-discriminatory fashion, however. Another way would be to negotiate an elimination of fossil fuel subsidies within the WTO framework, on a similar template to that of the agreement on agriculture. These subsidies could be redeployed to fund renewable energy projects or to alleviate energy poverty, but industry lobbying and lack of political will are serious obstacles to this scheme.

- Fourth is national security. Trump has recently alleged this reason as grounds to levy tariffs on steel and aluminium imports. It is held to be self-judging, as no country can credibly judge the national security interests of another, and until now has been seldom invoked: there is therefore little jurisprudence to turn to for guidance. Such a linkage is dangerous because of its inherent lack of justification and scope for unduly seeking to constrain a partner's foreign policy: the US threatening to impose sanctions on EU companies after withdrawing from the JCPOA, for example.

It is true that linkage of trade and other issues has at times been abusive, as special interest groups can wield influence to extract advantages. These special interest groups can have concerns at first glance far removed from trade. It is questionable whether trade agreements and the WTO are the proper fora for advancing and adjudicating these claims. However, deepening economic integration means that interaction of trade and other policies becomes inevitable. This involves going beyond minimal, relative standards mandated by national treatment, to advance harmonized standards. This can threaten democratically determined national preferences. These should be debated openly in top level discussions rather than being left solely within the WTO.

Trade is one of the rare fields of global governance where a binding dispute settlement system (still) exists. Since it is difficult to parse the degree to which trade can be dealt with as a standalone issue, linkage with other policy areas runs the risk of overburdening it. This is not necessarily the case, as WTO rules allow for forbearance and flexibility for measures which may be distortionary to trade but are informed by genuine national preferences, on labour or environmental standards for example. Some, even more optimistically, are confident that if restored to its proper functioning it can be used to impose genuine duties on states. Be that as it may, there is consensus that a narrow focus on trade may foreclose dealing with the "causes of Trump".

European University Institute ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES SCHOOL OF TRANSNATIONAL GOVERNANCE GLOBAL GOVERNANCE Programme TOMMASO PADOA SCHIOPPA CHAIR

Seminar programme

19 JUNE

20.00 – 22.00	*Welcome dinner and keynote address* **Lim Hng Kiang** | Former Minister for Trade, Singapore

20 JUNE

09.00 – 09.10	Introduction by **Bernard Hoekman** | EUI and **Jean Pisani-Ferry** | EUI
09.10 – 11.00	**Session I - Has global trade governance broken down?** Introductory remarks: **Alan Wolff** | WTO, **Mark Wu** | Harvard
11.00 – 11.20	*Coffee break*
11.20 – 12.40	**Session II - Trade structures and trade institutions** Introductory remarks: **Sébastien Jean** | CEPII
12.40 – 13.40	*Lunch*
13.40 – 15.00	**Session III - Clubs and the new trade governance arrangements** Introductory remarks: **Bernard Hoekman** | EUI
15.00 – 15.20	*Coffee break*
15.20 – 16.40	**Session IV - Governance implications of the interaction between trade and other policy areas** Introductory remarks: **Robert Howse** | NYU
16.40 – 17.30	**Wrap-up - Lessons for global governance** Introductory remarks: **George Papaconstantinou** | EUI and **Jean Pisani-Ferry** | EUI

Seminar participants

Giorgio Barba Navaretti	Centro Studi Luca d'Agliano
Suman Bery	Bruegel
Emily Blanchard	Tuck School of Business
Adrien Bradley	Robert Schuman Centre, EUI
Bernard Hoekman	Global Governance Programme, Robert Schuman Centre, EUI
Robert Howse	New York University
Sébastien Jean	Centre d'Etudes Prospectives et d'Informations Internationales
Knud Erik Jørgenson	Aarhus University
Brigid Laffan	Robert Schuman Centre, EUI
Jean-Pierre Landau	Banque de France
Lim Hng Kiang	Former Singapore Minister for Trade
Doug Nelson	Tulane University
George Papaconstantinou	School of Transnational Governance, EUI
Ernst-Ulrich Petersmann	Law Department, EUI
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Miguel Poiares Maduro	School of Transnational Governance, EUI
Michael G. Plummer	Johns Hopkins University, School of Advanced International Studies
Stefan Profit	German Federal Ministry for Economic Affairs and Energy
Denis Redonnet	DG Trade, European Commission
André Sapir	Bruegel
Alan Wolff	WTO
Mark Wu	Harvard Law School

Section 2

Competition policy on a global scale

Extraterritoriality and Cooperation in Competition Policy

Seminar insights[1]

George Papaconstantinou, Jean Pisani-Ferry and Guntram Wolff[2]

In a context where a few global firms dominate key sectors worldwide, the proper functioning of product markets rests on enforcing both a non-distortive trading regime and pro-competitive competition laws. Whereas trade is governed by multilateral rules, however, there is no global competition law nor a global competition authority. Competition policy remains in the sole remit of national authorities operating under national law. National decisions, however, have strong extraterritorial effects. This raises significant international coordination issues.

1. A case of voluntary cooperation amongst national authorities. Competition provides an illuminating case of global governance through voluntary cooperation of independent national authorities. The key ingredients of this model are the following:

- Policy objectives are largely similar across countries;
- Policy implementation is almost everywhere delegated to independent national authorities whose mandates are therefore largely similar;
- National authorities cooperate informally in assessing potential cross-border effects of policies;

1 The seminar was held on 16 October 2018 in Bruxelles (Belgium), jointly organised with Bruegel.

2 Director of Bruegel.

- They recognise the right of their partners to take decisions which apply to firms in their own jurisdiction, provided they are respond to demonstrably harmful effects of firms' behaviour;
- Within the framework of their mandates, national authorities refrain from taking decisions that would be disproportionately harmful to partner countries.

While this model has some resemblance to the one at work amongst central banks, there is a significant difference: central bank decisions do not target specific economic actors in partner countries, whereas competition authorities do. In merger control cases, they may impose remedies such as the sale of assets located outside the border of their jurisdiction.

2. A model whose permanence cannot be taken for granted. This model has been in operation successfully for more than two decades. About half of the competition cases dealt with by authorities in large countries explicitly involve cross-border dimensions. The global competition network includes about 130 countries. The resilience of this model however rests on ingredients whose permanence cannot be taken for granted:

- The convergence of competition mandates was largely due to the similarity of those of the two main players: US and EU. Until recently, China's competition policy was underdeveloped and competition laws were largely copied on those of the two incumbent powers. As China develops its own competition policy philosophy and as other newcomers play a greater role, the commonality that has characterised competition regimes worldwide may not last;

- Even if legal texts remain similar, the environment of competition authorities may change. Pressures from policy departments in charge of industrial or trade policy may undermine the peaceful coexistence between competition policy authorities;

- Ad-hoc cooperation between competition policy authorities does not deliver a first-best result. Depending on the size of the corresponding market and the degree of concentration of the firms involved, decisions by national authorities may suffer from under-enforcement (for small countries) or over-enforcement (for large ones). Equity in the distribution of costs and benefits of competition rulings can therefore not be taken for granted. Such asymmetry will grow as digital business develops and gives rise to heightened competition concerns.

Seminar minutes

Adrien Bradley

Session I - The extraterritorial reach of competition policy decisions: evidence, successes and pitfalls

There is no global competition policy, nor a global authority in charge of coordinating national competition authorities (CAs). National (or European) authorities rule independently on the basis of their domestic mandate, which is to uphold the welfare of domestic consumers. But intensified cross-border economic integration increasingly leads them to pronounce on the behaviour of foreign firms and to impose extraterritorial remedies (for example, to condition the approval of a merger on the divestiture of assets held outside the jurisdiction of the competition authority). Such extraterritoriality especially regards merger control, but may also apply to cases of abuse of dominant position or to cartels. More than half of merger or cartel cases investigated by the European Commission nowadays involve an extraterritorial dimension.

The origins of the extraterritorial reach of competition policy are to be found in the US Sherman Act of 1890, which spelled out what became known as the "*effects doctrine*": that the reach of competition policy decisions can extend beyond borders when foreign firms' behaviour is having "direct, substantial and reasonably foreseeable effects" on domestic consumers. This was broadly endorsed by the EU and provided the basis for a series of landmark decisions, of which best known is the 2001 decision declaring the GE-Honeywell merger incompatible with EU law.

> *"It is a strange system, that shouldn't work on paper, but does in practice"*

Extraterritoriality in competition policy raises five main issues.

- First is the obvious question of *sovereignty*: states targeted for the allegedly anti-competitive behaviour of undertakings based in their jurisdiction may complain of overreach and infringement into their domestic affairs. Until now cooperation has prevailed and disputes have been avoided, but this is by no means guaranteed.

- Second is the issue of *consistency*. Peaceful coexistence among national authorities requires as a necessary (though not necessarily sufficient) condition a high degree of convergence of competition laws and their applications.

- Third is increasing *complexity* in the system and the widening scope for potential conflict. The number of competition authorities and regimes has more than doubled in the last decade, numbering some 130 currently, forming a network of different rules, standards and procedures, with both overlaps and gaps. Their status vary: they can be independent authorities, or tied to the judicial system, which can impact their work and cooperation.

- Fourth is the *opportunistic use of competition policy*. A state's competition authority, especially if it is insufficiently independent, may selectively or strategically enforce its rules, furthering domestic interests and favouring protectionism. One participant pointed out that a CA's mandate can include elements that go beyond competition policy as commonly understood, which can enable this kind of behaviour (South Africa's competition authority's remit over "diversity of ownership" of undertakings, for example).

- Fifth is the problem of *under- and over-enforcement* of competition regimes depending on the size of the relevant markets. No firm can disregard the EU market, but the competition regime of small, less economically robust states might be under-enforced, even if there is significant economic harm to people, because of little effective power on the global stage. Conversely, a state's competition regime may be over-enforced due its global power; or because that state's competition authority is the last one involved in a case to deliver its ruling, and thus will hold much greater bargaining power and influence on the final result.

Cooperation among competition authorities: principles and practice

In legal terms, extraterritoriality is asserted, in principle, to preserve the integrity and proper functioning of one's own market. In the US, the well-established *effects doctrine* has led to quite broad claims. The EU's dominant approach is similar but slightly narrower: its *implementation* *doctrine* aims to catch activities "implemented" by undertakings in its jurisdiction. The EU has been prudent in adopting the effects doctrine approach, though it has been less shy to do so for merger control cases. Participants all acknowledged that legal determination of where and when it is justifiable to claim extraterritoriality is necessary and important, but many highlighted the fact that in practice, however, it cannot ignore political concerns, as well as the geopolitical and geoeconomic weight of the parties involved.

In practice, competition authorities manage these concerns by coordinating on three levels. First is the important, still emerging practice among competition authorities of the use of *comity*, whereby they attempt to take into account principles, rules and interests of their counterparts in elaborating their rulings. This is meant to avoid direct jurisdictional conflict and calling the sovereignty of another state into question.

Comity can be *negative* or *positive*. In its negative form, a CA will voluntarily refrain from intervening if that would lead to a hard conflict of law in implementing the remedy it deems appropriate. In its positive (and less frequent) form, one competition authority may ask its counterpart to remedy the anti-competitive behaviour affecting it, which originates in its counterpart's jurisdiction. Comity can be stronger or weaker, and more or less institutionalised. One practitioner, however, cautioned that comity is observed more in books than in practice, and that the main competition authorities do not often formally invoke this principle.

Negative comity corresponds to unilateral restraint, and positive comity consists in asking and relying on another authority to provide redress. In between are less defined forms of cooperation, based on case-specific discussions between competition authorities. For example, the Australian competition authority may assess a global merger, and decide to defer to the EU and the US authorities, which are investigating the same case. One participant estimated that around half of merger cases are settled this way.

Fully institutionalised comity consists in a formal bilateral cooperation agreement on competition policy. This corresponds to a second level of cooperation and was inaugurated between the US and the EU in 1991. This kind of agreement officialises agreed-upon cooperation processes, a step up from unilateral notification regimes and *ad hoc* consultations, and has proliferated internationally in the past decade.

On a third level, CAs participate in exchanges in international forums, most often within the OECD and the International Competition Network

(ICN) established in 2001 following the failed attempt to create a global competition system with a home in the WTO. These interactions have allowed progress on aligning views and establishing best practices, creating a solid epistemic community. ICN principles (as well as the OECD ones) help ensure convergence of views between competition authorities and provide guidance in case of differences.

One participant deemed the resulting rules to be fairly robust, and remarked that states are in fact changing their laws to comply with them, but also observed that they may have been "low-hanging fruit" and that further convergence may prove more difficult, for example on tools of industrial policy, or on issues raised by digitalisation.

State of play

The strongest points of convergence so far have involved, for the most part, catching the worst offenses and risks in competition policy, where enforcement interests are highest, namely cartels and horizontal mergers. One participant noted no major divergences in approach across the world, both in legal and effective terms. The weaker points, where divergences remain, are more ambiguous categories of cases, such as foreclosures, abuses of a dominant position, or export cartels. Participants agreed on the difficulty of getting states to agree on what constitutes anti-competitive behaviour for these.

Furthermore, legal mandates may represent obstacles to a proper enforcement of competitive behaviour: whereas the EU law neither mandates nor prohibits taking into account the effect of anti-competitive behaviour on foreign consumers, US law explicitly excludes it. One participant underlined the fact that the legal appreciation of these cases is still evolving, even in the EU, while reminding that there is a strong incentive for common approaches to avoid conflicts and diverging outcomes, as they may damage a competition authority's legitimacy. Peer pressure was deemed an effective tool.

> *"Ironically enough, competition authorities may work best as a cartel."*

Participants speculated on what a global competition authority might look like. Such a global body would require a large-number multilateral agreement, establishing rules compatible with all involved states' sovereignty claims. It would be optimal for enforcement in theory, though the cost and methods of doing so remain open questions. It would also raise serious redistribution issues. Thus, it is far from clear that it is a realistic possibility.

Participants also debated the scope for including competition policy in the WTO, as has long been proposed, and as was the original plan for the International Trade Organization in the Havana Charter of 1948. They tentatively agreed that while the issue of subsidies could be integrated to the WTO, there is little scope for much else. The idea of an international body dealing with competition issues is by no means new, and its repeated failure has led to cooperation between CAs as a “third best”.

Session II - Rivalry and cooperation among competition authorities: towards fragmentation or convergence?

The China challenge

The multiplication of competition authorities in recent years has raised the fear of more frequent international tensions. Of particular concern has been China: first due to its unsanctioned, or even government-led anti-competitive behaviour of its state-owned enterprises (SOEs), and second due to the evolution of its competition policy and authorities and their increasing assertiveness on the international stage.

The concept of competition policy in China was in large part “imported”, so the mandate of its authorities is quite similar to those it mimics in the West. In practice however, there is a lack of experience and expertise, and much depends on which authority is dealing with which undertaking. Fundamental questions such as the respective role of SOEs, the Party, and the government in competition policy, or the very compatibility of a planned socialist market economy and competition policy, remain unanswered, if not unasked.

> *“Protectionism and easy politicisation make it difficult to deal with China”*

China’s competition policy has developed gradually and very recently. Its Antimonopoly Law came in force in 2008 with three main bodies tasked with enforcing it (including the Ministry of Commerce), in different domains and at different levels. Consumer protection is not a key objective; rather, it is to curb inflationary pressure. The enactment of the

Fair Market Review System followed in 2016, designed to allow some of the competition agencies to review local government actions for potential negative effects on the market. Only a few cases have been examined though, and there are no clear guidelines or sanctions. Finally, three large agencies, including one of the CAs empowered by the Antimonopoly Law, were merged in March 2018 into a "super market supervisor". It is an ongoing process whose effects are not yet discerned.

Three avenues can be envisaged for cooperation with China. The first is to give China some latitude, while making efforts to elaborate rules for a proper role of SOEs at the technical level. A second is to refuse to let competition policy be used for protectionist purposes. At this point, this means discouraging China's temptation to escalate the trade war the US has launched. The third would be to aim for a higher goal, namely co-writing new rules for a new economy, characterised by platforms, big data and AI. China is moving very fast in these fields, aided by Chinese consumers who adopt technology avidly as well as by Chinese governmental support; one participant assured there is genuine interest in cooperating with the EU and US in this field.

The future of US-EU cooperation

Participants engaged in a historical analysis of the development of competition policy in the EU and the US and their relationship, in order to review critically claims of convergence and divergence. As one recounted, the US led in this area before the EU caught up around the turn of the century, fostering deregulation in member states and establishing the Single Market. Now, most EU member states rate better than the US in industry competition indexes. The same participant compared a fragmented US competition policy system to a more coherent EU one, and shared three concerns: that broadening the sphere of public policy will raise the risks of conflict between competition policy stakeholders; that a self-proclaimed "political" Commission can lead to increased misunderstandings, especially on state aid; and that populism could unwind competition policy and impact European integration itself.

What can be expected from US competition policy looking forward? In the last decades US authorities seem to have been more lenient than their EU counterpart. Will the stance of the Trump administration lead to a more pronounced departure from pro-competition practices and a divergence between EU and US policy philosophies? This would involve heightened risks of transatlantic conflict. Beyond the bilateral dimension, divergence between the US and the EU would have profound consequences for competition policy globally.

Several participants pointed out elements of continuity in the US approach. As far as competition policy is concerned, until now the current administration has not broken with past behaviour. But things may change, and President Trump's apparent willingness to selectively enforce competition policy risks damaging its reputation. One may question how resilient current arrangements may prove to be in the face of potential profound changes in behaviour.

Participants debated whether the fact that competition authorities share common objectives ensures similar outcomes: one participant made a parallel with central banks, their domestic objective of price stability, and their tradition of cooperating closely. Several participants remained unconvinced that disputes can be avoided, pointing out competition authorities' differentiated effects on customers of different countries, temptation to interpret or distort their mandate in service of other objectives, and lack of dispute settlement mechanisms.

There was also debate over the definitions and delimitations of competition policy and industrial policy. As one participant characterised it, to general approval, industrial policy means industrial development spurred by the state, using tools that can be categorised as anti-competitive behaviour such as exclusionary practices, vertical mergers or state aid. Thus, competition policy, with its focus on non-discrimination and a level playing field, is perceived to have a strong potential to hinder industrial policy, especially in China. One participant asserted that industrial policy seldom works, generating instead negative spill-overs such as overcapacity and bad loans, giving examples from the Chinese solar and electric vehicle industries.

How resilient is the global competition regime?

Participants agreed that changing patterns of trade and the development of services and digitalisation made closer cooperation in competition policy a necessity, and some regretted the impossibility of a global body dedicated to dealing with this field. It was recalled that strong epistemic communities, like that of competition policy, can fall prey to self-absorption and disconnection from the flow of events, even if it is underpinned by a robust body of theory and common understanding of its practice.

> *"The functioning of the global competition policy system is a miracle to be preserved."*

Another participant judged that global governance of competition policy has functioned fairly well as a "second best" system, buttressed by a commonality in its implementation and understanding of its relevant law, coexistence (or comity) promoting cooperation and limiting damaging assertions of extraterritoriality, and a common culture reflected in the epistemic community. But the governance system seems to be somewhat fragile and non-resilient, relying on assumptions that all stakeholders are pursuing the same goals and playing by the rules.

Seminar programme

16 OCTOBER

14.00 – 14.15	Introduction by **Maria Demertzis** | Bruegel, **Jean Pisani-Ferry** | EUI and **Guntram Wolff** | Bruegel
14.15 – 15.45	**Session I - The extraterritorial reach of competition policy decisions: evidence, successes and pitfalls** Introductory remarks: **Laurent Eymard** | MAPP, **Carles Esteva Mosso** | DG COMP
15.45 – 16.15	*Coffee break*
16.15 – 17.45	**Session II - Rivalry and cooperation among competition authorities: towards fragmentation or convergence?** Introductory remarks: **Fan He** | Peking University, **Mario Monti** | Bocconi University, and **André Sapir** | Bruegel
17.45 – 18.00	**Wrap-up - Lessons for global governance** Introductory remarks: **George Papaconstantinou** and **Jean Pisani-Ferry** | EUI
18.00 – 19.00	*Closing reception*

Seminar participants

Geneviève Barré	Asia-Europe Foundation
Suman Bery	Bruegel
Adrien Bradley	EUI
Maria Demertzis	Bruegel
Carles Esteva Mosso	DG Competition (Mergers)
Laurent Eymard	MAPP
Gabriel Felbermeyr	ifo Centre for International Economics
Hugh Gimber	Blackrock
Joachim Glatter	Merics

Fan He	Peking University
Brit Hecht	BBVA
Mathew Heim	Bruegel
Alexander Italianer	European Commission
Sébastien Jean	Centre d'études prospectives et d'informations internationales
Mario Monti	Bocconi University
Julian Nowag	Lund University
George Papaconstantinou	School of Transnational Governance, EUI
Pier Luigi Parcu	Robert Schuman Centre, EUI
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
José Rivas	Bird & Bird
André Sapir	Bruegel
Vincent Verouden	e.ca Economics
Guntram Wolff	Bruegel

Section 3

Capital markets and the global financial safety nets

The Governance of Global Financial Safety Nets: Fit for Purpose?

Seminar insights[1]

Erik Berglof[2], George Papaconstantinou, Jean Pisani-Ferry and Andrés Velasco[3]

1. Financial globalisation has reshaped financial interdependence and increased the demand for global financial safety nets. The IMF-centred safety net of the post-war decades was quantitatively and qualitatively adequate in a world of limited capital flows and mostly national banking. It does not respond to the needs of a world of unfettered capital flows, global value chains, market interdependence and international banking. Under such conditions, global financial safety nets must consist of several coordinated layers whose combination matches the potential needs of financially open countries.

The current international regime departs from the 1990s template in fundamental ways. Capital flows are increasingly driven by push factors resulting from the global financial cycle and US monetary policy, rather than pull factors from domestic policies. Ergo, while conditional assistance remains the right response to capital outflows from domestic policy errors, it may not be the right response to externally-driven boom-bust financial cycles and self-fulfilling crises. At the same time, in times of stress, commercial banks doing business in foreign currency face

1 The seminar was held on 1-2 April 2019 in London (United Kingdom), jointly organised with the London School of Economics.

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liquidity shortages but may lack adequate foreign currency collateral, needing access to an international lender of last resort.

2. Economic and political reasons explain why the IMF alone cannot respond to such needs. Tackling financial account crises may require amounts of financial assistance that exceed by a wide margin what the multilateral system can realistically mobilise. Whereas the overall pool of resources available for international financial assistance has tripled in proportion to world GDP, IMF permanent resources represent only one-eighth of available resources excluding national reserves. In addition, whereas IMF governance correctly limits the politicisation of lending, it also limits availability of precautionary support. Despite attempts to broaden the scope of its facilities, the Fund is not yet well equipped to provide unconditional liquidity to prequalified countries. Stigma effects and a reluctance to move away from conditional lending explain why it has not succeeded.

The IMF is also not better prepared to provide liquidity support to commercial banks operating in foreign currency. Covering such needs is an extension of the traditional role of central banks acting as lenders of last resort to commercial banks. They cannot be substituted in this role by an international institution. By the same token, the Fund cannot exercise conditionality towards central banks providing liquidity to their banking sector. Speed and scale require this operation to be based on trust.

3. Massive accumulation of reserves at national level is indicative of pervasive distrust in the multilateral Bretton Woods system. Reserves-to-GDP and reserves-to-trade ratios have reached unprecedented levels. Preference for such costly self-insurance, most notably in Asia where it emerged in reaction to the Asian crisis of the late 1990s and the IMF programmes that followed. Its rise amounted to a first major departure from the principle of mutual insurance embodied in the IMF articles of agreement. It signalled that several emerging countries regarded the Fund as excessively driven by the perspective, and even the interest of the advanced Western countries.

4. In a significant departure from the established multilateral regime, a three-layer system has come into existence. In addition to national reserves, it consists of:

- *Bilateral support schemes, especially through swap lines.* Such swap lines may serve as confidence-signalling devices, macro-financial support, trade- or currency-promoting instruments, or channels of provision of international currency liquidity to banks ;

- *Regional safety nets* to provide financial assistance to participating countries. There are by now seven, uneven in terms of size, institutional infrastructure and potential effectiveness, developed in part for resources, in part in response to IMF mistrust;

- *Multilateral financial assistance* through the IMF, in the form of traditional conditional assistance or of liquidity provision schemes granted to prequalified countries.

- Such a system is necessary in a world of deep financial integration with private financial institutions, not only states, needing access to liquidity and with regional spillovers, especially in currency unions, justifying mobilising resources from neighbours and partners. As things stand, however, this network does not constitute a coherent system, in terms of coverage, resources, capabilities, predictability. It is questionable whether it will evolve into a coherent system, or degenerate into fragmentation.

5. Within the GFSN, coordination problems are being addressed pragmatically, but difficult issues remain unsolved. Coordinating them raises issues of:

- *Availability.* Commercial, political or geopolitical considerations weigh on the choice of countries to which liquidity lines are being provided by major central banks;

- *Conditionality*. Even if institutions share the same philosophy the aims, maturity and scope of loans may differ, and so will the associated conditionality;

- *Terms of lending*. Whereas Fund lending conditions are broadly uniform across countries, bilateral or regional lenders may tailor theirs to programme countries;

- *Debt relief*. Multilateral debt relief granted to insolvent borrowers is in principle based on objective criteria and broadly uniform across countries; this is less true for bilateral or regional lenders, which may be based on economic or strategic interest and even seize collateral instead of participating in a multilateral restructuring;

- *Seniority*. The hierarchy of official creditors raises difficult issues of principle, especially when loans were provided at the same time and on the basis of tightly coordinated conditional programmes.

6. While the central role of the IMF in the global financial architecture is generally regarded as essential, its future cannot be taken for granted. The Fund is now part of a heterogeneous network where it is neither dominant nor indispensable. This may affect fundamental principles of the international financial architecture such as equality of treatment and transparency. More fundamentally, the IMF was part of a post-war order characterised by a monetary and financial architecture dominated by the US. Whether this can evolve into a more symmetric multipolar architecture where several currencies coexist and power is more evenly distributed is highly uncertain.

7. Architecture issues and governance issues cannot be separated. As the dominant veto player, the US exercises overwhelming influence over the IMF but is not willing to increase its resources significantly. China, India and other emerging countries are unlikely to invest much into the future of the institution as long as they feel massively underrepresented in its governance. Europe is a staunch supporter of the Fund but is unwilling to renounce the influence that it currently enjoys within it. Unless addressed as a matter of urgency, this configuration portends the risks of a persistent deadlock in the reform of the international financial architecture and of its eventual fragmentation.

Keynote – Financial Safety Nets: A European Perspective[4]

Thomas Wieser, Non-resident fellow at Bruegel. Former President of the Economic and Financial Committee/ Euro Working Group

We are gathering ten years after the Vienna Initiative was launched*. It was a cooperative solution to a problem whose gravity few suspected at first and which needed adaptability and flexibility to arrive at. The banking system in central and eastern Europe (CEE) was largely owned non-domestically, and when the crisis hit, liquidity started to flow out. There was strong incentive to be "first out the door", to defect first, as in a standard prisoners' dilemma. And there was a deplorable Western European lack of concern about potential consequences. The lesson from this episode is that closer integration implies spillovers, which have consequences for the allocation of supervision responsibilities and for the distribution of losses.*

Back then the risks were understood, but not taken seriously by sovereign decision-makers*. Western Europe governments had to be convinced that it was in their interest to nudge banks headquartered in their countries to stay in CEE in order to stabilise the macroeconomic situation. No coercion mechanisms existed, so leadership had to emerge, and cooperative structures and principles of loss attribution had to be invented in a crisis situation. The stars aligned and good cooperation was achieved, thanks perhaps to enlightened self-interest or the positive dynamic of an epistemic community, but these are all but guaranteed in a future crisis. Crisis structures and clear and transparent principles for crisis management should rather be put in place in good times.*

Turning to the euro crisis, the situation can be likened to "trapeze artists with only some safety nets"*. It is only when the ECB provided assurance of a full safety net that speculation was deterred and that the doom loop was dampened. Yet the ECB cannot play the role of a national central bank, and despite the fact that the ESM is fairly well equipped, monetary union remains incomplete.*

The relation of regional to global safety nets in the European case remains unclear*. The division of labour between the ESM and the Euro-*

4 Summary by Adrian Bradley

pean Commission, as well as the role of the ECB in future Eurozone programmes remain in question, as does the involvement of the ESM with countries outside the Eurozone, and their cooperation modalities, both in and out of crisis situations. Moreover, the participation of the IMF in possible future Eurozone programmes is now uncertain. Should it participate, the combination of EU and IMF conditionality remains an issue; and were the IMF not be involved, there is the question of member states' buy-in to the institution.

***One reason why IMF participation is likely to remain necessary is that the ESM has little to no autonomy from national governments and parliaments, while the IMF does**. Although the nature of the contingent liabilities resulting from conditional assistance are the same for IMF and for ESM loans, member states' parliaments do not regard them in the same way. The autonomy of the IMF and, to be clear, the lack of direct democratic control of its decisions are a good thing, because otherwise it would be a slow-moving Leviathan. It should also be observed that it has thus far been insulated from the vagaries of the Trump administration.*

***The EU should better prepare to deal with financial turmoil in its neighbourhood**. Both the ESM (for assistance) and the ECB (for swap lines) face legal and political limitations. Yet the implicit interdependence model of policymakers relies too much on trade linkages and tends to underestimate financial linkages. In view of the situation in the near neighbourhood (Ukraine, Balkans, Mediterranean), the EU should develop a strategy for contributing to financial stability beyond its borders.*

Seminar minutes

Adrien Bradley

Session I - The GFSN: An irreversible departure from Bretton Woods?

The first speaker enumerated a number of points touching on recent developments:

- Governance issues and the GFSN are linked: revised IMF governance through its quota increase made recourse easier, especially in emerging markets (EMs). Quota issues are very political; but politics can change, especially in crisis. It is however difficult to convince politicians to increase resources for safety nets: to maintain momentum, it is thus important to keep making the point it is necessary.

- It is difficult for the IMF (or other international organisations) to handle swap lines: providing quick, cheap and large amounts of money is incompatible with its governance structures. Despite Fed support in short-term liquidity lines for EMs, the resulting Flexible Credit Line (FCL) was too small and expensive; however, it paved the way for large balance of payment precautionary facilities. It may be the avenue of precautionary arrangements is more fruitful to pursue for the IMF and RFAs.

- Discussions of governance must confront the roles of the US and China. The US has a de facto veto on IMF reform, and does not yet accept the necessity of a safety net with more resources. China's approach to multilateral safety nets is unclear, while being forthcoming bilaterally with its own conditionality and lack of transparency.

- The relationship between global and regional safety nets is a difficult one. There has been much back-and-forth with Chiang Mai, but progress is slow. The urgency of the situation with the ESM made it so that modalities (e.g. debt solvency analyses) were not discussed ex ante. Cooperation guidelines are developed, but more is needed.

- The role the private sector can play is underestimated: crises can be attractive times to invest, but only if there is "light at the end of the tunnel". Precautionary arrangements can be helpful in these situations, though exit may be tricky.

The second speaker recalled that freeing capital movement was a major departure from Bretton Woods. He then criticised the mental model whereby crises requiring financial assistance are the result of either policy mistakes or exogenous shocks; it would be more correct to analyse them as shifts of expectations leading to self-fulfilling moves to bad equilibria. Such shifts can arise from several mechanisms, including the "original sin" of borrowing in dollars (Argentina) or the "doom loop" between banks and sovereigns (Europe). To rule some of these out a lender of last resort is necessary.

This analysis implies that the standard debt solvency paradigm and the categorisation of countries as "sinners" vs. "virtuous" are both problematic. This suggests a large, rapid, and ex-post unconditional (though ex-ante conditional) GFSN, as a deterrent which would not need to be used. Potential recourse could be granted by prequalification to avoid stigma. This seems preferable to uncertain access to non-transparent swap lines or patchy RFAs with heterogeneous rules.

A large part of the discussion revolved around assessing the relative successes of the IMF and ways forward. Many agreed with the first speaker, arguing that the Fund had in fact performed well in the past 15 years: the GFSN commands eight times more resources than in 2007, IMF cooperation with the EU has worked well in most cases (excluding Greece), and no one questions its central role any longer. While in the 1990s the proposed Asian Monetary Fund was rejected as a rival to the IMF, now all RFAs cooperate with it: ESM assistance for example is conditional to participating in an IMF programme. Nevertheless, the Fund's firepower is insufficient. Crisis catalysed action to increase it, but growing capital flows means it will have to work with RFAs. In the crisis the ESM disbursed in the EU three times more than the IMF has done so globally.

> *"In governance discussions, there are two elephants in the room: the US and China.*

The IMF should also rely more on precautionary facilities; attempts to develop them, however, have been frustrated by member reluctance, often for contradictory reasons. To increase its firepower, the IMF could involve the private sector or borrow itself on financial markets, though this last option, a taboo in debates, would likely require a politically herculean change in quota nature, and imply higher lending costs.

To one participant's interrogation on the appropriateness of capital flow management measures, another responded that the IMF's stance was coming to "a more modern view"; one participant recalled such measures have been common in many Asian countries, and perceived as sensible by financial markets there. Another put forth the idea that the IMF could review the quality of sovereign assets to instil a measure of trust, but was answered that it could never do so in sufficient depth.

Some participants cautioned against the IMF having to rely on RFAs or swap lines to supplement its activity, as clear lines of responsibility and governance practices are still missing, and impartiality cannot be assured. Others warned that overly ambitious conceptions of safety nets invite moral or political hazard. Prequalification for assistance could be a problematic signal if made public, and may carry a stigma, while potential subsequent disqualification could trigger adverse market reaction.

One participant questioned why the IMF's centrality is unchallenged. It used to rest on its resources, expertise, and the quality of the institution itself; only the last justification still stands, but it is unclear for how long. Another answered that it is the only institution with a global mandate; it provides a forum for all to discuss issues, and is equipped with a good decision structure for what it is meant to do. Its expertise derives from its large number of programmes, giving it unique hands-on practical knowledge. Another however recalled the importance of getting the diagnostic right, to justify conditionality.

In concluding, the first speaker nuanced IMF success: before the crisis, its funds were in decline, and their emergency increase was temporary: they expire in 2020. Internal discussions on governance and norms of behaviour were set aside during the crisis to "keep everyone in the room" and achieve quota reform; it is an open question how long the status quo can last. Prequalification and precautionary arrangements are the solution to moral hazard: this was discussed but deadlocked over subsequent potential disqualification. Two issues remain outstanding for private sector involvement: unclear conditions for debt restructuring, and possibility of capital flows management measures.

> *"We are learning to do internationally what we learned to do nationally a century ago: create a lender of last resort."*

The second speaker summed up the problem of the GFSN as creating an international lender of last resort. Central banks perform this function quickly with large amounts ex post. Thus, developing prequalification mechanisms is important, and would imply turning the IMF into a kind of rating agency; which in turn would imply that it would be tougher ex ante, in order to be able to provide assistance unconditionally ex post. The speaker concluded on a pessimistic note: that the global financial crisis had huge repercussions, deteriorating political conditions worldwide, and that it is uncertain whether democracy could survive another crisis of that magnitude. The problem is deeper and the system needs more than just tweaks.

Session II - Swap lines: What are they for?

Swap lines address different problems than the IMF does. They are meant to assist international banks facing foreign currency funding pressures (usually in dollars). Drawing on bilateral swap lines, central banks can perform the function of lender of last resort to the banking system. The alternative would be for the requesting central bank to use up its foreign exchange reserves and risk capital outflows. The question is whether to move from specific uses of swaps to broader uses, to avoid the need for costly self-insurance, and what framework would be necessary to do so. The crux of the problem is that there is a tension between the full discretionary firepower of central banks and an institutionalisation that would abolish this discretionary character.

The first speaker highlighted key lessons from the use of swap lines from a market point of view. They served two different purposes in the crisis, depending on destination. To advanced economies, they were motivated by self-interested domestic monetary policy concerns: they alleviated a dollar crunch in destination states but also avoided unwanted dollar appreciation domestically. To EMs, they were motivated by geopolitics and a genuine desire to fight contagion. They were useful in turning market sentiment around, despite the fact that only four states were designated recipients, and only two (S. Korea and Mexico) drew upon their swap line.

> *"At the time, Fed swap lines were the only game in town."*

From the point of view of European banks these lines are still needed, due to remaining dollar liquidity mismatches and low dollar coverage ratios. Dollar lending has doubled since 2007, which may be creating conditions for another potential dollar crunch. There is no substitute for Fed swap lines since they are liquidity creation from scratch; but other pockets of liquidity exist and could be made available. As the Fed is unlikely to extend swaps to EU EMs (e.g. Poland), the ECB could play a role in stewarding swaps for the entire banking union. The question of euro swap lines must also be confronted in view of an enhanced global role for the euro.

The second speaker recalled that there are three types of swap lines: Fed swap lines, meant to support banks, and explicitly not for balance of payments difficulties; small, conditional and discretionary Fed swap lines to a few selected Ems, designed to provide means to intervene in capital flows or exchange rates; and (of a clearly different nature) People's Bank of China (PBOC) swap lines to its 32 counterparts, meant to support exporters and the push for the renminbi to become an international invoicing currency.

IMF facilities and swap lines are both meant to remedy capital flows crises, which affect banks. In the crisis, banks faced acute currency mismatches; only the Fed could remedy this by lowering the cost of "synthetic dollars", but it made sense that partner central banks operated according to their domestic market knowledge and carried the counterparty risk. It was an effective strategy. Two issues can be pointed out however: first, swaps can strengthen the bank-sovereign doom loop, rendering IMF intervention necessary; second, swaps are by design meant to deal with short-term liquidity problems; but if the problem is one of solvency, its scope could require IMF intervention.

In sum, central banks are best equipped to deal with certain disruptions, and therefore swap lines are an essential tool that cannot be replaced by IMF programmes. However, the IMF can have a role to play, for example by evaluating the contingent liabilities involved in swap lines, by drafting swap line arrangements, or by underwriting some swap contracts as a fiscal counterpart to monetary programs. This need not trigger conditionality, but the quality of the collateral could be a problem; in turn, the IMF could take the exchange rate risk and play a role in determining the haircut if necessary. One participant noted that the IMF had considered underwriting swap lines but concluded it was difficult to do so within its current framework. This has been the origin of its Short-term Liquidity Swap proposal, which might materialise in the next few years.

Another participant suggested the ECB, like the Fed, gave swap lines out of self-interest for domestic financial stability, using monetary policy tools in line with its mandate. But, mindful of its own balance sheet risks, it could only give them to member states with sound fundamentals. This meant that it had to offer some member states (PL, HU, LT) repos instead of swap lines. It has standing arrangements with G10 countries, Denmark and China, and temporary arrangements with other countries. He suggested the ECB approach is flexible, tested, replicable, part of a framework and effective; but found it difficult to see how it could be developed further. Another participant recalled the growing interest in turning the euro into a global currency, and called for making clear the implications of this: the ECB would have either to endorse the fiscal risk, or be backed by a treasury, both of which are not yet possible.

One participant argued that the forex swap line network had been the key backstop in the crisis, and pointed out that in addition to uncertainty about their renewal in the future, there is a large gap as there is no line between the US and China. The participant argued that if swap lines are now key and the system is more bilateral, there is considerable uncertainty over what might happen if a crisis hits China. One avenue the participant sketched out was a "chain swap", whereby the ECB would draw on the Fed to extend a line to the PBC; but others considered this an abuse of the system that would quickly see the line shut down. One participant returned to the question of the political contingency of swap lines, questioning why European countries were relying on swaps and not building dollar reserves like Asian countries.

Discussion also revolved around the political questions and risks of central banks wielding such discretionary power given the non-negligible fiscal risk. The argument that they perform the function of lender of last resort in foreign exchanges was broadly accepted, though necessarily context-dependent. Some participants were uncomfortable with central banks taking inherently political decisions, conditional on the tacit agreement of political authorities; one added that despite the demonstrable usefulness of swaps for domestic monetary management, they are (especially in the US) not perceived well by the public, who see it as "lending to foreigners". One participant recalled the awkward experience of having the IMF push for a swap line with another country while both the government and the parliament were opposed.

> *"We're all second-guessing what central banks will do the next time around."*

The discussion concluded in broad agreement that multilateral nets cannot substitute swap lines: both layers are necessary, and it is equally necessary to minimise the blurring of their edges. It was argued that central banks should provide clear principles for their use of swap lines so that market actors can make informed decisions.

Session III - Regional financing arrangements: IMF complements or substitutes?

The first speaker recalled the importance of the links between trade and finance: apart from traditional trade finance proper, the development of global value chains has driven FDI and financial support for transactions along the chain, thereby increasing liquidity needs. EMs have become more exposed to market sentiment. Whereas in the past they built foreign exchange reserves to avoid having recourse to the IMF, they are doing so now to counteract market volatility. At the same time, they are being denied swap lines by the central banks of advanced economies. In a similar process to the one that led foreign exchange accumulation, RFAs have emerged in reaction to advanced countries' lack of trust in the emerging countries and to the latter's mistrust of the IMF. As long as these problems are not fixed, RFAs will continue to flourish. But, swaps, RFAs and the IMF are not substitutable: it comes down to which is most easily callable.

The second speaker delved deeper into the details of RFAs. There are seven major ones today (ESM, CMIM, BRICS CRA, EU BoP assistance facility, EU EFSM, AMF, FLAR) but are heterogeneous in age, types of issues they deal with, funding source, conditionality, terms/duration of lending, relationship with the IMF. They have been interacting and learning from each other and the IMF more intensely since the crisis. They accept the centrality of the Fund, and are collaborating with it on surveillance, coordination of programme design, and co-financing. RFAs are considered as potentially more lenient than the IMF, but also as having better expertise due to being "closer to the ground" – an expertise that can conversely be clouded by partisanship. The speaker highlighted the positive role of RFAs and the cooperation they can produce thanks to different competitive advantages.

> *"The odds are getting stacked against having an orderly system."*

One participant challenged this view of complementarity, taking the example of the EFSF and Greece. The EFSF was born because a large part of the European political system was adverse to involving the IMF and there were disagreements over Greece's debt sustainability. The speaker answered that those arguing against IMF involvement eventually lost out; the subsequent ESM made IMF involvement mandatory. Another participant reported the IMF has developed flexible principles for coordination with RFAs and the learning process is still ongoing. The Greek case had prompted the Fund to revamp its debt sustainability toolkit and take political considerations (keeping the Eurozone together) into account. Another participant expressed concern over RFAs encountering the same problems the IMF and the ESM have, such as enforcing conditionality, market misperception and negative reactions, and blame-shifting.

> *"There are two kinds of arrangements: those with money, and those without. A regional arrangement without the elephants is just a bunch of monkeys."*

Discussion revolved around the mechanics of cooperation, as well as China's Belt and Road Initiative. One participant classified the BRI as an unorthodox RFA, and expressed concern over its political underpinnings and future deployment; there was agreement that concern was warranted, and that IMF reform is necessary to maintain China's buy-in to the institution. On the mechanics of cooperation, one participant advocated joint scenario planning for crises, while stressing the importance of communication in ensuring acceptability of measures taken.

A participant opined that the true issue at stake, along with governance structures, is the constituency to which the institutions involved respond to, and deplored the lack of top-down coordination from the G20. Another suggested the important issue was resource size. As regards cooperation between RFAs and central banks and RDBs, it was said that there are always informal talks, as central banks are shareholders in both. The discussion concluded with participants concurring that common principles are needed, sufficiently strong to ensure a degree of consistency across safety net layers; but it is unrealistic to expect common rules, as circumstances and political environments differ.

Session IV - Managing a multi-layer and more diverse GFSN

The first speaker suggested that the international system may be more asymmetric than acknowledged and more fragile than recognised. He recalled the Bretton Woods system was designed to serve US interests, and US hegemony over the current system is still far stronger than the UK's was over the 19th century's gold standard. He dissented from the earlier agreement that the IMF stands at the centre of the system (and disagreed that it can in any sense be apolitical), putting forth that the central actors in the system are the US Treasury and Fed. With the dollar as international currency, the lender of last resort is in fact the Fed, and it will not pre-commit itself to granting swap lines: the US will keep its options open on weaponising its currency. Accumulation of dollar reserves is no protection; holders can be prevented from accessing them.

> *"The current system may be shifting in uncomfortable ways. Have we been thinking radically enough? […] In this field, power politics is the name of the game."*

With China seen as a challenger to the system, the IMF is in an impossible position: if moves are made to give China and India the weight they deserve, the US may oppose its veto or walk away; if they are not, it cannot be called truly multilateral and its legitimacy suffers. It is still possible, but not likely, that the "China threat" will dissipate like that of Japan in the 1980s, and that the US will pivot back from President Trump's politics. But otherwise, the development of regional currency blocks ($, €, RMB) is a real possibility.

The second speaker tempered this view, suggesting the US has always had a pragmatic, if instrumental relationship with the IMF, and that its current behaviour is simply more naked. China professes a commitment to multilateralism, but is at the same time sowing the seeds of a parallel financial universe by building up its own structures such as the BRI and the AIIB, and massively developing its fintech and data handling capacities. The world may end up being split between the PayPal world and the Alibaba world.

Both speakers agreed that the IMF's governance is outdated, but expressed doubts that the articles of agreement could be reformed. Nevertheless, technical work is being carried out under the "Integrated Policy Framework" umbrella. Further revamping, for example through larger arrangements to borrow, may be possible; G20 impulse is helpful in this respect.

Discussion bore on the previously discussed themes of the importance of maintaining the IMF as an institutional lender of last resort and as the key, multilateral part of the financial safety net in a multipolar world. Doing so requires at minimum the buy-in of the democracies, to ensure pull on others. It was observed that there is some room to reallocate quotas without the US losing its veto power, playing on their three components (overall resource levels, calculation formula, and member state weights) - probably to Europe's detriment, and the possibility is at the mercy of US electoral timings.

> *"The hegemon tends to endure; but until when?"*

Turning to the EU, recommendations were made to strengthen its participation in, and linkages with, the GFSN. This should be achieved in several ways, more or less politically probable: by producing safe assets, consolidating swap lines and developing forward market capacity to favour euro invoicing, also deepening EMU and giving itself fiscal capacity, and completing banking union. Some participants argued that a multipolar currency system has already emerged.

Several participants recalled the difficulty of reconciling slow, small-scale technical reform within the IMF and other international financial organisations and the political necessity to ensure continued democratic allegiance. The system is already not seen as completely legitimate anymore in advanced economies. A 4-pillar system might serve the interests of EMs better than that in the past. One participant countered however that GFSN elements are patchy and that the IMF's share in GFSN reserves is falling. Another highlighted the importance of unpacking the IMF: its staff, its board, its different constituencies.

Wrap-up - Lessons for global governance

The first speaker likened the GFSN to a bucket, half-full after the crisis but leaking. The system is fragile: one or more of its nodes may fail in a crisis, which bolsters the case for RFAs as another layer in it. He asked whether the IMF might be split into its surveillance and lending functions. In his opinion, it makes sense to more actively involve the private sector; central banks were originally private, it would be more productive to make private players part of the solution rather than a problem to deal with. He concluded by urging the recognition that more crisis prevention measures are needed: regulation, macroprudential instruments, and capital flow measures.

The second speaker summed up by giving seven points.

1. The evolution of the GFSN has been conditioned by governmental wills, and has caused at times large and unequally distributed costs.

2. Different parts of it perform different actions;

3. And this diversity can be seen as a sort of strength.

4. The IMF cannot do the job alone; it is stretching its statutes as it is, has little room or time to evolve to work with the rest of the system, and faces strong political and social headwinds.

5. RFAs are very heterogeneous and still finding their place — and it is clear some matter much more than others (ESM).

6. The purpose of the GFSN itself is changing, due to both endogenous and exogenous factors.

7. Governance of the GFSN is an increasingly messy affair, as there is little political drive to reform and clear it up. The G20 may play a role here, but it is worrying that its legitimacy is being corroded in advanced economies and emerging markets alike.

Seminar programme

1 APRIL

19.30	*Welcome dinner and keynote address* **Thomas Wieser** | Former President of the Economic and Financial Committee / Euro Working Group and Bruegel

2 APRIL

9.00 – 9.15	*Introduction* by: **Erik Berglof** | LSE, **Jean Pisani-Ferry** | EUI
9.15 – 9.30	*Tour de table*
09.30 – 11.00	**Session I – The Global Financial Safety Nets: An Irreversible Departure from Bretton Woods?** Introductory Remarks: **Reza Moghadam** | Morgan Stanley, **Andrés Velasco** | LSE
11.00 – 11.30	*Coffee break*
11.30 – 13.00	**Session II – Swap Lines: What are they for?** Introductory Remarks: **Isabelle Mateos y Lago** | Black Rock Investment Institute, **Ricardo Reis** | LSE
13.00 – 14.30	*Lunch*
14.30 – 16.00	**Session III – Regional Financing Arrangements: IMF Complements or Substitutes?** Introductory Remarks: **Urjit Patel** | Former Head of the Reserve Bank of India, **Klaus Regling** | European Stability Mechanism
16.00 – 16.30	*Coffee break*
16.30 – 18.00	**Session IV – Managing a multi-layer and more diverse GFSN** Introductory Remarks: **Charles Goodhart** | LSE, **Martin Mühleisen** | International Monetary Fund

18.00 – 18.30	**Wrap-up – Lessons for Global Governance**
	Introductory Remarks: **Charles Bean |** LSE, **George Papaconstantinou |** EUI

Seminar participants

Charles Bean	LSE
Erik Berglof	LSE
Patrick Bolton	Columbia University, Imperial College
Creon Butler	Cabinet Office, UK
Mark Bowman	HM Treasury
Adrien Bradley	Robert Schuman Centre, EUI
Pietro Catte	Banca d'Italia
Karolina Ekholm	Ministry of Finance of Sweden
Nicola Giammarioli	European Stability Mechanism
David Gillespie	Oliver Wyman
Charles Goodhart	LSE
Hans-Joachim Klöckers	European Central Bank
Jean-Pierre Landau	European Bank for Reconstruction and Development
Isabelle Mateos y Lago	BlackRock Investment Institute
Reza Moghadam	Morgan Stanley
Martin Mühleisen	International Monetary Fund
Piroska Nagy-Mohacsi	LSE
George Papaconstantinou	School of Transnational Governance, EUI
Ant Parham	HM Treasury
Urjit Patel	Former Head of the Reserve Bank of India
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Klaus Regling	European Stability Mechanism
Ricardo Reis	LSE
Polly Sculpher	HM Treasury
Christina Segal-Knowles	Bank of England
Beat Siegenthaler	UBS
James Talbot	Bank of England

Adam Taylor	HM Treasury
James Usmar	HM Treasury
Shahin Vallée	LSE
Dimitri Vayanos	LSE
Andres Velasco	LSE
Edouard Vidon	Banque de France
Thomas Wieser	Former President of Economic and Financial Committee/Euro Working Group and Bruegel

Section 4

The regulation of global banking

The Governance of International banking: Regulating for Crises, Past and Future

Seminar insights[1]

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In 2009 then-Treasury Secretary Tim Geithner described the newly created Financial Stability Board (FSB) as the "fourth pillar" of global economic governance alongside the WTO, the IMF and the World Bank. In reality, the FSB is far from having the legal competences, clout and resources of the other three organisations. It serves as a coordinating body and as an intermediary between the political G20 and the series of public and private bodies in charge of the various segments of financial regulation.

1. International banking regulation: A coordinate-and-review model. In this context, international banking regulation – a segment of global financial regulation – provides a telling test case for assessing the effectiveness and adequacy of international regulatory coordination. Its *modus operandi* is to set common non-mandatory standards, whose implementation is subject to external monitoring – in short a *coordinate-and-review* mechanism:

1 The seminar was held on 11-12 September 2018 in Milan (Italy), jointly organised with Bocconi University and the Florence School of Banking and Finance.

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- Common regulatory standards (for, e.g., capital and liquidity ratios) are agreed upon within the framework of the Basel Committee for Banking Supervision (BCBS), a 28-members body hosted by the Bank for International Settlements. These standards are negotiated amongst participating governments, with significant indirect involvement of industry representatives;

- Participating countries or entities such as the EU are free to decide if and to what extent they transpose the standards in their legislation, while they remain fully responsible for their enforcement;

- The BCBS monitors both the legislative transposition of the agreed standards (adoption) and their effective implementation at jurisdiction and bank levels. It carries out quarterly compliance assessment reports, whose results are published. Other governments and market participants are therefore informed in real time of both the conformity of the national legislation with the agreed standards, and their actual implementation;

This micro-prudential regulatory coordination system is complemented by cooperation procedures for macro-prudential oversight and banking crisis resolution. However, these procedures are less formalised and as things stand their effectiveness is disputed. At any rate, there is no evidence one can rely on to assess their effectiveness.

The regulatory coordination system can be assessed from three complementary perspectives:

- *First, how effective is the overall harmonisation of financial stability standards?*

- *Second, how adequate is the regulatory framework resulting from international coordination?*

- *Third, how resilient to disruption emanating from outsiders is the prevailing regime?*

2. An effective harmonisation of banking solvency and liquidity standards. The answer to the first question is that *the overall harmonisation of banking solvency and liquidity standards* is fairly effective. Although not mandatory, the agreed standards are implemented in most participating jurisdictions, as illustrated by the general rise in capital ratios and liquidity ratios. Cases of non-compliance are limited. Furthermore, the system seems to have successfully passed an important test, as the US under President Trump has not significantly departed from commitments inherited from the previous administration.

There are several reasons for this qualified success. To start with, standards are negotiated by national regulators with the indirect participation of industry representatives. This ensures a high degree of ownership of the agreed benchmarks, which then serve as yardsticks of financial soundness. External compliance monitoring provides national regulators an incentive to implement them thoroughly; failure to do so is regarded by markets and the community of the other regulators as a sign of fragility. Banks themselves, especially international ones, have a strong incentive to anticipate the agreed compliance deadlines, in order to ensure high-quality ratings. In short, reputational concerns on the part of regulatory jurisdictions and the banks reinforce the effectiveness of an otherwise toothless regime.

3. The adequacy of international standards is however disputable. The answer to the second question, regarding *the adequacy of the regulatory standards resulting from international coordination*, is much less positive. Basel II, the set of regulatory standards agreed upon in 2005 that went into force shortly before the Global Financial Crisis, has gone down in financial history as a blatant case of regulatory capture: major banks had successfully lobbied for low, loosely defined capital and liquidity ratios, and an excessive reliance on the largest financial institutions' internal risk assessment models. In retrospect, Basel II regulation was evidently not demanding enough, not strict enough and not uniform enough.

Arguably, this failure – which contributed to the severity of the crisis – has largely been corrected with the substitution of the Basel II standards by those in Basel III. Nevertheless, even the Basel III framework can be criticised for regulatory limitations and gaps.

4. The regulatory regime is vulnerable to disruptions emanating from outsiders. The answer to the third question regarding the *resilience* of *the existing regime*, is unfortunately that it is vulnerable. As for any sectoral regulation, economic agents outside its scope – fintechs, but also platforms and market places – benefit from relative regulatory leniency. The growing blurring of the distinction between "banks" and "non-banks" may provide a significant regulatory advantage to the latter, with the result that overall effectiveness is being diminished. The same applies, though to a lesser extent, to the participation in global banking of financial institutions not headquartered in the major advanced economies. These may benefit from excessive regulatory leniency or forbearance.

5. Trade-offs in international regulation. Analysis therefore suggests that international regulatory harmonisation through voluntary coordinate-and-review schemes involves three significant trade-offs:

- An *implementation-quality trade-off*: The closer the involvement of national regulators and industry representatives in regulatory design, the stronger the chances of thorough implementation. However, this may be at the cost of biases in the content of the regulation;

- A *thoroughness-coverage trade-off*: As for any regulatory club whose membership remains open to new applicants and does not provide defined advantages, stricter regulation may discourage certain jurisdictions to participate;

- An *ownership-resilience trade-off*: ownership is facilitated by the like-mindedness of participants, be it in institutional or sectoral terms. But to leave out the potential disruptors involves the risk of leaving the problems they may pose outside the scope of the regulatory endeavour.

Keynote – Global dimensions of Banking Regulation[1]

Vítor Constâncio, Former Vice-President of the European Central Bank

I thank the Organisers for inviting me to speak at this event, included in the very topical project on the Transformation of Global Governance. There are certainly several drivers behind the idea of this project. The first, is the concern about the potential fragmentation of the multilateral system of international governance that has been built up after 1945. The fears stem from the present disturbing US policies, the emergence of new powers, especially China, and the growing relevance of populist nationalism as the backlash to the crisis and the excesses of globalisation. These tendencies have been historically the harbinger of global disasters.

The deep geo-political change induces a second motivation for our general subject, as it simultaneously increases the need for cooperation but also adds to the complexity of getting consensual decisions on all kinds of domains. Multipolarity increases the heterogeneity of interests, the intricacy of new problems generates institutional inertia, the whole process leading to what David Held and co-authors characterised as gridlock in international cooperation. [2]

However, I see gridlock not just as a difficulty to act but rather as an incapacity to provide appropriate responses to the problems that now beset the world, our democracies, and a liberal multilateral system. The system cannot be protected without significant changes, correcting flaws that became more apparent after the Big Recession: extreme inequalities in advanced economies; more intrusive trade agreements intruding too much on national social contracts; financial instability generated by the ever-increasing role of finance; environmental damage.

There were many warnings about the potential socio-political consequences of hyper-globalisation, beyond the benefits of higher economic

1 Keynote speech at the Workshop on "The Governance of International Banking: Regulation for crises, past and future" included in the "The Transformation of Global Governance Project" - Milan, 12th September 2018.

2 See Hale, T., Held, D, and K. Young (2013) " *Gridlock: why global cooperation is failing when we need it most*" Cambridge: Polity Press; and Hale, T., Held, D, (ed) (2017) " *Beyond gridlock*" Cambridge: Polity Press.

efficiency. In 1996, Ralf Dahrendorf wrote about the contractor trinity of competitiveness, social cohesion and freedom and foresaw that "A new authoritarianism may indeed be the main challenge to liberal democracy in decades to come." [3] In 1997, Rodrik published his first book expressing concerned with "…making globalization compatible with domestic social and political stability" [4] and introduced his globalization paradox in 2011, exploring the incompatibility between deep global integration, democracy and national sovereignty" [5]. Already in 1988, on the pages of the magazine *Foreign Affairs*, and later in some scholarly papers, Jagdish Bhagwati, a staunch defender of free trade and globalisation, railed against the excessive instability of free capital movements that did not have the same theoretical justification of free trade and were more an ideology of the "Wall-Street / Treasury complex" as he put it[6]. In 2004, Paul Samuelson published a paper demonstrating with impeccable theory, that a productivity jump by a less developed country, China, could generate trade effects negative to an advanced economy, the US, showing that free trade may lead to some country losses, beyond the well-known losers and winners within each country. In a spirited answer to the critics who worried about his supposed apostasy on free trade, Samuelson concluded that "It may be of interest that none of my chastening pals expressed concern about globalization's effects on greater inequality in a modern age when transfers from winners to losers do trend politically downward in present-day democracies."[7]

These and other warnings were not heeded by many ruling establishments, including in our profession, blinded by the gains in economic efficiency and general growth, the spectacular decline of poverty in emerging countries and the illusory hopes on pure trickle-down distri-

3 In a speech at the British Academy in 1996, included as chapter 7 in the book "*After 1989: morals, revolution and civil society*" MacMillan Press, 1997.

4 Rodrik, Dani (1997) "*Has globalization gone too far?*"

5 Rodrik, Dani (2011) "*The globalization paradox: Democracy and the future of the world*", WW Norton & Co. ; see also Rodrik, Dani (2018) "*Straight talk on trade: ideas for a sane world economy*" Princeton UP

6 Bhagwati, J. (1988) "The Capital Myth: the difference between Trade and Widgets and Dollars" in *Foreign Affairs,* Vol 77, no 3; see also Bhagwati, J (2002) "Globalization and appropriate Governance" UNU/Wider Annual Lecture

7 Samuelson, P.A. (2005) "Response to Dixit and Grossman" in *Journal of Economic Perspectives, Journal of Economic Perspectives* Vol 19, no 3; see the original article in *Samuelson*, P.A. (2004) " Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization" in *Journal of Economic Perspectives* , vol 18, no 3, Summer of 2004

bution in advanced economies. The consequences are now being felt in the spreading of populism in an increasing number of democracies and widespread divorce between populations and expert elites. The global system of governance was not able to address the identified risks and challenges, continues to be unprepared to correct flaws and steer a more intelligent inescapable globalisation.

Fortunately, I don´t have to dwell on these big subjects today, as my remit is much narrower, centred on financial regulation, particularly on banking. International standards and governance for finance and banking developed over the years into a complex network of institutions with different degrees of independence, sometimes with some overlapping competences. Some of them are even private, like the IASB in accounting or ISDA in derivatives contracts. What they produce is some form of soft law, made of standards and recommendations, and expect compliance via legislation transposition by different jurisdictions or simply voluntary implementation. The public institutions of the network decide by consensus and are involved in a diplomatic game subject to significant asymmetries of international power and a relevant role played by the big private institutions that are addressees of the regulations and are part of the domestic politics that interacts with the diplomatic negotiations, as theorised by Robert Putman (1988)[8].

This multilateral system evolved with the growing internationalisation of finance and the occurrence of disturbances that triggered waves of regulatory initiatives. In Banking, it started modestly in 1972 with the creation of the Groupe de Contact, followed quickly by the Basel Committee in 1974, formed by the G10 on the wake of turbulences in exchange rates and banking markets with the failure of the German bank Herstatt. The Concordat, signed in 1975, focused in matters of supervisory guidelines for subsidiaries and branches of international banks. The Basel I Accord emerged in 1988, following the Latin American debt crisis and the S&L disaster in the US. Both created the need and the domestic pressure for higher capital for American banks and Basel was used by the US to generalise the additional requirements internationally and ensure a level playing field. This logical pattern of the influence by the financial hegemon, usually seconded by the UK, has been repeated in other instances. The outcome was, nevertheless, a compromise, as the US had a preference for a leverage ratio but had to accept a risk weighted capital ratio solution.

8 Putman, R. D. (1988) “Diplomacy and domestic politics: the logic of two-level games” in *International Organization,* vol 46(3) 639-64

Basel I was crude and created incentives for banks to go for riskier assets with the same capital charge and to take off assets from the balance-sheet, spurring securitisation in the early 90s. Developments of risk management, particularly the invention of Value-at-Risk (VAR) modeling led to the major victory for the industry of convincing regulators to include it in the 1996 Market Risk Amendment to Basel I. VAR is not even a good measure of risk, as it says little about the amount of losses. Assuming normality and the principle that a reliable estimation requires at least 30 observations per parameter, the introduced rule of a capital charge 3 times the VAR for a horizon of 10 days at the 99% percentile, implies for statistical reliability, the existence of 109 years of data that are obviously not available[9].

As capital ratios were decreasing, in 1998, the Basel Committee announced a new Accord to substitute Basel I, to promote "safety and soundness" of banks, stating that the new regime would keep at least the same capital as with Basel I and would ensure "competitive equality" of treatment. In the end, the powerful lobbying by industry through the IIF, ISDA, ICMA, ISLA and other industry bodies, influenced the final outcome in two important ways: first, the introduction of internal models to assess also credit risk, reserved in practice for the big banks that could build them; second, an exceptionally low risk weight for securitizations and the elimination of an initial proposal for an explicit capital charge for credit derivatives risk[10]. Consequently, the 4th official QIS estimated that the Advanced-IRB banks would have a median reduction of 31% and 5th QIS showed a 26.7% average capital reduction for Advanced-IRB banks and an increase of 1.7% for banks on the Standardised Approach, in stark contrast with the initial announced objectives[11]. Basel II was an egregious example of regulatory capture by the big credit institutions.

Despite its limitations, concluded in 2005, the new standard had little

9 At 1% occurrence probability, one day horizon event occurs 3.65 times a year; so, to have 30 observations, 10.95 ears; for a ten days horizon that means 109.5 years, as pointed out in Brown, Aaron (2012) " *Red-blooded Risk: the secret history of Wall-Street*" John Wiley $ Sons. Aaron also explains that while since 1980 GDP almost doubled but financial business quadrupled and the additional capital needed for that did not come from more invested savings but from "capital creation" by re-defining it in terms of risk-based assets value (see page 348).

10 See Lall, R (2012) "From failure to failure: the political economy of international bankingn regulation" in *Review of International Political Economy*, 19:4 609-638. See another critical view of Basel II in Tarullo, Daniel (2008) "*Banking on Basel: the future of international financial regulation*" Peterson Institute for International Economics.

11 Lall, R. (2012) ibid

time to start before the financial crisis came to change everything. Even so, Basel II was not fully applied, in the US by absence of timely legislation and in Europe because subtle interpretations allowed jurisdictions not to apply the output floor of 80% of the Standardised Approach capital calculation, defining a maximum deviation of 20% that could result from using internal models, an issue that would beset the negotiations to finalise Basel III.

I went through this brief historical detour, to illustrate some of the conditions surrounding the production of multilateral standards and regulations. Naturally, the financial crisis, triggered a major new effort to step up financial regulation. The standards already approved and implemented, although positive in general, are below what was initially expected.

The new capital requirements for high quality capital for loss absorption were on the low side and part of them even in the form of a buffer, supposedly to be depleted in stressful situations. Adding the 2.5% conservation buffer, the total common equity requirement was set at 7%. The leverage ratio was finally fixed a just 3% of Tier 1 capital, allowing a multiplier of 33 times that capital. Fortunately, market pressure and the use by supervisors of the SREP and Pillar 2, led to the present situation of a common equity capital ratio on average of 14% in the euro area. Recall that 7% was precisely the average ratio in 2007 for the euro area banks. Significantly, the leverage ratio has also been increasing and the average for euro area banks is now above 4. Before the crisis, the extraordinary expansion of the financial sector was not enabled by savings invested in the capital of financial institutions but mostly by a redefinition of risk capital and its endorsement by regulators. A few significant European banks had a leverage ratio (equity over total assets) of just 1.5% to 2% while capital ratios were well above the regulatory minimum of 8%. The "magic" of internal models to calculate risk weights in regulatory capital explains the difference, although the low leverage ratio meant that a loss of 3% of total assets would wipe out banks' capital.

Resistance to the new standard was, nevertheless, fierce. The IIF published a study in 2010 with the conclusion that a 2 percentage points increase in the capital ratio would induce a 3.1 loss of GDP in the euro area. A justified level of capital between 15% and 20% has been the conclusion of numerous papers in academia or in central banks: Miles et al

(2011)[12], Brooke et al (2015)[13], William Cline (2017)[14], Morris Goldstein (2017)[15] or Firestone et al (2017) from the FED showing that even considering the protection of TLAC, the optimal range of the capital ratio lies between 13 % and 25%[16].

The same pattern of resistance manifested itself in relation with the two new liquidity ratios. In the end, the LCR was weakened but the NSRF essentially resisted and played already a role in the reduction of the credit/deposits ratio of European banks from 144% in 2007 to 116% today. In the deciding period about the two ratios, what we heard from the industry referred to the impending catastrophes if the standards were approved. Both are nowadays complied with without any upheaval.

Regarding the too-big-to-fail problem, the series of adopted measures were more consensual: the prohibition of public bailouts in Dodd-Frank and the BRRD; the G-SIB surcharge; the TLAC or higher MREL in the EU; the streamlined cross-border bank´s resolution. This last point is in a state of flux with details about implementation among major jurisdictions still to be finalised. For instance, the somewhat ambiguous changes introduced by the US in its Orderly Liquidation Authority, created some doubts about the single point of entry regime. The remaining concern is that the framework may not be appropriate to deal with general financial crises like the one we just had, when the problem is the existence of too-many-to-fail banks. Examining the history of crises, it is hard to avoid the conclusion that such situations require public intervention to backstop liabilities and recapitalise the system. Exceptional interventions that were carried out in the crisis are, however, no longer legally possible in several

12 Miles, D., J. Yang and G. Marcheggiano (2011), "Optimal bank capital", *Bank of England, External MPC Unit, D.P.No. 32*.

13 Brooke, M., O. Bush, R. Edwards, J. Ellis, B. Francis, R. Harimohan, K. Neiss and C. Siegert (2015), "Measuring the macroeconomic costs and benefits of higher UK bank capital requirements" *Bank of England Financial Stability Paper 35*.

14 Cline, W. (2017), "The right balance for banks: theory and evidence on optimal capital", *Peterson International Institute of Economics*.

15 Goldstein, M. (2017), "Banking's final exam: stress testing and bank capital reform", *Peterson International Institute of Economics*.

16 Firestone, S., A. Lorenc and B. Ranish (2017), "An empirical economic assessment of the costs and benefits of bank capital in the US", *Finance and Economics Discussion Series, Federal Reserve Board, Washington, D.C., No. 2017-034.*

jurisdictions[17].

Other reform domains were treated in a much lighter way. For instance, the one related with the so-called shadow banking, whose role was in the crisis greatly depended from the use of securitisation, repos and OTC derivatives. The creation of inside liquidity by repos was important for the funding of the housing bubble[18].

The crisis itself made securitisations and repos shrink significantly. In the U.S., broker-dealers changed into banks, making the shadow banking sector smaller. Post-reform, securitisations became less attractive being now subject to higher capital charges, securities vehicles were consolidated with bank sponsors and repos and some OTC derivatives have moved to central clearing, which leaves the still unresolved issue of CCPs safety and resolution. The overall progress in reducing risk in STFs and derivative markets has been significant but might not be enough. No effective regulations prevent the expansion and misuse of those instruments in any future euphoric episode. The recent recommendations by the FSB regarding the re-hypothecation and re-use of securities in repos are in my view not sufficiently far-reaching[19]. Concerning the use of margins and haircuts, the FSB recommendations to introduce minimum initial levels are also quite narrow: they exclude sovereign paper and transactions between regulated institutions and apply only to non-centrally cleared operations. Going forward, more may have to be done. Setting minimum margins and haircut floors would limit the build-up of leverage and reduce the procyclicality of current margin and haircut setting practices[20].

17 For the U.S. see Geithner, T. (2016), "Are we safer? The case for strengthening the Bagehot arsenal", *Per Jacobson Lecture at the 2016 Annual Meetings of the IMF and WB*. See also Bernanke, Geithner and Paulson in the NYT " What we need to fight the next financial crisis" at https://www.nytimes.com/2018/09/07/opinion/sunday/bernanke-lehman-anniversary-oped.html?smid=tw-nytopinion&smtyp=cur

18 See Bayoumi, T. (2017) *ibid* , page 73.

19 See Financial Stability Board (2017), "Non-cash collateral re-use: Measure and metrics", Policy Report and Financial Stability Board Policy Report (2017), "Re-hypothecation and collateral re-use: Potential financial stability issues, market evolution and regulatory approaches".

20 See Constâncio, V. (2016), "Margins and haircuts as a macroprudential tool", remarks at the ESRB international conference on the macroprudential use of margins and haircuts, 6 June 2016 available at8 https://www.ecb.europa.eu/press/key/date/2016/html/sp160606.en.html ; see also Constâncio, V. (2017), "Macroprudential policy in a changing financial system", remarks at the second ECB Macroprudential Policy and Research Conference, 11 May 2017 available at https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170511.en.html

Furthermore, the policy recommendations by the FSB to address vulnerabilities arising from asset management activities are also too soft. They cover guidelines for the sector and reporting and monitoring but not real new powers for supervisors. They refer to liquidity mismatch between fund investments and redemption terms, operational risk, securities lending activities and leverage reporting by investment funds, including synthetic leverage built up usually with OTC derivatives. Leverage requirements for investment funds, already partially introduced in Europe, represent an important point.

The final aim should be to extend LR requirements to a broader set of financial institutions as recently proposed by Dirk Schoenmaker and Wierts (2016)[21]. That should include the risks posed by synthetic leverage from the use of derivatives.

Another aspect to highlight is that the whole set of reforms has taken a long time to be approved and it is still far from implementation. In Europe, the Leverage Ratio, the NSFR, the Fundamental Review of the Trading Book are included in the revisions of the CRD /CRR, expected to be approved until December. The package related to the finalisation of Basel III has yet no proposal for transposition and includes: the treatment of Operational Risk; the new Standardised regime of risk-weights for credit risk; the revision of the Credit Valuation Adjustment (CVA) in derivatives; the important revision of the Internal Models for credit risk and finally, the overall output floor of 72.5% binding the effect of using internal models which is to be gradually introduced until 2027! All the other points I just mentioned are entering into force only in 2022 or 2023.

This delay of many years since the crisis to conclude the new regulatory regime resulted from institutional and political gridlock and has created a lot of uncertainty affecting banks´ behaviour. It also generated so-called reform fatigue and opened the door to continuing pushback against regulation.

After the change of Administration in the US, the expectation was that some backtracking in regulation would happen. This risk has not

21 A convincing argument for a wide application of leverage ratios can be found in Schoenmaker, D. and P. Wierts (2016), "Regulating the Financial Cycle: An Integrated Approach with a Leverage Ratio", *Duisenberg School of Finance - Tinbergen Institute Discussion Paper, TI 15- 057 / IV / DSF 93*. The risks from synthetic leverage have been outlined in ECB Financial Stability Review (2015) "Synthetic leverage in the investment fund sector" Box 7, May. See also V. Acharya (2014), "A Transparency Standard for Derivatives," in *Risk Topography: Systemic Risk and Macro Modeling*, M. Brunnermeier and A. Krishnamurthy (eds), Chapter 6.

disappeared, and international weakening or fragmentation may still develop. However, so far, divergences of regulatory implementation have not been very significant. In assessing the first round of transpositions of Basel III, the Basel Committee considered that the US was largely compliant and the EU not compliant for two reasons: first, for allowing banks that have adopted the IRB (internal models) to use zero risk weights for credits to the public sector and reduced weights for SMEs; second, for the exemptions of a capital charge resulting from the CVA (Credit Valuation Adjustment) on certain derivative transactions with public entities and non-financial corporations.

This year, two Reports from the US Treasury and some initiatives in the US Congress (The Choice Act), pointed to possible significant changes, regarding the Leverage Ratio (reduction and exemption for Sovereign Bonds and repos), the LCR, the NSFR, the market risk rules (FRTB) and the possible of the OLA (Orderly Liquidation Authority). In the end, the changes approved by the US Congress were much softer, namely, some exemptions for small and community banks as well as the increase from $50 to $250 billion the threshold for the enhanced supervisory regime, although the FED was granted the power to make justified exceptions. Later, the Leverage Ratio was reduced to big banks (G-SIBs) by replacing the current 2% leverage buffer add-on with a leverage buffer set at 50% of each firm's G-SIB risk-based G-SIB surcharge; reducing the current 6% threshold for covered insured depository institutions (IDIs) that are subsidiaries of G-SIBs to 3% plus 50% of the G-SIB surcharge. At the same time, the methodology of stress tests was softened. It seems strange to introduce these changes at the peak of the cycle, facilitating expansion even further, but even after these modifications the US is still compliant with the Basel standard of just a 3% LR.

In Europe, the texts under discussion for final approval of the revised CRD IV / CRR contains several differences from the Basel III text, concerning the LR, the NSFR and the FRTB, deviations that were opposed by the ECB in its public opinion[22]. In the LR case, these refer to the exemptions for inter-group exposures, for pass-through exposures of regulated savings, for export credits and the initial margin for derivative exposures related to client clearing. The NSFR proposals also comprise

22 See OPINION OF THE EUROPEAN CENTRAL BANK of 8 November 2017 on amendments to the Union framework for capital requirements of credit institutions and investment firms, at https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2017_46_f_sign.pdf

four signalled deviations whereas the FRTB issues are basically related to the proposed transition regime. Hopefully, not all these deviations will remain in the final text and their material impact on banks´ prudential ratios will have to be carefully assessed. I believe that we can conclude that the risks of regulatory fragmentation foreseen since last year have, overall, not materialised.

There are several reasons why financial regulation seems less prone to divisions than we see happening in the trade or environment fields. In an interesting paper, Young and Pagliari (2015)[23] analysing quantitively the reactions of the regulated sector to regulatory consultations in energy, pharmaceutics, agriculture, telecommunications, and finance, find clear evidence that the unity of views and preferences is higher in finance than in all the other sectors. This is related with the wider reaching of finance as an economy infrastructure and the weakness of the intervention of outsiders lobbying about financial regulation with different objectives.

I think we could also add the view that financial products are some sort of club good, where the group of suppliers and owners share mutual benefits, making several characteristics of these goods only collectively excludable. This feature of not being pure private goods, highlighted among others by Selmier (2014) and Cerny (2014)[24] partially elucidates the unity of lobbying positions and explains why there are many examples of self-regulatory associations in the sector. This sometimes facilitates regulatory compliance, as peer pressure and the threat of ostracism exerts some degree of discipline. Nevertheless, as Cerny (2014) puts it "… from a political economy perspective, finance goods, like many other club goods, are provided not according to the logic of market efficiency, but rather that of market control and manipulation". This angle links well with the criticism of the market efficiency hypothesis by Dimitri Vayanos and Paul Wooley (2008)[25] and the Wooley (2010) analysis of rent-seeking

23 Young, Kevin and S. Pagliari (2015) " Capital United? Business unity in regulatory politics and the special place of Finance" in *Regulation and Governance* and also available at City, University of London Institutional Repository http://openaccess.city.ac.uk/12093/1/Young%20and%20Pagliari%20-%20Capital%20United%20~%20Forthcoming%20in%20RegGov.pdf

24 W.T. Selmier II (2014) "Why club goods proliferated in investment finance" ; P G. Cerny (2014) " Rethinking financial regulation: risk, club goods and regulatory fatigue" . Both texts are chapters of the book edited by Thomas Oatley and W. Kindred Winecoff "*Handbook of the International Political Economy of Monetary Relations*" Edward Elgar, 2014.

25 Vayanos, D. and P. Wooley (2008) "An institutional theory of momentum and reversal", The Paul Wooley Centre for the study of capital market dysfunctionality wp n. 1

and principal-agent problems that " … do a good job of explaining how the global finance sector has become so bloated, profitable and prone to crisis"[26] Some of his recommendations to mitigate these features are the wider use of GDP-linked bonds, the recognition that mark-to-market accounting is inappropriate when pricing is inefficient, and that " … regulators should not automatically approve financial products on the grounds that they enhance liquidity or complete markets". I would add to this list the overhaul of housing finance to further reduce the risks of funding mortgage credit with short-term deposit liabilities. Many ideas have been put forward to change this[27] including tilting even more the NSFR to correct that bias; encouraging securitisation with low maturity transformation; creating a new type of financial institutions specialised in mortgages or, introducing a new type of mortgage contract that would have more equity participation by lenders in exchange of sharing the returns of appreciating housing prices, proposed by Mian and Sufi in "House of debt".[28]

Housing credit has been growing steeply in importance for banks in most jurisdictions over the past decades, as shown by Jordá, Schularick and Taylor (2016) in their paper "The great mortgaging"[29]. In 17 developed countries, the weight of real estate bank lending in total credit increased from 25% of GDP in 1980 to 69% in 2010. As they highlight: "… the core business model of banks in advanced economies today resembles that of real estate funds" They also show how mortgage credit has shaped the business cycles in the last decades, has created financial instability and contributed to slower recoveries associated with high household debt. It is, therefore, odd that the issues of housing finance have not been addressed by regulators and policy makes in different ways. Macroprudential policies, like Loan-to-value or (better) Debt-to-income, help to mitigate the risks but they still confront great resistance in being used and may not be sufficient.

Let me add a brief reference to the institutional framework that organises the governance of production and enforcement of financial

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26 Paul Wooley (2010) "Why are financial markets so inefficient and exploitative – and a suggested remedy" Chapter 3 of the book by Adair Turner and others (2010), *The Future of Finance: The LSE Report",* London School of Economics and Political Science.

27 See Goodhart, C. and E. Perotti (2017), "Containing maturity mismatch", *VoxEU*.

28 Mian, K. and A. Sufi (2014), "House of debt", *University of Chicago Press*.

29 Jordá, O., M. Schularick and A. Taylor (2016), "The great mortgaging: housing finance, crises and business cycles", *Economic Policy* Vol 31, n. 85.

regulation. The big changes, after the crisis, were the strengthening of the G20 political role at the top of the process and the transformation of the FSF into a Financial Stability Board that, however, was never given the competences to become the fourth pillar of the global economic architecture in charge of financial regulation announced by the US Treasury Secretary. It has now the coordinating role in preparing G20 decisions, working with several standard setters, and issuing recommendations about financial institutions not covered by the Basel Committee. Initial overlaps with the IMF have been streamlined and settled, with the IMF keeping his dominant role in analysing financial stability through country FSAPs and the compliance reports concerning the implementation of Standards and Codes. I do not think that it is worthwhile to consider changes in the international Institutions roles and competences about financial regulation.

Summing up, progress was made in stepping up regulation to make the system safer but, despite the big financial crisis, no deep structural change was introduced to properly tame finance and debt, making the system prone to new crises.

Seminar minutes

Adrien Bradley

Global banking regulation: Why and how

The aftermath of the global financial crisis prompted regulators, legislators and industry actors to reflect on what went wrong, why, and what could be done. Cross-border finance had provided a massive credit boom, and leveraging enabled a huge amount of borrowing, facilitating the accumulation of risk and heightened vulnerability in the system. These features amplified the effects once the crisis erupted in 2008. Crises in the 1990s and early 2000s had been more contained, forcing authorities to rethink models and innovate.

As one participant pointed out, the alleged benefits of cross-border banking do not command consensus. They are not derived from a widely accepted theory, as for example is the case for trade). This helps explain why it is difficult to present a straightforward argument for global convergence of financial regulation: there are just as strong arguments for decentralising the governance of scaled-down and less internationalised banks. Assuming banks remain what they are, there seems to be some convergence around the notion of public goods in global finance. However, some reactions to the crisis aiming at securing these may have in fact exacerbated the downturn, from which the system is only just recovering ten years afterwards.

> *"There is no Ricardo of finance."*

Session I - Regulatory convergence or divergence

Effectiveness and quality of global standards

Banking regulation post-crisis has been challenging to implement, and it is unclear whether it is effective. Most (if not all) participants agreed, however, that had the regulation in place now been in place before the crisis, the effects of the crisis might have been considerably lessened – but it would not have been averted. One participant noted that failings in banking regulation have run concomitant with a deeper shift in the nature of the activities of banks, from deposit collection and lending to more profitable asset management activities; another suggested that regulation might be more efficient by targeting banking activities rather than institutions traditionally understood as banks. One participant asserted that as financial crises are in fact inevitable, the point of regulation is to limit the burden to taxpayers when one strikes again.

Some participants were optimistic, noting several encouraging advances. Basel III standards have spread through a mix of peer pressure and international cooperation, increased capital and common equity requirements and liquidity ratios in a bid to ensure stability in the financial system. Regulatory consistency is monitored by the Basel Committee on Banking Supervision. A framework is emerging for the resolution of troubled cross-border banks. The EU has been building a banking union, strengthening its ability to prevent crises and deal with them.

Others were however more pessimistic about the state of current regulatory coverage. A rush to implement outdated and ultimately inappropriate structural measures took attention away from governance issues proper. Important issues (such as wholesale funding, money market funds, shadow banking, or special purpose vehicles) were more or less left out; national accountability was completely ignored. International measures clashed with national interests, decreasing political will to implement them effectively, spurring risks of regulatory competition and a race to the bottom. Banks now face poor returns on capital, and unless their profitability improves, their ability to perform intermediation functions might be impaired. Credit might dry up, impacting growth.

Basel III is a set of global standards that at least has the virtue of existing, allowing comparability across banking institutions. But, as one participant observed, it remains an empirical question whether there is, from a positive point of view, difficulty in attaining convergence; or, from a negative point of view, significant divergence. Different national circumstances in politics and the industry make the setting and implementation of global standards a thorny coordination problem. This is compounded by the fact that these standards now seem to blur the line between regulation and supervision. One participant mused that this reflects a deeper, “philosophical” shift in regulatory strategy from setting ratios and benchmarks for banks to defining and testing their capabilities.

The EU framework

As one of the epicentres of the crisis, the EU has responded by initiatives to strengthen its regulatory environment. The creation of the Single Supervisory Mechanism and the Single Resolution Mechanism have streamlined *ex ante* and *ex post* measures to ensure financial stability in the Eurozone. According to many participants, the emergence of the banking union in the EU has significantly consolidated the regional regulatory landscape. It remains incomplete however without a common deposit scheme, and the problem of sovereign exposure (the "doom loop") remains. National resistances hamper quick and effective implementation.

The EU's regulatory preference goes to heavier supervisory demands, focusing on structural issues. In an underlying divergence in preferences, the US prefers a lighter touch with more emphasis on personal responsibility within banks. But both face the same regulatory dilemmas: the question of the distribution of costs that regulation can imply, and the fact that a desire for reinforced supervision requires a more complex system. Keeping supervised institutions at arms' length means the supervisor will have less information at their disposal, whereas a more embedded supervision is costlier and makes regulatory capture that much more of a risk.

> *"Having uniform regulation without uniform supervision is like having a lighthouse and not switching it on."*

One participant noted the critical role of big data in supervision efforts and expressed concern about the EU's data protection regime towards that end. Taking a broader view, one participant highlighted the potential for regulatory divergence inherent in supervision activities, since they entail a degree of subjective appreciation for the situation at hand, based on different methodologies and different underlying interests.

What should be done at global level?

Several participants were in agreement that global regulation should be concerned with core issues, leaving detail to the national level; many however recalled the concomitant risk of regulatory divergence. One participant expressed sympathy towards the agenda of international regulatory convergence, but called attention to its prior failures and path dependency. Increasing the footprint of international regulation could provoke a backlash; and transnational supervisory colleges were mentioned as a type of structure capable of handling a lean regulation agenda at the regional level.

On the issue of divergence in enforcement, another participant noted that whereas taking repressive measures against bad conduct within banks is relatively robust, enforcement of prudential regulation is weak and contested. The EU itself has been found materially non-compliant with Basel III, and has not yet faced pressure sufficient to enact corrections. While one participant asserted that this is a case of significant divergence, another felt that it is relatively unimportant and that the development of the assessment process outweighs it.

One participant identified two major challenges for regulatory convergence: the place of China in the international banking system; and the Trump administration. China's banking sector is now the largest in the world, but remains almost completely opaque and detached from global regulatory standards. While it is moving towards global integration, control of the banking system remains largely politicised: benignly, this can be considered a stabilising factor; or malignly, as a worrying lack of rule predictability and supervisory transparency and honesty.

On the American side, thus far, the Trump administration has not initiated significant regulatory divergence, despite President Trump's manifest aversion for multilateral methods. Deregulatory action has only brought supererogatory American standards down to match lower global ones, despite heated rhetoric from Trump loyalists like Congressman McHenry, who sent a letter in January 2017 to then Chair of the Federal Reserve System Yellen, demanding the US withdraw temporarily from all international financial regulatory bodies until President Trump could appoint officials that "prioritise America's best interests".

Divergence appears limited for now, though this may be the result of a relatively hierarchical structure of global finance, thus far dominated by large players from selected jurisdictions. Most participants agreed that there are two more pressing issues. First is the complexity of regulatory coordination: domestically with other policies, internationally between regulators, and at both levels for macro policies. Second is citizens' hostility towards international financial regulatory efforts, stoked by populism: one participant pointed to the current backlash against elites, wondering whether such regulatory efforts were not merely "shuffling chairs on the Titanic."

Session II - Crisis prevention and macroprudential coordination

The counterpart of higher interconnectedness is systemic risk. Following the global financial crisis, a consensus emerged on the necessity of macroprudential policy to help prevent crises (or at least smoothen financial cycles and improve bank resilience). MacroPru policies aim at complementing the microprudential approach, which is oriented towards ensuring safety and soundness of individual financial institutions. MacroPru regulation is actively implemented in a number of jurisdictions, even though its objectives, contours and effectiveness are hotly debated.

While recognising that it has had positive effects on real estate markets and credit growth, one participant was critical of macroprudential regulation as designed until now. He deemed it too focused on banking institutions and the real estate sector, and too limited to the national level. It was pointed out that national supervisors often have little incentive to stop build-ups of known causes of financial imbalances (such as credit or real estate booms) until spillovers become egregious; and that build-up of less well-understood causes of imbalances (due to maturity transformation or shadow banking for example) remain unaddressed. Another participant noted that macroprudential policies are "necessary, but not sufficient," as they do not deal with problems such as regulatory capture or leakages, or "credit populism".

> *"It's all about mortgages and housing credit."*

Macroprudential policy raises a host of coordination issues. It was observed that these concern both coordination across policies and coordination across jurisdictions. The latter is difficult because macroprudential policies may involve significant spillovers (especially when credit markets are dominated by foreign banking institutions) and because instruments have to be tailored to the specificities of different credit markets. Participants touted the governance of MacroPru policy efforts as a modestly successful example of a transnational regulatory network, cautioning however that it would be difficult to scale up to global governance.

Some participants were critical of macroprudential policies *per se*, asking whether they were not redundant in the face of monetary policy. They did admit however they might be useful in the limited case of an exogenous shock where monetary policy stays unchanged. Speaking against this view, one participant pointed out the relevance of macroprudential policies in the Eurozone, doubting whether monetary policy can "fill in all the cracks": where there is a single monetary policy, macroprudential policies can tend to the national level.

Another participant concurred, suggesting that "the fact that monetary policy goes in all the cracks is part of the problem, not part of the solution," recalling that these policies appear to deal primarily with the real estate market. Echoing this, one participant recalled that central banks have several instruments at their disposal, and that the issue is calibrating them so they complement each other. The same participant warned that since financial stability is a public good, it is imperative to connect practitioners and the general public, and to reduce complexity in the system for better governance and transparency.

Session III - Cross-border resolution

Ten years after the global financial crisis, a strong point of consensus which has emerged is that formal procedures or frameworks are necessary to resolve financial institutions in distress, especially those that engage in banking activities across borders. None such framework existed pre-crisis, and the several bank collapses, starting with Lehman Brothers, demonstrated that disorderly insolvency is an unaffordably costly event. Now, firms and authorities have realised the need for clarity and transparency in managing a bank's failure and assigning costs. One imperative that has emerged, in the face of citizen's backlash, is to avoid bailing out institutions with public funds, even if they are deemed "too big to fail".

Cross-border resolution presents particular problems however. An international border between parent and subsidiary means that there is more than one responsible supervisory authority. Appreciations on the viability of the institution and who has the power to decide that resolution is required necessarily vary, as well as how resolution liquidity and new equity should be provided. This is the inevitable consequence of information asymmetry and diverging interests. There are good reasons to be sceptical about how adequate current resolution instruments are in an international context. The important time dimension in resolution, also questions how long the perspective of institutions and regulators should extend regarding the viability of a troubled institution. One participant warned that "when there is a liquidity crunch, timing constraints don't conform to models".

One participant called attention to the problem of ensuring continuing operations after resolution, prompting a discussion over the ultimate objective of the process. Many participants agreed that resolution should not necessarily imply liquidation and exit: in the EU at least, resolution aims to salvage what is salvageable. Many also agreed that liquidity could be provided by central banks if the institution undergoing resolution is solvable, though there was debate over how long it should be extended and under what conditions.

> *"The thrust of resolution in the EU is about rescuing; not winding up and bankruptcy."*

Some participants criticised current resolution frameworks. One likened resolution requirements as "making banks carry their own coffin, which might not even fit in the end"; another wondered whether the resolution process was not mostly for psychological benefit. Broad consensus was reached in characterising resolution as financial reconstruction, useful to manage situations of a globally systemically important bank failing. It is less than clear however whether resolution strategies could treat a generalised crisis: situations where public intervention is necessary to backstop liabilities and eventually recapitalise the system can still arise. While the development of resolution regimes in all jurisdictions (except China) is a notable achievement, they are not a panacea.

Session IV - Challenges of digital transformation

Digital transformation is profoundly reshaping banking activities, while regulation can only hope to play catch-up fast and smartly enough to avoid potentially dire outcomes. Information technology and the huge amounts of data it requires and processes are being used to disrupt traditional banking activities. Cryptocurrencies challenge the very idea of fiat currency, while the blockchain technology they are based on has the potential to radically disrupt banking infrastructure. The threat of cyberattacks has become the new normal for banks, with potentially serious consequences for global financial stability.

> *"Pandora's box is open."*

One participant raised three aspects of transformations due to big data for consideration. First, that big data will be used to devise new financial services; second, that big data will increasingly condition market entry and the landscape of competition within the sector; and third, that these changes will have implications for systemic risk and regulatory efforts. A banking model of the future was sketched out, based on a small number of platforms (due to high entry costs), resembling Amazon, providing products, services or applications relying on data storage and analysis (with much lower entry costs), creating an environment with more competitive prices at every stage.

Other participants debated whether more competition was always positive, highlighting that new entrants and new products could bear significant, or even systemic risks, while escaping regulatory attention. Another underlined the enormous advantage to incumbent platforms, questioning the extent of predicted disruption and envisaging rather a slow eviction of riskier activities from the industry. Yet another was sceptical of the Amazon analogy and professed to be unconvinced about comparison in cost structures. Many agreed however that fintech would soon catch the attention of regulators, most likely due to consumer protection issues: as one participant asked, "Who is responsible if an algorithm gives bad advice?"

Another participant underlined the similarities between the technology and banking sectors, in that they both establish sophisticated platforms to match supply and demand. In their ideal state, the empirically-derived methods and procedures in both are highly standardised, scalable, fault-tolerant, safe and secure, structured around quality with robust testing and clear methodologies to do so. Both try to operate in organised and relatively transparent ways, relying on trust to exchange information globally. This is a solid basis for synergies, which the industry is already taking advantage of; the same participant estimated that IT staff in large banking institutions represented up to a quarter of the total workforce, and that it is standard for US boards to include at least one person, or even a committee, with some expertise in technological stakes and issues.

On the other hand, traditional banking institutions are also under siege by tech firms moving into banking territory. They remain protected for now by a "wall" of sector-specific regulation, reserving their exclusive right to accept deposits: as one participant asserted, "The deposit contract is the linchpin [of banking activities]… Whichever fintech company offers to accept deposits is a bank and should be regulated as such." However, banks have had to face major disruptions such as losing exclusivity of the management of payment systems and the rise of peer-to-peer lending (especially in China), bypassing commercial banks and the central bank system in settlements. Another concern is cryptocurrencies, though one participant dismissed them as speculative assets, not currencies, assuring that "Currency needs the power of the state. Fiat currency cannot exist without it."

Banks are apprehensive of this complex and fluid environment, and some are asking for regulatory action and enforcement, while potential systemic risks are still poorly understood and the full implications of current changes are not yet clear. Some participants argued that heavy regulation on some issues was an appropriate response to slow financial innovation, "a train going at 200mph". Others argued instead that the absence of regulation can work positively, not granting legitimacy to the use of an instrument (like cryptocurrencies) by not giving it regulatory ground to establish itself.

Wrap-up - Lessons for global governance

All participants agreed that digital will be the point of focus of future banking regulation, but differing emphasis was put on the equilibrium between on one hand risk and innovation, and on the other regulation and the contested concept of systemic risk. Most agreed that supervision would have to evolve as well in a more global direction. Overall, there was consensus that reforms in the governance of international banking need to ensure they are fighting the battles of tomorrow, not those of yesterday.

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BAFFI CAREFIN
Centre for Applied Research on International Markets, Banking, Finance and Regulation

Seminar programme

12 SEPTEMBER

19.30 – 20.00	*Welcome apéritif*
20.00 – 22.00	*Dinner, speech and working session: Global dimensions of banking regulation* Introduction by **Elena Carletti** | Bocconi University and Florence School of Banking and Finance, EUI Keynote Speaker: **Vítor Constâncio** | Former ECB Vice-President

13 SEPTEMBER

09.00 – 09.10	Introduction by **Donato Masciandro** | Bocconi University and **Jean Pisani-Ferry** | EUI
09.10 – 11.00	**Session I - Regulatory convergence or divergence** Introductory remarks: **Martin Hellwig** | Max Planck Institute, **Nicolas Véron** | PIIE
11.00 – 11.15	*Coffee break*
11.15 – 12.45	**Session II - Crisis prevention: Macroprudential coordination** Introductory remarks: **José Manuel Campa** | Banco Santander, **Luiz Awazu Pereira da Silva** | BIS
12.45 – 13.45	*Lunch*
13.45 – 15.15	**Session III - Crisis management: Cross-border resolution** Introductory remarks: **Mark Flannery** | Warrington College of Business, **Andrew Gracie** | formerly Bank of England
15.15 – 15.30	*Coffee break*
15.30 – 17.00	**Session IV - Challenges of digital transformation** Introductory remarks: **Jan-Pieter Krahnen** | Goethe

	University of Frankfurt, **Lara Warner** | Credit Suisse
17.00 – 17.45	**Wrap-up - Lessons for global governance**
	Introduction by: **George Papaconstantinou** | EUI and **Jean Pisani-Ferry** EUI

Seminar participants

Giorgio Barba Navaretti	Centro Studi Luca d'Agliano, University of Milan
Guido Bichisao	European Investment Bank Institute
Adrien Bradley	Robert Schuman Centre, EUI
Stefano Cappiello	Bank of Italy
Elena Carletti	Florence School of Banking and Finance, EUI; Bocconi University
José Manuel Campa	Banco Santander
Vítor Constâncio	Former Vice-President of the European Central Bank
Paolo Fioretti	European Stability Mechanism
Mark Flannery	Warrington College of Business
Federico Fubini	Corriere della Sera
Francesco Garzarelli	Goldman Sachs
Andrew Gracie	Formerly Bank of England
Martin Hellwig	Max Planck Institute for Research on Collective Goods
Jan-Pieter Krahnen	Goethe University of Frankfurt
Domenico Lombardi	Banca di San Marino
Donata Masciandro	Bocconi University
Stefano Micossi	Assonime
Stilpon Nestor	Nestor Advisors
Marco Onado	Bocconi University
George Papaconstantinou	School of Transnational Governance, EUI
Luiz Awazu Pereira da Silva	Bank for International Settlements
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Alastair Ryan	Bank of America Merrill Lynch
Fabrizio Saccomanni	UniCredit

Pierre Schlosser	Florence School of Banking and Finance, EUI
Andrea Sironi	Bocconi University
Agnieszka Smoleńska	EUI
Kaushalya Somasundaram	HSBC
Nicolas Véron	Bruegel; Peterson Institute for International Economics
Silvia Vori	Bank of Italy
Lara Warner	Credit Suisse
Spyridon Zarkos	European Banking Authority

Section 5

Tax competition and tax coordination

Taxation Governance in Global Markets: Challenges, Risks and Opportunities

Seminar insights[1]

George Papaconstantinou, Jean Pisani-Ferry and Pascal Saint-Amans[2]

Progress in tax governance: a miracle or a new paradigm?

1. Amongst the different global governance policy areas, tax governance presents a unique contrast: with taxes at the core of national sovereignty, it would in principle be a particularly difficult area for effective tax coordination and cooperation arrangements to be agreed on and implemented; for decades, indeed, lasting cooperation failures led to ever-increasing tax avoidance. And yet, in practice there has been substantial progress in recent years, and while hard challenges remain to be tackled, international cooperation undoubtedly benefits from a momentum. Some speak of a "miracle"; others of an aberration; or, perhaps, a new paradigm for collective action has started to emerge. Whichever way, there are important broader lessons for global governance to be drawn from the circumstances and methods in which progress has been achieved, as well as from the limits encountered in the search for workable solutions in global tax governance.

1 The seminar was held on 18-19 February 2019 in Paris (France), jointly organised with the OECD.

2 Director of the Center for Tax Policy and Administration at the OECD

2. Beyond the issue of sovereignty, major obstacles hamper international cooperation in the field of taxation:

- First, preferences differ across countries as regards both the level and the structure of taxes;

- Second, tax competition pays off: many countries can individually benefit from lowering effective tax rates on highly mobile factors;

- Third, players in the tax competition game are not only countries: we have witnessed the endogeneous emergence of aggressive subnational tax jurisdictions that are not part of the web of international policy cooperation agreements;

- Fourth, the global framework for international coordination is seriously outdated: its essential principles reflect the channels of interdependence that characterised the goods-producing economy of the early 20th century, not today's technology-driven, digital, service-intensive economy; furthermore, it relies on a myriad of heterogeneous bilateral agreements rather than on common rules.

3. Yet results have been obtained despite all these obstacles. As far as individuals are concerned, bank secrecy and the resulting evasion from income and wealth taxes is largely a thing of the past: 150 jurisdictions have committed to exchanging information on request and close to 90 participate in automated information exchange through about 4500 bilateral conventions. According to the OECD, bank deposits in international financial centres have decreased by one-third since 2008 and a significant part of this decline is attributable to cross-border information exchange. No equivalent result has been reached as regards multinational corporations, but a structured multilateral process has started within the framework of the *Base Erosion and Profit Shifting* (BEPS) initiative of the OECD. Moreover, discussions are being held on possible cooperative solutions to the tax challenges arising from digitalisation.

How progress was achieved, and where

1. Progress achieved in the field of bank secrecy was due to a confluence of factors:

- Acute public finances needs in a series of countries;
- Public opinion pressure for international tax fairness following the crisis;
- A conceptually simple problem to solve (abolishing banking secrecy);
- One country (the US) using its power and extra-territorial reach to impose change;
- An alignment of interests of the largest advanced and emerging sovereigns participating in the G20;
- The existence of a nimble institution which seized the moment (OECD).

2. It was a case of unilateralism helping pursue multilateralism. Intentionally or not, the unilateral US decision to coerce financial institutions to disclose individual data (through the FATCA scheme) resulted in triggering international discussions on a cooperative solution to tax evasion. After the goal of ending bank secrecy was supported by other major economies and endorsed by the G20 in 2008, the (small) veto players that had successfully blocked any agreement within the framework of the EU or the OECD were forced to concede defeat.

3. The role played by the OECD illustrated how institutions can flexibly serve global governance beyond their formal remit. The OECD convention does not give it an explicit mandate in the field of taxation and it does specify that all decisions are taken by unanimity by its member countries. And yet, it served as a venue for international tax discussions that included non-member countries and jurisdictions and resulted in overcoming long-standing oppositions to cooperation. Instead of the organisation functioning on the basis of its formal mandate and rules, the OECD secretariat was effectively tasked by the G20 to work in inclusive format and to participate in putting pressure on reluctant players (including some of its members).

4. Implementation still lags behind commitment. Despite success in legislating, enforcement and supervision remain problematic, and for a number of countries a lack of capacity building limits the effectiveness of data exchange.

Why corporate taxation and the challenges of digitalisation have not been successfully tackled yet

1. Efficiency and equity issues raised by reform of the international regime for corporate taxation are an order of magnitude larger. As far as efficiency is concerned, existing formulas for allocating taxing rights among tax authorities is based on an outdated model of international interdependence. They do not take into account synergies within multinational firms and do not match the actual location of value creation in a world of global value chains, intangible investment and digital presence. But interests are not aligned when it comes to defining methods to apportion profits or determine where value is being created in a digitalised economy. As far as equity is concerned, reform is bound to raise major distributional conflicts: while ending bank secrecy only resulted in losses for wealthy individuals and a few tax havens, a comprehensive solution to corporate tax avoidance will create winners and losers amongst major countries. Against this background, the BEPS framework has helped improving transparency and curbing the development of preferential tax regimes, but progress towards tackling tax avoidance has been limited thus far.

2. The way forward is not to separate out the taxation of digital services, but to redefine principles and instruments for corporate income taxation in a globalised, digital economy. Problems with taxing providers of digital services are not fundamentally different from those when taxing other multinational companies. They are just bigger and more visible. Concepts underlying the international tax cooperation regime (such as that of permanent establishment) or instruments tax authorities rely on (such as transfer prices) are fatally outdated. What is needed is a radically new set of principles and instruments for today's global economy.

3. Whether or not the international community is able to rise to these challenges will have deep consequences for efficiency, equity and the legitimacy of globalisation. The issue of global corporate taxation is not a technical issue for specialists anymore. It affects business models and internationalisation patterns. And as citizens worldwide are now acutely aware of the problem, failure to tackle it undermines support for continued international economic integration.

4. It is possible, but by no means certain, that unilateral action will again help unlock multilateral discussions. Though their motivations and stances towards international cooperation differ markedly, the Trump administration's decision to effectively impose a minimum taxation on the global income of US multinationals (through the BEAT and GILTI schemes) may be a game-changer in the same way the Obama's decision on FATCA was instrumental to end bank secrecy. After it has lowered the corporate income tax rate markedly, the US government has now a vested interest in taxing all multinational companies, including the digital ones.

5. The outcome of this discussion will also have institutional implications for the governance of globalisation. For some, the current framework of tax cooperation provides a template for achieving results in other fields. For others, it is an idiosyncratic setup, useful in exploring solutions in increasingly intractable tax areas, but exhibiting problems in enforcement and monitoring, with effectiveness already showing diminishing returns, and difficult to replicate in other policy areas.

Keynote – A European perspective on recent developments in international tax coordination[3]

Pierre Moscovici, European Commissioner for Economic and Financial Affairs, Taxation and Customs

Global taxation problems have achieved a great amount of salience in recent years, with the leaks of confidential documents swaying public opinion and bringing the issue to third place in citizens' concerns in a recent Eurobarometer poll. The speaker was pleased to recall that thanks to the work of the OECD under G20 instruction, 14 international proposals against tax evasion as well as 8 against tax fraud have been adopted by EU member states since 2014: more than in the 20 preceding years.

The speaker emphasised three guiding principles for working towards coordination in international taxation: transparency, cooperation, and modernisation. Much progress has already been made on transparency: banking secrecy has for the most part been abolished with the extension and automatisation of exchange of information procedures, making it more difficult to hide revenues and assets. Efforts are under way to make reporting of tax planning schemes mandatory in EU member states by 2020.

On international cooperation, there is robust dialogue with states who use their taxation rates as a comparative advantage. The speaker emphasised that working only within the European perimeter was insufficient, crediting interactions between the EU, the OECD and the G20 for a good implementation of rules and an effective name-and-shame process against non-cooperative jurisdictions. To one participant questioning the wisdom of EU designs for a digital services tax while the US-led trade war ratchets up, he answered that it was not such an uncooperative move, as different reactions had come back from different parts of the administration: for example, the Trade Department was openly hostile whereas the Treasury was not opposed.

Finally, the speaker recalled the need for modernising outdated tax rules leading to tax injustice, highlighting the European Commission's proposals for VAT reform (which could recover 50b€ per year), for a consolidated

3 Summary by Adrien Bradley.

corporate tax base, or for a digital services tax. He deplored the fact that despite successes in fighting tax fraud and evasion, certain member states have been blocking these bolder proposals due to the unanimity imperative, and voiced his support for unblocking the issue with the passerelle clause and advocated for clearer governance within the EU, with a Eurozone Minister for Finance with powers over taxation. The speaker concluded by looking forward to action on digital taxation and a unified EU position for the G20 in Osaka.

Seminar minutes

Adrien Bradley and Alexander Sacharow[4]

Session I - The framework for transparency and exchange of information: achievements and shortcomings

Critical to the social contract is the idea that all must pay their fair share of taxes. Before the global financial crisis, it was estimated that a significant proportion of global wealth (some 6% or 9T$) was held in offshore accounts, impacting developing and less-developed countries disproportionately. Information exchange was very limited due to banking secrecy. Public outrage after the crisis and a series of leaks detailing how individuals and multinational corporations (MNCs) were avoiding paying their fair share goaded governments to step up their abilities to identify and capture mobile tax bases.

Effective action was initially slow beyond conditional information exchange upon request, prompting to G20 reaction in 2008. In 2009, the Global Forum on tax transparency and Exchange of Information, which now includes more than 150 jurisdictions, created and implemented a peer review mechanism, ensuring a level playing field on the application of information exchange on request.

But it was unilateral action by the US that had game-changing effects, paving the way for further multilateral initiatives on automatic exchange of financial information. The 2010 Foreign Account Tax Compliance Act (FATCA) used the US market power to coerce financial institutions to report data concerning US citizens or face penalties. This created problems in jurisdictions where complying meant violating domestic law. Their financial actors lobbied for a solution, kicking off the debate on information exchange led by the OECD. FATCA conventions and concepts were essentially multilateralised by the OECD and were adopted in 2014 as the Common Reporting Standard (CRS), instituting automatic exchange of information. While concerns exist about the information's quality (it does not include assets such as real estate for example), its usability for developing countries, or its potential misuse by authoritarian regimes, it is a powerful step forward in international taxation governance.

4 Research associate at the German Bundestag and the Hertie School of Governance.

To date, 108 jurisdictions have agreed to automatic exchange of information (excluding, notably, the US), 90 have begun exchanging, and 95B$ has been recovered. However, success was attained only because the interests of the largest sovereigns aligned with other countries' against those of tax havens: there was no developed/developing countries divide since the benefits of cooperation were non-rival. Attempts to replicate this strategy for corporate taxation would most likely backfire due to the underlying distributional issues. Politicians have celebrated perhaps prematurely and complacently the progress made, out of step with public opinion for whom it is less effectively visible; the result may be increased demand for more radical change.

Discussion among participants focused on present challenges in automatic exchange of information, remaining problems in taxation governance (especially corporate taxation), and anticipated the discussion of taxation of the digital economy. One participant praised the ongoing work within the OECD's Global Forum on tax transparency and exchange of information as well as the OECD/G20 Inclusive Framework on base erosion and profit shifting (BEPS) on outstanding issues such as beneficial ownership, transfer pricing, taxpayer rights, and country-by-country reporting, while recalling the difficulty of supervision and enforcement even when national legislation has been enacted.

Exchanges took place over the necessary degree of transparency of the information exchanged: while some confidentiality is necessary to ensure member states' trust in the instrument, more transparency can be a powerful tool. Several participants underscored the fact that data exchange without capacity-building is ineffective, even for developed countries: one pessimistically remarked that we could be facing a situation where "Before, rich people lied and governments did not know; now, rich people lie and governments do not act." To one participant remarking that taxation, for simplicity's sake, had long focused on immobile factors of production, which led governments to taxing those they were accountable to, another participant suggested that corporate taxation could be conducted at the individual level for the same reason: this would require more global cooperation, but raise less thorny distributional issues.

Some questioned whether the issue of corporate taxation is as intractable as was presented, since it is has an (admittedly difficult) distributional conflict, but

> *"Before, rich people lied and governments did not know; now, rich people lie and governments do not act. Which is better?"*

with the possibility of recovered income and side-payments. One participant asserted that the US had solved the issue for itself by imposing a minimum tax on MNCs headquartered in its jurisdiction to capture stateless income, whereas the EU had not. The same participant had to concede, however, that such a tax only works for some large jurisdictions; it is residual, creating a floor unlikely to impulse additional cooperation; and it only works as a global solution if there are compliance mechanisms to ensure no defectors.

It also leaves the problem of mobility intact, and questions were raised as to whether the level of the tax is sufficient to discourage offshoring. Nevertheless, with revenue thus assured, it is ironically the US which is willing to shift the principle to taxation from source to destination market base, whereas it is the EU that is reluctant due to the distributional issues: it seems to prefer to try to capture revenue from American tech giants and platforms, but not have its own big companies or financial institutions taxed elsewhere. To the unease over the method used as expressed by one European participant, an American participant responded that American unilateralism had been an effective use of realpolitik that had benefitted both the US and the world; but later exhorted other countries to put pressure on the US to join the CRS.

Session II - Tax coordination and the digital economy: Alternative ways forward

Digitalisation of the economy has not only disrupted traditional business models, but also triggered a difficult debate on its taxation: most (if not all) countries, as well as large and increasing swathes of public opinions worldwide believe it is still not being taxed in a satisfactory manner. Earlier iterations of BEPS sought to address the issue but backfired in strengthening the arm's length principle while deadlocking over transfer pricing rules, creating perverse incentives for companies to offshore profits. This led to the US unilateral move to minimum taxation. While at first glance this rationale can be invoked to justify the EU's proposed Digital Services Tax (DST), as well as similar measures being enacted in European countries while it stalls (France in particular), some argue it would conflict with existing and developing tax treaties, or that it is a quick-fix solution, artificially separating the digital economy from the rest of economy (ring-fencing). The crux of the debate is how to allocate profit depending on observable factors: much more than BEPS, this raises difficult distributional issues.

The OECD lists two other models for capturing the same revenue apart from the DST, which is based on "significant economic presence" in a given jurisdiction and aims at changing the definition for permanent establishments of businesses. The UK proposal is based on "user participation", but does not avoid the problem of ring-fencing. The US favoured proposal is based on "marketing intangibles" but poses difficulties regarding the substantiation of linking intangibles with specific markets and the apportionment of market intangibles to other intangibles.

Taking a wider look, the failure in capturing the digital economy is merely an extension of the fact that large enough companies can essentially choose where to make profits and pay tax. Public pressure, especially brought to bear after the LuxLeaks, has been a driver of change, but it is slow, difficult, and there is an enormous lack of data that could contribute to better policy formulation and the emergence of international leadership. In this context, unilateral or regional measures (such as the DST) have their use, as they can jumpstart action.

"Allocation is the biggest question: who gets what and why?"

Participants agreed that revenue and employment impact on states is a concern in this debate, though some argued that changes in tax policy may be less of a factor than believed. All agreed that smaller, developing countries have specific issues requiring consideration. One participant analysed digital profit in three categories: IP rent, brand rent, and data rent, and insisted that the principle that data has taxable value should be recognised. Participants largely agreed that more and better data is needed to achieve a better understanding of the global landscape.

The discussion centred on the three big approaches to digital taxation. The proposed European DST promises a fast solution for taxing the digital economy, but it only captures some digital business models, and member states are deadlocked. It was also criticised on the grounds of being protectionist, based on a minimum tax threshold, and potentially involving double taxation issues actionable before the ECJ; it was argued that if this approach were to prevail it would be better to apply at least at OECD level. Moreover, the UK opposes this approach within the EU. Its own user-based contribution approach, and the US marketing intangibles approach were credited for circumventing a thorny debate on source/destination allocation.

While the US had been unwilling to change the transfer pricing model more than marginally, and had rejected discussions of digital taxation under the previous administrations, its recent tax reform had a structural effect causing it to find renewed concern over its own tax base. It endorsed BEPS and unilaterally enacted its own minimum tax legislation in an attempt to effectively capture stateless income and tackle low tax payments of digital companies. It was argued that this approach could be an effective instrument to stop the race to the bottom of corporate tax rates. However, it was rebutted that such a tax only works for large jurisdictions; it is residual and creates hardly any revenue for smaller jurisdictions, and by establishing a floor it can inadvertently turn it into a ceiling. It also leaves the problem of mobility intact, and questions were raised as to whether the tax is sufficient to discourage offshoring.

"Tax rules are the cream on the coffee: the business environment is the coffee."

Nevertheless, the US is now disposed to tax the digital economy, whereas it is Europeans who are reluctant. One participant strongly defended continuing work on updating current transfer pricing rules as the politically feasible incremental step, and drew attention to the underlying conceptual debate over whether users should be considered sources of value (and therefore be considered for corporate taxation), or providers of data in exchange for services. Others cautioned that the issue might not be resolvable by corporate taxation measures alone, and that following through on these measures might entail having to accept abandoning some local tax policy competition.

Session III - Assessing the institutional framework: participation, incentives and the drivers of cooperation

Speakers examined the institutional framework that has emerged after BEPS and sought to identify further drivers of cooperation. The OECD and the G20 have gained new roles, in part by exploiting the sudden political consensus around ending banking secrecy. While they are impressive achievements of international cooperation, new tax policy instruments raise the question of their inclusivity and efficiency, first numerically speaking, but also notably with regard to developing countries. The EU has emerged as an important agenda setter, but suffers tax policy questions of its own. NGOs and civil society groups have also emerged and taken active part in the process.

Globally, there is an encouraging growing commitment to avoid double non-taxation, but the increasing complexity of the landscape causes uncertainty and unpredictability. Other dangers loom. Poorly designed unilateral action in a tense global context can be used or interpreted as protectionist measures. Moreover, the pace of technology may impose speedy responses, which may be equally poorly designed, whereas international coordination is a much slower process. The arm's length standard is no longer fit for purpose and it is unclear what can replace it; perhaps radical changes such as a destination-based cash flow tax or residual taxation. But most options under consideration involve some form of modifying allocation, a redistributive problem. The digital economy taxation debate reflects the underlying absence of a strong shared sense of what is value creation and how tax revenues should be shared.

Participants wrestled with the issue of trust, between all actors and stakeholders: countries, governments, NGOS, tax administrations, and tax paying citizens. Without trust there can be no effective leadership or cooperation. The OECD was deemed effective at mitigating double taxation, but perhaps less suited to tackling evasion and avoidance; the EU however disappointed in generating cooperation and policy change. A lack of dispute settlement mechanisms incentivises countries to deviate from their commitments, while their necessary complexity in the face of proliferating complex new business models hampers the implementation of the agreed-upon rules.

One participant proposed a game theoretic approach to the situation as a repeated coordination game (but partly exhibiting characteristics of a prisoners' dilemma); another voiced doubts that any perfectly satisfactory answer could be found for the problem of profit allocation. Somewhat incredulously, one participant asked whether a "miracle" had taken place, where a conceptually simple yet vexing problem (banking secrecy) had been resolved by a conjunction of crisis, aligned interests, and a nimble institution which seized the moment.

"Have we witnessed a miracle?"

Another participant praised the OECD's method as the most promising, recalling the need to quickly lay down foundational principles in view of the Osaka G20 in June. Another refuted the idea that special rules are needed for the digital economy, and against its current "barter economy" where users trade their data for services under conditions of poor understanding and control, sketched out a speculative economic governance scheme based on individuals possessing their data and monetising it as they wish, a possible basis for a "universal basic data income". One participant drew attention to the intimate proximity between sovereignty and tax policy: whereas its sensitivity had impeded progress, effective international cooperation has vastly improved, flowing down from ministerial level to national tax departments through peer-review mechanisms.

While participants agreed that one should not simply pay lip service to inclusivity and that technical assistance must be provided to countries that require it, there was disagreement on who might provide it best between the OECD and the UN as a better representative of non-OECD countries' interests. The complexity of the system was also a concern for some, though others refuted that a more complex system is necessarily more unfair; one participant highlighted the fact that increased complexity affects workers doubly, by enabling profit-shifting and corporate opacity.

One participant brought up the understudied interaction between tax and competition policy, and warned that the monopolisation of the digital economy was unsustainable. Another remarked that attempts to tax away monopoly profits, using tax policy as a second-best substitute for competition policy because it proved incapable of breaking them up, would test the limits of a fragile system. Another participant contested the characterisation of the digital economy as populated by monopolies, suggesting instead that they are monopsonies on data collection, and that competition policy is poorly equipped to address such a situation.

Wrap-up - Lessons for global governance

Summing up, one participant returned to the current "miraculous" (and under-acknowledged) progress in international tax governance, driven by a nimble institution exploiting a newly salient political urgency, and questioned whether diminished returns should be expected due to the difficult issues lying ahead. Personal taxation reform being difficult enough to elaborate and implement, corporate and digital taxation will be even more so. Perception of the situation as a zero-sum game might make it difficult to do anything else than tinker with the current framework, while unilateral action is taken and the underlying problems posed by few large tech companies go unaddressed. The participant recalled that these might be better solved if the nexus between tax and competition policy were explored.

In the discussion, participants' exchanges involved national sovereignty implications of monitoring and enforcement, their effectiveness, as well as interpretations of principles and concepts like value creation. It was agreed that some kind of international yardstick for profit allocation is sorely needed.

One participant welcomed the debate over allocation and value creation, drawing a parallel to the practice of competition policy: in both, it is necessary to come to an agreement over where profit lies and whether it is legitimate and taxable. The same participant drew a further parallel with climate change action and banking supervision to explore the line between enforcement and monitoring mechanisms, and their effectiveness. Another participant responded that whereas it is unclear what value creation is, it is becoming clearer what it is not, which was the focus of the earlier iteration of BEPS.

> *"It is important to have this discussion in tax analysis, similar to the one in competition analysis: what is this profit and what part is legitimate and taxable."*

Some participants reiterated criticism towards the EU, internally paralysed due to leadership dissonance (UK) and its own internal decision procedures (unanimity), and recalled that the current driver of change is, unexpectedly, the Trump administration. One affirmed that whereas the other EU leaders boast concern for tax issues in the G7, their minimum taxation proposal is really meant to counter American designs on the reallocation of taxation, and that it might give rise to race to the bottom problem: the minimum rate floor could turn into a ceiling. They expressed doubts of the existence of a digital economy, arguing that speaking of a digitalisation of the economy may be more appropriate, and reminded participants that it is still the US that is blocking serious work on taxation solutions for inclusive growth and against inequality (capital taxation), as well as for environmental challenges (transport fuel tax); though a recent Republican shift on the subject of carbon taxes may change this. Participants echoed the caution against politically improbable action that could destabilise a fragile system.

Seminar programme

18 FEBRUARY

19.30	*Welcome dinner and keynote address*: **Pierre Moscovici** | European Commissioner for Economic and Financial Affairs, Taxation and Customs

19 FEBRUARY

09.00 – 09.15	*Introductory remarks by:* **Jean Pisani-Ferry** | EUI
09.15 – 09.30	*Tour de table*
09.30 – 11.00	**Session I** - **The framework for transparency and exchange of information: achievements and shortcomings** Chair: **Mateja Vranicar Erman** | Former Minister of Finance of the Republic of Slovenia Speakers: **Monica Bhatia** | OECD, **Itai Grinberg** | Georgetown Law School **Claire Waysand** | Cercle des économistes
11.00 – 11.30	*Coffee break*
11.30 – 13.00	**Session II** - **Tax coordination and the digital economy: Alternative ways forward** Chair: **Alain Lamassoure** | Member of the European Parliament Speakers: **Will Morris** | PwC US, **Paul Tang** | Member of the European Parliament
13.00 – 14.30	*Lunch*
14.30 – 16.00	**Session III** - **Assessing the institutional framework: participation, incentives and the drivers of cooperation** Chair: **Stephen Quest** | European Commission, DG Taxation and Customs Union

	Speakers: **Ruth Mason |** University of Virginia, **Liselott Kana |** Ministry of Finance of Chile
16.00 – 16.30	*Coffee break*
16.30 – 17.00	**Wrap-up - Lessons for global governance** Introductory remarks: **George Papaconstantinou |** EUI
17.00 – 18.00	*Farewell cocktail*

Seminar participants

Andrew Auerbach	OECD
Monica Bhatia	OECD
David Bradbury	OECD
Adrien Bradley	Robert Schuman Centre, EUI
Robert Danon	University of Lausanne
Aisling Donohue	MGPartners
Joachim Englisch	University of Münster
Mateja Vranicar Erman	Former Minister of Finance of the Republic of Slovenia
Tatiana Falcão	European University Institute
Itai Grinberg	Georgetown Law School
Helmut Herres	Ministry of Finance of Germany
Reijer Janssen	Ministry of Finance of the Netherlands
Julien Jarrige	OECD
Liselott Kana	Ministry of Finance of Chile
Alain Lamassoure	Member of the European Parliament
Jean-Pierre Lieb	E&Y
Philippe Martin	Sciences Po
Ruth Mason	University of Virginia
Nara Monkam	African Tax Administration Forum
Will Morris	PwC US
Pierre Moscovici	European Commissioner for Economic and Financial Affairs, Taxation and Customs
George Papaconstantinou	School of Transnational Governance, EUI

Grace Perez-Navarro	OECD
Severine Picard	OECD Trade Union Advisory Committee
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Natalia Pushkareva	European University Institute
Stephen Quest	European Commission, DG Taxation and Customs Union
Thomas Rixen	University of Bamberg
Alexander Sacharow	Hertie School of Governance
Pascal Saint-Amans	OECD
Ludger Schuknecht	OECD
Paul Tang	Member of the European Parliament
Coen Teulings	University of Cambridge
Claire Waysand	Cercle des économistes

Section 6

Migration

Migration Governance - A Common Approach?

Seminar insights[1]

Andrew Geddes[2], George Papaconstantinou and Jean Pisani-Ferry

1. Global migration governance is important to study, not because of its successes but because of its failures. It is the oldest form of economic interdependence: it developed long before any international trade took place. And yet, there is no comprehensive global regime for migration governance and barely any regional regimes. Although mass migrations triggered by geopolitical, natural or economic events, and the response to them, involve strong cross-country spillovers, international cooperation is generally weak and ineffective – if not conflictual.

2. Analysis has to start from the unique characteristics of the field. Chief amongst these characteristics is a high asymmetry between the origination and the destination of migratory flows; this has repercussions on (dis-)aligning incentives and hence on the difficulty in arriving at commonly agreed solutions and governance rules. It is a process chiefly driven not by states but rather by people (migrants, intermediaries assisting their migration and businesses who hire migrants), including against the will of states. The recent flows which have dominated the policy debate are simply a more visible component of broader displacement and of deeper trends. Interdependence tends to be regional rather than global. States

1 The seminar was held on 20-21 May 2019 in Florence (Italy), jointly organised with the Migration Policy Centre at the EUI's Robert Schuman Centre for Advanced Studies.

2 Chair in Migration Studies and Director of the Migration Policy Centre, Robert Schuman Centre for Advanced Studies, European University Institute.

react to the movement of peoples, usually in crisis situations, mostly in regional settings. Governance is characterised by several interconnected but separated layers corresponding to different "migration regimes" (the protection regime, the travel regime, and the labour migration regime); however, these cannot always be distinguished in practice and decisions taken for one regime may spill over onto the other ones.

3. Interactions across layers and amongst countries are complex and impacts are disputed. The evidence on the migration costs and benefits for sending and receiving countries depends amongst other factors on the scale of migration, demography, skill levels, and the time horizon involved. "Brain drain" for sending countries is often combines with "brain waste" in terms of over-qualification for existing jobs in receiving countries. There is significant substitutability across different migration layers. For example, restrictions to labour migration lead more potential migrants to seek asylum. There can also be significant substitutability across countries. Home countries are often substitutable when considered as pools of labour. Destination countries are often substitutable when considered from the point of views of personal safety and economic opportunity. For these reasons there are major spillovers across layers and amongst countries (e.g. the effects on country A's labour migration policy on refugee flows into country B). Such substitutability makes estimates of costs and benefits of migration harder.

4. The migration governance regime is incomplete and fragmented. The migration governance landscape is characterised by high heterogeneity of preferences amongst countries, and as a consequence by few rules, no institutions, and no enforcement at a global level. It is mainly characterised by frequent unilateralism, patchy regional agreements, a web of bilateral agreements as well as by the intervention of subnational actors (cities, NGOs). The relevant knowledge base regarding both patterns and impacts has become highly politicised and is as a result also highly contested. Unlike what happens in other fields where "epistemic communities" have significant influence on policy, the debate on migration governance tends to be driven by ideological beliefs rather than by hard facts. An additional complicating factor is that migration cannot be easily separated from other fields (trade, aid) in negotiations between receiving and sending countries.

5. The flawed governance regime has major social, economic and political impacts. Recent crises have highlighted the major human and welfare costs for people of mass and often sudden migratory flows that are being opposed through unilateral and often very brutal measures. Next to human costs, efficiency costs from the lack of a functioning governance regime lead to serious obstacles to development, especially in the loss of a large number of skilled people in origin countries. International frictions abound as a result of migratory flaws and the lack of a migration governance regime, including a commonly agreed set of core rules and procedures for migration and assimilation. The toxic and often fact-free debate surrounding migration in destination countries has had adverse domestic political consequences, polarising positions (liberal rights vs. majority rule, national vs. human security), with some countries choosing ethnic homogeneity irrespective of economic outcomes. It has also undermined migration regimes such as that for international protection that enjoy governance structures, making it harder to arrive at commonly accepted international norms and agreements.

6. A hesitant and controversial step forward at global level. Spurred by the 2015 migration crisis in Europe, the Global Compact for Migration (GCM) affirms for the first time a multilateral approach to managing migration and provides common but non-binding principles for national policies and international agreements. The agreement is softer than soft law, with no monitoring but regular reviews. However, while it remains non-binding, and cannot be invoked to claim rights in courts, it could progressively become more binding by repeated reference in legal practice. Nevertheless, despite its deficiencies and limited character, the GMC is a step forward; its usefulness will be tested in its implementation. In principle the GCM could produce effects through peer pressure, potentially through courts and by providing a template for international agreements; it has the advantage of setting out a framework and a menu of possible measures/policies for discussion and implementation. In practice it may have already backfired; during its adoption it has been misrepresented by demagogues, with the US and some European countries withdrawing, and generally little ownership). In addition, the GCM may be flawed in specific respects, such as in its approach to regulating labour migration.

7. Going beyond the inadequate response at European level. The discussion surrounding migration in EU MS has obscured the potential gains from a common high-skill labour migration policy, which would arguably help limit the EU disadvantage vis-à-vis US, and harmonisation of policies to create legal pathways of migration to the EU. The recent migration crisis in Europe has highlighted the fact that a no-border space and heterogeneous asylum policies are incompatible; the asylum and migration debate has had inevitable spillovers onto the Schengen regime. Europe's asylum system is broken; the internal coordination regime is beyond repair: it is inefficient, with no agreement on principles, captured by interior ministries, and externalities that are not dealt with. The external joint action regime remains ineffective: the EU lacks competence and means to negotiate with source countries or transit countries, and states do not cooperate. A workable solution requires (a) coalition of like-minded countries, (b) single law and a single agency for asylum policy, (c) coordination in relationships with third countries.

Seminar minutes

Adrien Bradley

Session I - Deciphering the migration governance landscape

The first speaker introducing the session sketched out four points currently driving and affecting global migration governance:

1. Economic, political, social, demographic and environmental changes form broad trends informing migration dynamics. Economically, the mutation of regulatory environments has increased pre-existing expectations for governance, as well as created new ones, on the part of citizens (not only in migration). Politically, state-to-state conflict has decreased, which bodes well for migration governance, but this may conceal new challenges such as intra-state displacement. Social media have become a prime vehicle for inflammatory disinformation about migration. Demographically, while world population growth is slowing, an "African youth bulge" might contribute to migration patterns in the future. Finally, the likely catastrophic effects of climate breakdown on migration are raising particular concerns.

2. While historically multilateralism was used to smooth over power differentials and reinforce states (and was perceived as doing so), appetite for it is diminishing. Absent its possibility, governance is produced through other means: "minilateralism", soft law instruments, involvement of sub-national (cities) or non-national (NGOs) actors.

3. Migration governance is so complex because it is so difficult to reduce to broad categories to think about and deal with their governance. The three regimes concept (protection, travel, and labour migration) can be supplemented with more regimes: for international students, family reunion or retirement abroad for example, complicating the governance landscape.

4. Difficulties abound for migration governance going forward. Right-wing nativists employ populist tactics use migration governance failures as a wedge issue, polarising electorates and profoundly affecting

politics, nationally, regionally and globally. This undermines migration regimes that already enjoy governance structures, such as the international protection regime: for example, support for asylum claims is fragilised by their conflation with economic labour migration to developed host countries. In turn, transit countries are seeing their leverage increase. The political leaders of cities, important and underestimated usually positive actors in migration governance, may cave under the multiple pressures they are facing, further fragilising migration governance.

The second speaker introducing the session covered similar ground in five points:

1. Migration governance is a patchy and weak regime complex whose existing structures, especially at the sub-national and the regional levels, have potential for bolstering; recent developments have been uneven, however.
2. Perceptions (especially of decision-makers) frame action, though the situation may have changed factually: the perception that migratory pressure at the border is a "new normal" may be without empirical grounding.
3. Mobility is increasing worldwide, but unequally: European citizens enjoy twenty times the mobility of African citizens. The trend is towards divergence and greater gaps in mobility opportunities.
4. Careful attention must be paid to the structure and drivers of attitudes towards migrants in host countries. There is significant evidence that the cleavage over "globalisation" has become more salient than ever in developed host country politics, especially its migration aspect, and this must be taken seriously. While some will be intractable, others' attitudes are amenable to change.
5. Research, data and knowledge production on migration are progressing, providing better evidence of trends and dynamics, but it remains difficult to connect it effectively with decision-makers.

The ensuing discussion revolved around the problems caused by the complexity stemming from overlapping migration governance regimes and the subsequent lack of policy coherence. One participant recalled that governments have in fact little power to control migration: its true drivers are the migrants themselves, the intermediaries assisting their migration (and often profiting from it), and the businesses who will hire them. Some governments are even giving up more control, privatising border control and search-and-rescue functions. Beyond harming migrants, poorly thought-out policies can harm established patterns of migration, or have negative spillover effects on other states; but sometimes what looks like bad policy is in fact the point.

Multiplying obstacles to migration or outsourcing migration control functions is not irrational, but functions as deterrence, a signal in domestic politics, or a means to apply pressure in international politics. One participant suggested it is illusory to expect policy coherence, as people are not coherent themselves, employing undocumented workers while deploring their supposed effect on the economy, or rejecting migrant workers but welcoming international students. The complexity and diversity of the migration landscape is often understated.

> *"The US is currently in a governance arrangement of 'how much can I get away with'. Migration is used as a bilateral irritant or sweetener… It's sheer bloody-mindedness, and it's working."*

Discussion also touched upon questions about the reliability and presentation of indicators and their effects on attitudes towards migration. Policy-making should rely on data and facts, but discourse surrounding migration is notoriously impervious to them. Experts already face difficulty in swaying public opinion, but decision-makers aren't much more receptive; they often presume that their electorate is hostile to migration and act in consequence, in a self-fulfilling vicious circle reinforced by media and politicians misrepresenting the situation as an ongoing existential "crisis" for host countries. In fact, attitudes towards migration are more complex and less hostile than presumed.

Negative attitudes to migration are generally attributed to two causes: economic concern over redistributive outcomes, and cultural concern over "identity", with the accelerating factor of mass media and the manipulation of content. One participant disagreed with this characterisation, arguing that economic concerns are what really matter and that cultural concerns are a form of "false consciousness" where migration is scapegoated. Another cautioned that evidence on this is patchy, but that the psychological dynamics of concern over migration are clear enough: it is easy to activate and difficult to shift. Inflammatory narratives play well in electoral politics, which compound the problem precisely because they cannot be fulfilled. Governments also engage in damaging doublespeak in governance fora, professing toughness on migration and making a show of uncooperativeness, while quietly signing up to implementation measures. Resulting anti-migration attitudes may originally target a fraction of migrants, but quickly affect all of them, discouraging even officially desired migrants.

One participant drew attention to the fact that measured attitudes may not be towards migration per se, but of its control and management, and that focusing on integration could provide potential for a fruitful dynamic. Another advocated humility in the expert community, recalling the near-universal approval of trade liberalisation while the dynamics of the redistributive effects turned out to be deeper and more complex than touted. One participant summed up the changes in attitudes and policy by distinguishing three types of issues: those with low salience, where special interests have a large potential to drive policy; and those with high salience, which can be contested, or not. Of the high-salience issues, the uncontested ones (like growth) will be driven by general public opinion. High-salience contested issues (as migration has become in the last decades) will no longer be driven solely by special interest groups, nor by the public (since it is contested): in this case parties are the ones who will drive the issue.

There was also discussion about another factor of complexity: the interdependence of migration and other fields of global governance such as trade, development, or climate change. Attitudes to one do not correlate well with another: the left/right cleavage remains more pertinent. Existing international treaties and agreements, though imperfect, can be key tools for accountability and policy-making; while at the national level it is important to emphasise that migration is not a destabiliser to a previously balanced system, but an integral part of it. One participant recalled that migration is only one side of the story: 96% of the world population is not mobile, often trapped in poverty and exposed to deleterious conditions: it is the richer and more capable of the global poor who can migrate to escape their situation.

The speakers concluded the session by summing up the consequences of the increased salience of migration. It has been seized upon in political narratives, driving a discussion based on issues of security and leading to instances of its weaponisation. Its intertwining with other bilateral, thematic and geographical processes is increasingly recognised and engaged with, if not always acted upon effectively. Rhetoric surrounding it, heavily influenced by media (traditional and social) and far-right nativists employing populist tactics, can become reality in governments and administrations with little critical examination. The increased salience of migration has not translated enough to attention paid to source countries however, where important regional and sub-regional dynamics and processes remain under-examined.

"There is a democratic deficit inbuilt in migration: the people who decide are not the ones who are affected."

Session II - Labour mobility and skills

The first speaker introducing the session presented three basic challenges in matching demand for skills in host countries with mobile labour.

1. Harmonisation of policies to create legal pathways of migration to the EU has had limited success and created few effectively binding frameworks, due to member state (MS) reluctance to establish joint strategies.
2. The asylum regime is inappropriate to deal with labour migration. Cooperation with origin countries has become a priority, but there is intense political tension.
3. A better match of academic or professional skills of migrants to host country needs requires a system of competence checks, which remains to be developed.

The second speaker recalled the fact that the educated and/or skilled are twenty times more likely to migrate than average. There is a global market for skills, but in fact migration flows are extremely concentrated, with half of the total going to the US, another quarter to Anglophone countries (principally the UK), and the remaining to the rest. The need for a regulatory framework is evident but attempts to integrate this into a policy narrative encounter virulent resistance, and tend to fail if there is no long-term path to integration. On the side of origin countries, there is concern over brain drain, but it is perhaps overstated: it creates incentives for these countries to retain and train their human capital. Trade and migration are complementary: both build bridges, enhancing the circulation of positive factors of production. The speaker saw less scope for governance mechanisms, judging that, at least for highly skilled migrants, market mechanisms might work well enough.

Discussion focused on the relative costs and benefits of skilled migration to origin and host countries. While skilled migration can give rise to fears of brain drain, which is naturally viewed unfavourably by origin countries, discourse has shifted to how it can be leveraged for their benefit, through skill transfer programmes or encouragement of return migration. These countries already benefit from the remittances sent back by migrants, which exceed FDI in Africa for example; and their departure may level inequality with low-skilled workers there. Brain drain fears are often exaggerated however: "brain overflow", whereby skilled workers do not meet with adequate demand, may be the more pressing problem. Correspondingly, there is "brain waste" in host countries, where migrants are overqualified for the positions they hold: in the US for example, a full half of migrants hold degrees. This points to the need for programmes to recognise skills and competences (acquired formally or informally). In the long term however this phenomenon can result in a persistent failure to concentrate and agglomerate high-skilled workers in origin countries, compounding international inequality.

One participant, summing up the dynamic, identified the basis for cooperation in this case as the interest in counteracting long term excessive concentration in host countries and its negative consequences for development and growth in origin countries, and asked what policy tools could be employed to do so, apart from outright transfers or restrictions (preferably temporary) on migration flows. Another participant contested the identified basis for cooperation as unsound, since developing origin countries in fact gain in the short term and therefore have little incentive to oppose flows: they diminish unemployment and thus stabilise social conditions, while ensuring much-needed remittances.

> *"Host countries gain; skilled migrants gain; origin countries lose short term but win long term. So what to do?"*

Many participants argued against restricting flows on normative grounds; some advocated instead, more or less ambitiously, the use of industrial policy, the creation of larger, regional poles to spread the costs and benefits, enhanced mobility schemes ensuring circular flows, or joint host/origin country training schemes; but short term electoral concerns make it difficult for MSs to cooperate with EU institutions on pilot projects for legal migration. One participant highlighted that to regulate migration, policies in origin countries (such as encouraging education, return, specialisation, niching in a sector, greening…) have the most impact. Another participant recalled that almost all legal migration in developed host countries are guest worker programmes that, without integration programmes, have not had a good track record in effectively regulating migration. Moreover, they are accused of inflaming xenophobia, despite a compromise where newer migrants are allowed access to the labour market but excluded from welfare state benefits. This poses the question of countries, such as Japan or Hungary, who prefer economic stagnation or decline as the price to pay for ethnic homogeneity.

> *"We need good governance for asylum; we need governance tout court for economic migration."*

Discussion also focused on the tension between high- and low-skill migration, by way of contrasting legal avenues of migration: the labour regime and the protection regime (while they do not map exactly to each other, there is a fair degree of overlap). Most participants agreed that the line between the two regimes is blurring, a worrying development. One participant strongly advocated keeping these two regimes strictly separated, arguing that both have different logics, and that if legal pathways for migration don't exist then the asylum regime will be abused to that end, putting it in danger. One participant questioned how the existing two regimes could be strictly separated, as they follow similar processes and feed into each other.

Another participant suggested that it is difficult to disentangle asylum seekers and economic migrants, but that the former tend to arrive in waves whereas the latter tend to arrive as a more steady flow; another responded that however difficult to parse, these categories matter very much as they confer different bundles of rights and access to labour markets. In any case, all will need to acquire or upgrade their skills to integrate the labour market of their host country; thus programmes to facilitate this in short time are necessary, as are integration programmes that will take longer. However, looming automatisation and digitalisation will impact future migration flows as well as host country societies, increasing the imperative for reskilling and upskilling of workers. One participant evoked the importance of not leaving by the wayside refugees who due to injury or trauma cannot join the labour market; another recalled that while in general labour market participation of refugees takes longer, the situation consistently rebalances after the second or third generation.

Concluding the session, the first speaker recalled that skilled migration is self-selecting; it is a normative question with serious consequences whether decision-makers act on concern over their country's human depletion: pithily put, acting to prevent ghost towns may end up creating zombie states. The good situation of the origin country is key to fostering return migration. The second speaker took the EU as an example, deploring its limited competence and limited appetite of its MSs for developing migration policy, urging experimentation on the national level to create a dynamic of regional progress, possibly leading to harmonisation.

Session III - The Global Compact for Migration

The first speaker introducing the session presented the process leading to the GCM and its content. Mounting salience of migration as an issue led to it being taken up in various international fora, until the 2015 migration crisis in Europe tipped the balance, spurring the UN process towards adopting the GCM. It enjoyed a large consensus initially (only the US refused to even be involved in its negotiation), but the decision to delay formal adoption and endorsement at Morocco's request, so it could organise the ceremony in Marrakesh, allowed opposing forces to mobilise and spread disinformation, leading to a number of countries to drop out of it. The GCM is the first internationally negotiated agreement on migration in all its aspects: not legally binding, it is a political and fairly coherent document affirming a multilateral approach to managing migration, achieving balances between individual rights and states' prerogatives, and between origin and host countries. It is structured in three baskets: reducing the negative drivers of migration (such as smuggling and trafficking); amplifying its benefits (investment, development, using migrants' skills, etc.); and bringing order to the process (improving data collection and their quality, providing relevant information to migrants, etc.). It contains three kinds of objectives: specific and non-controversial (e.g. data collection); specific but controversial (e.g. cooperation on returns); and broad and idealistic (e.g. eliminating discrimination). MSs decided to include such numerous and heterogeneous measures and objectives to dilute the more contested issues. It is much too early to gauge its effectiveness, but it has the merit of setting out a framework with a menu of measures. Time will tell whether their implementation will be effective or not, yet there are cautious grounds for optimism.

> *"The GCM is an incremental step in the right direction. It's full of lofty goals, all on paper; but at least they're down on paper."*

The second speaker focused on the objective of regulating labour migration contained in the GCM, arguing that there exists a gap between its contents and the reality of labour markets, which will obviate its effectiveness. Its objectives touching upon labour market access are in tension with the use of temporary work permits, the major tool of developed countries. These are awarded in function of labour market tests to evaluate demand for certain skills from employers, to show that no domestic workers are available; whereas the objectives emphasise the right to change employers. But if migrants can change jobs or sectors, this negates the original incentive to facilitate their migration.

The speaker thought it better to focus on defining a core of rights for migrants (as ILO has done for workers) and was pessimistic about the GCM's effect on regulating labour migration. The first speaker offered a rejoinder, recalling that the GCM had emerged in response to anarchical mass flows, not narrower, practical concerns over labour markets; and that the value of the GCM lies in its process as the first global negotiation over migration, overcoming taboos in previous migration governance fora.

Discussion revolved around on the drawbacks and benefits of the GCM. Whereas many participants expressed measured praise towards its content and relief that it managed to be adopted at all despite mass diffusion of inflammatory "fake news", some felt it was not ambitious enough.

> *"It wasn't the best time or place for the GCM. It's better to have it than not, but it really could have gone the other way."*

One participant pointed out the positive impact of civil society groups in helping to draft it, in a fairly open and transparent process: even migration-critical groups were invited to contribute, but elected not to. This NGO involvement may have diminished state ownership of the text. Several participants agreed that these non-state actors will be key in the implementation and review processes.

Some participants drew attention to the fact that negotiation was conducted by foreign affairs ministries, creating tension with home or labour ministries who will be the ones to deal with the effects. Others questioned the feasibility of the prescribed measurement and reporting, citing the example of crisis-hit and displaced populations. One participant quipped that it is easy to criticise ex post: the process will go through gradual, long term build-up. If having it in place will stop some abuses, and if it can it be used proactively, then the benefits will outweigh the drawbacks.

A prominent part of the discussion focused on just how legally binding the GCM is and might be in the future. Participants concurred that it was explicitly designed as non-binding "soft law"; the text pays overt obeisance to national sovereignty. It is a statement of principles followed by a "shopping list" of measures states can pursue, with no obligatory actions or sanctions. It can be referenced in legal practice, but not invoked to claim rights in courts. However, it can gain bindingness progressively by repeated reference, linkage and use in related processes (one participant suggested the SDGs), as its language and principles spread down and out; the European Parliament has already made reference to it. Origin countries could take into account other countries' action on its measures in undertaking new bilateral (or regional) agreements with them.

The session concluded with the first speaker elucidating the envisaged implementation method of the GCM: it is the responsibility of states, which have no individual formal monitoring and reporting obligations or standardised indicators. A global review will be conducted in four years however, as well as alternating regional reviews. The speaker reflected on the role of EU MSs, who at the time of the crisis needed to involve origin countries and thus bought into a global process which may have unexpected consequences for them. The second speaker advocated for more and better data collection and scholarship to obtain a granular understanding of key issues at regional and national levels.

Session IV - Migration governance in the EU

The first speaker introducing the session presented some statistics on migration in the EU and drew conclusions. Asylum-seekers represent a tiny 0.4% of all cross-border movements. Since the financial crisis, labour migration has almost halved; asylum claims spiked during the 2015 migration crisis but are rapidly declining (40% of Council meetings at the time dealt with this subject); it is family migration that contributes most to migration to the EU. 30% of migrants end up in three MSs (DE, UK, IT); 90% end up in 10 (+ ES, FR, SE, AT, BE, NL, PL; the latter because of flows from Ukraine).

Responsibilities for different aspects and types of migration are splintered between the Commission and MSs; the latter's uncoordinated decisions create externalities, while they compete to attract skilled migrants. The situation is sub-optimal: third countries could more easily be approached by the Commission, and marketing the EU as a single destination could make it more attractive. The crisis spurred the Commission to strengthen the external dimension of the Schengen system supporting inter alia naval action in the Mediterranean, with mixed results. It also facilitated "gentleman's agreements" with Turkey and Libyan actors and developed carrot-and-stick approaches towards other sending countries (mostly African), with some effectiveness, but at the cost of belying its professed values.

However, it failed in resettling already arrived migrants, as some MSs flatly refused to implement the first Council QMV decision in this field. The EU faces a number of challenges stemming from migration: with an ageing and shrinking labour force, it must attract the right migrants for its labour markets, while ensuring the freedom of mobility of its citizens, the protection of refugees, and the security of all on its territory. Moreover, it must manage its diverse societies and promote integration. One major challenge, however, is that historically European conceptions of national identity integrate migrants much less easily than those of other states such as the US or Canada.

The second speaker covered similar ground with a more institutional lens. The EU needs a longer term strategy to protect freedom of movement and deal with demographic challenges, detached from a narrow and unhelpful focus on security; at the moment there is no common view and thus no common policy. Migration governance is especially difficult due to the intertwined competences of the institutions and the MSs, which blame the former when things go wrong; cities can be powerful actors (for better or worse), but do not receive adequate support. The EU brings a striking amount of resources to the table, but much of its impact is wasted due to lack of coordination and inability to foster synergies. The humanitarian/security/development/external relations nexus that lies at the heart of migration is inextricable; but more so for MSs alone.

However, the EU has many design flaws in dealing with migration: the Dublin asylum system suffers from serious flaws, and is not balanced by a corresponding system for labour migration; in external relations, the unanimity requirement in the Council and the EEAS being walled off from relevant issues with domestic impact (e.g. trade) is a serious impediment. In order for the EU to grapple with the challenge properly it needs a complete set of sectoral policies at its disposal; to acquire this, it needs political will and the backing of MSs. It has begun to seriously engage with origin countries, but more work is needed.

One participant was extremely critical of the state of EU migration governance: obstinacy in maintaining the failed Dublin "non-system" is now threatening the Schengen system. Countries of first arrival failed

> *"If we don't manage to fix this, it might be an existential threat to the Union… Let's put it this way: in this area, the Union has to grow up."*

to apply it due to lack of means and general EU solidarity; this, plus lack of mutual recognition by MSs in asylum decisions, led to forum-shopping by migrants, and in the end has fed far-right populist nativism. EU-tabled reforms are completely inadequate, proposing more of the same. This obstinacy is not irrational however, since the point of the system is deterrence rather than actual governance; moreover, it is now deeply embedded in the administrative cultures of EU institutions and MSs (where one very negative factor is the management of asylum by home ministries).

Even more danger lies in outsourcing asylum (as in e.g. the deal with Turkey): it runs against all professed European values and MS constitutions; and what's more is not even efficient. A fitter, three-level system could be a solution: a revamped asylum regime (with e.g. mutual recognition of asylum decisions, an EU asylum agency with real authority); a new humanitarian regime (which could accommodate climate refugees for example); and a labour regime to deal with economic migration. Yet, host countries' concerns over identity or their choice of homogeneity over growth must be taken into account somehow as well.

Discussion pursued the theme of flaws in EU migration governance and ways forward. Participants concurred for the most part that the focus on security concerns, linking border control, immigration and cross-border crime to asylum, is unhelpful; so are ethically dubious stopgap agreements. One participant disagreed however that this focus on security concerns is strong in the foreign policy facet of migration, questioning what a strongly coordinated EU foreign policy would be able to effectively achieve, and arguing that smaller policy items (e.g. visa facilitation for countries included in the EU's Neighbourhood Policy) could have broad reverberations.

One participant questioned the Commission's role in asylum externalisation, asking how it can better evaluate and monitor coordination partnerships largely put in place by the European Council and regain influence; another replied that it does not enjoy much competence in this area and is hemmed in by MSs, as the ignored QMV decision on resettlement demonstrated. New attempts at coordination will have to take a basis that MSs are profoundly divided on the issue, to the point where legally binding decisions are not implemented and with no possible sanction to boot. Another participant put forward that the principle of differentiated responsibility could have been applied, whereby recalcitrant MSs could have refused resettlement but paid more of the costs. One participant urged passionately to not miss the forest for the trees, recalling that the main goal should not be to salvage systems, but people.

The session concluded with the first speaker questioning the hard practicalities of EU solidarity: if a MS receives significant funds with little improvement, it is difficult to justify spending more. Mutual recognition is double-edged: asylum rejections by migration-critical MSs would have to be recognised too. Relocation is unjust because for many the destination country will be designated arbitrarily, and is in any case extremely difficult to enforce. The second speaker echoed points made in discussion, regretting the lack of tools and clear governance mechanisms at the Commission's and MSs' disposal, and drawing a comparison between the migration crisis and the Eurocrisis. The fundamental question is how to share the burden: there is a window of opportunity now with the drawing up of a new EU budget and rule of law consultations with certain MSs.

Wrap-up - Lessons for global governance

The speaker introducing the session summed up the points made during the day and pointed out some under-discussed issues such as supra- or sub-state levels of governance (regional consultation processes; cities), the role of transit countries, or GCM implementation. Discussion touched upon the patently insufficient political action in the face of crisis and mass human suffering; one participant urged to maintain a politics of hope rather than a politics of fear. Another participant underscored the tensions at work in migration governance: the liberal rights regime vs. majority rule, national vs. human security, expertise vs. values.

> *"This has been the rawest seminar."*

Seminar programme

20 MAY 2019

19.30	*Welcome Dinner*

21 MAY 2019

09.00 – 09.10	*Welcome and Introduction*
09.10 – 09.30	*Tour de table*
09.30 – 11.00	**Session I – Deciphering the migration governance landscape** Chair: **Jean Pisani-Ferry** | Tommaso Padoa-Schioppa Chair, EUI Introductory remarks: **Marie McAuliffe** | International Organisation for Migration, **Andrew Geddes** | Migration Policy Centre, EUI
11.00 – 11.30	*Coffee Break*
11.30 – 13.00	**Session II – Labour mobility and skills** Chair: **Ninna Nyberg Sørensen** | Danish Institute for International Studies Introductory remarks: **Petra Bendel** | The Expert Council of German Foundations on Integration and Migration, **Hillel Rapoport** | Paris School of Economics
13.00 – 14.00	*Lunch*
14.00 – 15.30	**Session III – The Global Compact for Migration** Chair: **Joseph Kofi Teye** | Centre for Migration Studies, University of Ghana Introductory remarks: **Kathleen Newland** | Migration Policy Institute, **Martin Ruhs** | Migration Policy Centre, EUI
15.30 – 15.45	*Coffee Break*
15.45 – 17.00	**Session IV – Migration governance in the EU**

	Chair: **Andrew Geddes** | Migration Policy Centre, EUI
	Introductory remarks: **Rainer Münz** | EU Commission, European Political Strategy
	Centre, Claus **Haugaard Sørensen** | Norwegian Refugee Council
17.00 – 17.30	**Wrap-up – Lessons for global governance**
	Chair: **George Papaconstantinou** | School of Transnational Governance, EUI
	Introductory remarks: **Pascal Brice** | Former Director, French Office for the Protection of Refugees and Stateless Persons
17.30 – 18.00	*Farewell Cocktail*

Seminar participants

Petra Bendel	The Expert Council of German Foundations on Integration and Migration
Tito Boeri	Bocconi University, Italy
Adrien Bradley	Robert Schuman Centre for Advanced Studies, EUI
Pascal Brice	Former Director, French Office for the Protection of Refugees and Stateless Persons (OFPRA), France
Tiziana Caponio	Migration Policy Centre, EUI
Sergio Carrera	Migration Policy Centre EUI; Centre for European Policy Studies (CEPS)
Cecilia Corsi	Robert Schuman Centre for Advanced Studies; University of Florence, Italy
James Dennison	Migration Policy Centre, EUI
Franck Düvell	German Centre for Integration and Migration Research
Malin Frankenhäuser	International Centre for Migration Policy Development
Andrew Geddes	Migration Policy Centre, EUI
Leila Hadj-Abdou	Migration Policy Centre, EUI
Tomáš Jungwirth	School of Transnational

	Governance, EUI
Thomas Klau	Asylos
Reuben Joseph Babatunde Lewis	School of Transnational Governance, EUI
Patrick Marega	International Labor Organisation (ILO)
Mehari Taddele Maru	Migration Policy Centre, EUI
Marie McAuliffe	Migration Policy Research Division, International Organisation for Migration (IOM)
Rainer Münz	EU Commission, European Political Strategy Centre
Philomena Murray	University of Melbourne; Director, Comparative Network on Refugee Externalisation Policies
Kathleen Newland	Migration Policy Institute
George Papaconstantinou	School of Transnational Governance, EUI
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Hillel Rapoport	Paris School of Economics
Alexandra Ricard-Guay	Migration Policy Centre, EUI
Martin Ruhs	Migration Policy Centre, EUI
Gabriella Sanchez	Migration Policy Centre, EUI
Claus Haugaard Sørensen	Norwegian Refugee Council; Former Director-General, EU Commission, Civil Protection and Humanitarian Aid Operations
Ninna Nyberg Sørensen	Danish Institute for International Studies
Imogen Sudbery	Policy and Advocacy, International Rescue Committee (IRC)
Joseph Kofi Teye	Centre for Migration Studies, University of Ghana
Anna Triandafyllidou	Global Governance Programme, EUI

Section 7

Climate

The Governance of Climate Change: Making it Work

Seminar insights[1]

George Papaconstantinou, Jean Pisani-Ferry and Laurence Tubiana[2]

1. Climate change is the most pressing and challenging collective action issue. Climate change mitigation exhibits all the characteristics which ought to drive collective action. The preservation of the climate is a paradigmatic public good problem whose urgency is underscored by abundant and unequivocal scientific evidence. Climate is also a policy area where delays may lead to potentially irreversible damage. At the same time, it involves an unavoidable risk of free-riding on any solutions commonly agreed, as regards governments' willingness to enter into commitments to reducing carbon emission or in implementing these. Furthermore, climate change raises daunting intergenerational and international equity issues that are hard to solve in theory and even harder in practice. Any solution involves distributional choices along those two dimensions, and also raises in all countries further issues of distributional equity amongst living citizens.

The transition to a socially superior equilibrium therefore creates both relative winners and losers across generations, between countries and within countries. For these reasons collective action in the field of climate requires solving major problems of intertemporal choice,

1 The seminar was held on 20-21 June 2019 in Paris (France), jointly organised with the European Climate Foundation.

2 CEO of the European Climate Foundation; former Special Representative for the 2015 UN Climate Change Conference (COP21) in Paris.

international coordination and distributional equity, as well as tackling enforcement challenges.

2. The global climate governance framework is not up to the task. At its centre sits the 2015 Paris Agreement on mitigating climate change, which de facto substituted the more coercive but far less comprehensive Kyoto protocol of 1997. After having failed in 2009 to negotiate and implement binding targets for each and every country, the eventual agreement on a series of nationally determined, non-strictly binding objectives was and remains indicative that the international community has chosen breadth at the expense of depth. Yet, despite the fact that "the house is burning", the sum of individual commitments by countries, local authorities, businesses and investors do not add up to the collective objective set by the Paris Agreement: limiting the average temperature increase to well below 2°C, aiming for 1.5°C.

The Paris Agreement reflected a new reality and a recognition that emission reduction pledges could not be limited to the advanced countries, that the model of timetables and targets could no longer work, that national sovereignty could not be circumvented, and that agreements needed to represent the diversity of the multiple players involved. It was a watershed as it represented a shift from negotiated national commitments to coordinated unilateral pledges. In essence, it defines a process, a learning method, an enabling framework coupled with a peer review and an agreement to assess at regular intervals whether intentions and actual actions measure up to the commonly agreed overall goal.

It is meant to be a platform for accelerating climate action, a way to motivate countries — but also the many other actors of the climate regime, through a process of information exchange, of constant benchmarking and pressure, with the aim of aligning objectives as a substitute to a centralized governance mechanism. Its effectiveness however is yet to be ascertained; it has certainly been hamstrung by political shifts since 2015, most notably the US withdrawal from the Agreement. Nevertheless, commitments under the Agreement must be revised and increased by 2020, when it starts its effective implementation. The idea is to progressively internalise the long-term goal as net zero GHG emissions by 2050, making it become the new reference point for governments and other actors.

As things stand, the intended contributions registered under the Paris Agreement are grossly out of line with its stated goal. Incentives to free-ride by under-pledging and under-delivering remain massive. Furthermore, climate coalitions are by nature unstable and leadership risks being ineffective as first-movers in the emissions reduction game end up having made themselves, by their very success, irrelevant for the next step of climate action. This best-performer curse is inherent to the problem at hand.

3. Departure from the simplistic one-agent, one-period model may lead to more optimism. Climate change mitigation strategies cannot be assessed through simplistic lenses. To start with, states are not the only players. Cities and local governments are also involved, especially as greenhouse gas emissions and local pollution are often correlated. Several have started using the regulatory means at their disposal to foster speedier decarbonisation than envisaged by national governments. Second, private companies have incentives to engage in the development of low-carbon technologies because of the first-mover advantage that may result from early research and investment. Third, states themselves have reasons to encourage such investment because of the comparative advantage that may result from having been involved in the shaping of new technologies.

The important point here is that for those dynamic forces to be set in motion and strengthen the drive towards decarbonisation, it may not be necessary that international agreements be credible and deliver decarbonisation with a high probability. It is sufficient that they credibly set the course towards an irreversibly greener economy. This may be enough to change the nature of the game and make it possible that a soft agreement such as the Paris Agreement provides enough incentives to action to affect private behaviour significantly.

4. A widening gap between frontrunners and laggards raises concerns about the adequacy and the viability of the current framework. The Paris Agreement brings under the same umbrella front-runners (such as Scandinavian countries) actively engaged in the decarbonisation of their economy and laggards (such as Poland, the US or Gulf states), whose commitment to reducing emissions is at best shallow. The question is how long all these can remain, nominally at least, part of the same endeavour. Front-runners are likely to be increasingly concerned they are incurring the cost of climate action while others free-ride on their dedication while enjoying the benefits from lower production costs. Laggards may feel that they are not part of the race for technology leadership and are unlikely to reap the benefits of investing into clean technology. The former may insist on more binding agreements or compensatory measures. The latter may fall further behind as following the lead is a challenge, with little scope to expect being rewarded for one's effort.

This logic may result in an unstable bimodal distribution of efforts and outcome, with the consequence that an economically inefficient and politically toxic two-tier club structure may emerge. Solutions to such divergence may involve specific trade measures (such as adjustment taxes) and/or transfers on a wider scale than envisaged (and hardly implemented) thus far.

5. The plethora of available policy tools need to be harnessed to deliver the desired result. The climate governance challenge today is to create a collective action framework which amounts to more than the sum of its parts; to reconcile precise and binding global top-down goals with voluntary bottom-up contributions that do not add up to the stated goals - certainly not to the aspirational goal of capping temperature increase to 1.5°C or carbon neutrality by 2050.

Given the size of the task and the collective action challenge, this necessitates an approach which combines incentives for behavioural change (such as agreements to reduce emissions in particular sectors) with direct action (such as direct carbon capture). It is also an approach which needs to pay more attention to the problems both consumers and producers are faced with in the transition period, and to issues of burden-sharing and fairness. Practically, this may also imply segmentation as a future policy direction: breaking up problems into pieces and looking to create agreements on smaller climate-related issues, as a complement to the global climate framework rather than a substitute.

A number of policy tools have been used for climate change mitigation: Pigouvian price-based such as carbon taxes; Coasean rights-based such as emission trading permits; regulatory, driving the adoption of cleaner technologies; and legal requirements, which have helped phase out harmful substances. These have all individually contributed to climate change mitigation but have not however created the critical mass required.

Part of the reason lies in the lack of political support for tools such as a global carbon tax or the coordinated phasing out of fossil fuel subsidies. Such support has been undermined by policy design not taking into account distributional effects or failing to include side payments (for example incremental costs to developing countries being borne by richer countries). More broadly, an impact assessment on the various policy tools is required; a broader view incorporating their macro (economic and social) impact, and their potential to help tip the incentives from the static costs to the dynamic benefits of shifting to clean technologies.

6. The climate emergency is also a unique investment challenge. Seen in a dynamic setting however, a major policy challenge is to change business expectations concerning the future in order to generate a critical mass of investment in clean technology, renew the capital stock, accelerate the transition and turn the climate issue from a catastrophic vision to a solution for growth. This requires the transformation of private finance to support such investments (some of which is already taking place), coupled with large public investments in the same direction that act as demonstration effects and as incentives.

It is often hoped that a change in investors' attitude and the promotion of green finance will be key drivers of the transition to a carbon-neutral economy. Despite the certainty about the impact of climate change, however, there is a case of market failure combined with information failure when it comes to forward-looking investments: the existing uncertainty as well as the increasing returns involved in clean technology are bound to generate investment below what is socially optimal in the longer run.

7. Climate action must not be left to specialised bodies and institutions. Governance at global level is mostly driven by states; and it is most successful when political support (expressed for example at G7 or G20 level) combines with existing multilateral institutions to generate cooperative behaviour and solutions. This is unfortunately not the case in climate governance at the moment: global institutions such as the IMF and the WTO are in principle supportive of climate action but not actively engaged in promoting it.

There is by now a clear need to mainstream climate change mitigation, so that it is taken on board in policy design, policy coordination and policy surveillance. This should apply for example to public finances, tax policy, financial stability policies (where action has started already) and trade and investment policies, to mention key fields only.

Climate governance furthermore exhibits some promising characteristics. One is the already mentioned mobilizing role of sub- and supra-national entities (cities and regions); these cannot substitute for action at state level, but act as complements, generating pressure as well as a real contribution towards attaining climate goals. A second is the political pressure from grass roots movements. Both in the US and in Europe, civil society is making up for lack of leadership at political level; as a result, climate issues have risen in the political agenda. This may help generate the required ambition in the governance framework, with the danger however that whatever positive governance developments materialize are swamped by the extent of the climate problem.

Keynote – The Paris Agreement and its future[3]

Laurent Fabius, President of the French Constitutional Council. Former French Prime Minister; former chair of the 2015 UN Climate Change Conference (COP21)

Almost four years after the conclusion of the Paris Agreement (PA), the speaker made five points about it, followed by five forward-looking points.

- *There is an unfortunate discrepancy between goals, commitments, and results. The goals were simple and ambitious; commitments are looser; and results are far from satisfactory, putting the world on a track for 3-5°C of additional warming. The PA itself is criticised for this, despite the fact that it is states that are responsible for not fulfilling their commitments.*
- *Institutional fora have less and less spectacular results. This results from a decline in authority of COPs and G7-20s. This is in line with the crisis of multilateralism and international law, leaving irresponsible attitudes unpunished globally. These can be outdated, but it would be a mistake to abandon them.*
- *The necessity of consensus made sense when multilateralism was vibrant; now it can only produce minimal results. The PA was made possible by an alignment of forces (US, EU, China) that no longer exists. Facing the ecocidal Trump and Bolsonaro administrations, the EU faces difficulties assuming a leadership role, and China is unlikely to move forward absent a richer counterpart. Worse, Trump's announced withdrawal from the PA gives other states license to do the same or ignore it.*
- *Meetings and coalitions between and with non-state actors (cities, regions, NGOs, PPPs) are developing and taking an important governance role. Subnational actors, scientist groups, youth movements and courts are having a growing influence on climate change governance. This is challenging the prevailing perception that climate change is a long-term, international issue whose solution cannot come from*

3 Summary by Adrien Bradley.

short-term oriented, democratic choices made within national contexts. States retain a decisive role, but subnational actors in particular can drive effective action. California, New York, universities, cannot force Trump back into the PA, but they can uphold its goals with significant effect.

- *Different environmental problems are interrelated, whereas political agreements within the framework of the prevailing global governance regime are mostly sectoral. This creates a dangerous and underestimated potential for governance gaps.*
- *Complex governance structures and new international organisations could be dreamt up to deal with these points, but it is important to be realistic.*
- *Political will must be insisted upon more than ever before. Epistemic communities and public opinion can block, sway or eventually replace ecocidal governments. Political will must also be deployed to at least maintain COPs as institutional fora for taking stock, reporting and comparing commitments; or more, to improve them. COPs should be better coordinated with IPCC reports to leverage effects of scientific work on public opinion and political leaders. Their core should be opened to non-state actors, who are for now kept to side-events. They should be prepared with Finance ministers to remind governments of the nature and structure of commitments made, and to highlight costs, benefits and opportunities of climate change mitigation and adaptation efforts for states. By the same token the IMF should get involved. They should pay serious attention to innovation in technology. In all of these respects, the 2020 COP26, where revised NDCs will be submitted, will be very important as a chance to enhance COPs as meaningful mechanisms of climate change governance.*
- *Focus must be brought to under-discussed sectors and themes, such as greening air travel, shipping, agriculture, finance, and technology, as well as drawing attention to the effects of climate change on global health. Immediate action on mitigation and adaptation is imperative, but two major mistakes must be avoided: losing the long-term, holistic vision, and framing the struggle exclusively as risks and negatives to be averted.*
- *The EU has a role to play in multilateral fora, especially vis-à-vis*

China and India; discussions can be held on the basis of specific objectives. Action plans requiring consensus have foundered (e.g. recently the Global Pact for the Environment project proposed by President Macron): states should have the courage to start taking some decisions by QMV.

- *Special attention must be paid to two issues. First is coal, which represents the bulk of the problem: if all currently projected projects are completed, there will be no way to avoid catastrophic climate change. Second is carbon pricing, which, as the only feasible tool in a market economy, commands widespread support in theory, but needs hard work to materialise in practice. Coalitions supporting it exist but are insufficient.*
- *Attention must also be paid to the question of a just transition. The PA addresses this only imperfectly, and frustrations due to mismatches between climate policies and poorer people have become glaringly obvious with the emergence of the Gilets Jaunes movement for example. This concern must include the issue of climate refugees.*

The 2019-21 period will be critical. NDCs will be reviewed and states will have to start integrating the 2050 horizon; there will be short-term consequences, but it is the first time so many states will have to look so far ahead, and that is worth supporting.

A daring comparison of the PA to the Final Act of the 1815 Congress of Vienna can be made. They were very different ways of doing diplomacy and tackling problems in two very different worlds. Vienna was secret; Paris had to deal with public opinion. Vienna involved only states through their Foreign Affairs ministers; Paris involved all relevant state and non-state stakeholders. The same format can and should be used in the future for other topics, though established institutions will still have a role to play. Optimism should be maintained moving ahead.

Seminar minutes

Adrien Bradley

Session I - The framework for climate governance: Exploring international achievements and shortcomings at global level

The first speaker explored what has been learned since the adoption of the PA. The Kyoto model of timetables and targets did not work, and the club model did not work alone. National sovereignty cannot be bypassed (especially relevant for the US, where the Senate is a near-insuperable barrier) and top-down measures do not work: there are multiple loci of decision. Climate change governance is a regime complex, which must be approached with tools of multilevel governance; its actors are engaged in a learning process to break through its impasses and achieve collective action that amounts to more than the sum of its parts. In this respect, the PA is meant to be a "hook" on which to hang more action on decarbonation.

The NDCs were designed to try to conciliate the (top-down) global goals and national sovereignty, by allowing states to determine their own contribution towards emissions reductions. While the numbers aren't binding, the surrounding framework is; as are the hard-fought benchmarks of carbon neutrality by 2050 and the goal to limit warming at 1.5°C, which is where the battle will lie. The PA sets out a form of experimentalist, learning governance where numbers, metrics, and policy are uncertain, thus mandating stock-taking and revision every five years to update wrong predictions. Repetition is therefore a key condition to cooperation.

Implementation and enforcement thus rest upon peer pressure and common expectations of the future, which can be enhanced by state- and non-state actors (cities, regions, businesses, financial institutions…). The goal would be for all to integrate in their decision processes the PA's goals, turning rational expectations into a self-fulfilling dynamic, with civil society as a watchdog. The scientific community has a role to play in shifting from catastrophistic, victim-mentality narratives to ones emphasising agency and opportunities.

Significant headwinds can be expected however, the most obvious being the Trump and Bolsonaro administrations. Subnational actors and civil society involvement, picking up the slack of national leadership, is vital, but needs to go further. It remains to be seen how far businesses and financial institutions will align with the PA's goals.

The second speaker took a historical look at climate negotiations. At the 1988 informal Toronto conference, a plurality of states (led by the EU) managed to set a collective target for emissions reductions, and agree on the instrument of a carbon tax to avoid free-riding, but the positions of the US (energy costs) and developing countries (differentiated responsibility) meant that negotiation was pushed back to the Rio conference. The Kyoto Protocol enshrined the principle of differentiated responsibility and top-down negotiated targets, but the US refused to ratify it; but on a deeper level, lack of enforcement mechanisms made it unworkable, and the same reason doomed the Copenhagen conference. This is where language shifted from commitments to contributions, diminishing countries' individual responsibility towards achieving a collective goal. The process was rescued at Cancun, leading to Paris.

The PA manages to state the collective goal more precisely than before, but at the price of leaving the means to achieve it severely undeveloped; it scrupulously respects national sovereignty while appealing to states' responsibilities and self-regard through peer pressure. Intended NDCs (I-NDCs) are very different from the negotiated targets of Kyoto, but even if all fulfilled and added up, emissions would still continue to rise, which is completely incompatible with the stated goal. While there has been a change in rhetoric, the free-rider problem remains intact.

> *"The Paris Agreement changes what the players say, if not what they do."*

One successful instance of curbing free-riding while tackling a collective action problem is represented by the Montreal Protocol and its Kigali Amendment on curtailing HFC emissions. A key provision is its trade ban between parties and non-parties of HFC-containing goods, so that participating states can keep trusting others' commitments. It is an example of coordination, not voluntary cooperation, with no presumption of an inability to enforce its provisions. It would be possible to forge ahead on climate change governance in the same way as with HFCs, acting on different aspects of the problem discretely; the PA opens the door to this. A more radical approach would be a Nordhaus-style climate club with border tariffs, but it does not factor in potential retaliation, nor that its carbon pricing is too low. Thus, beyond the fact that coordination games are difficult to play, it is not even certain that their conditions are met; and were they met, and a critical mass of states assembled, the sum total of avoided emissions might not be sufficient. It may become necessary to seriously count on immature or speculative technologies such as mechanical carbon capture and storage (CCS), or solar geo-engineering.

In discussion, one participant proposed that when a problem can't be solved, the context should be widened. International tax reform coordination could ignite self-fulfilling expectations for business and the public, moving the politics and easing the way for governments. Another participant (Victor) agreed with the need for this, calling it "deep tax reform" as opposed to the (equally necessary) shallow tax reform of eliminating subsidies to emitting industries.

Post hoc ergo propter hoc fallacies should not be committed in assigning success to the Montreal Protocol cautioned one participant: the emissions it covers come from essentially a single technology (refrigeration); the US was favourable as Dupont was phasing out the gases; widespread anger in India helped ratification there. The alignment of a single issue with a clearly identifiable political economy made it an easy issue to tackle. Another participant opined that what had worked for Montreal and Kigali was a clear and mutually acceptable fixing of the distribution of short term-costs in the deal; but recognized this was difficult to attain, politically difficult to sell, and potentially socially divisive.

Selective history is indeed a danger agreed one participant, observing that Montreal was not simply a bargaining exercise but a learning one as well. It may not be an adequate bearer of lessons for the PA: the prevailing, top-down bargain view of the world that produced an excellent but politically unworkable result at Toronto has given way to a learning view, where more actors than states are used to experiment in co-creating governance. Learning implies making mistakes however, and institutions and states must face the politics of admitting them. Learning is also a slow process — which, given the pace of climate change vs the uncertain possibilities of new technology, is likely lead to undermitigation or overadaptation.

> *"Greenpeace has done a better job than the IEA in predicting the falling prices of renewable energies."*

One participant commented that the learning view of climate change governance implies analysing it as an information failure as well as a market failure. As such, like the keynote suggested, it would be good for COPs, which bring all actors together, to be coordinated with IPCC reports; though this would not be sufficient to shape expectations, as the first speaker called for. This is a big problem, as good forecasts are needed when commitments are being elaborated. One learned lesson is that the current system has perverse incentives to set low targets so they can be easily met and revised. Another is that the sectoral approach (like Montreal) can be a useful complement, and should be applied to coal, aviation and maritime shipping, despite the difficulty. The WTO rules can also be leveraged.

To another participant, the PA is not just a learning model of governance, but an enabling one through its incentives. It has "carrots", but only the weak "stick" of peer review. Incentives and disincentives should be seen as dynamic and kept on the agenda; the G7-20 should get more involved. Another participant agreed that leaders should actively explore what mitigation efforts could be pursued outside the PA. One called for radical ambitions to be set due to the discrepancy of PA goals and commitments, warning that if Trump is re-elected the PA risks falling apart and geoengineering becoming, frighteningly, necessary. There is no way of knowing what the costs might be and who would bear them, not to mention the global democratic problem this kind of scheme would pose.

> *"If we want to limit warming to 2°C, we need three times the NDCs' ambition. If we want 1.5°C, that's six times."*

The second speaker defended the positive, future-oriented effects of Montreal: it stimulated R&D, innovation and patent applications. The distributional and enforcement aspects are indeed crucial: richer countries should pay the incremental costs, e.g. of switching to less-emitting technologies for poorer countries. This kind of scheme exists in Montreal but not in the PA. Advancing CCS is the only way to stabilise temperatures without behavioural change; it just requires financing and is akin to a coordination problem. Other than technologically, this can be done by large-scale reforestation, though this poses land-use problems. Solar blocking should also be seriously examined. It will take decades to ascertain whether action has had the right impact, but the risk of inaction is much greater.

The first speaker recalled that the PA cannot be more than a hook on which outside action (such as sectoral action) should hang. G7-20 involvement may not be ideal however: the G20 in particular is disinclined to produce more global goods than in the financial domain, and that was spurred only by a huge, tangible crisis. There is a failure of global leadership and institutions here. Montreal will soon be truly tested, as CFC emissions are growing illegally, probably due to China; it remains to be seen how this will be dealt with. Informational failure is a reality: governments, but also businesses and civil society hold false beliefs about the costs and feasibility of renewable energy generation. This extends to the distributional issues: e.g. determining what is rent-seeking and what is a legitimate demand for assistance to transition for fossil fuel industries. Good governance is attained where there is the capacity to articulate different mechanisms and get to common measures, bridging power, bargaining interests, and the learning process.

Session II - Second-best solutions: Regional coalitions, creative coalitions and other alternatives to a global agreement

The first speaker evoked the proliferation of non-state/subnational actors since the PA and the importance of supporting them to pressure governments, especially in non-democratic countries like China. China is guided by three principles: its self-interest; its sovereignty; and enhancing its international image. The PA was acceptable to China because China has redefined its self-interest as lying in clean energy. China does not want to be seen as lagging on targets, but will not commit to them unless it is certain it can attain them (unlike some other states). This domestic and international interplay can create virtuous circles, as happened with sulphur emissions in shipping: China figured out how to meet its own pollution targets, then supported the International Maritime Organisation's global cap, and then reinforced its own regulation. This highlights the importance of bringing together domestic coalitions and fostering local champions for effective sectoral action; these can be leveraged to raise China's long-term decarbonisation ambitions. To do so, it is necessary to collect detailed information on impacts and how to distribute efforts; develop good policies to propose to local governments; and dovetail with national priorities (like the 5-year plans). Globally, a carbon neutrality club will be key for the future. Many state and non-state actors have made ambitious commitments: coalitions should be built with a wide range of actors to work out how targets can be met at subnational level based on common goals.

The second speaker was more pessimistic, noting that while fostering virtuous circles and grassroots mobilisation is important, precise mechanisms of change are unknown. Mobilisation can be fungible (e.g. extending concern from plastic pollution to the petrochemical industry), and is increasingly questioning corporate concentration and financial power; but it can be a double-edged sword, helping or hindering action. Institutional investors and ratings agencies are beginning to demand and use better environmental impact assessments. These kinds of signals (also from business, courts, shifting consumption patterns) were important in getting to the PA, and will be more so moving ahead. Widening the scope (to tax, trade…) to tackle the problem is a good idea; all levers of action should be used by creative coalitions.

It is less important to analyse leadership than followership, proposed one participant. On the one hand, best performers become irrelevant: the more one actor does to attain their commitments, the more they marginalise themselves in terms of volume of emissions. A systemic view should be privileged. On the other hand, when experimentation yields good results, studies should be made on how these early "niches" of activity propagate: e.g. France's development of unprecedented ramping technology for its nuclear power plants, allowing greater contribution of renewable energy to the grid. Fragmentation is inherent to the experimentalist process, but governance and innovation are developed best organically at small-scale; there should be a mechanism to sift the chaff from the wheat. The lure of first-best coordinated strategies should be weighed carefully against the reality of second-best solutions.

Successful small-scale initiatives should be built on regionally to coordinate wider application added one participant. Another participant seemed the followership game view pertinent, as the EU represents 8-9% of global emissions now, 5% by 2050; other actors will matter far more. China's consulting the EU on carbon markets design in a context of comparable sub-unit diversity is a good case of followership exhibiting experimentation and learning. A darker example would be the EU imposing tariffs on the US, possibly in view of protecting the PA, following the Trump administration's "first shot" and continued assault on the WTO. One participant warned against using the trading system unilaterally for other policy goals: the use of trade measures in

"Trade wars lead to real wars."

Montreal was multilaterally agreed upon and dissuasive only.

One participant argued in favour of leadership however, considering it counterproductive to introduce conditionality in emissions reducing schemes: a carbon border adjustment tax for example would just prompt other countries to tax the exported products at the same rate. The main question is distributive: the EU should unilaterally act in the global interest by complementing the ETS scheme with a carbon tax, and use its "carbon dividend" to support green investments and poorer regions.

> *"Macron has understood it is not possible to increase fuel taxes and cut tax rates on the rich."*

Another participant recalled the leadership role of non- and subnational actors. Business has a role to play as economic signal co-creators, but the PA is silent about accountability for its commitments. Cities played an important role in shaping and carrying out the PA. They experiment at a level close to their constituents, lead by example and put pressure on national governments; but also exacerbate a dangerous growing rural/urban political divide. This defined the last European election; better to focus on broader sectoral approaches (e.g. food production and land use, transport and energy, social cohesion).

One participant thought the first speaker's bottom-up coalition building model could be usefully linked with development agencies' practice. Direct involvement of Finance ministers is also important to mainstream green tools in their field; they should participate in COPs. The SDGs can serve to frame or hook climate issues. Another participant judged recent youth movements an effective form of creative coalition that has provided productive political pressure — but feared that pressure would also rise from catastrophic climate events.

The question should rather be which second-best to choose based on enforceability, argued one participant. The MARPOL Convention on maritime pollution has been successful as a coordination game with a critical mass of players, for example. Another participant expressed support for market mechanisms. A third participant added that much action has been focused on demonstrating immediate demand to provide political cover for governments for action; now action must be shown to be credibly taken. Another participant urged for widespread action with as many instruments as possible (markets, taxes, innovation support, public opinion leverage), recalling the role of contingency (e.g. Dieselgate spurring electrification) and the virtues of nimbleness and creativity in reacting to it to direct the political economy.

The session concluded with the first speaker commenting on the BRI: China is sensitive to criticisms of a project meant to enhance its international image, and has set up committees to deal with them (though some are hypocritical). The rural/urban divide is also relevant there, keeping the authorities from really cracking down on coal. The second speaker saw the PA less as a hook than as an umbrella, covering partial, second-best governance structures in need of coagulating mechanisms to make them tend towards the first-best solution. Instruments based on consumption emission measurement could be considered anew.

Session III - Taxes, subsidies, R&D and private finance for clean technologies: The battle between dirty and clean technologies as an instrument against climate change

The chair drew attention to the wide variation in market and state instruments employed, from a US market extreme to a more statist China. The EU stands in between.

The first speaker enumerated several tools at states' disposal to fulfil their commitments within the PA framework, which specifies none. Carbon taxes in particular are an effective instrument compared to e.g. grants, effectively leveraging an existing system and extracting revenue. The Swedish carbon tax has become a cornerstone of its climate policy: it started early and ramped up gradually, and has achieved decoupling, combining significant emissions reductions with economic growth (as currently measured). It is flexible: it abolished its remit over the covered industries when the ETS scheme was introduced; it was reintroduced in certain sectors (not subject to competition) when its price was too low; it was combined as necessary with time- and scope-limited grants or exceptions.

The speaker conceded that the Swedish carbon tax was adopted as part of a broader tax reform package, and that Sweden holds a higher preference for tax instruments than other countries. A carbon tax is politically difficult to introduce, but international organisations and national financial authorities are networking their experience and knowledge, including on cooperating to mobilise private investment and phase out fossil fuel subsidies. This and the "Greta effect" of new climate movements means international awareness and willingness to act is rising, but some sectoral issues (aviation, maritime shipping) are gridlocked due to existing international agreements. Bilateral arrangements to remedy the situation are being evoked.

The second speaker took the EU's past and recent action as a case study for instruments used. Transition costs are estimated to be huge, and the big question is how to pay for them. Carbon pricing procures two dividends, by cutting emissions and raising revenue. In the EU, the ETS and renewable energy regulations, covering 45% of industry and energy production, have reduced emissions by 29% in 14 years while raising 14B€ in 2018. The speaker did concede however that it was unclear in what proportions the avoided emissions were attributable to the ETS, renewable energy production or energy efficiency amelioration. Industrial exports kept increasing (concrete, chemicals, textiles), but there is genuine reduction: emissions were not displaced by imports (Chinese steel). More energy-intensive states receive more revenue, and all mostly follow recommendations to spend the revenue on climate change adaptation and mitigation projects. Revenue is also used to constitute innovation and cohesion funds.

The EU budget is another instrument. Currently 20% of it is climate-related; there is ambition to increase it to 25%.

Despite all this, the sums do not nearly match the needs. Private investment must be leveraged, through e.g. public/private schemes. The EU must achieve a capital markets union, while devising an action plan on sustainable green finance; it is already making a taxonomy of green bonds. There is active demand and interest for this in central banks and by institutional investors, especially long term-looking ones (pension funds).

In addition, the EU contributes to international climate finance, raising 20B€/year for the whole range of climate expenditure. But in sum, much more is needed, and it is not clear what signals can produce the right incentives.

In discussion, one participant recalled a controversial statement by Tommaso Padoa-Schioppa on the usefulness of taxes in providing public goods. The remaining uncovered 55% of emissions in the EU could be dealt with by carbon

> *"I am reminded of something Tommaso Padoa-Schioppa said as Finance minister: 'Taxes are a beautiful thing, a civilised way of contributing all together to indispensable public goods such as education, security, the environment and health.'"*

taxation and if necessary border adjustment taxes. This would provide own resources to the EU, to be used on social cohesion and productive sustainable investment. A European Citizen's Initiative on the topic is ongoing. The second speaker was sceptical however: national preferences on taxation instruments are very far apart; the EU lacks competence in the field; and border measures, attempted for e.g. aviation, were quickly abandoned due to international pressure. Carbon markets may be the more politically realistic instrument.

Macroeconomic implications of massive renewable energy production deployment and infrastructure decarbonation needs are becoming clearer reported one participant: states and international financial institutions are beginning to apprehend the opportunities of zero- or negative interest rates for investing in the future. Economists are devising new macroeconomic models based on sustainability, e.g. Kate Raworth's Doughnut Economics. Impact attribution of different measures remains a difficult problem however, and measurements and analytics are needed; better ones, integrating subsidy costs, would show that investment in natural gas is a bad bet for example. Ex post assessment should also take place to transparently evaluate efficiency and social impact of the used instrument.

One participant drew attention to the distributive effect of climate policies, which tend to be more regressive than necessary. There is an opportunity to bridge policy and politics here: technocratically focusing on policy does not positively engage people.

Another participant drew attention to the need to set expectations, for renewable energy production in particular. Feed-in tariffs are useful instruments to develop new capacity, but the larger challenge is the decarbonation of installed capacity: an exit committee for coal on the German model could be set up, following the UN Secretary-General's call for no new coal plants to be built. Gas is defensible as cheaper than full electrification in some places, and can even be carbon-neutral if power-to-gas technology can be scaled up. Investments are plateauing, but are still sorely needed for innovation in electrical storage technology and efficiency projects.

The second speaker concluded by responding that innovation is also needed to decarbonise whole industrial sectors (concrete, steel, chemicals), not just energy production, to build the cities and infrastructure of the future. The question is how to incentivise the larger actors to do more; sometimes economic incentives don't work and regulation must be resorted to. The EU may be facing unique constraints due to the Euro and its debt and deficit rules. The first speaker concluded the session by agreeing that better measurements, ex ante and ex post, are indeed necessary; as is the inclusion of all stakeholders, and taking seriously the distributive aspects while ensuring alternatives and choices for citizens.

Session IV - Fostering popular and efficient policies conducive of political support: Framing the popular and political debate to achieve carbon emissions reduction goals

The chair drew attention to the recent sharp politicisation of climate issues, and its mobilisation by all actors: the *Gilets Jaunes* affirm to be acting with ecological interests at heart. Equitable distribution and accountability issues are coming to the fore.

> *"The 1.5°C target should be our North Star. This is a unique, turning point in human history where the viability of the planet is at stake."*

The first speaker warned that latest IPCC reports predict significant differences between 2 and 1.5°C trajectories in terms of global warming and extreme climatic events: the lower target should guide the use of the full panoply of instruments available given the inevitable march of rising emissions pushing the planet dangerously beyond its boundaries.

Three doublings will occur: the global economy will double in the next 20 years, led by currently emerging economies. So will the stock of infrastructure and the extent of urban space and population. Lock-in effects of capital and spatial expenditure will resonate in the future: 9/10^{ths} of global urban areas are in floodable zones. This makes mitigation and adaptation a huge challenge.

The world stock of capital is 5-600T$. Its doubling must be coupled with the imperative of getting to zero net emissions by 2050. Even if all this new capital stock is decarbonated, emissions must still be cut. The technology exists to accelerate phase-out of polluting assets and build new ones according to new standards, but investment choice issues and arbitrary debt ceilings obstruct the extraordinary level of needed investment. It will pay for itself (and ensure the viability on the planet), but clear models are needed to secure revenue over the long term and tap into spillover effects. Japan is a unique example.

Even as these models are needed, the urgency of change has to be imparted to the financial sector despite the immediate nature of capital. In DC, water and waste renovation faced huge capital requirements: smart metering provided a reliable long term revenue model, and once demonstrated, was used to raise capital for a 100-year green bond. This very long term timeframe is already a challenge; capital markets in emerging markets have even less depth or structure to take it up. The private sector won't simply step in with reasonably cost finance: development finance will be needed at unprecedented scale. Nor will carbon pricing at the necessary scope and price. The UK model of infrastructure investment seems promising, mostly private-oriented but financially innovative and long term-driven.

The second speaker drew attention to the specific challenges of emerging economies, taking the example of Brazil. President Lula spearheaded climate action domestically and cooperation internationally on energy as well as land use and food production aspects. The current Bolsonaro administration is resolutely following an opposite path, instrumentalising global reproval to drum up domestic fervour and support. Private and financial actors are seeking bilateral solutions, especially with China, but they may still be open to other actors. Regional, but also national development banks can have an important role to play. Emerging markets should not be viewed as homogeneous; India is not Brazil. The G20 is not adapted to lead on holistic climate change action, but can work on some sectoral issues (energy). China's BRI is driving a massive demand of concrete, a significant source of emissions (global 3rd if the industry counted as a country). Bilateral and regional cooperation form a valuable "new multilateralism".

> *"30 million people live in the Amazon; not just monkeys."*

The effects of catastrophic climate change will be huge. Brazil is already hosting climate refugees. Global health will become a strategic issue as endemic illnesses shift geographically. Worse, the science is still unclear on the possible tipping points at which damage becomes irreversible: preserving the Amazon and the oceans is vital to preserve and foster carbon sinks and biodiversity. In Brazil, the military considers climate as a strategic sovereignty issue, linked to securing territory and extracting its resources. Militaries have large carbon footprints (the US' would be global 3rd if counted as a country).

One participant noted the leading role of new youth movements for climate in mobilising and informing about the scale and urgency of the task, as well as the enthusiasm in the US around the Green New Deal; the rhetoric of both is infused with social justice, but their effects remain to be seen. Another participant reported that President Macron had become convinced of the necessity of more robust climate action internationally when President Trump withdrew from the PA, and domestically with the *Gilets Jaunes* movement. It remains to be seen what his international orchestration efforts on the Global Pact will bear.

Deliberative processes have been successful in managing complex trade-offs and engaging citizens recounted one participant, with better results than classical representative democratic processes; though this might be attributable to their globally exceptional democratic environment. The framing must shift to the costs of inaction rather than action, and social justice rhetoric is an insufficient mobiliser. There will be distributional issues to face head-on, but the imperative seems to have penetrated in most quarters; even the CDU. It is telling that the extreme right is targeting climate movements. Climate issues can be leveraged against populists to take the wind out of their sails: making them debate on the topic reveals their lack of seriousness and wider governance vision.

> *"Humans are more concerned about future humans than politicians are about future politicians. Social justice rhetoric is not enough: you need to tell people, "You won't be able to buy your way out of this; they will."*

It has become acceptable to talk with the urgency that is truly needed, while states are beginning to take repressive measures pretexting climate imperatives argued one participant. Widespread societal destabilisation and civil wars are real threats. This urgency should be used to mobilise support on action, starting with collecting and using better data and measurements to deal with the distributional issues; e.g., the PNR for aviation carbon tax purposes, though some participants expressed doubts on the privacy aspects of such a scheme. Some participants thought catastrophist rhetoric counterproductive and potentially dangerous.

The session concluded with the first speaker insisting on the fact that worldwide opinion polls show the depth and breadth of concern over climate change. This must be translated to political action by building a new narrative; until now however this has not penetrated domestic or international orchestrators levels sufficiently. The 2000s debt relief campaign is an interesting parallel of mobilisation on a similarly neglected issue. Phasing out coal requires intense thinking in political economic terms: vested interests may weigh more towards capital than labour. The cost of capital is a key factor: infrastructure in emerging markets is not inherently riskier, but there are temporal, monetary and informational asymmetry issues that make it look astronomical. The second speaker stressed the contingency of politics and advocated acting bravely in peoples' needs at all governance levels; Parliaments are important democratic loci.

Seminar programme

20 JUNE

19.30	*Welcome dinner* and *keynote address*: **Laurent Fabius** | French Constitutional Council

21 JUNE

09.00 – 09.15	*Welcome and introduction*
09.15 – 09.30	*Tour de table*
09.30 – 10.45	**Session I – The framework for climate governance**: Exploring international achievements and shortcomings at global level Chair: **Jean Pisani-Ferry** | EUI Introductory remarks: **Laurence Tubiana** | ECF, **Scott Barrett** | Columbia University
10.45 – 11.15	*Coffee break*
11.15 – 12.30	**Session II – Second-best solutions:** Regional coalitions, creative coalitions and other alternatives to a global agreement Chair: **Sébastien Treyer** | IDDRI Introductory remarks: **Barbara Finamore** | NRDC, **Bernice Lee** | Chatham House
12.30 – 14.00	*Lunch*
14.00 – 15.15	**Session III – Taxes, subsidies, R&D and private finance for clean technologies:** The battle between dirty and clean technologies as an instrument against climate change Chair: **Heather Grabbe** | Open Society European Policy Institute Introductory remarks: **Jos Delbeke** | EPSC, **Susanne Åkerfeldt** | Ministry of Finance (Sweden)

15.15 – 16.30	**Session IV – Fostering popular and efficient policies conducive of political support**: Framing the popular and political debate to achieve carbon emissions reduction goals Chair**: Laurence Tubiana |** ECF Introductory remarks: **Amar Bhattacharya |** Brookings, **Izabella Teixeira |** UNEP
16.30 – 17.00	*Coffee break*
17.00 – 18.00	**Wrap-up – Lessons for global governance** Introductory remarks: **George Papaconstantinou |** School of Transnational Governance, EUI
18.00 – 19.00	*Farewell cocktail*

Seminar participants

Susanne Åkerfeldt	Ministry of Finance of Sweden
Scott Barrett	Columbia University
Amar Bhattacharya	Brookings
Simone Borghesi	Florence School of Regulation, EUI
Adrien Bradley	Robert Schuman Centre, EUI
Jacqueline Cottrell	Green Budget Europe
Jos Delbeke	European Political Strategy Centre; EUI
Jacques Delpla	Economic Analysis Council (France)
Laurent Fabius	President of the French Constitutional Council; former COP21 chair, former French Prime Minister
Barbara Finamore	Natural Resources Defence Council
Heather Grabbe	Open Society European Policy Institute
Emmanuel Guérin	ECF
Tomáš Jungwirth	School of Transnational Governance, EUI
Bernice Lee	Chatham House
David Levai	Institute for Sustainable

	Development and International Relations (IDDRI)
Alberto Majocchi	University of Pavia
George Papaconstantinou	School of Transnational Governance, EUI
Andris Piebalgs	Florence School of Regulation, EUI; former European Commissioner for Energy and for Development
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Alberto Pototschnig	Florence School of Regulation, EUI; Agency for the Cooperation of Energy Regulators
Artur Runge-Metzger	Climate strategy, Governance and Emissions from Non-trading Sectors Unit, DG CLIMA, European Commission
Saskia Sassen	Columbia University
Izabella Teixeira	UNEP International Resource Panel; former Minister of the Environment of Brasil
Sebastian Treyer	Institute for Sustainable Development and International Relations (IDDRI)
Laurence Tubiana	ECF; former COP21 Special Representative
David Victor	UC San Diego
Georg Zachmann	Bruegel

Section 8

Historical perspectives

The Governance of Trade, Finance and Macroeconomic Cooperation: A Historical Perspective since the 1970s

Seminar insights[1]

Emmanuel Mourlon-Druol[2], George Papaconstantinou and Jean Pisani-Ferry

1. The 'paradise lost' feeling that there was a golden age of global governance dominates policy reflections. Nostalgia of this golden age inspires recommendations to make globalisation sustainable again by revamping its rules and by strengthening the institutions that support it. Recurrent calls for a "new Bretton Woods" illustrate the attractiveness of an idealised past.

2. But the core task of historians is to de-idealise the past and this applies very well to global governance. Even a cursory assessment of a few key episodes of the recent decades leads to question the widely held assumptions that there was a time when the global economic governance framework was comprehensive, unified, rules-based and cooperative.

3. The framework of governance rules and institutions was never comprehensive enough to cover adequately the multiple channels of interdependence. In fact, tension between the actual pattern of integration and the institutional set-up has been nearly permanent and the history of global governance is one of institutional arrangements catching up slowly and haphazardly with reality.

1 The seminar was held on 14 November 2019 in Florence (Italy).

2 Senior Lecturer at the University of Glasgow's Adam Smith Business School.

- International trade offers a case in point: the Uruguay round launched in the 1980s was intended to fill existing gaps in the sectoral coverage of the international trade rules, while an enlargement of membership in the GATT (not least to China) was being pursued in parallel. It was an ultimately successful, but conflictual and imbalanced process, the outcome of which generated frustrations and grievances on the part of emerging as well as advanced countries;

- Supervisory coordination in banking and finance is another case. Attempts to define an international regime for supervision and resolution started in the 1970s but failed to produce meaningful results and degenerated into weak cooperation procedures. It is only in response to successive crises (the Latin American debt crisis of the 1980s, the financial accidents of the late 1990s, the global financial crisis of 2008) that rules were tightened and that monitoring procedures were strengthened.

4. **Complaints about the fragmentation of the global governance regime go back to the 1970s at least.** The lack of a coherent, or even unified regime was actually one of the key motivations for instituting regular summits of the heads of state and government (the Gs). At the first summit in Rambouillet in 1975, British PM Harold Wilson already complained about the proliferation of institutions; but he, and his colleagues, noted at the same time that these institutions gathered officials at ministerial level only. Heads of government did not have an international forum where to meet on a regular and frequent basis. The G7, and later the G20, took up the responsibility of orchestrating the responses to prevailing challenges – by coordinating national policies but more often by setting priorities and tasking institutions. Whether the emergence of this rather informal mode of governance (and of the parallel institution of the European Council, whose creation occurred a little earlier, in 1974) should be regarded as a testimony of the failure of the rules-based institutional order, or as a necessary complement to it, is a matter for debate.

5. The "rules-based" regime was never entirely rules-based – or when it was, rules could be breached. This is very apparent in the monetary field. Surveillance of national policies has generally been toothless and even the concepts that underpin it have been left trailing reality. In the early 1970s the US unilaterally departed from the rules of the Bretton Woods system by taking the dollar off gold, devaluing it and ultimately going for a floating exchange rate regime. This was a major break away from a fundamental rule of the post-war system. Their decision represented a trauma for Europe. It created confusion and international tension, before cooperation resumed and eventually resulted in defining new rules.

6. A recurring theme of the history of global governance has been whether it changes because of the need to adapt to evolving interdependence structures or as a result of power struggles between participating nations. If anything, the question has gained relevance in today's context.

Seminar minutes

Adrien Bradley

Session I - Macroeconomic cooperation and leadership in the 1970s

> *"We need to look at the 1970s and 1980s for the norms that still govern our international organisations."*

The speaker introducing the first session noted that the early 1970s were a time when international relations were widely perceived to be in the throes of a multifaceted crisis. The decision of the US to unilaterally terminate convertibility of the dollar to gold in 1971 effectively brought the Bretton Woods system of fixed exchange rates to an end. This was compounded in 1973 by OPEC's decision to proclaim an oil embargo against nations perceived as supporting Israel during the Yom Kippur War, quadrupling the price of oil. The sense of urgency in the face of generalised crisis was underscored by a shared epistemic script based on a fear of a repeat of the crisis of the 1930s and the Second World War that ensued. Also furthering this sentiment was the Cold War context, where leaders felt they had to present a united front to prove the superiority of their values and economic system.

The situation led heads of state and government to look for new venues where they could discuss macroeconomic cooperation. Existing fora such as the UN, the IMF or the OECD (or on the European level, the Council of the EU) were felt to be unfit for that purpose, too formal or too technical. Other international gatherings were emerging at the same time, such as the meetings in Davos and the Trilateral Commission, but they were private endeavours. It was also felt that reliance on expert solutions was fuelling a democratic deficit, and that global governance was impaired due to a fragmentation of issues. In the context of increased interdependence, specialised institutions were perceived as unfit for the purpose of strengthening across-the-board cooperation.

December 1974 saw the creation of the European Council, bringing together European heads of state and government (of Belgium, France, West Germany, Italy, Luxembourg, the Netherlands, plus the newly joined Denmark, Ireland and the U.K.). The creation of what would become a key pillar of the EU institutional architecture followed informal summits in 1961 and 1969. In a similar vein, November 1975 marked the first G6, bringing together for informal exchanges the heads of state and government of the world's major industrialised countries (France, West Germany, Italy, Japan, the UK and the US). Canada was invited to join in 1976, completing the G7. Annual G7 summits soon became a pillar of global economic cooperation (and they lost their informality).

Three historical milestones stand out: the 1975 Rambouillet Summit, the 1978 Bonn Summit, and the 1985 Plaza Agreement on exchange rates, which was followed by the 1987 Louvre Accord. The Rambouillet Summit is noteworthy in that it was the first of its kind, acknowledging the collapse of the Bretton Woods architecture and the new international monetary non-system. While French President Valéry Giscard-d'Estaing had initially envisaged a summit on narrower monetary issues, German Chancellor Helmut Schmidt helped broaden the scope, setting the themes of macroeconomic cooperation that have remained on the agenda since.

The Bonn Summit is remembered for producing a comprehensive agreement on Japanese and German reflation as well as on the US fight against inflation. More generally, it reflected the shifting international balance of economic weight, away from the US dollar and towards Europe and Japan. The agreement was celebrated at the time, but was short-lived; despite this, it is remembered by some as having been very successful, while others (especially in Germany) regard it as having produced ill-conceived plans. In contrast, the Plaza and Louvre Accords were landmark international agreements between G7 member states (France, West Germany, Japan, the US and the UK, joined by Canada for the Louvre Accord). Beyond the agreement to depreciate and the stabilise the US dollar, they delivered an exchange rate coordination regime that lasted for several years.

> *"The core job of the historian is de-idealise the past."*

While the G7 meetings are not treaty-based, their creation resulted in lasting governance changes, plugging a glaring gap in global governance and enabling leaders at the highest level to exchange and develop shared diagnoses of the economic situation and the economic challenges. These changes were not necessarily major in terms of *outcome*, but certainly in terms of *process*: a permanent forum for cooperation and trust-building was established that offered the leader the possibility of setting priorities for technical discussions and of reaching agreements that involved cross-sectoral trade-offs (for example on trade and at the same time on exchange rates). Nevertheless, these arrangements remain informal, with a low level of enforcement. This executive deficit in global governance persists today.

In the discussion that followed the presentation, one participant reflected on the role of the US then and now in setting up and maintaining governance arrangements, seeing concern over the lack of rules and constructive search for political discussion arrangements at the time; this was met with a rejoinder that it was the US which had toppled the Bretton Woods system to begin with. One participant recalled that the Bretton Woods rules-based system was far from autonomous, requiring significant intervention to keep exchange rates stable.

> *"It's all about the US."*

Participants debated whether the establishment of the G7 reflected a failure of formal institutions and a breakdown of a rules-based system, or whether it simply filled a gap in that same system. One participant noted that the continuation of G7 meetings was by no means acquired from the start, only resulting from an informal agreement in 1977, comparing it with the institutionalisation of the European Council in the 1986 Single European Act. Another contested the parallel, arguing that the European Council resulted from the European Community's institutional development whereas the establishment of the G7 reflected institutional failure. The same participant expressed surprise that the involvement of heads of state and government was not seen as necessary until then, and reflected on the evolution of the method of their meetings, from a direct, "hands-on" approach to one of agenda-setting.

Session II - The challenges to the governance of trade in the 1980s

The speaker introducing the second session suggested that the trade governance regime was under great pressure by the 1980s for five main reasons. First, several commodities like agricultural products and textiles were exempt from GATT disciplines, and the absence of an agreed framework led to tensions between developed and less developed countries. Second, trade in services was expanding without corresponding GATT rules. Third, advanced countries were beginning to feel frustration over the lack of protection of intellectual property rights. Fourth, emerging economies had an increasing weight in global trade but they were either acting as free riders within, or weren't part of GATT. Fifth, finally, GATT's relevance was diminishing: China was not (yet) part of it and major geopolitical and economic changes (such as China's economic reform and the opening up of formerly socialist countries) were not reflected in the governance of international trade.

These tensions provided the impetus for an American-European "deal" to seek to strengthen the rules and institutions of the multilateral trade regime while integrating new members: this was the origin of the Uruguay Round and the resulting creation of the WTO.

GATT rounds until the 1960s had mostly focused on reducing tariffs. The Kennedy Round, started in 1964, added anti-dumping as a concern; the Tokyo Round, started in 1973, significantly expanded the agenda by including non-tariff issues. The Uruguay Round began in 1986, concurrently with China's accession request, and ended in 1994: it not only achieved further tariff reductions, but also saw the inclusion of services (GATS), intellectual property rights (TRIPS) and investment (TRIMS) under its remit, as well as an agreement to gradually include textile and agricultural products in its disciplines. It also transformed the GATT into the WTO, a full-fledged international organisation equipped with a binding dispute settlement mechanism. Its creation had been strongly advocated by European countries and Canada, with the argument that liberalisation had to be matched by institutionalisation.

> *"As Pascal Lamy said, 'If you liberalise you must organise'."*

In hindsight however, institutionalisation went against long-held US preferences, concerned with maintaining their sovereignty and wary of creating more international bureaucracy. As far as trade negotiation were concerned, developing countries have considered that they gave up more in the Uruguay Round negotiations than what they gained; and while international trade volumes increased, it is unclear whether the negotiated tariff reductions and assorted agreements can be held directly responsible, though it has become part of the WTO's self-promotional narrative.

China's bid for GATT/WTO accession took 15 years of negotiation, but it finally gained membership in 2001. Its aim was to stabilise and gain larger access to Western markets in order to support its export-led economic growth. On the other hand, the US's aim was to oblige China to abide by enforceable trade rules, while pushing Chinese leadership to reform the country's economy so as to make it more compatible with the global capitalist economy. In this, the US's strategy changed from containment under George H. W. Bush to engagement under Bill Clinton, the latter being a driver for Chinese accession. In contrast, the European priority was to place economic and trade relations with China under a legally binding framework. China did not gain its accession cheaply however, having to make protocol commitments substantially exceeding those of other members. However, one seminar participant noted that China effectively retained a number of tariffs, while gaining by being freed from its burdensome annual review of trade relations by the US Congress.

The Uruguay Round was the last to be dominated by American and European interaction and preferences, as evidenced by the stalemate of the Doha Round where developing countries have reshaped the bargaining dynamics. Both the US and the EU shifted priorities to pursuing plurilateral agreements like TTIP and TPP, with the more or less explicit goal of isolating or forcing compliance on China. While TTIP foundered for political reasons, TPP, however, was repudiated by President-elect Trump, whose approach to trade governance has been explicitly transactional and bilateral. Participants agreed that while US grievances against the WTO began before his tenure, he has imposed tariffs on steel and aluminium under the dubious pretext of national security, and has been blocking the nomination of judges to the Appellate Body, gravely threatening the multilateral trade regime.

In the discussion, participants agreed that challenges in trade governance have stemmed from both geopolitical and structural factors. On the one hand, the system was dominated by the US and European countries, refusing to play by the agreed-upon rules once they suited them no longer and cede some of their power to newcomers, provoking a backlash on their part. On the other, it was changing patterns of trade that made the system meant to govern it obsolete. Participants questioned the degree to which the WTO could function with the US acting in bad faith, groundlessly invoking the national security "nuclear option", or indeed without the US, to which the answer was pessimistic.

One participant asked why the establishment of the WTO coincided with the rise of regional trade agreements, taking the example of NAFTA. Another explained that NAFTA was designed as an alternative to the

Uruguay Round by aiming for deepening regional integration, and that opinion is mixed on whether it was a stumbling block or a stepping stone to further trade liberalisation. The same participant noted however that other trade agreements of the time were mainly geopolitical and had little to do with trade *qua* trade.

Session III - Financial account liberalisation and the challenges to the governance of finance

The speaker introducing the second session suggested that the late 1970s and the 1980s were a transformational period for the international monetary system, whose governance challenges bear more than a passing resemblance to those of the 2000s. The period saw a rapid internationalisation of banking and finance, with corresponding financial innovation and risk; accompanied by, on the other hand, trade protectionism, commodity shocks (especially oil), and accumulation of sovereign debt. Accordingly, attempts were made to bolster existing and set up new governance frameworks to face these challenges. Elements of these comprise the IMF and bilateral central bank swaps, to provide emergency liquidity, and the Basel Committee, to provide uniform banking guidelines: an incipient global financial safety net.

Bilateral central bank swaps were part of a two-tier global financial safety net before the 1970s. Renewable swap lines were established in the 1960s, climbing to significant amounts. Recourse to these lines was a "first line of defence", before having to go to the IMF.

When the US suspended dollar convertibility, effectively kicking off the world floating exchange rate regime, the IMF attempted to head off and mitigate potential effects by publishing its important surveillance decision in 1977, which remained unchanged until 2013. It puts forth the *obligation* for members avoid manipulating exchange rates or the international monetary system; and *recommends* that members intervene in the exchange market to counter disorder, while taking into account other members' interests. An additional provision was added in 2007 to the surveillance decision, that members should avoid exchange rate policies that create external financial instability. The decision specifies the situations in which the IMF can engage a dialogue with a member state; but appreciation of when this is warranted is inevitably very difficult due to the political sensitivity of such a decision. This kind of dialogue is in any case only advisory and bilateral, and has displayed a mixed record in effectiveness.

The IMF's Special Drawing Rights system had been introduced in 1969 to supplement a shortfall of preferred foreign-exchange reserve assets. They underwent reform in the 1970s and 1980s. The SDR was made the unit of account of the Fund in 1972, but more ambitious plans such as devising a "market SDR", to be used widely in global financial markets, or allowing the creation of an SDR-denominated substitution account housed in the IMF to facilitate reserve diversification and shift exchange rate risk away from the dollar, foundered mostly due to US disinterest.

International financial surveillance was glaringly lacking in the 1970s. A series of bank failures and fraud led in 1974 to the creation of the Basel Committee on Banking Supervision (BCBS) by the G10[3], plus Luxembourg and Spain. The committee was established within the Bank for International Settlements and it is composed of central bank and regulatory authority representatives. Original projects for an early warning system or a coordinated supervisory arrangement were quickly abandoned due to sovereignty concerns, falling back on informal communication and best practice sharing. This "Basel Concordat", established in 1975, failed however to draw clear-cut rules about where responsibility for supervision ultimately laid between home and host countries, since international supervision had been rejected.

"BCBS members were like regulatory generals fighting the last war."

The BCBS works as an informal forum encouraging convergence towards common standards and approaches. However, its functioning at its inception was reluctant and slow, and the standards it produced were backward-looking and, since they were negotiated with the banks it was attempting to regulate, vulnerable to regulatory capture. The three painstakingly negotiated Basel Accords have done little to prevent crises, and still rely on national interpretation and implementation of their guidelines. Rules-based financial regulation may not be an optimal solution: incentives-based regulation may work better, due to the pace and depth of innovation.

In the discussion, seminar participants remarked that issues considered novel today are in fact not new, though significant qualitative changes have taken place. They agreed that some past and present gov-

3 Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, UK, US

ernance problems were common, such as issues with the IMF's traction, legitimacy and even-handedness, or the difficulty of requesting help from the Fund due to stigma; or more broadly, the fact that the burden of adjustment still weighs on for the greater part on debtors. One participant noted that a regional/global two-tier global financial safety net system has already emerged, sharing the same problems as the bilateral/global system preceding it: the global level remains too weak, while at the infra level creditors may have difficulty refusing to extend loans to close partners. They also likened private information held by banks as a kind of wealth, which prompted another participant to observe that willingness to share this kind of information with a central repository is growing and that it would be useful to have a global authority capable of presenting a complete picture of the financial situation.

Wrap-up - Lessons for global governance

Summing up, it was put forward that increased systemic complexity may have favoured fragmentation; but it may be perception of complexity that is the more relevant factor. In keeping up with the core historian's task of de-idealising the past, all three speakers thus insisted that the widespread impression that today's crises were more complex than those that occurred 20, 30, or 50 years ago was often a retrospective construct: policymakers confronting these problems in the past equally felt overwhelmed by the complexity of policy challenges then. The challenges of the credibility of institutions, and of their trade-off between inclusivity and efficiency, remain. The institutions themselves display continuity through structural shifts, which have sometimes been brutal; in parallel, solutions to their problems have also displayed surprising continuity.

Seminar programme

14 NOVEMBER 2018

9.00 – 9.30	*Welcome and introduction*: **Emmanuel Mourlon-Druol** | University of Glasgow, **George Papaconstantinou** and **Jean Pisani-Ferry** | EUI
9.30 – 10.30	**Session I - Macroeconomic cooperation and new international groups** Introductory remarks: **Emmanuel Mourlon-Druol** | University of Glasgow
10.30 – 10.50	*Coffee break*
10.50 – 11.50	**Session II - The challenges to the governance of trade** Introductory remarks: **Lucia Coppolaro** | Università di Padova
11.50 – 12.50	**Session III - The challenges to the governance of finance** Introductory remarks: **Catherine Schenk** | University of Oxford
12.50 – 13.00	**Wrap-up - Lessons for global governance** Introductory remarks: **George Papaconstantinou** and **Jean Pisani-Ferry** | EUI

Seminar participants

Grace Ballor	Max Weber Programme, EUI
Adrien Bradley	Robert Schuman Centre, EUI
Klodiana Beshku	EUI

Stefano Cappiello	Florence School of Banking and Finance, EUI
Lucia Coppolaro	Università di Padova
Emmanuel Mourlon-Druol	University of Glasgow
Alfonso Iozzo	Intesa San Paolo
George Papaconstantinou	School of Transnational Governance, EUI
Antonio Padoa-Schioppa	University of Milan
Jean Pisani-Ferry	Tommaso Padoa-Schioppa Chair, Robert Schuman Centre, EUI
Anna Sakurai	School of Transnational Governance, EUI
Massimiliano Santini	School of Transnational Governance, EUI
Catherine Schenk	University of Oxford

Conclusion

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Collective Action in a Fragmented World

Jean Pisani-Ferry[1], July 2019

Highlights

1. The need for international collective action is an order of magnitude larger than it has ever been. The menaces of catastrophic climate change and of a collapse of biodiversity epitomise the increased importance of global commons and the urgency of coordinating responses at global level. But heightened need for collective action also arises from a series of other challenges: risks to financial stability, threats to internet security, mass migrations and tax avoidance by multinational firms, to name only some of the most prominent ones.

2. Obstacles to global collective action are no less formidable. The stance of the Trump administration is currently the single most significant one, but impediments to global governance are of a more structural nature: The China-US rivalry is in the process of restructuring the system of international relations, while the emergence of a multipolar world and heterogeneity of preferences complicate the functioning of the global policy regime.

3. The global governance apparatus provides a weak basis for collec-

1 European University Institute, Bruegel, the Hertie School and Sciences Po. This note is based on research undertaken jointly with George Papaconstantinou at the EUI. It builds on remarks given on 22 March 2019 at the ECB conference *Challenges for supervisors and central bankers* organised on the occasion of the farewell of Ignazio Angeloni. Thanks to Adrien Bradley, Pascal Lamy, Manuel Lafont-Rapnouil, George Papaconstantinou, André Sapir, Reinhilde Veugelers and Georg Zachmann for comments on earlier versions.

tive action. The rules and institutions inherited from the post-war era provide limited coverage, limited effectiveness and limited legitimacy. As exemplified by issues such as climate change or internet governance, the formal legal and institutional architecture of the rules-based global system is increasingly at odds with the shape, depth and intensity of international interdependence. It is furthermore undermined by a process of fragmentation that has started to affect its core tenets.

4. None of the main players is able and willing to provide leadership. The ability and willingness of the US to promote, uphold and guarantee the global policy regime has been permanently diminished by the decline of its relative economic weight. China is unwilling to invest in a rules-based system that is alien to its own system of government, whose principles and procedures have been designed by others, and where it does not enjoy adequate representation. Europe is too weak and fragmented to offer leadership.

5. New forms of cooperation have nevertheless emerged in a series of fields. These are soft mechanisms relying on the pledge-and-review template, cooperation between independent agencies endowed with similar mandates, coalitions of the willing and open partnerships involving private players, subnational governments, civil societies and epistemic communities. Their effectiveness depends on the incentives to cooperation that participants face, which in turn rests on the nature of the underlying interaction and the resulting game structure.

6. International collective action is in search of a new paradigm suited to a more interdependent but also more diverse, multipolar and sovereignty-conscious world**.** As international cooperation can only draw on a limited toolkit, clarity should prevail on what can be expected from soft arrangements. At the very least they should rely on (a) a parsimonious set of universal principles, (b) coalitions of the willing that help break the deadlock of unanimity while remaining consistent with such universal principles, and (c) the involvement of non-state actors and epistemic communities. To be effective, collective action should furthermore be served by (d) nimble and legitimate institutions. In some cases, enforcement mechanisms such as (e) pecuniary levies remain indispensable.

1. State of play

1. The 1990s represented the high noon of the collective action model characteristic of the post-WW2 system. This system relied on universal, treaty-based institutions tasked with the organisation of international cooperation and the enforcement of legally binding rules in major fields of interdependence. At the time, the template became truly universal as membership in the Bretton Woods institutions was extended to Russia and the former Soviet bloc, while preparations were made for Chinese and Russian membership in the WTO. However, this system did not gain wide sectoral currency. Efforts to replicate it in fields such as investment, competition and climate action have been frustrated.

2. Once regarded as a milestone towards the completion of the institutional architecture of globalisation, the creation of the WTO did not achieve its aims. Since the mid-1990s multilateral negotiations have stalled, trade governance has fragmented into a myriad of preferential agreements, and China's membership in the WTO has failed to trigger the convergence of its economic system (let alone its political system) with the Western model. But although the combination of multilateral and bilateral or regional arrangements was fragile, the essential GATT principles and the dispute settlement mechanism instituted with the creation of the WTO were upheld until mid-2010. Since then, the Trump administration's focus on bilateral balances and its deliberate sabotage of the dispute settlement mechanism have undermined the core tenets of the post-WW2 order. The one success the WTO could claim, its conflict resolution system, is at risk of paralysis.

3. For the Bretton Woods institutions, the Asian crisis of the late 1990s was a turning point. Intrusive and economically misguided IMF programmes were seen as testimonies that these institutions were at the service of the Western powers. A decade later, the multilateral response to the euro crisis was regarded as a further proof of this built-in bias. Political events and economic forces have jointly contributed to a growing fragmentation of the global financial architecture.

4. The global financial crisis did not result in a permanent upgrade of global governance. While the response to the financial meltdown and the ensuing recession was swift and forceful, and while the elevation of the G20 to leaders' level adjusted the political leadership body to the new reality of the global economy, changes to the rules and institutions of global governance fell short of the leaders' 2009 promise that "a global crisis requires a global solution". Financial regulation was upgraded, but international macroeconomic coordination was short-lived and hopes that the crisis would provide an opportunity to reform the international monetary system were frustrated.

5. The urgency of climate change mitigation did not result in a revival of the post-WW2 template. At Kyoto in 1997 and Copenhagen in 2009, attempts to create a legally binding, enforceable system of negotiated emission reduction commitments failed. The Paris agreement of 2015 was based on an entirely different paradigm: national "contributions" are unilaterally determined and non-binding. The expected effectiveness of the collective endeavour to contain the rise in temperature relies on review mechanisms, peer pressure and the involvement of non-state actors.

6. The governance of the internet epitomises the obsolescence of the post-WW2 model. The emergence of the first truly global, borderless infrastructure has essentially been based on uncoordinated state and private initiatives coordinated by broad principles and a series of information exchange protocols. Its governance structures have remained weak and informal, and all attempts to give them a more formal structure ended in a deadlock. Since the start of the decade divergent preferences as regards privacy and the limits of free speech, and more fundamentally state control over national citizens, have given rise to a process of balkanisation. The unity of the internet has become a thing of the past and the question now is what geometry will emerge from its fragmentation.

7. The historic core of the global regime – trade and finance arrangements – is undergoing a process of fragmentation. Global rules and institutions are still there, but their grip is fast diminishing and a new geography made up of partially overlapping blocks has started to emerge. Existing multilateral arrangements lost muscle already in the 2000s and the early 2010s, and the process is accelerating. Trade rules are fast giving way to a new US-initiated bilateralism. Development finance is undergoing a process of balkanisation, most notably as a consequence of the Chinese Belt and Road Initiative and its adverse consequences on multilateral debt relief procedures. In international finance, several layers of unilateral, bilateral and regional safety nets have piled up, not least because of the need to tackle the euro crisis, and the centrality of the

IMF is being questioned; a further decomposition may well arise in the medium term with the emergence of a multi-currency monetary system.

2. Geopolitical obstacles

1. The post-2016 political context certainly complicates global governance. Multilateral rules and institutions embody all what populist nationalists love to hate: a non-national definition of the common good, equality amongst nations, supranational bureaucracies, limits to discretionary power, and the influence of experts in policy design.

2. The stance of the Trump administration is currently the single most significant obstacle to global collective action. Its worldview does not build on the premise that a series of issues require global cooperation and that well-structured collective action may yield benefits to all participants. It favours a transactional approach of international relations and regards most international issues as zero-sum games.

3. US grievances against, and doubts about global rules and institutions however did not start with this administration. Already in the 1940s, the US Congress rejected membership in the US-designed International Trade Organisation. President Clinton objected to the creation of the International Criminal Court. President G.W. Bush refused to ratify the Kyoto protocol. The Obama administration expressed serious concerns about the functioning of the WTO.

4. Changes in the international stance of the US reveals deep and widely shared doubts about the benefits of continued international leadership in the current context. From World War 2 to the 2000s the US mostly played by the international rules of the game and it furthermore acted as a guarantor and an insurer of the global system. This stance rested on the leverage this system provided to the global hegemon, but also on the hypothesis that it was in its best interest to promote, uphold and guarantee a global rules-based regime. Yet the declining relative economic weight of the US is prompting a reassessment of the benefits it derives from trading-off exorbitant duties for an exorbitant privilege.

5. China's assertiveness questions the stability of the global system. Seen from Beijing, the rules-based system embodies the preferences and privileges of the incumbent powers. Whereas China values the global trading regime, it has no ownership of a multilateral system that was designed by Western powers and whose rules embody their preference. The significance of the Belt and Roads Inititiative remains ambiguous, but it may be sowing the seeds of a different kind of system of international economic relations.

6. The US is reassessing its decades-long strategy towards China. From Richard Nixon to Barack Obama, all US presidents followed the same inclusive approach. It was assumed that China's disruptive power would be best tamed by shaping the direction of its development through making it a full member of the rules-based global economic community. But if this strategy has helped China to develop and catch up technologically, it has not led to system convergence and it has not contained geopolitical rivalry.

7. Europe remains the staunchest advocate of the multilateral system but it lacks force and coherence. As a rules-based construct, the EU feels at home in a rules-based system and it regards itself as a laboratory of global governance. But it does not stand ready to substitute the US as an anchor of the system and its hesitant response to the euro crisis contributed to its weakening.

3. Economic challenges

1. Beyond China, the emergence of a multipolar world is a systemic challenge for the operation of the global policy regime. Together with rules that apply to all countries, the post-war regime rested on the assumption that the US was responsible for exercising leadership and for undertaking discretionary action in times of crisis. It was implicitly agreed that it would remain the issuer of the main international currency and that it would act as liquidity provider of last resort, importer of last resort and crisis manager of last resort. In an economically more balanced global system, it is not clear how these roles should be distributed.

2.The heterogeneity of preferences is an obstacle to collective action. As participants in global interaction have become economically, systemically and culturally more diverse, it has become harder to agree on rules and governance mechanisms. From the Bretton Woods conference in 1944 to the Chinese accession to the WTO in 2001, the broadening of global governance has proceeded through the gradual co-optation of new members to clubs whose basic rules had been written by their creators.

The failure of the Doha round symbolically signalled that this process of homogenisation had come to an end. Developing countries, big and small, rightly claim that they cannot be simply asked to sign on rules that were shaped by the preferences of advanced countries. But while they have often been effective veto players, their positive contributions have been rare. Despite the BRICS, developing and emerging countries lack unity and leadership.

3. The formal architecture of global economic and financial governance is increasingly at odds with the shape and intensity of interdependence. The mandate of the WTO was predicated on an economic interdependence model that has been superseded by the rise of global value chains and foreign investment, and that is being overburdened by attempts to adjudicate trade-related matters increasingly removed from trade. The lack of a competition leg is increasingly a concern in the context of globally rising market power. The mandates of the Bretton Woods institutions were predicated on a financial interdependence model that has been superseded by unfettered capital flows, international banking and cross-border balance sheet interdependence. Moreover, major new interlinkages have developed that do not belong to the remit of any significant institution. This is evidently the case for environmental externalities, data flows, and migration, to name only the most important ones.

4. The growing asymmetry of the global economic system weakens multilateral rules and institutions. Network-based interdependence in fields like finance, international currency, global value chains and data flows confers exorbitant power and responsibility to whoever is in control of the nodes of the system. The assumption that all countries are equal never matched reality. But interdependence once seemed to be an equalising force. This is less the case today than ten or twenty years ago.

5. Conflicting representations of the same reality are a serious obstacle to collective action. As recently illustrated by European disputes over the solution to the euro crisis, "battles of ideas" are often harder to win than disputes arising from divergent interests. This problem is bound to be an order of magnitude bigger in a more diverse world. Investment in the building of common knowledge through the development of epistemic communities remains the most effective, though limited way to overcome such obstacles.

4. The toolkit for collective action

1. Ambitious global agreements on new, legally binding rules supported by new, universal institutions are highly improbable. The political and geopolitical conditions for such agreements are unlikely to be fulfilled anytime soon. In this context the agenda for rekindling international collective action can neither be to defend a twentieth century system whose adequacy has weakened, nor to make plans for unrealistic reforms. It must be to make the most of the web of existing rules and institutions inherited from the previous decades and to combine them with softer, much more ad hoc forms of governance of interdependence and global public goods management.

2. Soft mechanisms that do not curtail national sovereignty can effectively tackle a whole category of collective action problems. A solution to a collective action problem does not necessarily require compulsion to abide by international rules or to delegate decision powers to international organisations. The prisoners' dilemma model is less universally applicable than often believed and many obstacles to coordination can be tackled by ensuring transparency, creating trust and monitoring actual behaviour. In banking regulation, for example, significant results have been achieved through the negotiation of non-mandatory global standards and the thorough monitoring of their implementation. Such examples should not be overinterpreted: not all problems can be tackled by soft mechanisms. But they show that for a whole range of problems information exchange, indicative standards or pledge-and-review mechanisms can deliver results – on the condition that national behaviour is monitored effectively and transparently.

3. Independent agencies endowed with similar mandates can also achieve significant results. Historically, central banks have provided a template for international collective action by being able to cooperate effectively on the basis of domestically-oriented monetary policy mandates. The same applies to sectoral regulatory policies and financial regulation. The record of such cooperation is uneven: whereas it has often been disappointing in the field of financial oversight, significant results have been achieved in the competition policy field where national authorities exercise extraterritorial powers in a cooperative manner. Independent regulators generally work on the basis of common knowledge and common beliefs, which provide a platform for coordinated action.

Whereas they cannot by themselves internalise externalities, they can and do prevent disputes, share information and organise coordination.

4. Clubs may effectively address hard collective action problems, but they involve the risk of fragmentation. Soft forms of cooperation are hardly applicable to a collection of 200+ countries. They are more effective when the number of significant players remains limited – as for central banking, competition or banking regulation. "Coalitions of the willing" have developed in many fields, starting with international trade, sectoral regulation and the environment where the Montreal protocol on the elimination of CFCs provided an early template. The forming on a voluntary basis of sectoral, regional or development level-based coalitions can be an effective conduit to collective action, though at the cost that the policy choices embedded in flexible international agreements can be biased towards the preferences of their initial members, thereby restricting their size and limiting the gains they deliver.

5. The adoption of a dynamic perspective may strengthen otherwise weak incentives to joint action. Some global problems involve strong incentives to free-ride on common disciplines, either by failing to commit or by failing to implement. Common-pool problems are of this sort and addressing them requires stronger cooperation incentives than those provided by trust-building devices and the monitoring of delivery on existing commitments. But these obstacles can be reduced (though not eliminated) through involving private-sector players who can buttress an otherwise feeble cooperation agreement. For example, the Paris accord on containing climate change does not involve any compulsion and it even lacks mechanisms to enforce delivery on commitments. It is therefore vulnerable to the free-rider curse. But it has been effective enough to lead manufacturers to redirect their research and development towards zero-emission technologies. Their incentive to act is based on the perceived cost of losing out in international competition by having failed to keep up with clean technology developments. The effectiveness of such a mechanism does not rest on universal participation but on the participation of a critical mass of committed state actors and on the expectation that access to their markets will depend on the adoption of clean technologies.

6. Political leadership plays a decisive role by setting priorities and overcoming the curse of unanimity. Whereas the G20 has disappointed hopes that it would give rise to a permanent economic coordination apparatus, it has been much more effective as agenda-setter and an orchestrator. It has occasionally been an arm-twister too. An important case in point is taxation: whereas agreement on eliminating bank secrecy proved impossible to reach within the OECD, the combination of US unilateral action, G20 pressure and OECD expertise made it possible to overcome opposition. A similar game has started being played in the field of corporate taxation.

5. The policy agenda

1. Effective collective action for the 21st century should make a parsimonious use of the limited political capital available for multilateral endeavours. It can neither rely on an outdated and disputed global governance model nor on non-committal intentions and the involvement of a multitude of non-state stakeholders. The range of solutions accessible without having recourse to hard international law is however significant. What is needed is an approach that ensures that the best use is made of necessarily limited legal, institutional and financial resources. It must rest on a series of principles that command universal support, like national treatment for trade or the no-beggar-thy-neighbour principle in international finance - underpinning a set of nimble institutions able to provide support to international cooperation, and precise matching procedures that assign adequate resources, institutions and mechanisms to well-identified problems.

2. A way to control the risk of fragmentation involved in the reliance on clubs is to require them be rooted in common universal principles ("minilateralism"). This is actually the case with, for example, trade agreements that are subject to WTO scrutiny, must respect fundamental principles such as national treatment and may uphold the most favoured nation principle. Compliance with such principles ensures some coherence in the evolution of the international system. These issues arise in a series of fields, from trade and investment to climate and financial safety nets.

3. Existing institutions – which can be regarded as the globalisation's social capital - should be requested to serve collective action beyond the confines of their sectoral remit. Global institutions were once regarded as the masters of sectoral fiefdoms within the multilateral system. But nowadays the fiefdoms hardly cover globalisation's territory. With the principles, procedures and governance they are equipped with, institutions should rather be regarded as wells of social and informational capital that international collective action can draw from. The evolution of the IMF (from the coordinator of a financially autarkic world to that of a financially integrated one), the World Bank (from an infrastructure bank for Europe to, among other things, the promoter of educating girls in Africa) and especially the OECD (from the administrator of the European payments union to, among other things, the assessor of worldwide education systems) shows that institutions - some of them at least - can be nimble. A key priority for international collective action is to make the most of this social capital. This implies tasking institutions with responsibilities for ex-ante assessment, ex-post monitoring, evaluation and support for negotiation in fields that extend beyond their usual remit.

4. For universal institutions to be effective, it is essential to preserve their legitimacy. As far as rules are concerned, this requires distinguishing essential principles that command general recognition from more specific provisions that may reflect the preferences of advanced economies, or a subset of them. The re-examination of the IMF doctrine on financial account liberalisation was a case in point, as the institution departed from its initial stance to take on board the concerns of emerging countries facing repeated sudden stops. As far as governance is concerned, legitimacy requires adjusting representation and voting rights to the new realities of demographic, economic and political development on a global scale. Institutions whose policy doctrine or modus operandi are perceived as being excessively dominated by incumbent powers are bound to lose legitimacy and to be partially substituted by alternative sectoral or regional groupings. Europe in this respect should wake-up to the trade-off it is facing: either to preserve its power in existing multilateral institutions, with the risk of accelerating their obsolescence, or to concede a reduction of its role and influence, with the risk of not gaining much in exchange.

5. The involvement of epistemic communities, civil society and subnational governments ("polylateralism") can add to the effectiveness of otherwise feeble mechanisms. Shared knowledge is essential to identify issues and overcome obstacles to cooperation arising from divergent representations of the same problem. This is why the creation of the Intergovernmental Panel on Climate Change was a major step towards a shared awareness of problems and solutions (and the absence of a shared knowledge base is also a reason why international agreement is so difficult in the field of migrations). In domains that speak to public opinion like the preservation of the environment, public health or the fight against tax evasion, pressure from below may also help counter the incentives to free-ride that governments are subject to, and help overcome obstacles to collective action. But polylateralism risks being too weak to overcome obstacles to collective action in critical fields such as climate change.

6. In the absence of compulsory universal agreements, some collective action problems can only be tackled by having recourse to pecuniary levies and international transfers. Whereas it is wrong to assume that all international collective action problems can be represented by a prisoners' dilemma game, it is equally incorrect to assume that all can be solved without mechanisms that contain free-riding. Absent universally enforceable rules, such mechanisms can be provided by strict club rules. This is most evident in the climate field: should a group of countries decide to implement significant carbon taxes while their trade partners would abstain from introducing them, a border tax would serve both as a way to limit the risks of endogenous breakdown of the climate coalition, and as a way to avoid its members losing out in international trade. The critical questions in the years to come will be whether the US joins the climate club (in which case it will most certainly introduce border taxes) or whether the EU and other countries introduce them in an effort to discipline the US.

7. Democratic legitimacy is harder to ensure in a world of ad-hoc arrangements. Whereas it is a concern in a rules-based order, at least rules must be ratified and institutions can be subject to parliamentary oversight. A world that relies on a proliferation of clubs, institutions that operate beyond their mandates, private-sector participation, and soft arrangements is superficially less constraining, but substantially more alien to democratic principles. At the very least, it calls for scrutiny on the part of civil society organisations.

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